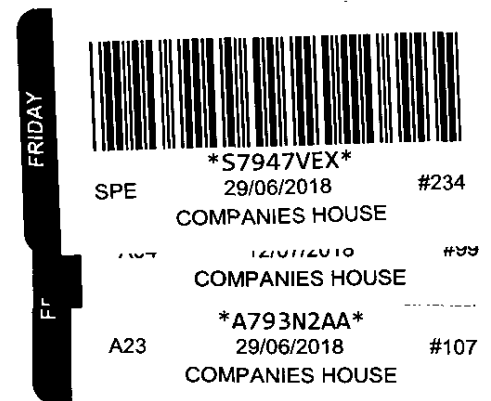


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Annual Report and Accounts 2017



Contents

Strategic Report

- 04 At a Glance
- 06 Chairman's Statement
- 09 Our Business
- 18 Key Performance Indicators
- 20 Principal Risks and Uncertainties
- 30 Viability Statement
- 32 Chief Executive's Review
- 44 Divisional Reviews
- 50 Finance Review
- 69 Corporate Responsibility

Directors' Report

- 86 Corporate Governance Report
 - 86 Board of Directors
 - 88 Chairman's Governance Overview
 - 91 Board and Governance
 - 93 Group Risk Committee Report
 - 96 Audit Committee Report
 - 102 Nomination Committee Report
 - 105 Corporate Responsibility Committee Report
 - 108 Compliance with the UK Corporate Governance Code
- 110 Remuneration Report
- 144 Directors' Report
- 150 Directors' Responsibility Statement

Financial Statements

- 152 Independent Auditor's Report
- 158 Consolidated Income Statement
- 159 Consolidated Statement of Comprehensive Income
- 160 Consolidated Statement of Changes in Equity
- 161 Consolidated Balance Sheet
- 162 Consolidated Cash Flow Statement
- 163 Notes to the Consolidated Financial Statements
- 228 Company Balance Sheet
- 229 Company Statement of Changes in Equity
- 230 Notes to the Company Financial Statements
- 234 Appendix: List of Subsidiaries
- 237 Appendix: Supplementary Information
- 238 Shareholder Information
- 239 Useful Contacts

Serco Group plc is a leading provider of public services. Our customers are governments or others operating in the public sector. We gain scale, expertise and diversification by operating internationally across five sectors and four geographies: Defence, Justice & Immigration, Transport, Health and Citizen Services, delivered in UK & Europe, North America, Asia Pacific and the Middle East.

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

+500
CONTRACTS

+20
COUNTRIES

+50,000
EMPLOYEES



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

Strategic Report

At a Glance	04
Chairman's Statement	06
Our Business	09
Key Performance Indicators	18
Principal Risks and Uncertainties	20
Viability Statement	30
Chief Executive's Review	32
Divisional Reviews	44
Finance Review	50
Corporate Responsibility	69

At a glance

What we do, and how we do it

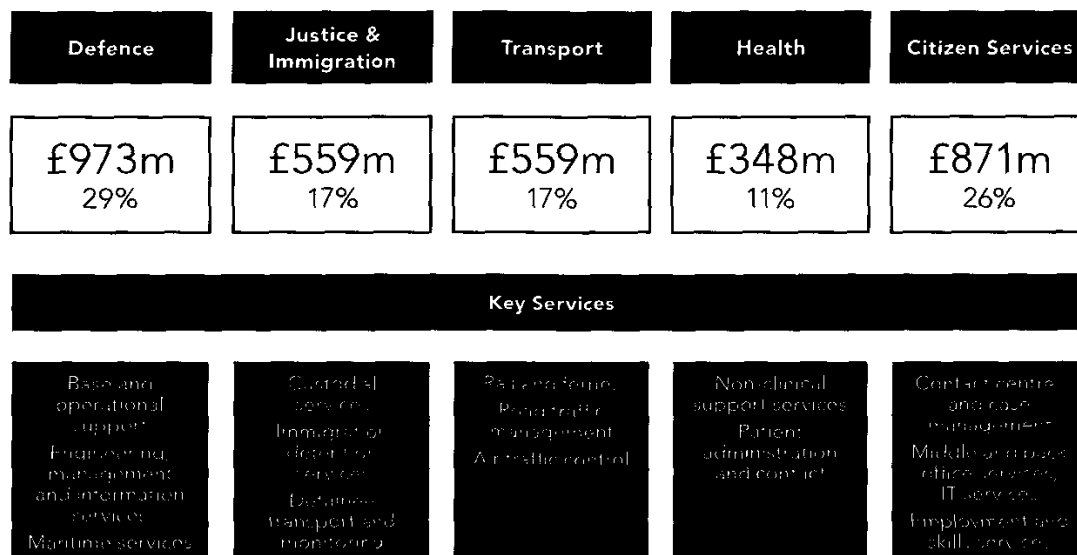
Serco delivers services to governments and other institutions who serve the public or protect vital national interests.

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

complex challenges facing governments, bringing our experience, capability and scale to deliver the service standards, cost efficiencies and policy outcomes governments want. In this way we make a positive difference to the lives of millions of people around the world, and help keep nations safe.

Our core sectors

Our business is focused across five core sectors and four geographies, with revenue in 2017 (including share of joint ventures and associates) of £3,310m



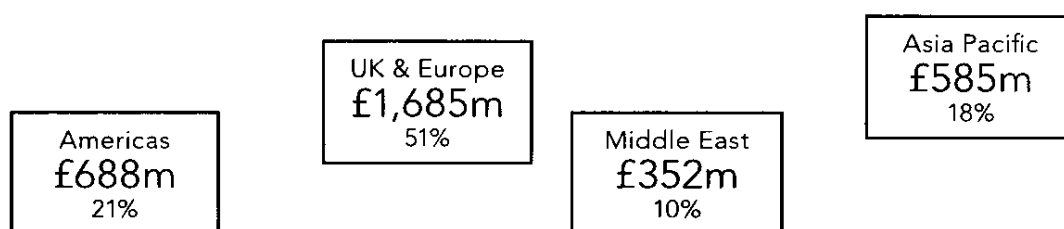
Our purpose and ambition

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

Our ambition is to be considered the best-managed business in our sector. Since our success in delivering is almost entirely dependent on people, we believe that such an ambition is a worthy and value-creating aspiration, and one that we can use to inspire our management teams and customers.

pg09 For more information on our business

Our geographical footprint



Revenue in 2017 (including share of joint ventures and associates).

Our values

Our values are lived every day, used to help us work through any challenges we may face and help us recognise and celebrate our achievements. They guide us in our dealings with colleagues, customers, suppliers, partners, shareholders and the communities we serve.

Trust Care

Innovation Pride

pg15 For more information on our values

Our method

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

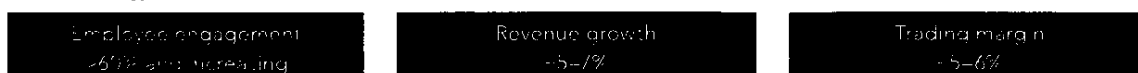


We try to make sure that everything we do improves our performance against one or more of these objectives, and start from a position where we know we can do much better. We can improve the way we bid and manage contracts; develop innovative propositions; measure performance; reduce the cost and improve the quality of our administrative systems and processes. None of these comes easily or quickly, and we need to steer a tricky course between the urgent need to reduce our costs in line with reduced revenues in the short term and investing in systems and processes that will produce sustainable benefits in the long term.

pg14 For more information on our performance framework

Our deliverables

We consider the tangible evidence of our success or otherwise can be measured in the three key planned outcomes of our strategy:



pg16 For more information on our deliverables

Chairman's Statement

2017 has seen further progress in implementing the strategy presented to shareholders in 2015. The transformation of the business continues apace and is delivering significant improvements in our efficiency and competitiveness.

I am delighted that we have delivered a trading result in line with expectations in 2017, as well as over £3bn of order intake and a further improvement in employee engagement. We have also added further skills and diversity to the Board, with strong governance being a key focus of the business at all levels. Whilst trading conditions are currently difficult in several of our markets, we have over the last three financial years delivered on the plan set out in 2015; having already stabilised the business, we have been improving our operating efficiency through our transformation programme. Importantly, as we now look ahead, we expect profits to start to grow over the next two years.

Serco's mission is to be a trusted partner of governments, providing superb public services that transform outcomes and make a positive difference for our fellow citizens, whilst delivering attractive returns to our shareholders and rewarding careers to our employees. Our aspiration is to be the best-managed company in our sector, and our method to achieve this is through concentrating on doing four things really well: winning good business; executing brilliantly; being a place people are proud to work; and being profitable and sustainable. 2017 has produced tangible evidence of performing well against these objectives. I am proud of the work we do and of the continued progress being made.

Delivering our strategic plan

In 2015, we set out a three-stage plan for Serco: Stabilisation, Transformation, Growth. Stabilisation was largely completed in 2014 and 2015 with the recruitment of a new management team, recapitalising the business and delivering the corporate renewal programme. Transformation then started in earnest, and will continue through 2018 and 2019. In 2018 we expect to also start delivering the third phase – Growth.

Three achievements in 2017 underline the progress Serco is making. First, we had very strong order intake, at £3.4bn. This represents a book-to-bill ratio – the value of how much we add to the order book compared to how much revenue we are billing our customers – of over 100%, the first time this has been achieved since 2012. The strong order intake, with very large contracts won in Health and Justice, underlines the progress we have made developing our customer propositions and business development skills.

Second, the work we have done transforming the business enabled us to meet our target of reducing the run-rate of our overheads by over £100m by the end of 2017. We expect to gain further cost efficiency benefits in 2018, notably from merging the UK operations into a single entity, as well as further reducing our other central support costs.

Thirdly, Serco employs over 50,000 people, including those at our joint venture operations, the vast majority of whom are responsible for delivering on a daily basis critical and sensitive frontline services for Government. Our success therefore is dependent on how well we select, manage, organise, motivate, develop and engage the people who work for Serco. Every year we run a detailed 'Viewpoint' employee survey to gauge how well our colleagues think we are doing, and I am delighted to say that, for the fourth successive year, the aggregated measure of 'employee engagement' improved again in 2017, with some 31,000 people responding.

You can read more about all of these points in the Chief Executive's Review on pages 32 to 43.

Achieving our financial targets

Our initial guidance for 2017 Underlying Trading Profit was between £65m and £70m, with the result of £69.8m therefore coming in at the top of that range. Supporting this, we achieved our targeted cost savings through the delivery of operational efficiency improvements. Furthermore, we have continued to reduce the burden of loss-making contracts, which is also paramount to ensuring sustainable profitability.

After exceptional items, net finance costs and tax, the profit for the year was £0.1m.

Net Debt at the year-end was £141m, also better than our guidance at the start of the year. This equates to EBITDA leverage of 1.4x, well within our medium-term target range of 1–2x and comfortably below the 3.5x debt covenant requirement.

You can read more about the drivers of financial performance in the Chief Executive's Review, with further detail provided in the Divisional Reviews on pages 44 to 49 and the Finance Review on pages 50 to 68.

Targeting further progress

As we look ahead to 2018, we expect Underlying Trading Profit to grow to around £80m on revenues of £2.8–2.9bn. Since the second half of 2016, we have been making progress on increasing our profit margin – a key deliverable of successfully implementing our strategy – and in 2018 we expect that further margin and profit progress will be driven largely by transformation savings.

Looking further ahead, we expect 2019 to be a year of further good growth in Underlying Trading Profit, which is again likely to be driven by additional transformation savings. As we have said previously, the rate of growth thereafter will be more dependent on our ability to grow revenues. The Strategy Review announced in March 2015 set out a long term ambition that the business could grow in line with a market which was expected to expand at a long term trend rate of 5–7% a year and deliver margins of 5–6%. Our margin ambition was predicated on three conditions: first, reducing costs as a percentage of sales; second, containing losses on onerous contracts and converting a number of them into profitable contracts on rebid; and, thirdly, increasing margins by growing revenues whilst bearing down on overheads. We remain broadly on track on costs and onerous contracts, but some markets, and in particular the UK, are currently challenging and therefore growing more slowly than their former trend rate. We can and will partly compensate for a weaker organic revenue outlook through increased actions on the cost base, and our ambitions of 5–7% revenue growth and 5–6% margin remain intact, but the timing of achieving this will be dependent upon when demand reverts to trend in our target markets.

Our Board

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

During the year, Ralph Crosby and Angie Risley stepped down from the Board, both having joined Serco during 2011. I would like to extend my sincere thanks to both Ralph and Angie for the sterling service they have given the Company through some very difficult times; in particular I would like to thank Angie for her expert leadership of the Remuneration Committee.

I was delighted to welcome three new Non-Executive Directors – Lynne Peacock, Ian El-Mokadem and Kirsty Bashforth – each of whom bring highly relevant and complementary skills. Lynne Peacock has assumed Chairmanship of the Remuneration Committee. The background and experience of each are detailed in the Directors' Report on pages 86 to 87 and details of the selection process to the appointments are set out in the Nomination Committee Report on page 102.

Ed Casey, our Chief Operating Officer, left Serco at the end of 2017 after 12 years of dedicated service to the Company. For the last four years, Ed had been commuting weekly across the Atlantic, and we quite understand his desire to return to the US, where he is taking up a senior role with a company in a different sector. I would like to express the Board's appreciation for Ed's significant contribution, particularly in supporting the stabilisation phase of our strategy and developing our plans for the transformation phase. We do not currently intend to seek a replacement for Ed as Chief Operating Officer, but will distribute his responsibilities amongst members of the Serco's Executive Committee, reflecting the strength of the established senior leadership of Serco.

We have continued in 2017 to further develop the effectiveness of our governance, operational resilience and organisational change processes. Your Board has also been actively involved in evaluating individual bids containing a particular concentration of risks, as well as meeting regularly with management responsible for the delivery of the Company's key operations and for the development of new business. Board members regularly visit contracts and meet with members of the wider management team; in particular, Non-Executives participate in our Oxford Saïd Serco Management training course, which is attended by around 30 managers and runs four times a year.

Chairman's Statement

I am pleased to report that we have fully complied with the provisions of the UK Corporate Governance Code with the exception of conducting an external-led Board evaluation, which, considering that our three new Non-Executive Directors joined in the second half of 2017, the Board considered would be more appropriate to defer to 2018. As in previous years, the Board conducted an internally-led evaluation, as detailed on page 92.

The Board believes that strong governance is a vital component in the long-term success of the Company; further detail on our structures and processes are set out in our Corporate Governance Report on pages 86 to 109, as well as the Committee reports.

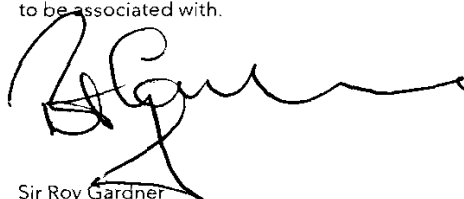
Securing our future success

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

We will continue to transform the business and expect good profit growth in 2018 and 2019. Beyond, our long-term ambitions for margins and revenue growth remain intact, but the timing of achieving these remains subject to seeing improvements in the trading conditions across our markets.

The current challenges in some of our markets are covered in the following section on Our Business, together with the Chief Executive's Review; importantly, these also cover the strong progress Serco is already making, the opportunities that are expected to arise for us, and the long-term effectiveness of the markets that remain in place.

I would like to thank all colleagues in the business for their efforts in achieving a successful 2017, and for their continued support in helping Serco to be a superb provider of public services that everyone will be proud to be associated with.



Sir Roy Gardner
Chairman

Our Business

Serco has deep expertise overlaid on our private sector techniques. Drive and energy is a public service ethos that means that we can help deliver government services efficiently, but in a way that recognises the need for public accountability, transparency and trust.

What we do, and how we do it

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

Serco's origin dates back to 1929, when the Radio Corporation of America established a UK subsidiary providing technical services to cinemas. In the years leading up to 1987, the UK subsidiary diversified its services to cover facilities management, systems engineering and support services. Following a management buy-out in 1987, the Company was subsequently listed on the London Stock Exchange as Serco Group plc. Throughout the eighties and nineties, Serco was at the forefront of the emerging outsourcing market in the UK, pioneering in areas such as large scale transfers of staff and in being the operations contractor for new public infrastructure and services.

Serco delivers services to Government through people, supported by processes, technology and skilled management. Our customers define what outcomes or services they need to deliver, and we develop new and more effective ways to deliver them. We deliver innovative solutions to some of the most complex challenges facing governments, bringing our experience, capability and scale to deliver the service standards, cost efficiencies and policy outcomes governments want. In this way we make a positive difference to the lives of millions of people around the world, and help keep nations safe.

Governments have two basic responsibilities: to develop policies, and to ensure that those policies are delivered. Some policies can be delivered simply by enacting legislation, relying on individuals and corporations to deliver the policy themselves by acting in accordance

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

Public services require people

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

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

Our Business continued

Public services and delivery by the private sector

Governments have used private contractors to deliver public policy, often in very sensitive areas, for centuries. In medieval times, fighting wars and tax collection were often outsourced, in whole or part, to private enterprise. The transportation of prisoners from the UK to Australia, which started in 1788 and continued until 1868, was carried out entirely by private contractors. Today, in the UK, frontline medical services by the National Health Service are provided by general practitioners, the vast majority of whom are employed by private partnerships and companies. Some of the most sensitive and secret defence work, such as developing and supporting strategic nuclear weapons, is carried out by private companies.

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

Unique demands of public service delivery

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

Serco's breadth and structure

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

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

We structure ourselves with three types of function: Divisions, Group, and Shared Services. All operational delivery is executed through four geographic Divisions: UK & Europe, the Americas, Asia Pacific and the Middle East. Within their domains, Divisions are responsible for everything involved in winning and delivering contracts; 97% of our employees work in these Divisions. A lean Group function provides governance, strategy, asset allocation, policy-setting and oversight, as well as certain specialist consolidation and functional roles in Finance, Risk and HR; the Group also manages Centre of Excellence (CoEs) which provide focused expertise and support to the Divisions, and enable sharing of best practice and the development of common propositions in areas such as Transport, Justice & Immigration and Health. Shared Services provide common functional and processing support in areas such as IT, HR and finance to the Divisions.

Our Strategy

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

We believe that good strategies are simply expressed. Our strategy is to be a superb provider of public services, by being the best-managed business in our sector. We are a B2G (Business to Government) business, specialising across five sectors: Defence, Justice & Immigration, Transport, Health and Citizen Services. We deliver these services in four regions: UK & Europe, North America, Asia Pacific and the Middle East.

The decision to focus on being a B2G business was taken in 2014, and was a change from the previous strategy which had been to serve both private and public sector customers. The strategy was changed as a result of the need to recapitalise the business following a troubled diversification into private sector outsourcing and the realisation that Serco had taken on a number of very heavily loss-making contracts. As a result of this the management team was changed in 2013 and 2014, and over £700m was raised by way of an equity Rights Issue in early 2015 and the disposal of non-core businesses later in that year.

Focusing the business on the public sector market was, in effect, going back to our roots. For some 20 years up until 2010, the company had delivered rapid growth and very significant value creation by being largely focused on the public sector. In recent years the public sector market has become more difficult as governments struggled with the effects of the financial crisis in 2008, slowdowns in military spending, and the election of governments committed to reducing public expenditure. Furthermore, governments have become much more skilled at contracting and focused on risk-transfer; as a consequence margins and risk-adjusted returns earned by many suppliers to government are much lower today than they were ten years ago.

However, despite what is now a more mature and difficult market than it was around the turn of the century, the business of providing services to government has attractions. We believe that the market will continue to grow, albeit at a slower rate than previously, because of two fundamental truths. First, that in many areas of public service provision, private companies, properly managed, can deliver services of higher quality and lower cost than governments can themselves. Second, that governments will continue to face huge pressure to deliver more and better public services, for less, and that this will lead them to focus relentlessly on value for money and the quality of service provision. This pressure comes from what we call the 'Four Forces' comprising:

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

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

In all of our markets the degree to which government should use private companies to provide public services is one debated, sometimes fiercely, and the pendulum can swing quite sharply. By way of example, the elections in Western Australia in 2017 saw a Labor government committed to reducing private sector participation replace a Liberal administration which had overseen the introduction of private sector companies into the prison and healthcare systems; on the other side of the country, however, in New South Wales, the administration is a sophisticated user of private sector services, as is the Federal Government. In the US, the Obama administration was notably seen as less 'private sector friendly', while the new Trump administration is considered the reverse. Recently, in the UK, the collapse of Carillion has reignited debate, with the two main political parties taking sharply divergent views. This 'two-way street' is well established, but on a smaller scale, in the commercial outsourcing market, where on a daily basis some companies decide to outsource, and others decide to insource.

Our Business continued

We believe, however, that the long-term pressures to deliver value-for-money, increasing demand for services, and the need to improve service delivery will ensure that the role of the private sector in the delivery of public services will remain robust.

There are other factors that make the public sector marketplace attractive to us: whilst some niches may be disrupted by technology or other exogenous factors, we can be very confident that the world will still need prisons, will still need to manage immigration, and provide healthcare and transport, and that these services will be highly people-intensive for decades to come. The bank teller or shop assistant may be rightly fearful that technology will disintermediate their role, but a prison custody officer can sleep soundly in the knowledge that his or her skills will be required for years to come.

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

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

An international footprint also helps us build customer interest and confidence. The fact that we are involved in running major urban rail infrastructure in the UK and Dubai helps us in rail bids in North America; our proven track record in reducing recidivism amongst offenders in Australia is of interest to authorities in the UK. But, more broadly, when governments are considering awarding us an important project, the fact that other governments trust us to help them manage some of their most critical and secret areas of national security infrastructure is helpful in building confidence.

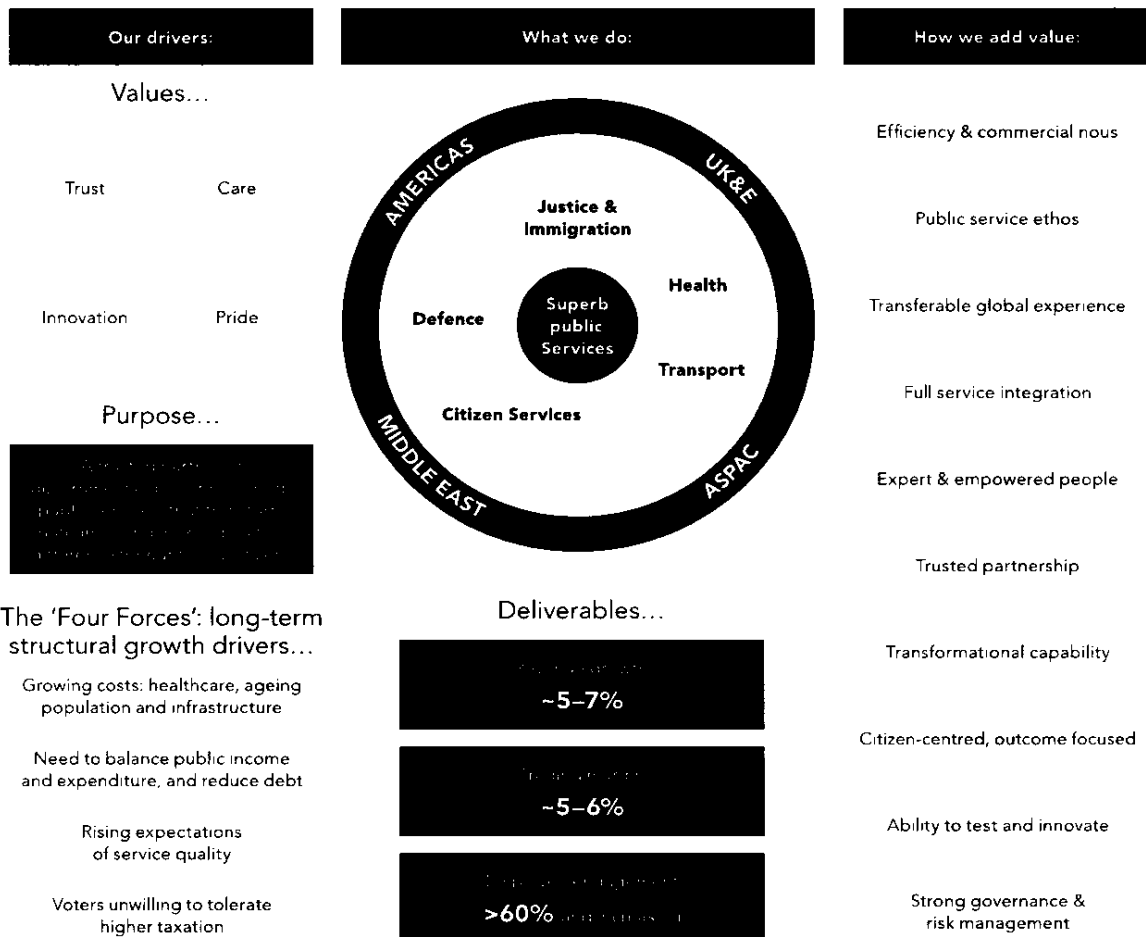
Market size

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

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

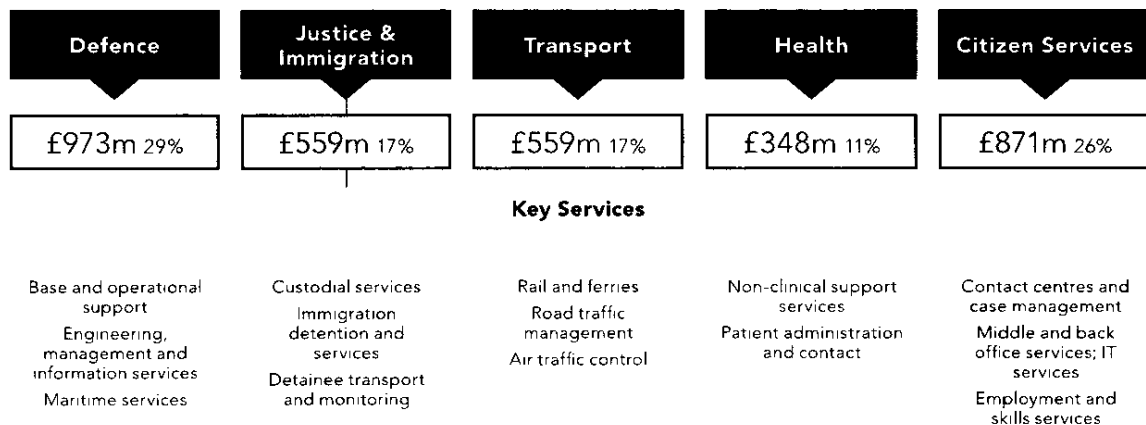
- the market for private sector delivery of government services is very large;
- the supply-side is fragmented; as a leading international supplier, our market share within our existing footprint, at around 3%, is small, although it is larger in some specific segments within certain sectors; and
- there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

Our business model



Our core sectors

Our business is focused across five core sectors and four geographies, with revenue in 2017 (including share of joint ventures and associates) of £3,310m



Our Business continued

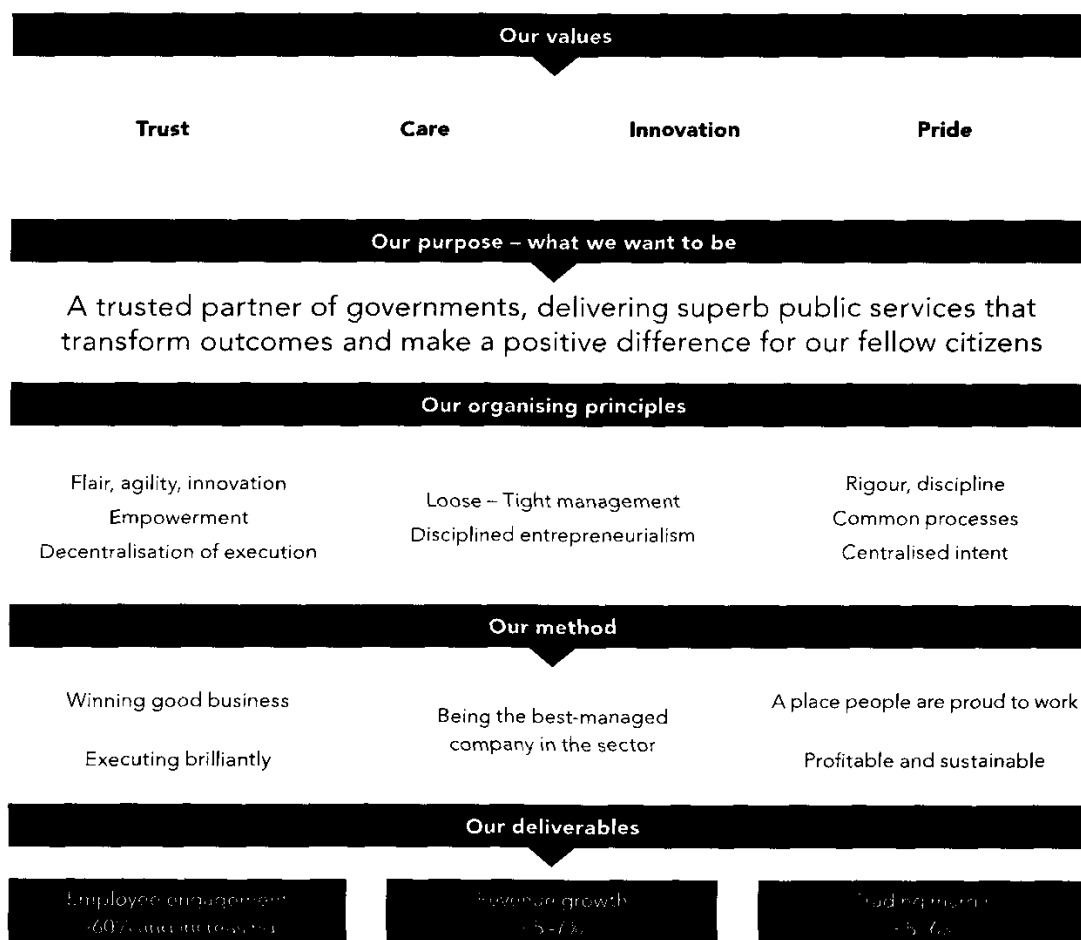
Implementing our strategy

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

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

We are great believers in succinctness and simplicity. Accordingly, we have managed to fit our strategy and performance framework – of what is a very complex and diverse business – into a single graphic that we use throughout the business:

Our performance framework



The purpose of the performance framework is to provide a structure which will deliver value to our customers, shareholders, and to the people who work in the business. We start with our Values.

Our values

Whilst we use technology and processes, the core of our business is people – many thousands of them – delivering public services. It is of central importance to our success that our colleagues, many of whom are former public servants, and our customers, believe that we have values appropriate to a company delivering services funded by taxpayers to often vulnerable and disadvantaged citizens. “Working at the leading edge of technology” may be inspiring to people working for IT businesses, but they are not reasons why a prison officer makes a cup of tea for a suicidal prisoner at two o'clock in the morning; why a housing officer leaves the comfort of an office to guide a nervous asylum seeker's child to school on their first day; why an engineer crawls into that impossibly small space in the foetid bowels of an aircraft-carrier to make sure the cable-ties are secured just right so they will stay in place in storm or battle. It is because they care about their work, they recognise the importance of what they do, and they take immense pride in it. Before our customers will give us sensitive work, they have to trust us. And to win business we have to come up with innovative solutions which will enable governments to deliver more, and better, for less. This is why our Values of Trust, Care, Innovation and Pride are so important. We don't pretend to be saints, or to be holier-than-thou; we are not so naïve as to believe that in a workforce of over 50,000 people there will not be some uncaring bad eggs. But the overwhelming majority of our colleagues are decent, hard-working, committed, and want to make a positive difference to those they serve. In this, we reflect the values of our customers, which they call a “public service ethos”, and we call our Values.

Our organising principles

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

“Loose-Tight... is the co-existence of firm central direction and maximum individual autonomy. ...Organisations that live by the loose-tight principle, are on the one hand rigidly controlled, yet at the same time allow (indeed insist on), autonomy, entrepreneurship, and innovation from their people.” Tom Peters: In Search of Excellence

“Avoid bureaucracy and hierarchy and instead create a culture of discipline. When you put two complementary forces together – a culture of discipline with an ethic of entrepreneurship – you get a magical alchemy of superior performance and sustained results.” Jim Collins: Good to Great

Our method

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

Winning good business

Executing brilliantly

Being a place people
are proud to work

Being profitable
and sustainable

We try to make sure that everything we do improves our performance against one or more of these objectives, and start from a position where we know we can do much better. We can improve the way we bid and manage contracts; develop innovative propositions; measure performance; reduce the cost and improve the quality of our administrative systems and processes. None of these comes easily or quickly, and we need to steer a tricky course between the urgent need to reduce our costs in line with reduced revenues in the short term and investing in systems and processes that will produce sustainable benefits in the long term.

Our Business continued

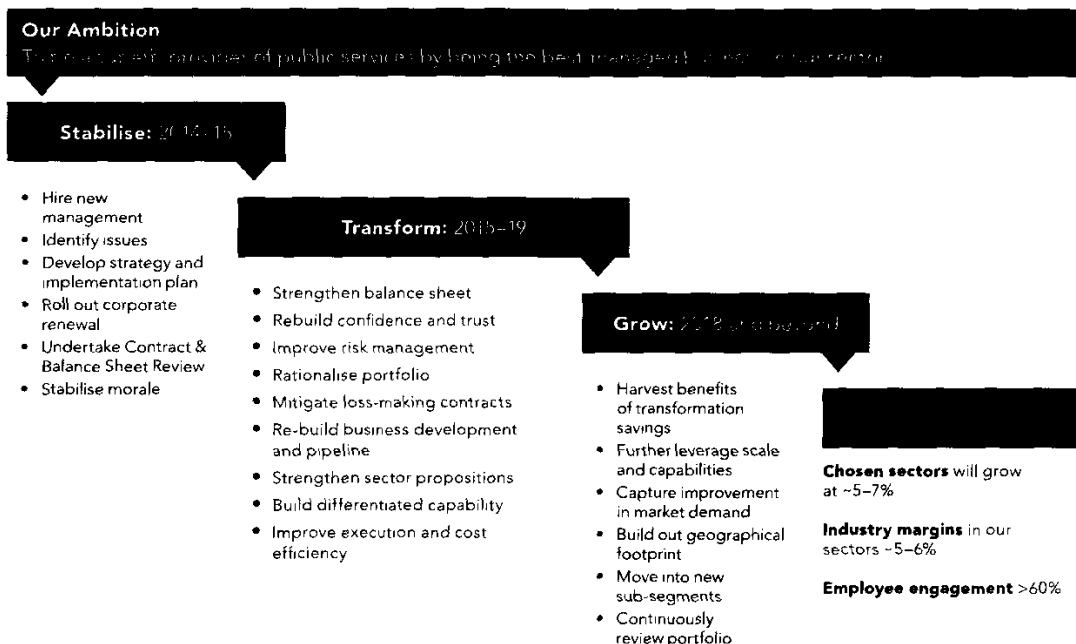
Our performance framework continued

Our deliverables

The tangible evidence of our success or otherwise will be a return to industry rates of growth and margins. In recent years our revenues have been shrinking and our underlying trading margins are far too low at around 2–3%. Our challenge, and our opportunity, is to get back to long-term industry rates of Revenue growth, which in the past were around 5–7%, and Trading Profit margins across Serco's mix of business in the range of 5–6%. In the last two years the rate of growth in our markets has probably declined as the UK, which is our largest region by revenues, having seen reduced expenditure in key government departments driven in part by the necessary focus on the challenge of Brexit. However, there is no reason to believe that the long term future rate of growth should be any different from the long term historic rate of growth. If this turns out to be correct, and markets turn out as expected, we believe that after a period of restructuring and transformation, it will be possible to increase growth rates and margins towards the historic average of our industry and to levels necessary to deliver appropriate returns.

Progress to date

In terms of progress towards our goals, in 2014 we identified three distinct phases in the implementation of our strategy. The first phase – Stabilisation – recognised the urgent need to recapitalise the business and restore customer confidence and employee morale following the very significant write-downs following the realisation that Serco had a number of very heavily loss-making contracts. This phase was largely completed in 2014, although the fundraising and essential stabilisation of our balance sheet did not take place until 2015 after which further rebuilding of customer confidence and trust could then follow. The Transformation phase gathered pace in 2016 and 2017, and in practice will continue through into 2018 and 2019, and will be an essential underpin as we progressively move into the Growth stage. When we launched the plan, it was conceived that Growth would refer to both revenues and profit. However, more recently, we believe that market rates of growth have been declining and certainly for the next few years revenues are likely to be flat, but margins will increase as we extend our Transformation phase and see more growth coming from cost reduction and increased efficiency. Nature does not draw lines – she smudges them, and the same applies to our strategy implementation, where the phases of Stabilisation, Transformation and Growth necessarily overlap.



In terms of progress in the Transformation phase:

- We have successfully strengthened our balance sheet, following the Rights Issue completed in April 2015 and the disposal of our private sector BPO business; together these raised over £700m, and our Net Debt: EBITDA now stands at 1.4x, with period-end net debt reduced from £745m at the end of 2013 to £141m at the end of 2017.
- We have made further excellent progress rebuilding confidence and trust with our major customers, in large part due to greatly improved operational performance.
- Portfolio rationalisation has been completed, concluding with the disposal of the majority of our private sector BPO business at the end of 2015.
- We continue to mitigate the impact of loss-making contracts; we have always regarded our Onerous Contract Provisions as a portfolio, knowing that the actual out-turn on individual contracts would almost certainly be different from the original estimates made at the end of 2014. Up to the end of 2017, actual expenditure against the £447m of Onerous Contract Provisions has been very close to the original estimate.
- We continue to strengthen our sector propositions, most particularly through the work carried out by our CoEs covering Health, Justice & Immigration, and Transport. These CoEs have been heavily involved in developing propositions to support major bids such as Barts Health NHS Trust (won in 2016), and Grafton prison in Australia (our largest ever order, worth £1.5bn, won in 2017).
- Our order intake has grown very substantially, and in 2017 was for the first time since 2012 ahead of our revenues, resulting in an increase in our order book, which at the end of 2017 stood at £10.7bn.

- We have succeeded in reducing the businesses' operating costs; in 2017 they were more than £1bn lower than in 2014. The majority of this reduction relates to costs removed from contracts which have ended and businesses disposed of, but it is certainly an achievement to have reduced costs broadly in line with revenues. Importantly, our cost reduction also includes over £100m removed through our programmes to deliver savings by reducing the number of management layers, implementing better procurement and driving greater efficiency in the operation of shared services.

Summary

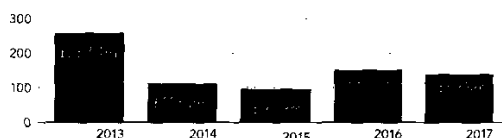
We believe we have the right strategy for our business, and over the last three years we have delivered in each year results which have been in line with our plan, which is no mean achievement. So far, so good, but the real test of the strategy will be our ability to start growing again. The market is currently growing at rates below historic trend, and we think that the growth we expect to achieve in 2018 and 2019 will come more from increasing cost efficiency and transformation than from growing revenues. It is nevertheless the case that if we can deliver the margin growth we are targeting over the coming years, this will of itself drive very considerable growth in profits.

Key Performance Indicators

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

For each KPI we explain the definition, relevance to our strategy and the performance in 2017. We have made no changes in 2017 to the KPIs presented and therefore there is comparability and consistency with our focus in the business and the guidance that we issue. The Finance Review provides further detail on our use of Alternative Performance Measures (APMs). Information on our carbon emissions that was presented in this section in previous years can be found within our Corporate Responsibility Report on pages 69 to 84. A large number of other corporate responsibility measures can also be found on those pages, as well as in our more detailed corporate responsibility report for the year which is available on our website www.serco.com

1. Underlying Trading Profit (UTP), £m



Definition

Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items; it includes the impact of discontinued operations for consistency with previous disclosures. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract & Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges), as well as the beneficial treatment of depreciation and amortisation of assets held for sale in prior years, and other material one-time items as set out in the Finance Review.

Relevance to strategy

The level of absolute UTP and the relationship of UTP with revenue – i.e. the margin we earn on what our customers pay us – is at the heart of our 'profitable and sustainable' business objective, as well as being an output of 'winning good business' and 'executing brilliantly'. We describe on page 16 that the delivery of strategic success, after the completion of further transformation, has potential to deliver revenue growth of 5–7% and trading margins of 5–6%.

Performance

The outcome was at the top end of our guidance of £65–70m given at the start of the year. The reduction on 2016 was driven by the first half of that year benefiting from £11m of non-recurring trading items. The underlying margin reduced from 2.7% to 2.4%.

2. Underlying Earnings Per Share (EPS), pence



Definition

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

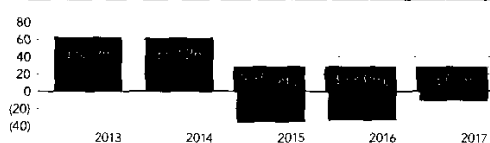
Relevance to strategy

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

Performance

The reduction reflects the UTP performance as described, partially offset by incurring lower finance costs; our underlying effective tax rate and the number of shares were broadly flat in 2017 versus 2016.

3. Free Cash Flow (FCF), £m



Definition

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

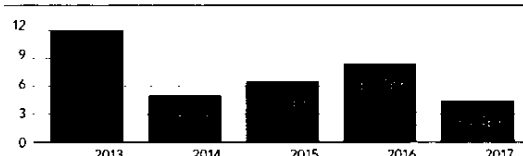
Relevance to strategy

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

Performance

Cash generated from UTP was largely offset by the outflows related to loss-making contracts subject to OCPs. These cash outflows lessened in 2017 versus 2016, as reflected in the lower rate of OCP utilisation. The working capital outflow was also lower at £9m, which included £8m of reduction in the utilisation of the Group's receivables financing facility, resulting in zero utilisation by the end of 2017.

4. Pipeline of larger new bid opportunities, £bn



Definition

The estimated aggregate value at the end of the reporting period of new bid opportunities with estimated Annual Contract Value (ACV) of at least £10m and which we expect to bid and to be adjudicated within a rolling 24-month timeframe. The Total Contract Value (TCV) of individual opportunities is capped at £1bn. The value of re-bid and extension opportunities is specifically excluded so as to measure only 'new' growth opportunities. Also excluded is the potential value of framework agreements, prevalent in the US in particular where there are numerous arrangements classed as 'IDIQ' – Indefinite Delivery/Indefinite Quantity.

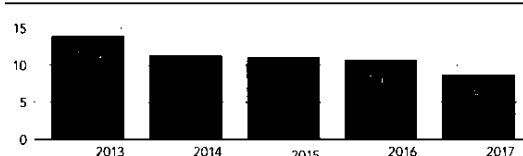
Relevance to strategy

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

Performance

As anticipated, the pipeline was noticeably lower given the number of unusually large opportunities that moved through the pipeline over the course of 2017 but also reflecting challenging market conditions in terms of the lower level of new opportunities being added. The reduction included winning new business, which is reflected in the order intake (the value of all signed contracts) being strong at £3.4bn and the book-to-bill ratio (order intake versus revenue) exceeding 100% for the first time since 2012.

5. Underlying Return on Invested Capital (ROIC), %



Definition

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

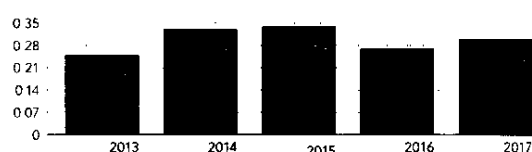
Relevance to strategy

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

Performance

The reduction in ROIC reflects both the lower UTP as described, as well as slightly higher invested capital largely resulting from the normalisation of average working capital balances. We expect an improvement in ROIC to be driven by the development in profit margin when we successfully complete the 'Transform' stage and make progress with the 'Grow' phase of our strategy.

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



Definition

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

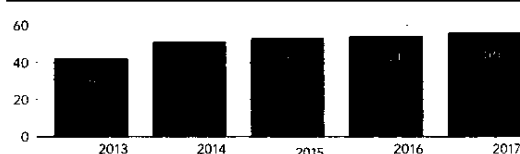
Relevance to strategy

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

Performance

There were 29 major incidents reported in 2017. This resulted in a frequency rate of 0.30 per 1m hours worked which is 11% up on 2016 and exceeds our target which was set at 0.23. This indicator has been impacted by increasing numbers of physical assaults and particularly serious physical assaults within our Justice & Immigration business. This and the range of initiatives being implemented to address the situation are covered in the Corporate Responsibility Report.

7. Employee engagement, %



Definition

We partner with Aon Hewitt to run Viewpoint, our global employee engagement survey. This covers all employees, excluding our joint ventures, and focuses on three key areas: whether people say positive things about working at Serco ('say'), people's intention to stay with Serco ('stay') and their intention to give discretionary effort ('strive'). Our engagement score shows how many employees exhibit strong levels of all three of these areas when we survey.

Relevance to strategy

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

Performance

2017's Viewpoint survey, which is based on some 31,000 employees responding, showed a fourth successive year of improvement in our global score. The score is now at the highest level since we started measuring it in 2011. The Viewpoint results are cascaded to the organisation each year and we have a global plan of activity in place to sustain and drive further employee engagement, led by our Executive Committee.

Principal Risks and Uncertainties

Risk management approach

We are faced with a number of challenges and risks due to the diverse services we provide around the world. We have to respond to the changing political environment which in some cases has unknown consequences. Brexit is just one example, where today there are few conclusions as to the real impacts, both negative and positive, on our economic landscape in the UK, Europe and the wider global economy.

We manage risks through our risk management policy, standards, and risk management lifecycle processes. The risk management lifecycle includes six key processes that aim to manage the key risks to our operations. This enables us to have a consistent approach to identifying, analysing, monitoring and reporting risks and a mechanism for providing assurance that the risk mitigation in place is effective.

These align to the guidance contained within the UK Corporate Governance Code and form part of the Serco Management System (SMS). The SMS is a set of requirements and procedures that define how we operate and how we behave. This system seeks to ensure that we identify, review and report risks at all levels of our business, reflecting the nature of the activities being undertaken at that level, the business and operational risks and the level of control considered necessary to protect our interests and those of our stakeholders.

Management oversight and risk appetite

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

The Group Risk Committee (initiated in 2016, as a focused committee that previously was covered as part of the responsibilities of the Corporate Responsibility and Risk Committee) is now fully embedded, reporting quarterly to the Board, and this has improved our management oversight on the principal risks (see pages 93 to 95 for the detailed Corporate Governance Report). 'Deep Dives' into a number of principal risks are carried out during the year, together with a review of the operating environment to determine any changes to our 'Top 10' risks.

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

Principal risks

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

The resulting principal risks have been reviewed and endorsed by the Risk Committee. Each risk is classified as strategic, financial, operational, people, hazard, legal and compliance. They are described on the following pages, together with the relevant strategic business objectives, key risk drivers, the Group-wide material controls which have been put in place to mitigate the principal risks, and the mitigation priorities going forward to improve the effectiveness of the controls.

The risks are considered over a three-year timeframe which is the same time period that has been used in the Viability Statement (see pages 30 and 31). The Viability Statement takes into account the principal risks in its assessment.



Summary of principal risks

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

Principal Risks and Uncertainties continued

Winning good business



Executing brilliantly

A place people
are proud to work

Profitable and sustainable

STRATEGIC RISKS**Failure to grow profitably**

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

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

Key risk drivers:

Lack of opportunities in chosen markets – some market sectors may not have a favourable policy of private sector provision of public services, reducing pipeline opportunities.

External factors reducing the pipeline of opportunities – political and policy changes in our markets (such as changes in federal or state governments, or decisions such as Brexit) may make it more difficult for us to win in some geographies, or result in fewer opportunities.

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

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

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

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

Material controls:

- Serco Group Strategy focusing on specific markets and geographies with the greatest growth potential.
- Serco Operating Model
- Investment Committee.
- Serco Management System (SMS).
- Sector-specific Centres of Excellence (CoEs) and Value Propositions.
- Business Lifecycle Review Team (BLRT) process.
- Pipeline and Business Development spend reviews to ensure efficient deployment of resources.
- Divisional Performance Reporting (DPR) process.
- Annual Performance Reviews, Talent Reviews and Succession Planning processes.

Mitigation priorities:

- Review pipeline opportunities to ensure all market activity is accurately captured.
- Review bid solution processes and SME resources to ensure our propositions remain competitive.
- Streamline and standardise the Business Development processes.
- Refinement of BLRT process to ensure lessons learnt and price-to-win competitive analysis are formally embedded in the solution process.
- Continued focus on account management for major re-bids to ensure existing clients are experiencing good service from Serco and fully understand the value and quality of our services
- Continuation of efficiency improvements to Group and Divisional overhead and shared services structures as part of the Transformation Programme to ensure we remain cost competitive.

Failure to manage our reputation

Failure to manage our reputation will mean that customers will be less likely to give us new business or renew existing business. It will also impact our ability to attract and retain high-quality people.

Key risk drivers:

Failure to clearly define what Serco stands for and how we wish to be seen – may result in inconsistent communication and misunderstanding by our key stakeholders

Not understanding our customers' and stakeholders' expectations – may result in a failure to recognise changes in our business environment or our customers' priorities

Failure to manage incidents appropriately – may result in us not responding in a collaborative approach with our customers, or not communicating in an open and ethical manner to key stakeholders.

Material controls:

- Serco Values.
- Group Reputation Brand and Communication Standard.
- Customer and stakeholder relationship and engagement programmes.
- Proactive engagement with the media
- Media training and understanding of reputational issues for senior management
- Continual media monitoring.
- Incident management processes and crisis management plans

Mitigation priorities:

- Maintain momentum of 'Executing Brilliantly'.
- Review and refine existing controls to ensure maximum effectiveness

Failure to deliver expected benefits from Transformation

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

Key risk drivers:

Non-delivery of required benefits – we fail to achieve the expected benefits due to poor programme management and/or solution design.

Severe disruption to the business – we fail to coordinate and prioritise the various programme objectives due to poor integration across activities and inadequate programme management, and we negatively impact on 'Business As Usual' activities

Watering down of value/ambition of Group Operating model – due to a sum of compromises across the organisation and the possible misalignment across the Divisions.

Failure of the businesses to understand the imperative to change – due to ineffective communication from the leadership teams.

Failure to comply with new operating model – due to ineffective enforcement of the model and changes not embedded into the business.

Failure to communicate the change and impact of the change to clients – potentially causing opposing short-term drivers.

Material controls:

- Serco Operating Model objectives.
- Group Transformation Programme Management Office (PMO) and Programme Governance Boards.
- Programme risk management process
- Stakeholder engagement and communication plans.
- Serco Management System (SMS)
- Divisional Performance Reporting (DPR) process
- Benefits management process
- Embedding benefits within Divisional budgets.

Mitigation priorities:

- Development of programme benefit cards to facilitate measurement of anticipated benefits.
- Full alignment of Group, Divisions and Business Units to Operating Model.
- Refine DPR to capture transformation delivery and performance.

FINANCIAL RISKS

Financial control failure

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

Key risk drivers:

Not setting the right tone from the top – without which, we may fail to embed the finance policy, processes and controls.

Poor financial processes – if processes are poorly designed, then inaccuracies and fraud may occur

Inadequate financial controls within the business – if controls are inadequate we may fail to provide adequate protection from sabotage of systems, fraud and error.

Impact of Transformation Programme activities – programme activities may lead to poor change control or an unstable financial control environment due to an increased workload on the finance community.

Failure of Finance Transformation Programme – we do not transform the finance processes and controls, and fail to deliver expected benefits.

Material controls:

- Group governance and finance strategy.
- Finance transformation programme governance.
- Active monitoring of outsourced partners.
- Serco Management System (SMS) – finance processes and controls.
- Standardised reporting, forecasting and financial processes.
- Standardised financial systems and data structures.
- Skilled and adequately trained finance staff
- Financial assurance and second line of defence assurance activities.

Mitigation priorities:

- Continued delivery of finance transformation programme.
- Complete knowledge transfer process within the UK.
- Embedding new forecasting tool, policies and practices
- Continuous improvement of reporting processes as a result of better data capture
- Monitor compliance with billing processes and continuous billing assurance programme.
- Standardisation of Integrated Assurance Maps.
- Complete gap analysis of benchmark controls and assurance activities across key risk drivers managed by Divisions.

Principal Risks and Uncertainties continued

OPERATIONAL RISKS

Major information security breach

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

Due to the nature of the services we provide, our technology and operational systems will be subject to threats from both internal and external breaches. We implement effective controls proportionate to the level of sensitivity of the information we are protecting, and where 'things go wrong', we act swiftly to minimise the impact of any breach and carry out remedial actions to prevent further breaches immediately.

Key risk drivers:

Non-compliant systems – if our systems are non-compliant with regulatory requirements for sensitive information, we are susceptible to breaches and penalties

Non-compliance with policies and standards – if staff do not comply with Serco policies and standards, then they may accidentally release sensitive information to third parties.

Vulnerability of systems and information – if we do not identify sensitive information and protect and test the vulnerability of our systems, then we are potentially exposed to a breach

Unauthorised use of systems – if we do not implement effective personnel vetting and access restriction processes and controls, then unauthorised use of our systems may occur.

Inadequate incident monitoring and response – if we do not monitor our systems and remediate and repel attacks, then we may fail to minimise the impact of any breach.

Material controls:

- Enterprise Architecture Boards and Solution Review meetings.
- Serco Management System (SMS).
- IT security infrastructure, process and controls.
- Privilege User Management (PUM) process.
- External accreditation (eg, Cyber Essentials Plus (CES+) in the UK).
- Third party due diligence checks.
- Global Security Operations Centre and Computer Security Incident Response Teams.
- My HR – standardised HR processes and corporate HR system
- Serco Essentials training.
- Cyber security awareness training, including regular Phishing training exercises

Mitigation priorities:

- Completion of Cyber Defence and Hardening Programmes in all Divisions.
- Completion of PUM roll out across all Divisions
- Routine vigilance and proactive vulnerability identification coordinated through our Security Operations Centre.
- Regular controls assurance
- Embed third party due diligence checks for key suppliers.

Contract non-compliance, non-performance or misreporting

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

If the misreporting is deliberate, it may constitute fraud, and the Group may be subject to litigation, inquiries or investigations that could divert management time and resources, and result in penalties, sanctions, variation or revocation of permissions and authorisations, suspension or debarment from doing business with government customers.

Key risk drivers:

Poor leadership and culture – if our leaders do not align with our Values, and staff feel under pressure to meet challenging operational targets and/or performance indicators, then deliberate misreporting may occur

Lack of process and controls – poorly documented or poorly communicated processes may lead to deliberate or unintentional misreporting or contract non-compliance.

Ineffective assurance and human error – insufficient oversight and assurance of contract performance, could lead to contract non-compliance, non-performance or a misreporting of performance

Poor understanding of contract obligations – may result in staff failing to acknowledge and act on obligations or a failure to provide adequate resources to deliver against contractual obligations.

Poor systems/IT – unreliable or incorrectly configured systems may result in late or incorrect data produced

Material controls:

- Viewpoint checks, communication of Our Values and Code of Conduct.
- Contract Management Application (CMA)
- Serco Management System (SMS)
- Business Lifecycle Review Team (BLRT) process
- Leadership Development Programme and Contract Manager training
- Contract governance including Monthly Contract Reviews, Business Unit reviews and Divisional Performance Reporting (DPR) process
- Speak Up process (EthicsPoint)

Mitigation priorities:

- Consistent Contract Management training
- Embed use of the CMA
- Development of additional contract performance Indicators ('health checks').

Failure of business critical partner, sub-contractor or supplier

As a result of the failure of a business critical partner, sub-contractor or supplier¹ to deliver and/or perform to the required standard, Serco may be unable to meet its customer obligations or perform critical business operations which could result in a financial, operational or reputational impact.

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

Key risk drivers:

Ineffective procurement and supply chain governance – no Group functional owner for procurement resulting in inconsistencies in implementation of standards, potential non-compliance to those standards and lack of consequence management for non-compliance.

Identification of significant suppliers – a failure to identify who are our critical suppliers may result in lack of focused oversight, and understanding of the impacts on Serco should they fail to deliver our customer critical service

Limited oversight – resulting in poor sourcing, contracting and monitoring of business critical partners, sub-contractors and suppliers as well as the potential for engaging in ineffective or onerous contracts with suppliers or sub-contractors.

Lack of resilience in the supply chain – exposing us to potential service provision or financial losses should they have ineffective Business Continuity and Disaster Recovery plans.

Material controls:

- Serco Management System (SMS) – procurement policy, standards and procedures.
- Sourcing Standard Operating Procedure.
- Supplier Management Standard Operating Procedure.
- Maintenance of business critical partner, sub-contractor and supplier list.
- Compliance Assurance Testing
- Consequence management.
- Financial health checks and monitoring.
- Supplier performance and risk reviews.
- Supplier Business Continuity Plan audits.

Mitigation priorities:

- Consistent understanding and management of the risk across all Divisions
- Establish Divisional compliance assurance testing.
- Supplier Relationship Management (SRM) Pilot and development of future approach to SRM.
- Audit business critical sub-contractor and supplier business continuity plans

PEOPLE RISKS

Failure to act with integrity

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

Key risk drivers:

Failure to communicate – if we do not define and communicate our Values and expected standards adequately, our staff and third parties will fail to understand these, which may result in inappropriate leadership actions and low engagement with our Values

Our ways of working do not align with our Values – staff or third parties being unaware of and/or not reflecting our Values may result in poor decision-making, unacceptable business conduct, and unethical or illegal behaviour bringing our operations into disrepute

Direct or indirect contribution to human rights abuse – staff either directly or indirectly contributing to human rights (including slavery and forced labour) abuses may result in a breach of laws/regulations

Material controls:

- Top level commitment/tone from top
- Strong, meaningful and understood Values.
- Code of Conduct.
- Corporate Governance with oversight by the Corporate Responsibility Committee (CRC)
- Delegated Authority Register (DAR).
- Serco Management System (SMS).
- Financial controls and processes, with segregation of duties for core financial controls
- Gifts and Hospitality process and registers
- Risk management procedures
- Third party due diligence.
- Leadership Academy
- People development and remuneration.
- Speak Up process (EthicsPoint)

Mitigation priorities:

- Implementation of on-line Conflict of Interest registers
- Refinement of divisional compliance risk assessment.
- Clarification of ethics roles and investigation responsibilities
- Embed the new third party due diligence tool.
- Refresh Serco Essentials Plus training
- Continue with divisional Anti-bribery and Corruption reviews

Principal Risks and Uncertainties continued

HAZARD RISKS

Catastrophic incident

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

Key risk drivers:

Lack of capability and experience – if our chosen market sectors are not aligned to our capability and experience, then a failure to operate optimally may result in a serious event

Lack of safety cultural alignment – a safety culture which does not reflect our Values and fails to engage our staff and work safely may result in a serious event.

Ineffective or inadequate policies, standards and procedures – if procedures/systems are not aligned with industry standard or customer expectations, an unacceptable level of safety management may occur.

Insufficient safety management oversight – devolved compliance of regulations to sector-specific SMEs without appropriate safety management oversight may result in safety management systems which are not fit for purpose.

Factors resulting in unsafe conditions – a lack of identification and assessment of risks, sudden equipment failure or inadequate security may result in poor mitigation of and/or response to a serious event

Inadequate response to a catastrophic event – if our contingency plans do not provide an adequate response to an event then escalation of an event or prolonged disruption may occur.

Material controls:

- Serco Health, Safety and Environmental (HSE) Strategy
- Effective and engaged safety culture.
- Regular safety communications and maintenance of safety awareness.
- Competency based recruitment programme.
- Role description and competency definition.
- Serco Essentials training.
- Access to subject matter expertise
- Serco Management System (SMS)
- Business Lifecycle Review Team (BLRT) process.
- Planned and preventative inspections, maintenance and repair programmes.
- Third party ethical due diligence procedure.
- Assure – Serco's incident and compliance reporting system.
- Incident/near miss investigations.
- Divisional Performance Reporting (DPR) process.
- Crisis and incident emergency response plans and testing.
- Business Continuity plans and testing
- Compliance assurance and audit programmes.
- Adequate insurance policies.

Mitigation priorities:

- Refinement of controls following effectiveness review.
- Testing of Crisis Management, Disaster Recovery and Business Continuity plans
- Review of contractual risk allocation and insurance.

LEGAL AND COMPLIANCE RISKS

Material legal and regulatory compliance failure

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

Key risk drivers:

Lack of governance and oversight – may result in a failure to identify potential or actual breaches to legal requirements and result in a failure to respond appropriately, or weaken our ability to confirm compliance with legal and regulatory requirements.

Failure to comply with the SMS and contractual obligations – may result in compliance failures for Group-wide material legal and regulatory requirements.

Failure to identify and respond to material changes in legal and regulatory requirements – may result in key subject matter experts within the business not remaining up to date and we then fail to comply with material legal and regulatory obligations.

Lack of awareness by employees of the legal and regulatory requirements placed upon them – may result in lack of identification and subsequent compliance to requirements.

Inadequate provision of systems and tools – may result in ineffective methods to support the management of legal and regulatory compliance.

Material controls:

- Automated alerts on material legal and regulatory obligations and changes.
- Investment Committee process and governance.
- Third party due diligence.
- Serco Management System (SMS).
- Legal Tracker case management software.
- Gift and Hospitality process and registers.
- Legal training.
- Serco Essentials training.
- Compliance Assurance Programme (CAP) reviews
- Business Lifecycle Review Team (BLRT) process and governance.
- External regulatory audit.
- Bi-annual reporting to Board and Executive Committee on new laws across the Group.
- Speak up process and case management system (EthicsPoint)

Mitigation priorities:

- Use of trend analysis and analytics from Legal Tracker software.
- Launch of revised Code of Conduct and Supplier Code of Conduct.
- Complete and embed General Data Protection Regulation (GDPR) readiness programme.
- Refresh Serco Essentials training programmes.
- Implement revised Group Standard Operating Procedures (GSOP).
- Develop and implement new GSOPs including export controls, parental guarantees and conflicts of interest.
- Continue with contract and compliance assurance reviews.
- Embedding and sustaining the Corporate Renewal Program.

Principal Risks and Uncertainties continued

SFO investigation

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

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

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

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

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

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

Material changes to principal risks**Failure of business critical partners, sub-contractor or supplier**

Following the 2017 November Group Risk Committee meeting, this new risk was proposed and accepted by the Board. We have a fundamental business dependence on critical partners, sub-contractors and suppliers, as a result of which, the failure of any of these to deliver and/or perform to the required standard, may result in our inability to meet customer obligations or to perform critical business operations.

(See detail on this risk within the Principal Risk description page 25).

Contract non-compliance, non-performance or misreporting

Previously we reported misreporting of performance and contract non-compliance as separate risks. Both of these areas have had a significant focus over the last few years and the positive impacts of these are being seen (our Key Risk Indicators (KRIs) demonstrate that our residual risk is decreasing in both areas). This is due to our improvements in contract assurance, the increased coverage of our contractual management systems, together with the roll out of our operational excellence programmes as well as a better understanding of our contractual Key Performance Indicators (KPIs) and reporting requirements. Given the overlap of the controls in place for both these risks, we have determined that they can be combined into a single risk on the Group Risk Register.

Failure to build reputation or act with integrity

This risk has been separated into two discrete risks: failure to manage reputation, and; failure to act with integrity. This enables greater ownership and focus given the distinct control sets and mitigation plans. By demerging the risks, we are able to assign separate Subject Matter Experts (SMEs) and Executive Sponsors with the correct expertise to take ownership of the risk and develop and implement separate mitigation plans, thereby supporting the achievement of our target risk rating.

Failure to attract and retain key resources and skills fit for the future

During 2016/2017, we focused on our Serco leadership model, functional talent boards, succession planning, market competitive reward packages, talent pool capability and a number of other initiatives. These initiatives, together with existing controls, were considered sufficient to reduce the risk to the extent that it no longer forms part of our principal risks.

Viability Statement

In accordance with provision C2.2 of the UK Corporate Governance Code published by the Financial Reporting Council in April 2016, the Directors have assessed the prospects of the Group over the three-year period to 31 December 2020.

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

- The Group has limited visibility of contract bidding opportunities beyond three years.
- Approximately 50% (2016: 40%) of the current year revenue relates to contracts where the contract term potentially comes to an end within three years.
- The United Kingdom's withdrawal from the European Union in March 2019 could potentially delay timeframes for public service outsourcing whilst politicians and civil servants focus on the timetable for Brexit and any potential transition arrangement.
- There is also significant political uncertainty in a number of our other markets.

The strategic plan set out in March 2015 significantly changed the direction of the Group as was necessary given its recent history as explained in previous shareholder communications and the onerous contracts which exist. The Group prepares a five-year business plan each year to establish whether it is on target to achieve its medium term goals. However, the financials for the last two years of this period are largely extrapolations of key assumptions as there is insufficient certainty, as discussed above, for conclusions to be drawn on the future prospects of the Group and for sensitivities and mitigation strategies to be overlaid. Therefore, whilst the strategic plan continues to be developed, it remains a goal for the Group and is not a forecast based on known assumptions and a proven track record of performance; this makes assessing the longer term viability a challenge.

Good progress has been made on the five-year plan however the ability of the Group to harvest fully the benefits of the transformation are still largely unproven. Management has previously highlighted the dependence on the external market and its ability to win new contracts whilst reducing its cost base. Market rates of growth have been declining in recent years and for the next few years revenues are likely to be flat, but margins are expected to increase as the Transformation phase is extended and growth comes from cost reduction and increased efficiency. The Directors expect this to deliver the target margin increases which has been set although achieving this will take longer.

The Board and the Group Risk Committee continue to monitor the principal risks facing the Group, including those that would threaten the execution of its strategy, business model, future performance, solvency and liquidity. Management and mitigations of those principal risks have been taken into consideration when considering the future viability of the Group. The Group's principal risk review, as set out on pages 22 to 27, considers the impact of these principal risks and the mitigating controls that are in place.

In assessing the prospects of the Group over the three-year period, the Directors have also considered the Group's current financial position as well as its financial projections in the context of the Group's debt facilities and associated covenants. These financial projections are based on a bottom up Budget exercise for 2018 and 2019 which has been approved by the Board, and an extrapolation to 2020 using higher level assumptions based on local market growth rates and identified opportunities.

The Group's covenant net debt balance at 31 December 2017 is £179m. The Group's base projections indicate that debt facilities and projected headroom are adequate to support the Group over the next three years. In testing the headroom available under the key sensitivities modelled, the Directors have assumed that the Group refinances the portion of the RCF maturing in April 2020 under similar terms.

The Group's financial plan has been stress-tested against key sensitivities which could materialise as a result of the crystallisation of one or many of the Group's principal risks, the objective being that the future viability of the Group is tested against severe but plausible scenarios. The sensitivities tested include a reduction in the win rates for rebids, extensions and the pipeline of new opportunities, a delay in delivering margin improvements and a potential penalty arising from risks such as contract non-compliance, major information security breach or a material legal and regulatory compliance failure. The ability for the Group to absorb these sensitivities within its exiting finance arrangements drove the assumptions below which the Directors felt appropriate to disclose in making this viability statement.

It is unlikely, but not impossible, that the crystallisation of a single risk would test the future viability of the Group; however, unsurprisingly, and as with many companies, it is possible to construct scenarios where either multiple occurrences of the same risk, or single occurrences of different significant risks, could put pressure on the Group's ability to meet its financial covenants. At this point, the Group would look to address the issue by exploring a range of options including, amongst others, a temporary or permanent renegotiation of the financial covenants, disposals of parts of the Group's operations to reduce net debt and/or raising additional capital in the form of equity, subordinated debt or other such instruments.

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

- There is no significant unexpected contract attrition of existing work that becomes due for extension or rebid over the next three years;
- There is no significant reduction in scale of existing contract operations or future bid pipeline as a result of customer policy or other changes;
- There is no significant deterioration in new bid win rates from those anticipated;
- The Group is able to complete the execution of its strategy, including further transformation in 2018 and 2019, and making progress to revenue growth and further margin improvement from 2019 onwards; and
- The Group is not subject to any material penalties or direct and indirect costs and/or losses arising from the current SFO investigation.

Chief Executive's Review

With profits at the top end of the expectations we set out some 15 months ago, net debt lower than we expected, fully funded pension schemes, and strong order intake, we delivered a solid performance in 2017 in a difficult market.

Most importantly, we expect profits to grow in both 2018 and 2019. We understand that getting to this point has been a long haul for investors, and that there is still a long, and probably bumpy, road ahead before we are producing acceptable returns. But we are now moving forward, not backward.

The benefits of our international footprint have never been more evident as the UK market for public service outsourcing is afflicted by well-publicised traumas. This environment may produce opportunities for suppliers with strong track records of delivery, and Serco also has the advantage of choice as to where we allocate resources and effort between different markets. Therefore, as well as ensuring that we support our UK customers, and respond appropriately to opportunities as they arise, we will also be investing in our businesses in North America, Europe, the Middle East and Asia Pacific.

The challenges facing governments around the world remain unchanged. Ageing populations are driving demand for more and better public services; almost all governments spend more than they receive in tax; citizens have ever-higher expectations of the quality of public services. In this environment, governments are likely to want to use all means at their disposal to deliver value for money and high quality public services, which should mean a strong continuing role for the private sector as a provider of innovation, investment and operational management.

Highlights

- Reported Revenue⁽¹⁾ down 2%, comprising a 6% organic decline from net contract attrition, partially offset by a 4% currency benefit.
- Order intake up 36% at £3.4bn (2016: £2.5bn), includes Grafton prison in Australia which is the Group's largest ever contract win, and over 30 other contract awards worth more than £10m each across the UK, Europe, America and the Middle East; book-to-bill ratio of over 100% for the first time since 2012; closing order book increased to £10.7bn, up from £9.9bn a year earlier.
- Underlying Trading Profit⁽²⁾ was at the top end of our guidance given at the start of the year; run-rate throughout 2017 has been approximately 10% ahead of that achieved in H2 2016.
- Operating costs reduced in proportion to the scale of revenue reduction; further shared services and overhead savings of around £20m achieved, taking total overhead savings over the last three years to over £100m.
- Reported result includes a £16m net charge of Contract & Balance Sheet Review adjustments, compared to a net release of £14m in 2016; cumulatively over the last three years, we are tracking 3% better than the Contract & Balance Sheet Review charges taken in 2014. Closing balance sheet Onerous Contract Provision (OCP) liability now stands at £168m, down from £220m in 2016 and £447m in 2014.
- Pre-exceptional tax costs were £14m (2016: £16m), and net exceptional costs were significantly lower at £25m (2016: £68m).
- Free Cash Flow⁽⁴⁾ outflow improved by £26m to (£6.7m), which includes (£8m) of outflow as we reduced our working capital facility utilisation to zero by the end of 2017. Net Debt at £141m (2016: £109m) was some £9m below our guidance range at the start of the year, and Net Debt : EBITDA leverage of 1.4x remains well within our medium term target of 1–2x.
- Pension schemes fully funded and in a surplus on an accounting basis; around half of our pension liabilities are now fully underwritten by bulk annuity purchases, further reducing pension scheme residual risks.
- Pipeline of larger new bid opportunities reduced to £4.4bn, as a number of unusually large opportunities moved through the pipeline during 2017; £3bn of the pipeline are opportunities added over the course of 2017.

- Acquisition of BTP Systems completed for \$20m, bringing deep skills in defence satellite communication and radar engineering technical services, together with a pipeline of \$200m.
- We have signed a revised agreement with the Special Managers and Provisional Liquidators of Carillion plc, and while it is subject to requisite third party consents, we continue to work with all relevant parties to acquire the portfolio of selected UK health facilities management contracts.
- IFRS15 estimated restatement to 2017 not anticipated to be significant; decrease revenue by £3m and Underlying Trading Profit by £0.3m.
- Guidance for 2018 unchanged: we expect revenues to be £2.8–2.9bn, broadly flat in constant currency, and Underlying Trading Profit to grow to around £80m, driven largely by transformation savings. We expect 2019 to see further good growth in Underlying Trading Profit.

How we performed

Year ended 31 December	2017	2016
Revenue – continuing and discontinued operations ⁽¹⁾	£2,953.6m	£3,047.8m
Reported Revenue (continuing operations only) ⁽¹⁾	£2,953.6m	£3,011.0m
Underlying Trading Profit (UTP) ⁽²⁾	£69.8m	£82.1m
Reported Operating Profit (after exceptional items; continuing operations only) ⁽²⁾	£30.0m	£42.2m
Underlying EPS, basic ⁽³⁾	3.42p	4.13p
Reported EPS, basic (after exceptional items; continuing and discontinued operations)	(0.02p)	(0.11p)
Free Cash Flow ⁽⁴⁾	(£6.7m)	(£33.0m)
Net Debt	£141.1m	£109.3m

Notes to summary table of financial results:

- (1) Revenue is as defined under current IFRS (before adoption of IFRS15), which excludes Serco's share of revenue of its joint ventures and associates. Revenue including that from discontinued operations (£nil in 2017 and £36.8m in 2016) is shown for consistency with previous disclosures. Reported Revenue excludes revenue from discontinued operations. Organic revenue growth is the change at constant currency after adjusting to exclude the impact of relevant acquisitions or disposals. Change at constant currency is calculated by translating non-Sterling values for the year ended 31 December 2017 into Sterling at the average exchange rate for the year ended 31 December 2016.
- (2) Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items, it includes the impact of discontinued operations in 2016. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract & Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges), as well as the beneficial treatment of depreciation and amortisation of assets held for sale during 2016, and other material one-time items such as the pension scheme settlement in the first half of 2016 related to the profit on early exit from a UK local authority contract that occurred in the second half of 2015. A reconciliation of Underlying Trading Profit to Trading Profit and Reported Operating Profit is as follows:

Year ended 31 December £m	2017	2016
Underlying Trading Profit	69.8	82.1
Include non-underlying items		
Contract & Balance Sheet Review adjustments	(15.8)	14.2
Assets held for sale depreciation and amortisation	–	0.5
Other one-time items	–	3.5
Trading Profit	54.0	100.3
Amortisation and impairment of intangibles arising on acquisition	(4.4)	(5.1)
Operating Profit Before Exceptional Items (continuing and discontinued operations)	49.6	95.2
Exclude Operating Loss Before Exceptional Items from discontinued operations ⁽⁵⁾	–	3.3
Reported Operating Profit Before Exceptional Items (continuing operations only)	49.6	98.5
Operating Exceptional Items (continuing operations only)	(19.6)	(56.3)
Reported Operating Profit (after exceptional items; continuing operations only)	30.0	42.2

- (3) Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs and related tax effects.
- (4) Free Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Consolidated Cash Flow Statement, adding dividends we receive from joint ventures and associates, and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases.
- (5) The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015 and 2016. Disposal of the offshore business was largely completed in December 2015, with the disposals of two remaining much smaller elements completed in March 2016 and December 2016. The residual UK onshore private sector BPO operations were sold or exited in 2016 with the exception of one business, consisting of a single contract, which completed in July 2017. Total revenues for the remaining operations were £5.4m and the loss before exceptional items was £0.6m for the year ended 31 December 2017, and therefore the results have been included in continuing operations in 2017 on the grounds of materiality.

Reconciliations and further detail of financial performance are included in the Finance Review on pages 50 to 68. This includes full definitions and explanations of the purpose and usefulness of each non-IFRS Alternative Performance Measure (APM) used by the Group. The consolidated financial statements and accompanying notes are on pages 151 to 227.

Chief Executive's Review continued

Summary of financial performance

Revenue and Trading Profit

Reported Revenue declined 2% to £2,954m (2016: £3,011m); this measure excludes Serco's share of revenue from joint ventures and associates of £357m (2016: £481m); also excluded in the prior year is revenue of £37m from discontinued operations, which reflected the residual run-off of the private sector BPO division. Net currency movements provided a £122m benefit or a 4% increase. At constant currency and adjusting for minor effects of relevant acquisitions and disposals, the organic revenue decline was £188m or 6%; around a third of the organic element of the decline relates to no longer recognising as revenue the value of goods purchased on behalf of customers following changes to two health procurement services contracts in the UK; the balance of the decline relates to the ending or transfer of contracts such as those for the UK Defence Science and Technology Laboratory (DSTL), Armidale Class Patrol Boats (ACPB) for the Royal Australian Navy, Virginia Department of Transportation (VDOT), US Army transition assistance (SFLTAP) and Western Australia Court Security and Custodial Services (WACSCS). These and the effect of other smaller contract attrition were only partially offset by growth elsewhere including that from the phased start of new services during the year at Barts Health NHS Trust, University Hospital Southampton NHS Foundation Trust and Skills Support for the Workforce (SSW).

Underlying Trading Profit was £69.8m (2016: £82.1m), a decline of £12.3m or, excluding the £6.5m net currency benefit, a decline of £18.8m. The reduction was driven by the first half of 2016 benefiting from £11m of non-recurring trading items, which included: the previous higher shareholding and therefore larger share of the profits of the Atomic Weapons Establishment (AWE); the final settlement arrangements on the transfer of the Northern Rail franchise; the conclusion of the VDOT and SFLTAP operations; and a spike in activity on a defence logistics contract in the Middle East. In addition, as well as the attrition impact from profitable contracts coming to an end, some of the new contracts added revenue growth in 2017 but were at reduced profitability due to their initial transition and transformation stages.

In the second half of 2016 our Underlying Trading Profit was £31.5m, which was a period that did not benefit from the non-recurring trading items that were a feature of the first half of 2016, and was a period that had broadly comparable average currency rates to 2017. Profits in both the first and second half 2017 were £35m, and therefore we have delivered a run-rate approximately 10% ahead of that achieved in the second half of 2016.

Within our performance for the year, we delivered our target of £20m of cost savings from efficiencies in central support functions and overheads. Cumulatively over the last three years, over £100m of cost has been removed through our programmes to deliver savings by reducing the number of management layers, implementing better procurement and driving greater efficiency in the operation of shared services. These savings have been central to our efforts to reduce the scale of Serco's cost base in proportion to the scale of the revenue reduction incurred through the loss of contracts and the disposals undertaken.

Trading Profit was £54.0m (2016: £100.3m), with three categories of adjusting items which are within Trading Profit, but excluded from our measure of Underlying Trading Profit. First, there was a £15.8m net charge (2016: net release of £14.2m) within Trading Profit arising from the review of Onerous Contract Provisions (OCPs) and other Contract & Balance Sheet Review items; the OCP adjustments comprised gross charges totalling £62m (2016: £56m), partially offset by gross releases totalling £43m (2016: £66m). By far the most significant charge (£47m) related to the future revenue and cost assumptions of operating the Caledonian Sleepers contract, though across other OCPs in the UK & Europe division there was a net release of £16m and in AsPac a net release of £11m. Notwithstanding this year's net charge, it is worth noting that cumulatively over the last three years, the net improvement to Trading Profit from OCPs and other Contract & Balance Sheet Review items is £19m; we are therefore tracking 3% better than the original charge taken through Trading Profit in 2014. A detailed review of provisions and Contract & Balance Sheet Review items is included in the Finance Review on pages 50 to 68. The second area that we exclude from Underlying Trading Profit is other material one-time items; in 2016 we therefore excluded from Underlying Trading Profit a £3.5m beneficial pension settlement negotiated as part of the early termination of the Thurrock contract. Third, and again only related to 2016, we excluded the beneficial impact of £0.2m related to depreciation and amortisation treatment of assets classified as held for sale during 2016.

As with prior years, both Trading Profit and Underlying Trading Profit benefited from losses on previously-identified onerous contracts being neutralised by the utilisation of OCPs; the £69m utilised in 2017 was both better than our expectations of around £80m, and lower than the £84m utilised in 2016. The closing balance of OCPs now stands at £168m, compared to £220m a year earlier and the initial charge of £447m taken at the end of 2014. We expect of the remaining £168m provision approximately £70m will be utilised in 2018.

Financing and pensions, tax and exceptional costs

Pre-exceptional net finance costs were £11.6m (2016: £12.6m); while average net debt of £184m was £65m higher than the prior year, the increased cost of financing this was more than offset by other small movements. Cash net interest paid was £17.0m (2016: £19.0m).

Within net finance costs is a net credit of £3.8m (2016: £4.7m) related to the strong funding position of Serco's pension schemes. This net credit is lower than the prior year following the purchase in June 2017 by the Trustees of the Serco Pension and Life Assurance Scheme (SPLAS) of a bulk annuity from an insurer, which, for a significant proportion of scheme members, has the effect of fully removing longevity, investment and accounting risks. Assets of the pension scheme have been transferred to the insurer to purchase the annuity, resulting in a reduction in the IAS19 net balance sheet asset. The gross liability remains recognised on our balance sheet, but there is now an equal and opposite insurance asset reflecting the perfect hedge established by the transaction.

Including the effect of the transaction, the overall pension scheme accounting surplus, before tax, was £26m at 31 December 2017 on a scheme gross asset base of £1,385m. As described below, the transaction resulted in an exceptional non-cash tax charge of £16.1m reflecting a deferred tax adjustment related to the pension asset movements. Further details of Serco's pension funding and the bulk annuity purchase are described more fully in the Finance Review.

Tax and exceptional costs

The underlying effective tax cost was £20.6m (2016: £24.4m), representing an underlying effective rate of 35% (2016: 35%) based upon £58.2m (2016: £69.5m) of Underlying Trading Profit less pre-exceptional net finance costs. The rate is higher than the UK statutory rate of corporation tax as there was no deferred tax credit taken against UK losses incurred in the year, and because it reflects the tax charges at locally prevailing rates in the international divisions which tend to be higher than the UK's rate; these two factors are partially offset by the proportion of Serco's profit before tax generated by consolidating our share of joint venture and associate earnings which have already been taxed. The Underlying effective rate was lower than our initial guidance of approximately 50% due to a beneficial mix of profitability earned for the year, and due to a one-off effect of UK tax legislation enactment being recognised as an exceptional tax cost rather than within the underlying measure.

Tax on non-underlying items was a net credit of £6.6m (2016: credit of £8.5m). The principal driver of this has been a credit to reflect recognising a UK deferred tax asset of £11.1m based upon the improved outlook of future profitability; there is now UK deferred tax asset totalling £17.4m recognised on the balance sheet; there is a further estimated £160m deferred tax asset in the UK that is currently unrecognised and therefore contingent upon further improvement in the outlook. Total pre-exceptional tax costs were therefore £14.0m (2016: £15.9m). Exceptional tax costs were £5.0m (2016: credit of £3.1m). The principal drivers of this were one-time non-cash deferred tax adjustments as follows: a charge of £16.1m related to the pension asset movements on the bulk annuity purchase; a charge of £3.7m related to the change in UK tax legislation regarding the speed of utilising tax losses and hence our deferred tax assets; and a £12.5m credit reflecting the reduction in the US deferred tax liability following the fall in future expected US rates primarily due to the enactment of the Tax Cuts & Jobs Act in December 2017.

Total tax costs were therefore £19.0m (2016: £12.8m). Cash net tax paid was £11.4m (2016: £5.6m). As previously described, although we expect our cash tax to be reasonably predictable in future periods, our effective tax rates are likely to be volatile until we are able to show sufficient profitability in our UK business to be able to recognise on our balance sheet all of the UK tax asset arising from losses in 2014 and 2015 principally as a result of the Contract & Balance Sheet Review. Our guidance of the underlying effective tax rate for 2018 is however for a modest reduction towards 30%, reflecting our forecast mix of profitability and the net effect of US tax reform, and for it to continue to reduce further over the longer term assuming further improvement in profits.

The Group incurred operating exceptional costs of £19.6m (2016: £56.3m), mainly comprising £28.6m of restructuring programme costs related to the Transformation stage of our strategy, including redundancy charges, asset impairments and other incremental costs; these were partially offset by a non-cash credit of £10.3m related to the previous transfer of employees from the Serco defined pension scheme back to the Principal Civil Service Pension Scheme (PCSPS). Together with exceptional tax costs of £5.0m (2016: credit of £3.1m) and exceptional items related to discontinued operations were £nil (2016: £14.6m); total net exceptional costs were therefore £24.6m (2016: £67.8m).

Chief Executive's Review continued

Reported result for the year

The reported result for the year, as presented at the bottom of the Group's Consolidated Income Statement on page 158, was a profit of £0.1m (2016: loss of £1.1m). This reflects: Trading Profit of £54.0m (2016: £100.3m); amortisation and impairment of intangibles arising on acquisition of £4.4m (2016: £5.1m); pre-exceptional net finance costs of £11.6m (2016: £12.6m); a non-cash fair value gain of £0.7m (2016: £nil) relating to increasing our ownership in a joint venture; pre-exceptional tax costs of £14.0m (2016: £15.9m); and total net exceptional costs of £24.6m (2016: £67.8m).

Earnings Per Share (EPS)

Underlying EPS, which reflects the Underlying Trading Profit measure after deducting pre-exceptional finance costs and related tax effects, was 3.42p (2016: 4.13p). The reduction reflects the lower Underlying Trading Profit, partially offset by lower net finance costs; the weighted average number of shares in issue was broadly unchanged at 1,089.7m (2016: 1,088.3m). Reported EPS, which includes the impact of the other non-underlying items and lower tax and exceptional costs, was a loss per share of 0.02p (2016: loss per share of 0.11p).

Cash Flow and Net Debt

Free Cash Flow was negative £7m (2016: negative £33m). Cash generated from Underlying Trading Profit was largely offset by the outflows related to loss-making contracts subject to OCPs. These cash outflows lessened versus the prior year, as reflected in the lower rate of OCP utilisation. There was a working capital outflow of £9m (2016: outflow of £24m), which included £8m (2016: £22m) of reduction in the utilisation of the Group's receivables financing facility; at 31 December 2017 there was £nil utilisation of the £30m facility, whereas £8m was utilised a year earlier.

Closing net debt at 31 December 2017 increased to £141m (2016: £109m); the increase includes the Free Cash outflow, together with a £33m cash outflow related to exceptional items. There was a beneficial gross currency translation effect on net debt of £17m, predominantly reflecting the Group's US Private Placement debt, however this was partially offset by a £3m adverse movement on hedging instruments. The closing net debt compares to a daily average of £184m (2016: £119m) and a peak net debt of £243m (2016: £183m).

At the closing balance sheet date, our leverage for debt covenant purposes was 1.4x EBITDA (2016: 0.7x), which compares with the covenant requirement to be less than 3.5x and remains well within our medium term target range of 1–2x.

Dividends

The Board is not recommending the payment of a dividend in respect of the 2017 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it believes it prudent to do so, in assessing whether we should resume dividend payments in respect of 2017, we have been mindful of the fact there has been a reduction in earnings, a free cash outflow and an increase in net debt. In these circumstances, the Board believes that it would not be prudent to resume dividend payments at the current juncture. For 2018, our guidance is for an improvement in Underlying Trading Profit, but we anticipate a further modest Free Cash outflow and expect net debt to still increase, largely as a result of cash outflows related to exceptional restructuring costs and taking opportunities for value-enhancing infill acquisitions. The Board will continue to keep the dividend policy under close consideration as we progress with transforming the Group and implementing our strategy.

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

Summary of operating performance and strategy implementation

Delivering a financial performance for 2017 at the top end of our expectations has been accompanied by strong operational delivery and further progress on implementing our strategy and transformation. Within our operating framework, we insist that all our management initiatives fit into one or more of four categories: winning good business, executing brilliantly, making Serco a place people are proud to work, and delivering profitability and sustainability.

Problematic contracts continue to reduce in number and financial impact versus where we started three years ago, and relationships with customers in each of our markets are also fundamentally improved. Where we have exited contracts during the year, we have done so with pride and excellence, mindful of the military adage that you judge a battalion as much by how it leaves its barracks, as by how it arrives. Where we have started new operations, which have involved the transition and recruitment of several thousand employees, again I am pleased with the

skill of our operational managers. Where we are making losses on contracts, we are resolute in still delivering what is required of us to appropriately serve our customers and service users; and while doing so, working to improve the financial performance of individual contracts. Three years on, it is reassuring to note how accurate was our initial estimation of the total level of onerous provisions required.

Similarly, delivering cost savings at the same time as investing in and improving the business is challenging, but this has also been paramount to ongoing transformation. We achieved our savings target for 2017, and the cumulative reduction of over £100m from efficiencies in central support functions and overheads is equivalent to approximately 24% over the last three years. Our guidance, as set out in more detail below, includes that we expect Underlying Trading Profit to grow over the next two years, and this will be driven largely by further transformation savings. Over that period, we are in particular looking to transform our IT systems, capabilities and structures. This means not only reducing their cost, but also improving their performance and security. We are implementing further operating model changes to deliver greater efficiency and effectiveness of the organisation; there will also be increased contribution to savings from the transformation of the finance function and centralising expertise for reporting, forecasting, planning and analysis with a third party provider, and seeking additional rationalisation of disparate procurement spend across the Group.

Our ongoing transformation of the business involves further strengthening of our sector propositions, building differentiated capability, and capturing business development opportunities to enhance our pipeline and order book. As previously reported, we are using Centres of Excellence (CoEs) for Group-wide propositions and capabilities in our core markets, which are improving the sharing of skills, best practice and intellectual property across Serco.

Whilst demand across our markets has not been as strong as we anticipated at the time we announced our strategy in 2015, the availability of value-adding acquisitions, be they of companies or of contracts, presents an opportunity to increase our scale and capabilities which was not foreseen in 2015. In our US defence business, the acquisition of BTP Systems for \$20m adds deep skills in satellite communication and radar engineering technical services, which complements our existing service offering, and also brings with it a pipeline of new opportunities of \$200m.

In December 2017, we also signed a Business Purchase Agreement to acquire a portfolio of selected UK health facilities management contracts from Carillion plc, and have subsequently signed a revised agreement with the Special Managers and Provisional Liquidators of Carillion; whilst it is subject to requisite third party consents, we continue to work with all relevant parties to give effect to achieving the transfer of the contracts. If it is executed as envisaged, this transaction would significantly increase the scale of our equivalent Health business, and would add around £1bn to our order book.

Serco employs (including our joint venture operations) over 50,000 people, the vast majority delivering services to customers. Motivating and engaging employees is absolutely central to our business, and will be a key determinant of demonstrating we have successfully implemented our strategy. The latest results of our global employee survey, managed independently by Aon Hewitt, and with some 31,000 responses, showed a fourth successive year of improvement in the aggregated measure of 'employee engagement'. During 2017, we also delivered many other elements to build capabilities and support our ambition to be the best-managed business in our sector. Some 200 out of 300 senior managers have completed our highly tailored Oxford Saïd Serco Management course. We have rolled out Continuous Improvement training to all managers and embedded it as part of onboarding new staff, and over 1,400 employees are now trained to more advanced levels. And we have further invested in our Contract Management tools such as apps that monitor contractual obligations and report in real time, our Learning Management System for tracking training and qualifications, and our Serco Management System which covers all aspects of a contract's lifecycle, processes and compliance requirements.

Contract awards, order book, rebids and pipeline

Contract awards

The Group signed contracts with a total value of £3.4bn during the year (2016: £2.5bn), which was another year of strong performance. This is the largest order intake since 2012, and represents a book-to-bill ratio of approximately 115%. There were over 30 contract awards worth more than £10m each, and the large value of new business won resulted in this being approximately 70% of the total value signed, with the balance represented by the value of secured extensions or rebids of existing work; the latter was also an abnormally small balance by virtue of there being a relatively small amount of contracts coming up for rebid or extension during 2017.

Chief Executive's Review continued

The largest new contract signed in the year was to operate the New Grafton Correctional Centre (NGCC) in New South Wales, which, when completed, will be the largest correctional facility in Australia; the estimated total contract value to Serco over a 20-year term is approximately AUD2.6bn (equivalent to approximately £1.5bn). The second largest new contract was with University Hospital Southampton NHS Foundation Trust to transform catering and cleaning, with an estimated value of £125m over the ten-year term.

The third largest was in the Americas division to deliver US Army base modernisation services and in particular IT support, valued at a total of \$140m for the five-year base period and five one-year option periods, with the fourth also in the US to provide three Navy Fleet Readiness Centers with supply chain management services for hazardous materials, valued at a total of \$101m for the base period and four one-year option periods. Smaller new bids won included environmental services for Rushmoor Borough Council, contact services support in Australia for the Department of Human Services, facilities management to a financial services company in Abu Dhabi, safety service patrol for the Texas Department of Transportation, and numerous US Navy ship and shore defence equipment modernisation task orders.

Of rebids and extensions secured, the largest was for NHS Forth Valley to continue providing facilities management services for a further seven years, followed by the US Patent & Trademark Office (USPTO) for a further ten years. Others of note included contact services for Hertfordshire County Council, specialist scientific and engineering support for the European Space Agency, facilities management at the Cleveland Clinic in Abu Dhabi, fleet services for Louisville Gas & Electric Company, air navigation services in Bahrain and Iraq, environmental services for various London boroughs, traffic camera support in the Australian state of Victoria, and support to passenger information services for the Western Australia Public Transport Authority.

Win rates by volume were over 50% for new bids and over 90% for rebids and extensions. Win rate by value was around 25% for new work, with the benefit from the sheer scale of the Grafton win being offset by the loss of the other big opportunities in Middle East rail and UK immigration escorting; the win rate by value was approximately 90% for securing existing work.

Order book

The Group's order book now stands at an estimated £10.7bn, up by £0.8bn versus a year earlier. There is £2.4bn of revenue secured in the order book for 2018, equivalent to around 85% visibility of our £2.9bn revenue guidance at current exchange rates. The secured order book is £1.6bn for 2019 and £1.2bn for 2020.

Rebids

Through to the end of 2020, across the Group there are around 60 contracts in our order book with annual revenue of over £5m where an extension or rebid will be required, representing current annual revenue of approximately £1.4bn in aggregate or approaching half of the Group's 2018 £2.9bn revenue guidance. This proportion of revenue that requires securing at some point over the next three years is not unusual given our average contract length of around seven years (or approximately ten years on average on a revenue-weighted basis, as larger contracts typically have longer terms). Contracts that could potentially end at some point by the end of 2018 have aggregate annual revenue of around £500m, with the higher amount versus recent years driven in particular by the US Affordable Care Act contract becoming due for full rebid this year, and with the next largest being Northern Isles Ferries. In 2019, it increases to around £700m, with Australian immigration services, the Dubai Metro, one of our US Navy installation contracts and COMPASS all due for rebid or potential extension. In 2020, it is around £200m, with PECS the only particularly large contract anticipated to become due in that year.

Pipeline

Our pipeline is tightly defined as new bid opportunities with estimated Annual Contract Value (ACV) of at least £10m and which we expect to bid and to be adjudicated within a rolling 24-month timeframe. The Total Contract Value (TCV) of individual opportunities is capped at £1bn. The definition does not include rebids and extension opportunities, and on average over the last five years, more than half of our order intake has come from opportunities outside the reported pipeline. It is a relatively small proportion of the total universe of opportunities, many of which either have annual revenues less than £10m, or are likely to be decided beyond the next 24 months, or are rebids and extensions. It should also be remembered that in the Americas division in particular, we have numerous arrangements which are classed as 'IDIQ' – Indefinite Delivery/Indefinite Quantity – which are essentially framework agreements under which the customer issues task orders one at a time;

whilst the ultimate value of such an agreement may be very large and run over many years, a value is only recorded in our order book as individual task orders are contracted, and few of them would appear in the pipeline as they tend to be individually less than £10m and contracted on short lead times.

Following several years of decline, at the start of 2015 the pipeline stood at around £5bn and began to grow again, increasing to £6.5bn at the start of 2016, and stood at £8.4bn at the start of 2017. During the year, around £7bn has come out of the pipeline, predominantly due to: wins, such as Grafton prison (which was capped in the pipeline at £1bn) and Southampton NHS Foundation Trust; losses, such as those in Middle East rail, UK immigration escorting and a US Navy systems support opportunity; as well as due to a small number of other opportunities being removed such as immigration services in the US. A number of new opportunities have now matured to the stage where they meet our pipeline definition, adding in aggregate around £3bn over the course of the year. As a result, the pipeline currently stands at £4.4bn, which consists of around 25 bids that have an ACV averaging approximately £30m and a contract length averaging around six years.

In the services industry in which Serco operates, pipelines are often lumpy, as individual opportunities can be very large, and when they come in and out of the pipeline they can have a material effect on reported values. In 2017, a number of unusually large bids travelled through the pipeline, and, as anticipated, immediately replacing these has been challenging in the prevailing market conditions. A lower pipeline is not a matter of undue concern: growing our pipeline should not be expected to be a smooth progression given the effects of the timing and scale of individual awards, and we expect profit growth in the next two years to be driven by transformation savings. However, progress beyond the next two years will require seeing improvements in the trading conditions across our markets which will need to be first evidenced by a pipeline that is growing once again.

Key opportunities in the pipeline are described further in the Divisional Reviews.

Risks associated with Serco's trading environment

Last year, we reported on the risks around our trading environment, and focused on the possible impact of Brexit, instability in the Middle East, and lack of clarity in the US following the election of President Trump.

None of these risks has markedly reduced in the last twelve months: in terms of Brexit, our business directly serving European bodies which accounts for around 5% of Serco's revenue is unlikely to be greatly affected, as it is served by EU-resident companies. We believe Brexit may have an impact on labour cost and availability in the UK if EU citizens cannot come to UK to work in essential frontline service roles. The greatest impact for us is that UK Central Government is largely focused upon the overwhelming need to manage Brexit, which has been described by the Head of the Civil Service as the greatest peacetime challenge ever faced by the Civil Service, and it is clear that their priority is going to be focused in this direction for several years to come. However, in the medium term the repatriation of swathes of regulatory functions may lead to important opportunities, and many of our largest customers – most notably the Ministry of Defence, the Ministry of Justice and the Home Office – still have pressing needs to reduce costs and increase efficiency.

In the US, it is clear that the Affordable Care Act or 'Obamacare', and associated contracts such as ours providing eligibility processing services to those seeking health insurance, will continue in some form, although the promised expansion in Defence spending is yet to be seen. Disappointingly, there are few signs of resolution in the dispute between Qatar and other states in the Middle East.

However, since last year's report, in addition to the risks set out above, the UK public sector outsourcing market has in recent months been thrown into turmoil as the result of the collapse of Carillion, and the crystallisation on some contracts of very significant risks which government had transferred to suppliers. This has reignited the debate about the wisdom of government outsourcing to private companies the delivery of public services, and we suspect that this will become a theme in the next General Election. There is a very real risk that this will make the UK Government more than normally cautious in dealing with its suppliers. On the other hand, it may make them more inclined to deal with suppliers who have established a track record for strong delivery, prudent accounting and who have a robust balance sheet. The possible consequences of these events are examined in more detail under 'Industry Backdrop and Concluding Thoughts', below.

Chief Executive's Review continued

Guidance and outlook

Our guidance for 2018 and outlook beyond is unchanged from that initially provided in our update on 13 December 2017.

For 2018, we expect that Underlying Trading Profit will grow to around £80m, on revenues of £2.8–2.9bn (i.e. broadly flat organic revenue growth on a constant currency basis). We therefore expect some improvement in margins, driven largely by transformation savings. Our guidance reflects latest currency rates, which now imply greater pressure from adverse currency impacts estimated at £5–6m for profit and £100–120m for revenue when compared to the average rates for 2017.

As we have noted before in regard to our previous guidance, we reiterate that the range of potential outcomes is significantly wider than that implied by our budget's central case, both to the upside and downside; this reflects Serco's relatively low margins and the sensitivity of our profits to even small changes in revenues and costs, as well as movements in currency. Furthermore, and as described in more detail in the Divisional Reviews, the outcome of new bids in our pipeline and in our progress securing extensions or rebids including that for the Affordable Care Act in the US, could have a material impact on our business both in 2018 and more so the following year.

The 2018 financial year will be the first to be reported under the new IFRS15 accounting standard. As previously disclosed and reflective of the prudent accounting practices adopted in recent years by Serco, we do not anticipate the impact to be significant – as set out in Note 2 to the Group's consolidated financial statements, the estimated restatement to 2017 is to decrease revenue by £3m and Underlying Trading Profit by £0.3m. IFRS15 will be potentially of more relevance to the Group in relation to the accounting for new contracts rather than those already in place at the time of adopting the new standard. The changes brought about by IFRS15 on previous percentage of completion accounting is expected to have little impact on Serco as this form of accounting has never been of particular relevance to Serco. However, if Serco enters into future contracts that have significant transition phases, this could result in a greater proportion of revenue and profit being recognised later on in the life of the contract than under previous accounting. The UK Defence Fire & Risk Management Organisation (DFRMO) contract, which we are currently bidding, is one such.

We anticipate a further small Free Cash outflow.

After the cash outflow on exceptional costs, and the acquisition consideration for BTP Systems, we anticipate closing accounting net debt to increase to £200–250m, equivalent to leverage for covenant purposes in the range of 1.5–2x EBITDA.

As noted in our previous announcement regarding the potential acquisition of health facilities management contracts formerly operated by Carillion plc, the effect of this transaction is not included in any of our guidance at this stage.

Looking further ahead, we expect 2019 to be a year of further good growth in Underlying Trading Profit, which is again likely to be driven by additional transformation savings. The rate of growth thereafter will be more dependent on our ability to grow revenues. The Strategy Review announced in March 2015 set out a long term ambition that the business could grow in line with a market which was expected to expand at a long term trend rate of 5–7% a year and deliver margins of 5–6%. Our margin ambition was predicated on three conditions: first, reducing costs as a percentage of sales; second, containing losses on onerous contracts and converting a number of them into profitable contracts on rebid; and, thirdly, increasing margins by growing revenues whilst bearing down on overheads. We remain broadly on track on costs and onerous contracts, but some markets, and in particular the UK, are currently growing more slowly than their former trend rate. We can and will partly compensate for a weaker organic revenue outlook through increased actions on the cost base, and our long term ambitions of 5–7% revenue growth and 5–6% margin remain intact, but the timing of achieving this will be dependent upon when demand reverts to historic levels in our target markets.

Industry backdrop and concluding thoughts

"No plan ever survives first contact with the enemy" was a phrase first coined by the military strategist Helmuth von Moltke in the 19th century. So far, Serco's three-stage plan (Stabilise – Transform – Grow), which we conceived in late 2014, has survived contact with the flow of events surprisingly well. After a period of decline, our profits have started to grow again; we have re-established our reputation for operational delivery; we have kept our promises to our customers; our portfolio of onerous contracts is running off in line with the expectations we set in 2014; we have had a strong year of order intake in 2017; and we are taking steps to improve margins to take us to more normal levels, even if weak demand will probably mean it will take us longer to get there. We are not yet able to resume dividend payments, but our pension schemes are fully funded and our balance sheet is robust.

Into this generally positive scene of Serco's own progress has intruded a traumatic event in the form of the collapse of one of the UK's largest suppliers of public services, Carillion. Quite apart from the usual miseries associated with the bankruptcy of a major company, it has put at risk the supply of a number of sensitive public service contracts and caused the UK Government distraction and expense. Not unnaturally, this has reignited the already-glowing embers of the debate about the desirability of allowing private companies to deliver public services. This cuts to the heart of what we do; the UK is Serco's home market, and accounts for around half of our revenue, and understanding recent developments is high on the agenda of many investors.

It must be stressed that the UK Government successfully buys some £200bn of goods and services from private companies and charities each year. There are over one million people employed by the private sector delivering services to Government, and the vast majority of this work is delivered to a high standard. Huge benefits have been delivered by private companies and charities providing public services which are both efficient and innovative. Nevertheless, the collapse of Carillion stands as a reminder that since 2010 a significant number of businesses supplying Government services in the UK have suffered very large losses, Serco included, and that all is not right in the market for Government services in the UK.

How has this situation arisen? In one sense, this is the market at work, with a tendency for the balance of advantage to move between buyers and sellers in accordance with supply and demand. In the '90's and '00's, Government was keen to enlist the support of private sector companies to improve the efficiency and productivity of public services, and many new opportunities came to market; the Government was feeling its way and trying to develop new contracting structures such as Private Finance Initiatives which had never been tested before, and was sometimes outrun by more sophisticated and canny suppliers, who were double-digit revenue growth a year with strong margins, cash flows and returns on capital. As is the way of markets, this strong growth attracted new competitors, many from abroad or from other sectors. As is also the way of markets, the flow of milk and honey did not last indefinitely.

Around 2010, the balance of power in the market began to turn. Government introduced austerity and sought to reduce expenditure, the supply of new work slowed, just as new competitors entered the market. At the same time, Government started to hire poachers and made them its gamekeepers, and in recent years has improved its commercial and contracting capabilities beyond all recognition. Feeling compelled to deliver the growth they had promised, suppliers competed fiercely for a reducing pool of new business; prices fell, and a newly-savvy Government discovered it had anxious suppliers prepared to accept risks and contract terms which in normal conditions they would not have agreed to. Sophisticated buying techniques were imported from the private sector; contracts for sensitive public services such as caring for asylum seekers were awarded to the lowest bidder by online auction. As margins fell, suppliers shrank their capital employed and increased their debt; some made assumptions in their accounting which had the effect of pulling forward reported profits; some used opaque financing facilities and extended the payment terms to their suppliers to make their reported cash flow more nearly match the stretched profits. At the same time, falling interest rates and increasing longevity sent pension deficits soaring. So in a matter of a few years, a sector which previously had delivered healthy returns and supported well-capitalised balance sheets became under-capitalised, over-leveraged, and operationally and financially fragile. Given the amount of contractual risk suppliers were carrying, that fragility was going to show itself sooner or later.

Chief Executive's Review continued

Serco was the first major UK public services supplier to reveal the consequences of carrying those risks. In 2014, we had to take £447m of onerous contract provisions to reflect the cost of contractual commitments we had made, and in total some £1.3bn of provisions and write-downs were required. Fortunately, our banks and shareholders backed our decision to stand by our commitments to our customers, and we raised some £700m of equity and a further £250m from disposals to make our balance sheet robust. Since then, few suppliers in the sector have escaped unscathed, but Carillion is the first major bankruptcy.

Does this matter? Over 12,000 companies go into insolvency in a year in the UK, so why should Carillion be of such concern? The reason is that the nature of public services contracts are that they often involve the delivery of services of national importance that need to operate 24 hours a day. Hospitals cannot operate without cleaners and caterers; courts cannot operate without prisoner transport; defence bases cannot operate without air traffic control. The security of supply of these contracts is a matter of national importance and a proper concern of Government.

How did we get into this position? The answer is: nobody is blameless. Company managers and directors should have remembered the adage that "no deal is better than a bad deal"; and that over-optimistic accounting judgements, or flattering reported cash flow, will always be found out in the end; and that pension deficits were not a temporary aberration but a liability that needed to be addressed. And for its part, Government has used its position as a monopoly buyer to push companies, large and small, into accepting contractual terms and risks that they could not conceivably manage or hedge. Sooner or later, some of those risks were bound to crystallise, and when they did, suppliers delivering vital public services would be mortally wounded and even become functionally or formally insolvent, which would not be in the interests of either taxpayers or service users.

Where will the market go next? Clearly, both Government and suppliers should take time to consider carefully the implications of recent events. Suppliers will likely become much more wary; there will be fewer new entrants; existing players may shift the balance of their attention towards other markets, if they can. The UK Government runs the risk of being offered less choice and innovation, less competition and higher risk premiums. And efforts to encourage small and medium sized suppliers into the market are likely to be set back, as they see what has happened to some of the large and strong companies who supply Government.

In the short term, the situation may offer opportunities to companies such as Serco which have already re-financed their balance sheets and focused on developing the strength and depth of their management. But this is no time for *schadenfreude*. Serco's interest lies in seeing the market restored to health as soon as possible, where suppliers have the confidence to invest in bringing innovation and efficiency to help Government rise to the challenges of providing what it so badly needs, which is more public services, of higher quality, at lower cost. And Government needs to feel confident that it has a choice of strong suppliers, who it can trust to deliver and stand by their promises, and who have balance sheets robust enough to sustain them through the lumps and bumps inherent in the delivery of large and complex contracts.

We believe that recent events present an opportunity for both Government and its suppliers to work together to construct a new approach to the provision of public services which will avoid the problems of the past. There is broad consensus that public service provision should be a mixed economy of the state, not-for-profit organisations, and the private sector; and also that the provision of public services should not be completely exposed to the harshest rough-and-tumble, boom-and-bust cycle of a totally free market where the relative powers of either buyer or seller may become unbalanced. Few people believe that the delivery of public services should always be a monopoly of employees of the state. The question is a practical one of how to make the procurement of public services, whether delivered by the state itself, by not-for-profits, or private companies, work better.

Serco will be contributing energetically to this discussion, and we will be proposing four principles which we suggest should govern relations between Government and its suppliers, be they public bodies, not-for-profit organisations or private sector companies.

- We should **strengthen transparency in public contracting**. This means that for large contracts for public services, which are not commoditised, which do not impinge on National Security, and which do not include significant amounts of intellectual property, the presumption should be in favour of open-book accounting, in which the Cabinet Office and National Audit Office can see the suppliers' accounts of major contracts, whether they be performed by public or private operators. There should also be far greater transparency of operational performance: except in exceptional circumstances, suppliers, be they private or Government-owned, should be required to publish

every six months their performance against key operational indicators, so they are held accountable for the delivery of their promises to the taxpayers who are paying for them and the users who they are serving. And we believe that there should be a formal, rigorous and transparent decision-making process by which Government decides what mechanism it should use, be it in-house or by a third party, to deliver a given project or policy. We call this the "Transparency Principle".

- **Both suppliers and the Government should have the right, on payment of an agreed break fee, to exit a contract** at pre-determined intervals. We call this the "Orderly Exit Principle". The purpose of this is to give both Government and supplier the ability to exit contracts which are not working out as intended. For instance, if the supplier is making greater than expected profits, or Government policy changes, or performance is unsatisfactory but still within the bounds of the contract, the Government should be able, on payment of a break fee, to re-compete or take back in-house the contract; and likewise if the supplier was making unexpected losses, or changes in regulation had made it impossible to deliver the contract as intended, the supplier can exit the contract on payment of a fee which would compensate the Government for the cost of re-tendering. This would, for both Government and supplier, significantly reduce the risk of being stuck together in unhappy marriages.
- **Suppliers of sensitive contracts should be obliged to lodge with Government a "living will"**, being a set of arrangements to facilitate the transfer of a contract back to Government or to another supplier if required. This would significantly reduce the operational risk to Government of supplier failure. This is the "Security of Supply Principle".
- **Government and suppliers should agree to abide by a mutually-agreed code of conduct**, which would set out expected standards of behaviour from Government and its contractors. This would involve the Government agreeing not to impose punitive or unfair terms and conditions or transfer unmanageable state risk; and suppliers would agree to maintain certain metrics of financial stability; pay their sub-contractors in a timely fashion; and adequately fund their pensions. We think it would be important to have a process of independent arbitration built into the code of conduct to ensure that there is some avenue of redress and calling to account those who do not abide by the code. We call this the "Fairness Principle".

It is vital to the well-being of any country that public services are delivered to high standards and offer value for money, and for the most part, in the UK, private and third-sector providers have done a good job of doing this. The UK has hundreds of new hospitals and schools, built and maintained to high standards; thousands of contracts have delivered innovation, improved services and lowered costs, along with far higher degrees of visibility of operational performance than is commonly available from public sector delivery. And as the UK advances towards Brexit, it is clear that there will be the need for a whole lot more Government as we "take back control". With this in mind, we believe that there is an urgent need to re-think the relationship between the UK Government and its suppliers. We believe an approach based on the Four Principles above would serve to restore trust and common sense in the market; remove the risk of excessive profits or losses; and encourage a more vibrant and competitive market for Government services, one in which Serco would be an enthusiastic participant.



Rupert Soames
Group Chief Executive

Serco – and proud of it.

Divisional Reviews

Serco's operations are reported as four regional divisions: UK & Europe (UK&E); the Americas; the Asia Pacific region (AsPac); and the Middle East. The Global Services division previously consisted of Serco's private sector BPO operations, which for statutory reporting purposes were classified in 2016 as discontinued operations following the previously announced strategic exit from this market and the subsequent disposals. Serco presents alternative measures to include the Revenue and Trading Profit of these discontinued operations in prior periods for consistency with previous disclosures. Reflecting statutory reporting requirements, Serco's share of revenue from its joint ventures and associates is not included in revenue, while Serco's share of joint ventures and associates' profit after interest and tax is included in Underlying Trading Profit. As previously disclosed and for consistency with guidance, Serco's Underlying Trading Profit measure excludes Contract & Balance Sheet Review adjustments (principally OCP releases or charges), and the benefit in 2016 from not depreciating and amortising assets held for sale, and other one-time items such as those in 2016 related to the early exit from the Thurrock contract.

Year ended 31 December 2017 £m	UK&E	Americas	AsPac	Middle East	Corporate costs	Total
Revenue	1,334.7	688.0	579.0	351.9	-	2,953.6
Change	(3%)	0%	(7%)	+8%	-	(2%)
Change at constant currency	(4%)	(7%)	(14%)	+2%	-	(6%)
Organic change at constant currency	(4%)	(7%)	(15%)	+2%	-	(6%)
Underlying Trading Profit/(Loss)	35.1	36.4	23.7	16.2	(41.6)	69.8
Change	(23%)	(15%)	(5%)	(2%)	(4%)	(19%)
Change at constant currency	(25%)	(21%)	(13%)	(10%)	(4%)	(27%)
Margin	2.6%	5.3%	4.1%	4.6%	n/a	2.4%
Contract & Balance Sheet Review adjustments	(30.6)	3.4	11.4	-	-	(15.8)
Trading Profit/(Loss)	4.5	39.8	35.1	16.2	(41.6)	54.0
Amortisation of intangibles arising on acquisition	-	(3.0)	(1.4)	-	-	(4.4)
Operating profit/(loss) before exceptionals	4.5	36.8	33.7	16.2	(41.6)	49.6

Year ended 31 December 2016 £m	UK&E	Americas	AsPac	Middle East	Corporate costs	Sub-total continuing	Global Services	Total
Revenue including discontinued operations	1,375.1	691.4	619.7	324.8	-	3,011.0	36.8	3,047.8
Discontinued operations adjustment*	-	-	-	-	-	-	(36.8)	(36.8)
Revenue	1,375.1	691.4	619.7	324.8	-	3,011.0	-	3,011.0
Underlying Trading Profit/(Loss)	45.7	43.0	24.9	16.6	(43.5)	86.7	(4.6)	82.1
Margin	3.3%	6.2%	4.0%	5.1%	n/a	2.9%	(12.5%)	2.7%
Contract & Balance Sheet Review adjustments	35.3	(36.6)	9.3	2.2	3.2	13.4	0.8	14.2
Assets held for sale depreciation and amortisation	-	-	-	-	-	-	0.5	0.5
Other one-time items	3.5	-	-	-	-	3.5	-	3.5
Trading Profit/(Loss)	84.5	6.4	34.2	18.8	(40.3)	103.6	(3.3)	100.3
Amortisation of intangibles arising on acquisition	(0.3)	(2.8)	(2.0)	-	-	(5.1)	-	(5.1)
Discontinued operations adjustment*	-	-	-	-	-	-	3.3	3.3
Operating profit/(loss) before exceptionals	84.2	3.6	32.2	18.8	(40.3)	98.5	-	98.5

* Statutory reporting only includes the post-tax result of discontinued operations as a single line in the Consolidated Income Statement

The trading performance and outlook for each division are described on the following pages. Reconciliations and further detail of financial performance are included in the Finance Review on pages 50 to 68. This includes full definitions and explanations of the purpose of each non-IFRS Alternative Performance Measure (APM) used by the Group. The consolidated financial statements and accompanying notes are on pages 151 to 227.

UK & Europe

Serco's UK & Europe division supports public service delivery and outcomes across all five of the Group's chosen sectors: our Justice & Immigration business provides a wide range of services to support safeguarding society and reducing reoffending, from secure accommodation management through to housing and welfare services for asylum seekers; in Defence, we are trusted to deliver critical support services and operate sensitive facilities; we operate complex public Transport systems and services; our Health business provides primarily non-clinical support services to hospitals; and the Citizen Services business provides environmental and leisure services, as well as a wide range of other front, middle and back-office services to support public sector customers in the UK or European institutions. Serco's operations in the UK represent approximately 40% of total Revenue for the Group, and those across the rest of Europe approximately 5%.

Serco announced in September 2017 that it would merge its UK and European operating divisions to create a single, integrated business, Serco UK & Europe. This combined the two previous divisions – UK Central Government and UK & Europe Local & Regional Government – and will simplify and improve the efficiencies and capabilities of our operations in the region, in particular as we continue to drive transformation benefits across the Group as a whole. Kevin Craven, previously Chief Executive of UK Central Government became the Chief Executive of Serco UK & Europe. Kevin joined Serco in September 2014, prior to which he was CEO of Balfour Beatty Services, leading a business with 16,000 employees and revenues of over £1.6bn, covering sectors such as facilities management, rail, highways and utilities. Before joining Balfour Beatty, he was the Managing Director for Healthcare, Education & Defence at Aramark, and the Managing Director of Transport & Travel for Sodexo.

Revenue for 2017 was £1,334.7m (2016: £1,375.1m), a decline of 3%; reported revenue excludes that from our joint venture and associate holdings which are predominantly the operations of AWE, Merseyrail and previously Northern Rail, with these representing the vast majority of the Group's activity in joint ventures and associates. At constant currency, the decline in revenue was 4%. Drivers of the reduction included: in our Health

business, we ceased to recognise as revenue the value of goods purchased on our customers' behalf following changes to two procurement services contracts; in our Defence business, the phased transfer back during 2016 of services that Serco had previously been providing to the Defence Science & Technology Laboratory (DSTL) and for Defence Business Services (DBS); we also saw reduced volumes in our Child Maintenance Group operations, and the ending or reduced scale of various other BPO and IT support services contracts. These revenue reductions were partially offset from growth elsewhere, namely the start of hospital facility management services for Barts Health NHS Trust and University Hospital Southampton NHS Foundation Trust, as well as some growth in our European agency operations and from the new Skills Support for the Workforce (SSW) contracts.

Underlying Trading Profit was £35.1m (2016: £45.7m), representing an implied margin of 2.6% (2016: 3.3%). Trading Profit includes the profit contribution (from which tax and interest have already been deducted) of joint ventures and associates; if the £350m (2016: £474m) proportional share of revenue from joint ventures and associates was also included and if the £7.0m (2016: £7.4m) share of interest and tax cost was excluded, the overall divisional margin would have been 2.5% (2016: 2.9%). The joint venture and associate profit contribution of £26.6m (2016: £31.3m) was £4.7m lower, reflecting the end of the Northern Rail franchise in March 2016 and the lower shareholding of AWE from September 2016. The reduction in Underlying Trading Profit also included the impact of other contract attrition and in-contract reductions, and the lower profitability from new contracts in their initial transition and transformation stages. The non-repeat of certain costs and impairments that occurred in 2016 and the progress made on cost efficiencies in 2017 only partially offset these areas of profit reduction. Within Underlying Trading Profit there was £55m of OCP utilisation (2016: £60m), which served to offset the Division's loss-making operations, principally COMPASS UK asylum seeker support services, the Caledonian Sleeper, Future Provision of Marine Services (FPMS), Lincolnshire Country Council, and the Prisoner Escort & Custody Services (PECS) contracts.

Divisional Reviews continued

Contract & Balance Sheet Review adjustments resulted in a £30.6m net charge, driven by updating the assumptions regarding operational and maintenance costs of running the Caledonian Sleepers contract, partially offset by a net £16m of releases across other contracts. The Caledonian Sleepers charge of £47m reflects a sharp increase in the estimated costs related to the delayed introduction and operation of the new sleeper service. We will be examining every option for reducing operating costs; the position under the contract is expected to improve over time, as the terms of the Franchise Agreement provide a mechanism that requires Transport Scotland to bear 50% of contract losses from 1 April 2020. In addition, from 1 April 2022, we have the right to seek adjustments to the financial terms of the Franchise Agreement that would result either in a small positive profit margin for Serco from that date, or allow us to exit the contract. A detailed review of provisions and Contract & Balance Sheet Review items is included in the Finance Review on pages 50 to 68. After these adjustments, Trading Profit was £4.5m (2016: £84.5m, reflecting £35.3m net release for Contract & Balance Sheet Review adjustments and a £3.5m one-time profit arising from a pension scheme settlement).

The UK & Europe division represented around £0.7bn of the Group's aggregate total value of signed contracts during 2017. The largest award was a new contract to transform catering and cleaning for University Hospital Southampton NHS Foundation Trust, with an estimated value of £125m over the ten-year term. Other new work included adding patient transport services to our relationship with Barts Health NHS Trust, and environmental services to Rushmoor Borough Council. Of large new bids where we were unsuccessful, these included immigration escorting for the Home Office and the regional MOD contracts for Technical Support Services Provision to the UK's Royal Air Force.

The largest rebid or extension that was due during the year was for our provision of facilities management services at NHS Forth Valley, where we successfully secured these for a further seven years. Others secured included contact services for Hertfordshire County Council, specialist scientific and engineering support for the European Space Agency, our helicopter aircrew training for the MOD and a number of other defence support services contracts, parking services for the West London Alliance, environmental services for Wandsworth Council, and citizen services support to customers including Invest Northern Ireland, the Department of Health and the Skills Funding Agency.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 30 contracts with annual revenue of over £5m within the UK & Europe division; in aggregate, these represent approximately a third of the current level of annual revenue for the division. The largest of these are the Northern Isles Ferries operations that are expected to be extended from April 2018 to the end of 2019; the COMPASS contract is also due in 2019, along with a large European agency contract; and in 2020, PECS is now assumed to be rebid if a final extension option is not exercised by the customer, as well as that year our Anglia Support Partnership healthcare shared services operations. The Glasgow ACCESS operations transferred by the end of 2017, therefore representing known attrition of approximately 4% of divisional revenue.

Our pipeline of new bid opportunities has been significantly reduced following the removal of wins such as the Barts and Southampton NHS contracts, as well as from losses such as immigration escorting for the Home Office. The Defence Fire & Risk Management Organisation (DFRMO) tender is still ongoing, as is that for an immigration removal centre. We have partially reloaded the pipeline with some other smaller tenders for various defence support, hospital facilities management and environmental services. For the successor to the COMPASS arrangements, we are also including in our new bid pipeline the incremental opportunity beyond the regions where we currently operate.

Americas

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

Revenue for 2017 was £688.0m (2016: £691.4m), a modest reduction in reported currency. In US dollars, the main currency for operations of the division, revenue was equivalent to approximately US\$890m (2016: US\$940m). The strengthening of local currencies against Sterling increased revenue by £42m or 7%; the organic change at constant currency was therefore a decline of 7%. The decline was driven by the end of the contracts during 2016 for the Virginia Department of Transportation (VDOT) and for US Army transition assistance (SFLTAP).

These and other smaller reductions were partially offset by growth in our support of advanced anti-terrorism systems for ships and infrastructure at US Navy ports and federal facilities, and some increases elsewhere in the volume of workload or task orders.

Underlying Trading Profit was £36.4m (2016: £43.0m), representing a margin of 5.3% (2016: 6.2%). While there was a £2.4m favourable currency movement, there was the impact of the first half of 2016 benefiting from the longer running of the VDOT and SFLTAP contracts which were only partially offset by cost efficiencies in 2017. Within Underlying Trading Profit there was £5m (2016: £9m) of OCP utilisation, which reflects the offset of losses on the Ontario Driver Examination Services contract.

Contract & Balance Sheet Review adjustments resulted in a £3.4m net release. After these adjustments, Trading Profit was £39.8m (2016: £6.4m, reflecting £36.6m net charge for Contract & Balance Sheet Review adjustments).

Americas represented around £0.8bn of the Group's aggregate total value of signed contracts during the year. The largest new award was for US Army base modernisation services and in particular IT support, valued at a total of \$140m for the five-year base period and five one-year option periods. The second largest was to provide supply chain management services for hazardous materials at three US Navy Fleet Readiness Centers, valued at a total of \$101m for the base period and four one-year options. Smaller new awards included safety service patrol for the Texas Department of Transportation, and numerous US Navy ship and shore defence equipment modernisation task orders. Of rebids and extensions secured, the largest was for the US Patent & Trademark Office (USPTO) for a further ten years, albeit the new contract is for a reduced volume of work; others secured included fleet services for Louisville Gas & Electric Company, parking meter management in San Francisco and support services for the US Federal Retirement Thrift Investment Board and the US Government Accountability Office. Serco was unsuccessful in a large new bid opportunity to be prime contractor for US Navy systems support, but has potential for a share of work through sub-contract relationships; there were no other major new pipeline decisions or large rebids or extensions due during the year.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 12 contracts with annual revenue of over £5m within the Americas division; in aggregate, these represent around 50% of the current level of annual revenue for the division; this high proportion reflects that our contract supporting the US Affordable Care Act (ACA), which currently accounts for around 30% of divisional revenue, requires securing a rebid from 30 June 2018; the Global Installation Contract covering areas of our defence ship modernisation work is due for rebid in 2019, while our support to the Federal Aviation Administration's (FAA) Contract Tower (FCT) Program will become due for rebid once again in 2020.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes further important opportunities to provide various support functions to the US Navy. A defence opportunity to support US Air Force radar systems as well as various other defence support bids were added during the year, as were other tenders for transport operations and fleet support and Citizen Services records management. Opportunities for immigration services were removed from the pipeline due to delays in tender processes.

Future profitability will as usual be shaped by the outcomes of the major new bid opportunities in the region, but in particular by the rebid outcome due by 30 June 2018 and the future scale of operation of the ACA contract and its absorption of overhead costs.

Serco was pleased to announce in June 2017 that David J. Dacquino would become Chief Executive Officer of the Americas division, with Dan Allen having informed the business back in February of his intention to retire. Dave Dacquino joined Serco in 2015 to lead the Americas' Defence business, bringing deep knowledge and experience from across the defence, aeronautics, logistics and technical services industries.

Divisional Reviews continued

AsPac

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

Revenue for 2017 was £579.0m (2016: £619.7m), a decline of 7%. In Australian dollars, the main currency for operations of the division, revenue for the year was equivalent to approximately A\$980m (2016: A\$1,140m). The movements in local currencies against Sterling increased revenue by £48m or 7%; the acquisition of the other 50% of a small defence services joint venture added 1% to revenue; the organic change at constant currency was therefore a decline of 15%. This reduction was driven by the end of the Armidale Class Patrol Boats (ACPB), Western Australia Court Security & Custodial Services (WACSCS) and Mount Eden contracts, together with some smaller reductions from other contracts ending or reducing in scope; there was some growth in Citizen Services contact and processing support which partially offset this attrition.

Underlying Trading Profit was £23.7m (2016: £24.9m), representing a margin of 4.1% (2016: 4.0%). While there was a favourable currency movement of £2.1m, the net of other movements reflected contract attrition and other margin pressures with only partial offset from progress on cost efficiencies and growth from new work. Within Underlying Trading Profit there was £9m of OCP utilisation (2016: £12m).

Contract & Balance Sheet Review adjustments resulted in a £11.4m net release, the largest element of which was a further OCP release on ACPB reflecting revised assumptions of the residual liability after the contract transferred to a new operator during the year. The ACPB contract was the largest of the OCP contracts, and is the first of the major OCP contracts to come to an end. After these adjustments, Trading Profit was £35.1m (2016: £34.2m, reflecting £9.3m net release for Contract & Balance Sheet Review adjustments).

AsPac represented around £1.8bn of the Group's aggregate total value of signed contracts during the year. By far the largest element of this was approximately £1.5bn for the 20-year contract valued at A\$2.6bn for the operation of New Grafton Correctional Centre (NGCC) which is expected to commence in 2020; NGCC will be the largest correctional centre in

Australia, consisting of a total of 1,700 beds in three individual security categories, and draws upon Serco's experience of managing correctional facilities in the UK, New Zealand and elsewhere in Australia, which includes Australia's current largest facility, Acacia Prison. Other smaller new wins included contact services support in Australia for the Department of Human Services. Extensions and rebids awarded in the year included traffic camera support in the Victoria, and passenger and integrated transport information services for transport authorities in Western Australia and New South Wales. There were no other larger rebids or major new bid pipeline decisions made in the year.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 10 contracts with annual revenue of over £5m within the AsPac division; in aggregate, these represent just over half of the current level of annual revenue for the division; this high proportion reflects that the Australia onshore immigration services contract requires rebid or extension at the end of 2019, with this accounting for over 30% of current divisional revenue.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes some further (but far smaller than Grafton) Justice & Immigration opportunities, as well as in Defence support services. We will look to build the pipeline further in these sectors as well as Citizen Services, Transport and Health.

Middle East

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

Revenue for 2017 was £351.9m (2016: £324.8m), an increase of 8%. The strengthening of local currencies against Sterling provided growth of £21m or 6%; the organic change at constant currency was therefore growth of 2%. Growth came from new contracts for facilities management at Dubai Airport and for a financial services company in Abu Dhabi, though these were partially offset by reductions related to the Dubai Air Navigation Services and Staff College training for the Qatar Armed Forces contracts, as well as a small number of other operations reducing in scope or volume including the Middle East Logistics & Base Support (MELABS) contract that supports the Australian Defence Force in the region.

Underlying Trading Profit was £16.2m (2016: £16.6m), representing a margin of 4.6% (2016: 5.1%). While there was a £1.2m favourable currency movement, there was an overall reduction in profitability due in large part to the non-repeat of the higher defence logistics volumes experienced in the first half of 2016, together with the impact of other contract scope reductions and attrition. There are no OCP contracts in the division and therefore no OCP utilisation within Underlying Trading Profit.

There were no Contract & Balance Sheet Review adjustments in the year, therefore Trading Profit was also £16.2m (2016: £18.8m, reflecting £2.2m net release for Contract & Balance Sheet Review adjustments).

The Middle East represented around £0.1bn of the Group's aggregate total value of signed contracts during the year. Amongst smaller contract awards were new wins to provide facilities management in Abu Dhabi and defence training support in Qatar. Serco was unsuccessful however in pursuing the very large tenders for light rail and tram operations in the region. Extensions to existing work included facilities management for Cleveland Clinic Abu Dhabi, and air navigation services and training in Bahrain and Iraq; there were no other large rebid or extension decisions due in the year.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 13 contracts with annual revenue of over £5m within the Middle East division; in aggregate, these represent well over half of the current level of annual revenue for the division. There is a high proportion of work to secure in 2019, when the Dubai Metro, MELABS and Cleveland Clinic Abu Dhabi contracts each require extending or rebidding; by 2020, our Dubai Air Navigation Services will also become due for further extension or rebid.

Our pipeline of major new bid opportunities in the region has reduced very significantly following the outcome of the light rail and tram bids. There are some other smaller opportunities in transport and defence support services, and effort is ongoing to rebuild a stronger pipeline.

Corporate costs

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

Benefiting from actions to deliver savings and improve efficiencies of our central functions, corporate costs in 2017 reduced to £41.6m (2016: £43.5m).

Finance Review

Adjusted Trading Profit of £69.8m was at the top end of our guidance given at the start of the year, it was £12m lower than 2016, driven by the first half of 2016 benefiting from our new long trading terms, and by net contract attrition. Revenue from continuing and discontinued operations was £91m, down on £295.4m. Closing Net Debt of £141m was better than expected and represents a year on year increase of £3m, driven by the outflows related to loss making contracts.

For the year ended 31 December 2017	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Less discontinued pre- exceptional* £m	Statutory pre- exceptional £m	Continuing and discontinued exceptional items £m	Less discontinued exceptional items* £m	Statutory £m
Revenue	2,953.6	–	2,953.6	–	–	2,953.6	–	–	2,953.6
Cost of sales	(2,688.9)	(15.8)	(2,704.7)	–	–	(2,704.7)	–	–	(2,704.7)
Gross profit	264.7	(15.8)	248.9	–	–	248.9	–	–	248.9
Administrative expenses	(222.2)	–	(222.2)	(4.4)	–	(226.6)	(19.6)	–	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	27.3	–	27.3	–	–	27.3	–	–	27.3
Profit before interest and tax	69.8	(15.8)	54.0	(4.4)	–	49.6	(19.6)	–	30.0
Margin	2.4%	–	1.8%	–	–	1.7%	–	–	1.0%
Net finance costs	(11.6)	–	(11.6)	–	–	(11.6)	–	–	(11.6)
Other gains	–	0.7	0.7	–	–	0.7	–	–	0.7
Profit before tax	58.2	(15.1)	43.1	(4.4)	–	38.7	(19.6)	–	19.1
Tax charge	(20.6)	5.0	(15.6)	1.6	–	(14.0)	(5.0)	–	(19.0)
Effective tax rate	(35.4%)	–	(36.2%)	–	–	(36.2%)	–	–	(99.5%)
Profit/(loss) for the period	37.6	(10.1)	27.5	(2.8)	–	24.7	(24.6)	–	0.1
Minority interest	0.3	–	0.3	–	–	0.3	–	–	0.3
Earnings/(loss) per share (pence)	3.42	–	2.50	–	–	2.24	–	–	(0.02)

* No amounts are recorded as discontinued operations for the year ended 31 December 2017

For the year ended 31 December 2016 (restated*)	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Less discontinued pre- exceptional £m	Statutory pre- exceptional £m	Continuing and discontinued exceptional items £m	Less discontinued exceptional items £m	Statutory £m
Revenue	3,047.8	–	3,047.8	–	(36.8)	3,011.0	–	–	3,011.0
Cost of sales*	(2,782.9)	18.2	(2,764.7)	–	40.1	(2,724.6)	–	–	(2,724.6)
Gross profit*	264.9	18.2	283.1	–	3.3	286.4	–	–	286.4
Administrative expenses*	(216.2)	–	(216.2)	(5.1)	–	(221.3)	(70.5)	14.2	(277.6)
Share of profits in joint ventures and associates, net of interest and tax	33.4	–	33.4	–	–	33.4	–	–	33.4
Profit before interest and tax	82.1	18.2	100.3	(5.1)	3.3	98.5	(70.5)	14.2	42.2
Margin	2.7%	–	3.3%	–	–	3.3%	–	–	1.4%
Net finance costs	(12.6)	–	(12.6)	–	–	(12.6)	(0.4)	0.4	(12.6)
Profit before tax	69.5	18.2	87.7	(5.1)	3.3	85.9	(70.9)	14.6	29.6
Tax charge	(24.4)	6.7	(17.7)	1.8	0.1	(15.8)	3.1	–	(12.7)
Effective tax rate	35.2%	–	20.2%	–	–	18.4%	–	–	42.9%
Profit for the period from continuing operations	45.1	24.9	70.0	(3.3)	3.4	70.1	(67.8)	14.6	16.9
Loss for the period from discontinued operations	–	–	–	–	(3.4)	(3.4)	–	(14.6)	(18.0)
Profit/(loss) for the period	45.1	24.9	70.0	(3.3)	–	66.7	(67.8)	–	(1.1)
Minority interest	0.1	–	0.1	–	–	0.1	–	–	0.1
Earnings/(loss) per share (pence)	4.13	–	6.42	–	–	6.12	–	–	(0.11)

* Costs included within cost of sales and administrative expenses have been reallocated, resulting in a restatement. See Note 2 to the Consolidated Financial Statements.

Change regarding the classification of cost items within cost of sales and administrative expenses

The Group has undergone a programme of work on its financial data structures to appropriately allocate and charge costs to the relevant divisions and between cost of sales and administrative expenses. As a result of the activities performed in this area, the Group's classification of cost items in the income statement has changed. The prior year's results have been restated to reflect the cost items identified which should have been reallocated in 2016. This resulted in increasing administrative expenses by £43.0m and decreasing cost of sales by the same amount. The change in policy has no impact on operating profit, any other item below this on the income statement, or any of the Group's key performance measures.

Cost of sales are considered to be the costs of operating contracts. This includes the unavoidable costs of servicing contracts and all costs that a contract would incur purely on its own without a parent company, regardless of how those services are delivered within the wider Group, such as IT or Human Resource management services provided centrally.

Alternative Performance Measures (APMs) and other related definitions

Overview

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

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

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

The methodology applied to calculating the APMs has not changed during the year for any measure.

Finance Review continued

Alternative revenue measures

Reported revenue at constant currency

Reported revenue, as shown on the Group's Consolidated Income Statement on page 158, reflects revenue translated at the average exchange rates. In order to provide a comparable movement on the previous year's results, reported revenue is recalculated by translating non-Sterling values for the year to 31 December 2017 into Sterling at the average exchange rate for the year ended 31 December 2016.

All revenue in 2017 arose from continuing activities.

For the year ended 31 December	2017 £m
Reported revenue at constant currency	2,832.0
Foreign exchange differences	121.6
Reported revenue at reported currency	2,953.6

Organic Revenue at constant currency

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

For the year ended 31 December 2017, an adjustment was required for the disposal of the remaining element of the UK private sector BPO business, consisting of a single contract, sold on 3 July 2017. This business was previously reported within discontinued operations but included as continuing in 2017 as it does not have a material impact on the Group's results. The Group disposed of Service Glasgow LLP on 1 December 2017, which also consisted of a single contract. However, this disposal arose as a result of normal contract attrition rather than as a result of the disposal of a wider business and hence this is not excluded for the Organic Revenue calculation.

The only acquisition excluded for the calculation of Organic Revenue in the year relates to the acquisition of 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd, resulting in full control being obtained. Serco Sodexo Defence Services Pty Ltd was previously a 50% owned joint venture accounted for on an equity accounting basis and therefore no revenues had previously been recorded in the Group's results.

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

For the year ended 31 December	2017 £m
Organic Revenue at constant currency	2,823.1
Foreign exchange differences	121.3
Organic Revenue at reported currency	2,944.4
Impact of any relevant acquisitions or disposals	9.2
Reported revenue at reported currency	2,953.6

For the year ended 31 December	2016 £m
Organic Revenue at reported currency (continuing activities only)	3,011.0
Impact of any relevant acquisitions or disposals	–
Reported revenue at reported currency (continuing activities only)	3,011.0

Revenue from continuing and discontinued operations

Reported revenue, as shown on the Group's Consolidated Income Statement on page 158, reflects only that from continuing operations, with the post tax result of discontinued operations consolidated as a single line at the bottom of the Consolidated Income Statement. The alternative measure includes discontinued operations for the benefit of consistency with previously reported results and to reflect the overall change in scale of the Group's operations. The alternative measure allows the performance of the discontinued operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result. No operations were classified as discontinued in 2017 as there was a single remaining business as at 1 January 2017 which generated insignificant revenue and profit up to the date of disposal of 3 July 2017. Discontinued operations in the prior year reflect the former Global Services division which consisted of the Group's private sector BPO operations.

For the year ended 31 December	2017 £m	2016 £m
Revenue from continuing and discontinued operations	2,953.6	3,047.8
Exclude revenue from discontinued operations	–	(36.8)
Reported revenue (continuing activities only)	2,953.6	3,011.0

Revenue from continuing operations, including share of joint ventures and associates

Reported revenue, as shown on the Group's Consolidated Income Statement on page 158, excludes the Group's share of revenue from joint ventures and associates, with Serco's share of profits in joint ventures and associates (net of interest and tax) consolidated within Reported Operating Profit as a single line further down the Consolidated Income Statement. The alternative measure includes the share of joint ventures and associates for the benefit of reflecting the overall change in scale of the Group's ongoing operations, which is particularly relevant for evaluating Serco's presence in market sectors such as Defence and Transport. The alternative measure allows

the performance of the joint venture and associate operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result.

For the year ended 31 December	2017 £m	2016 £m
Revenue from continuing operations, including share of joint ventures and associates	3,310.3	3,491.8
Exclude share of revenue from joint ventures and associates	(356.7)	(480.8)
Reported revenue (continuing activities only)	2,953.6	3,011.0

Alternative profit measures

For the year ended 31 December	2017 £m	2016 £m
Underlying Trading Profit	69.8	82.1
Non-underlying items:		
Include OCP charges and releases	(19.0)	9.6
Include other Contract & Balance Sheet Review adjustments	3.2	4.6
Include benefit from non-depreciation and amortisation of assets held for sale	–	0.5
Include other one-time items	–	3.5
	(15.8)	18.2
Trading Profit	54.0	100.3
Include operating exceptional items (continuing operations only)	(19.6)	(56.3)
Include amortisation and impairment of intangibles arising on acquisition from continuing and discontinued operations	(4.4)	(5.1)
Exclude operating loss from discontinued operations	–	3.3
Operating profit (continuing activities only)	30.0	42.2

Underlying Trading Profit (UTP)

The Group uses an alternative measure, Underlying Trading Profit, to make adjustments for unusual items that occur within Trading Profit and remove the impact of historical issues. UTP therefore provides a measure of the underlying performance of the business in the current year. For 2016 there were four items excluded from UTP, only two of which required adjustment in 2017.

Charges and releases on all Onerous Contract Provisions (OCPs) are excluded in the current and prior years. OCPs reflect the future multiple year cost of delivering onerous contracts and do not reflect only the current cost of operating the contract in the latest individual year. It should be noted that, as for operating profit, UTP benefits from OCP utilisation of £69.3m in 2017 (2016: £84.2m) which neutralises the in-year losses on previously identified onerous contracts, therefore it is only charges or releases of OCPs that are adjusted for.

Revisions to accounting estimates and judgements which arose during the 2014 Contract & Balance Sheet Review are separately reported where the impact of an individual item is material. Only one such item was noted in 2017, relating to a release of a provision made during the Contract & Balance Sheet Review which has been released following a change in the Group's obligations.

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

Finance Review continued

Underlying Trading Profit (UTP) continued

The benefit of depreciation and amortisation charges not being taken in the Group accounts in relation to assets held for sale were excluded in the prior year. Such charges were being taken in the subsidiary accounts to reflect the reduction in value of the underlying assets, and we consider it relevant to show the effect this would have on the Group performance measure. No assets are included as held for sale in 2017 and therefore no adjustment is required in 2017.

Finally, any other significant items that have a one-time financial impact are excluded, which for 2016 related to the one-time pension settlement associated with the early exit of a UK local authority contract in 2015. This item was distinct from exceptional items in that it arose from normal contract exit conditions. No such material one-time items occurred in 2017.

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

The non-underlying column in the summary income statement on page 50 includes the tax impact of the above items and tax items that, in themselves, are considered to be non-underlying. Further detail of such items is provided in the tax section below.

Trading Profit

The Group uses Trading Profit as an alternative measure to operating profit, as shown on the Group's Consolidated Income Statement on page 158, by making three adjustments. Trading Profit is a metric used to determine the performance and remuneration of the Executive Directors.

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

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

Third, the Trading Profit of discontinued operations is included as this benefits from consistency with previously reported results, reflects the overall change in scale of the Group's operations and takes account of the performance of the discontinued operations themselves. This allows their impact on the Group as a whole to be evaluated on measures other than just the post tax result. There were no discontinued operations in 2017.

UTP at constant currency

UTP disclosed above has been translated at the average foreign exchange rates for the year. In order to provide a comparable movement on the previous year's results, UTP is recalculated by translating non-Sterling values for the year to 31 December 2017 into Sterling at the average exchange rate for the year ended 31 December 2016.

For the year ended 31 December	2017 £m
Underlying Trading Profit at constant currency	63.3
Foreign exchange differences	6.5
Underlying Trading Profit at reported currency	69.8

Alternative Earnings or Loss Per Share (EPS) measures

For the year ended 31 December	2017 pence	2016 pence
Underlying EPS from continuing and discontinued operations, basic	3.42	4.13
Impact of non-underlying items and amortisation and impairment of intangibles arising on acquisition	(1.18)	1.99
EPS from continuing and discontinued operations before exceptional items	2.24	6.12
Impact of exceptional items	(2.26)	(6.23)
Reported EPS from continuing and discontinued operations, basic	(0.02)	(0.11)

EPS from continuing and discontinued operations before exceptional items

EPS from continuing and discontinued operations, as shown on the Group's Consolidated Income Statement on page 158, includes exceptional items charged or credited to the income statement in the year. EPS before exceptional items aids consistency with historical results and is a metric used in assessing the performance and remuneration of the Executive Directors.

Underlying EPS from continuing and discontinued operations

Reflecting the same adjustments made to operating profit to calculate UTP as described above, and including the related tax effects of each adjustment and any other non-underlying tax adjustments as described in the tax charge section below, an alternative measure of EPS is presented. This aids consistency with historical results, and enables performance to be evaluated before the unusual or one-time effects described above. The full reconciliation between statutory EPS and Underlying EPS from continuing and discontinued operations is provided in the summary income statements on page 50.

Alternative cash flow and Net Debt measures

Free Cash Flow (FCF)

We present an alternative measure for cash flow to reflect net cash inflow from operating activities before exceptional items, which is the measure shown on the Consolidated Cash Flow Statement on page 162. This IFRS measure is adjusted to include dividends we receive from joint ventures and associates and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases. FCF is considered relevant to reflect the cash performance of business operations after meeting usual obligations of financing and tax. It is therefore a measure that is before all other remaining cash flows, being those related to exceptional items, acquisitions and disposals, other equity-related and debt-related funding movements, and foreign exchange impacts on financing and investing activities. FCF is therefore a measure to assess the cash flow generated by the business and aids consistency for comparison to historical results. FCF is a metric used to determine the performance and remuneration of the Executive Directors.

For the year ended 31 December	2017 £m	2016 £m
Free Cash Flow	(6.7)	(33.0)
Exclude dividends from joint ventures and associates	(28.2)	(40.0)
Exclude net interest paid	17.0	18.7
Exclude capitalised finance costs paid	–	0.3
Exclude purchase of intangible and tangible assets net of proceeds from disposal	34.6	31.6
Cash flow from operating activities before exceptional items	16.7	(22.4)
Exceptional operating cash flows	(32.5)	(39.9)
Cash flow from operating activities	(15.8)	(62.3)

UTP cash conversion

FCF as defined above, includes interest and tax cash flows. In order to calculate an appropriate cash conversion metric equivalent to UTP, Trading Cash Flow is derived from FCF by excluding tax and interest items. UTP cash conversion therefore provides a measure of the efficiency of the business in terms of converting profit into cash before taking account of the impact of interest, tax and exceptional items. As Trading Cash Flow was an outflow in 2016, a conversion percentage of UTP is not presented.

For the year ended 31 December	2017 £m	2016 £m
Free Cash Flow	(6.7)	(33.0)
Add back:		
Tax paid	11.4	5.6
Non-cash R&D expenditure	0.2	0.4
Net interest received	17.0	18.7
Capitalised finance costs paid	–	0.3
Trading Cash Flow	21.9	(8.0)
Underlying Trading Profit	69.8	82.1
Underlying Trading Profit cash conversion	31%	N/A

Net Debt

We present an alternative measure to bring together the various funding sources that are included on the Group's Consolidated Balance Sheet on page 161 and the accompanying notes. Net Debt is a measure to reflect the net indebtedness of the Group and includes all cash and cash equivalents and any debt or debt like items, including any derivatives entered into in order to manage risk exposures on these items.

For the year ended 31 December	2017 £m	2016 £m
Cash and cash equivalents	112.1	177.8
Loans receivable	25.7	22.9
Loans payable	(271.5)	(299.9)
Obligations under finance leases	(20.2)	(28.2)
Derivatives relating to Net Debt	12.8	18.1
Net Debt	(141.1)	(109.3)

Finance Review continued

Pre-tax Return on Invested Capital (ROIC)

ROIC is a measure to assess the efficiency of the resources used by the Group and is a metric used to determine the performance and remuneration of the Executive Directors. ROIC is calculated based on UTP and Trading Profit using the Income Statement for the year and a two point average of the opening and closing balance sheets. The composition of Invested Capital and calculation of ROIC are summarised in the table below.

For the year ended 31 December	2017 £m	2016 £m
Non-current assets		
Goodwill	551.3	577.9
Other intangible assets	66.7	83.6
Property, plant and equipment	65.2	69.3
Interest in joint ventures and associates	14.3	14.4
Trade and other receivables	57.3	44.4
Current assets		
Inventory	17.4	22.4
Trade and other receivables	506.5	543.5
Total invested capital assets	1,278.7	1,355.5
Current liabilities		
Trade and other payables	(462.8)	(524.5)
Non-current liabilities		
Trade and other payables	(28.7)	(16.8)
Total invested capital liabilities	(491.5)	(541.3)
Invested Capital	787.2	814.2
Two point average of opening and closing Invested Capital	800.7	768.7
Trading Profit	54.0	100.3
ROIC%	6.7%	13.0%
Underlying Trading Profit	69.8	82.1
Underlying ROIC%	8.7%	10.7%

Overview of financial performance

Revenue

Reported Revenue declined by 2% in the year to £2,953.6m (2016: £3,011.0m), a 6% reduction in constant currency.

No revenue arose in 2017 from operations classified as discontinued, with total revenues for the year ended 31 December 2016 from continuing and discontinued operations being £3,047.8m.

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

Trading Profit

Trading Profit for the year was £54.0m (2016: £100.3m). Trading Profit for the year ended 31 December 2016 included a loss on discontinued operations of £3.3m.

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

Underlying Trading Profit

UTP was £69.8m (2016: £82.1m), down 15%. At constant currency, UTP was £18.8m lower than 2016 at £63.3m, with a movement of £4.6m relating to the results of discontinued operations in 2016.

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

Excluded from UTP were net charges from OCPs of £19.0m (2016: net releases of £9.6m) following the annual reassessment undertaken as part of the budgeting process. Also excluded from UTP were net releases of £3.2m (2016: net releases of £4.6m) relating to other provisions and accruals for items

identified during the 2014 Contract & Balance Sheet Review. UTP also excluded the benefit arising from the non-depreciation and amortisation of assets classified as held for sale in 2016 of £0.5m; there were no such assets in 2017. Other one-time items of £3.5m excluded from UTP in 2016 related to a pension scheme settlement arising from the early exit of a UK Local Authority contract in 2015; there were no such adjustments necessary for one-time items in 2017.

The cumulative to date improvement to Trading Profit as a result of OCP charges and releases and adjustments to items identified during the 2014 Contract & Balance Sheet Review is £19.3m (2016: £35.1m). This represents 3% of the 2014 total charge to Trading Profit arising from the Contract & Balance Sheet Review.

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

Discontinued operations

The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015 and 2016. Disposal of the offshore BPO business was largely completed in December 2015, with the disposals of two much smaller remaining elements completed in March 2016 and December 2016. The residual UK onshore private sector BPO operations were sold or exited in 2016 with the exception of one business, consisting of a single contract, the disposal of which completed in July 2017. Total revenues for the remaining operations were £5.4m and the loss before exceptional items was £0.6m for the year ended 31 December 2017, therefore the results have been included in continuing operations in 2017 on the grounds of materiality.

Finance Review continued

The amounts reported as discontinued operations in the prior year were as follows:

For the year ended 31 December	2016 £m
Revenue	36.8
Underlying Trading Loss	(4.6)
Onerous contract and Contract & Balance Sheet Review adjustments	0.8
Benefit from non-depreciation and non-amortisation of assets held for sale	0.5
Trading Loss	(3.3)
Amortisation and impairment of intangibles arising on acquisition	–
Operating loss before exceptional items	(3.3)
Exceptional loss on disposal of subsidiaries and operations	(2.8)
Other exceptional operating items	(11.4)
Exceptional operating items	(14.2)
Operating loss	(17.5)
Exceptional finance costs	(0.4)
Loss before tax	(17.9)
Tax charge	(0.1)
Net loss on discontinued operations (attributable to equity owners of the Company) as presented in the income statement	(18.0)

Joint ventures and associates-share of results

In 2017, the most significant joint ventures and associates in terms of scale of operations were AWE Management Limited, and Merseyrail Services Holding Company Limited, with dividends received of £17.1m (2016: £19.6m) and £7.3m (2016: £7.3m) respectively. Total revenues generated by these businesses were £951.8m (2016: £968.1m) and £155.7m (2016: £150.3m) respectively. From September 2016, there was a change in the AWE Management Limited shareholding structure, with the Group's shareholding reducing from 33.3% to 24.5% by way of a return of shares.

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

For the year ended 31 December	2017 £m	2016 £m
Revenue	356.7	480.8
Operating profit	34.4	40.7
Net investment finance costs	(0.1)	(0.6)
Income tax expense	(7.0)	(6.7)
Profit after tax	27.3	33.4
Dividends received from joint ventures and associates	28.2	40.0

The decline in revenue and profits on the prior year is partly due to the change in shareholding in AWE Management Limited and partly due to the end of the Northern Rail franchise on 31 March 2016.

Exceptional items

Exceptional items are items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the performance of the Group.

Exceptional items arose on both the continuing and discontinued operations of the Group in 2016. Exceptional items arising on discontinued operations are disclosed on the face of the Consolidated Income Statement within the profit or loss attributable to discontinued operations. There were no discontinued operations in 2017.

For the year ended 31 December	2017 £m	2016 £m
Exceptional items arising on continuing operations		
Exceptional profit on disposal of subsidiaries and operations	0.3	2.9
Other exceptional operating items on continuing operations		
Impairment of goodwill	–	(17.8)
Restructuring costs	(28.6)	(17.2)
Aborted transaction costs	–	(0.1)
Costs associated with UK Government review	(0.4)	(0.1)
Release of UK frontline clinical health contract provisions	0.4	0.6
Settlement of defined benefit pension obligations	10.3	(10.7)
Impairment of interest in joint venture and related loan balances	4.5	(13.9)
Impairment of AsPac customer lists	(6.1)	–
Other exceptional operating items	(19.9)	(59.2)
Exceptional operating items arising on continuing operations	(19.6)	(56.3)
Exceptional items arising on discontinued operations		
Exceptional loss on disposal of subsidiaries and operations	–	(2.8)
Other exceptional operating items on discontinued operations		
Restructuring costs	–	(1.1)
Movements in indemnities provided on business disposals	–	(13.7)
Movement in the fair value of assets transferred to held for sale	–	3.4
Other exceptional operating items	–	(11.4)
Exceptional operating items arising on discontinued operations	–	(14.2)
Exceptional operating items arising on continuing and discontinued operations	(19.6)	(70.5)
Exceptional finance costs-discontinued	–	(0.4)
Exceptional tax-continuing	(5.0)	3.1
Total operating and financing exceptional items in continuing and discontinued operations	(24.6)	(67.8)

Exceptional profit on disposals

There were no material disposals of continuing operations in 2017.

Other exceptional operating items

The annual impairment testing of CGUs in 2017 has identified no impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions, external advisory fees and other incremental costs, including in 2017 £2.8m of intangible asset impairment (2016: £nil). Due to the nature and scale of the impact of the transformation phase of the Strategy Review, the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non-business as usual costs. In 2017, a charge of £28.6m (2016: £17.2m) arose in relation to the restructuring programme resulting from the Strategy Review. The Strategy Review is discussed in more detail in the Strategic Report on page 11. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £11.1m (2016: £6.7m) and were included within operating profit before exceptional items. We expect restructuring costs of approximately £35m to be incurred in 2018 which will be treated as exceptional.

There were exceptional costs totalling £0.4m (2016: £0.1m) associated with the UK Government reviews and the programme of Corporate Renewal. These costs have historically been treated as exceptional and consistent treatment is applied in 2017.

Finance Review continued

Other exceptional operating items continued

There were releases of provisions of £0.4m (2016: £0.6m) which were previously charged through exceptional items in relation to the exit of the UK frontline clinical health contracts.

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result, a settlement charge of £10.7m arose, for which a provision was made. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items in 2017.

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

As a result of contracts coming to the end of their natural lives and no significant new contracts being awarded by the customer, the remaining customer relationship intangible assets of the DMS Maritime Pty Limited business acquired in 2012 were impaired, totalling £6.1m.

Exceptional tax

Exceptional tax for the year was a tax charge of £5.0m (2016: £3.1m credit), comprising a £2.3m credit on exceptional items within operating profit and a £7.3m charge in respect of other exceptional tax items.

Exceptional costs of £19.6m only gave rise to a credit of £2.3m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

The other exceptional tax items relate to two matters, the first is the impact on tax of the pension buy-in disclosed in Note 33 to the consolidated financial statements which led to a £95.0m reduction in the IFRS valuation of the Group's defined benefit pension schemes and consequently a deferred tax charge to the income statement of £16.1m. Movements in the valuation of the Group's defined benefit pension schemes and the associated deferred tax impact are reported in the Statement of Comprehensive Income (SOCi) and do not flow through the income statement, therefore do not impact profit before tax or the tax charge. However, the net amount of deferred tax recognised in the balance sheet relates to both the pension accounting and other timing differences, such as recoverable losses. As the net deferred tax balance sheet position is at the level supported by future profit forecasts, the decrease in the deferred tax liability associated with the pension scheme (with the benefit reported in the SOCi) leads to a corresponding decrease in the deferred tax asset to match the future profit forecasts. Such a reduction in the deferred tax asset therefore leads to a charge to tax in the income statement.

The second element is a credit of £8.8m related to legislative changes in the UK and the US which have impacted the value of deferred tax held on the balance sheet. There is a reduction in the deferred tax liability that is held in connection with our US operations of £12.5m, as future US tax liabilities are expected to crystallise at lower US tax rates. The fall in future expected US rates is primarily due to the enactment of the Tax Cuts & Jobs Act in December 2017 which reduces the corporate income tax rate in the US from 35% to 21% effective from 1 January 2018. In addition, there was a change in UK tax law in 2017. This UK change will reduce the quantum of loss brought forward that can be used to offset taxable profits arising in a year, and will also enable losses carried forward in one company to be used to offset profits in another. The combined impact of these UK law changes results in a tax charge of £3.7m.

Pre-exceptional finance costs and investment revenue

Investment revenue of £7.6m (2016: £9.3m) includes interest accruing on net retirement benefit assets of £3.8m (2016: £4.7m), interest earned on deposits and other receivables of £2.6m (2016: £3.6m) and the movement in discounting of other receivables of £1.2m (2016: £1.0m).

Finance costs of £19.2m (2016: £21.9m) includes interest incurred on the USPP loans and the Revolving Credit Facility of £14.0m (2016: £15.6m), facility fees and other charges of £3.0m (2016: £3.5m), interest payable on finance leases of £1.3m (2016: £1.6m), the movement in discount on provisions of £1.3m (2016: £2.4m) and a credit for foreign exchange on financing activities of £0.4m (2016: £1.2m).

Other gains

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

Tax

Tax charge

Underlying tax

In 2017 we recognised a tax charge of £20.6m on underlying trading profits after finance cost. The effective tax rate in 2017 (35.4%) is at a similar level to 2016 (35.2%).

Pre-exceptional tax

We recognised a tax charge of £14.0m (2016: £15.8m) on pre-exceptional profits which includes £20.6m underlying tax, £1.6m tax impact of amortisation on intangibles arising on acquisition and £5.0m credit on non-underlying items. The £5.0m credit consists of the tax impact of non-underlying items together with tax items that are in themselves considered to be non-underlying, specifically:

- As noted above with regards to exceptional tax, movements in the valuation of the Group's defined benefit pension schemes leads to a corresponding adjustment to the deferred tax asset to match the future profit forecasts. Such a change in the deferred tax asset impacts tax in the income statement. Where deferred tax charges or releases are the result of movements in the pension scheme valuations rather than trading activity, these are excluded from the calculation of tax on underlying profit and the underlying effective tax rate, with the prior periods being restated to reflect this. These amounted to £1.9m for 2017 (2016: £nil).
- During the current period we have recognised an additional £11.1m of deferred tax asset in relation to UK losses to reflect the improved forecast profits of our UK operations. This credit nets against the charge (£3.7m) taken to exceptional tax and described below, which relates to the UK law change in 2017 to give a net increase in UK deferred tax assets of £7.4m.

- The tax on non-underlying items during the period totalled a credit of £4.2m reflecting the impact of current or future tax deductions available.

The tax rate on profits before exceptional items on continuing operations, at 36.2% is higher than the UK standard corporation tax rate of 19.25%. This is due to the upward impact of higher rates of tax on profits arising on our international operations, together with the absence of any deferred tax credit for current year losses incurred in the UK. This is only partially offset by the downward impact of our joint ventures whose post-tax results are included in our pre-tax profit and additional deferred tax assets that have been recognised in relation to historic UK losses. Our tax charge in future years will continue to be materially impacted by our accounting for UK deferred taxes. To the extent that future UK tax losses are incurred and are not recognised, our effective tax rate will be higher than prevailing standard corporation tax rates. When our UK business returns to sustainable profitability our existing UK tax losses will be recognised or utilised, and the effective rate will be reduced.

The enactment of the Tax Cuts & Jobs Act in the US has not impacted our pre-exceptional tax charge during 2017 with the impact on our valuation of deferred tax shown as an exceptional item and explained further above. In the medium term, the new law is expected to have only a marginal impact on our tax liability in the US. This is because although we will benefit from the fall in tax rate, our US business bears interest cost, associated with historic funding put in place to acquire US businesses, an element of which will not lead to tax deductions in the medium term.

Exceptional tax

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

Contingent tax assets

At 31 December 2017, the Group has gross estimated A £17.4m UK tax asset has been recognised at 31 December 2017 (2016: £10.0m) on the basis of utilisation against forecast taxable profits.

At 31 December 2017, the Group has estimated unrecognised UK deferred tax assets of an additional £160m which are contingent on further improvement in the UK profit forecast.

Finance Review continued

Taxes paid

Net corporation tax of £15.3m was paid during the year, relating primarily to our operations in AsPac (£5.5m), Europe (£3.2m), Middle East (£1.5m) and Americas (£5.1m). The Group's UK operations have transferred tax losses to its profitable joint ventures and associates giving a cash tax inflow in the UK of £4.4m. In addition there were small cash tax refunds where we have overpaid tax in previous periods. This results in an overall tax paid figure in our cash flow statement of £11.4m.

The amount of tax paid (£11.4m) differs from the tax charge in the period (£19.0m) mainly due to the effect of future expected cash tax outflows for which a charge has been taken in the current period and the impact of the time lag on receipts of cash from joint ventures and associates for losses transferred to them.

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

Total tax contribution

Our tax strategy of paying the appropriate amount of tax as determined by local legislation in the countries in which we operate, means that we pay a variety of taxes across the globe. In order to increase the transparency of our tax profile, we have shown below the cash taxes that we have paid across our regional markets.

In total during 2017, Serco globally contributed £578m of tax to government in the jurisdictions in which we operate.

Taxes by category

For the year ended 31 December 2017	Taxes borne £m	Taxes collected £m	Total £m
Corporation tax	15.3	–	15.3
VAT and similar	9.7	152.2	161.9
People taxes	109.0	284.1	393.1
Other taxes	6.7	0.5	7.2
Total	140.7	436.8	577.5

Taxes by region

For the year ended 31 December 2017	Taxes borne £m	Taxes collected £m	Total £m
UK & Europe	82.8	235.7	318.5
AsPac	25.6	121.5	147.1
Americas	30.2	76.8	107.0
Middle East	2.1	2.8	4.9
Total	140.7	436.8	577.5

Corporation tax, which is the only cost to be separately disclosed in our Consolidated Financial Statements, is only one element of our tax contribution. For every £1 of corporate tax paid directly by the Group (tax borne), we bear a further £8.20 in other business taxes. The largest proportion of these is in connection with employing our people.

In addition, for every £1 of tax that we bear, we collect £3.10 on behalf of national governments (taxes collected). This amount is directly impacted by the people that we employ and the sales that we make.

Dividends

The Board is not recommending the payment of a dividend in respect of the 2017 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it believes it prudent to do so, in assessing whether we should resume dividend payments in respect of 2017, we have been mindful of the fact there has been a reduction in earnings, a free cash outflow and an increase in Net Debt. In these circumstances, the Board believes that it would not be prudent to resume dividend payments at the current juncture. For 2018, our guidance is for an improvement in Underlying Trading Profit, but we expect Net Debt to still increase, largely as a result of cash outflows related to exceptional restructuring costs and taking opportunities for value-enhancing infill acquisitions. The Board will continue to keep the dividend policy under close consideration as we progress with transforming the Group and implementing our strategy.

Share count and EPS

The weighted average number of shares for EPS purposes was 1,089.7m for the year ended 31 December 2017 (2016: 1,088.3m). EPS before exceptional items from both continuing and discontinued operations was 2.24p per share (2016: 6.12p); including the impact of exceptional items, EPS was a loss of 0.02p (2016: 0.11p). Underlying EPS was 3.42p per share (2016: 4.13p).

Cash flows

The UTP of £69.8m (2016: £82.1m) converts into a trading cash inflow of £21.9m (2016: outflow of £8.0m). The negative conversion in 2016 was primarily due to the adverse working capital movement of £23.7m and the cash outflows arising on the utilisation of contract provisions of £84.2m. In 2017, the working capital outflow is £9.0m and the OCP utilisation is £69.3m.

The table below shows the operating profit and FCF reconciled to movements in Net Debt. FCF for the year was an outflow of £6.7m compared to an outflow of £33.0m in 2016. The improvement in FCF is largely as a result of a reduction in operating profit before exceptional items on continuing and discontinued operations from £95.2m in 2016 to £49.6m in 2017, which is more than offset by an improvement in the net movement in non-exceptional provisions from a reduction in 2016 of £118.4m to a reduction in 2017 of £46.4m. The movement in non-exceptional provisions is partly due to the reduction in total provision utilisation from £123.4m in 2016 to £82.2m in 2017.

The movement in Net Debt is an increase of £31.8m in 2017, a reconciliation of which is provided at the bottom of the following table. The movement includes a net outflow of £5.6m arising on the acquisition and disposal of subsidiaries, primarily relating to the cash held by Service Glasgow LLP, an entity disposed of in the year. In 2016 a net cash inflow of £19.2m arose primarily as a result of the disposal of the private sector BPO business. The movement in Net Debt for 2017 also includes a net exchange gain of £17.4m, compared to a £41.8m loss in 2016.

For the year ended 31 December	2017 £m	2016 £m
Operating profit on continuing operations	30.0	42.2
Operating loss on discontinued operations	–	(17.5)
Remove exceptional items	19.6	70.5
Operating profit before exceptional items on continuing and discontinued operations	49.6	95.2
Less: profit from joint ventures and associates	(27.3)	(33.4)
Movement in provisions	(46.4)	(118.4)
Depreciation, amortisation and impairment of property, plant and equipment and intangible assets	50.0	52.4
Other non-cash movements	11.4	11.5
Operating cash inflow before movements in working capital, exceptional items and tax	37.3	7.3
Working capital movements	(9.0)	(23.7)
Tax paid	(11.4)	(5.6)
Non-cash R&D expenditure	(0.2)	(0.4)
Cash flow from operating activities before exceptional items	16.7	(22.4)
Dividends from joint ventures and associates	28.2	40.0
Interest received	0.5	1.4
Interest paid	(17.5)	(20.1)
Capitalised finance costs paid	–	(0.3)
Purchase of intangible and tangible assets net of proceeds from disposals	(34.6)	(31.6)
Free Cash Flow	(6.7)	(33.0)
Net cash (outflow)/inflow on acquisition and disposal of subsidiaries	(5.6)	19.2
Other movements on investment balances	0.2	0.7
Capitalisation and amortisation of loan costs	(0.8)	(0.7)
Unwind of discounting and capitalisation of interest on loans receivable	3.4	2.9
New, acquired and disposed finance leases	(4.7)	(0.5)
Exceptional items	(32.5)	(40.2)
Cash movements on hedging instruments	(2.5)	47.0
Foreign exchange gain/(loss) on Net Debt	17.4	(41.8)
Movement in Net Debt including assets and liabilities held for sale	(31.8)	(46.4)
Assets held for sale movement in Net Debt	–	4.7
Net Debt at 1 January	(109.3)	(67.6)
Net Debt at 1 January including assets and liabilities held for sale	(109.3)	(62.9)
Net Debt at 31 December	(141.1)	(109.3)

Finance Review continued

Net Debt

As at 31 December	2017 £m	2016 £m
Cash and cash equivalents	112.1	177.8
Loans receivable	25.7	22.9
Loans payable	(271.5)	(299.9)
Obligations under finance leases	(20.2)	(28.2)
Derivatives relating to Net Debt	12.8	18.1
Net Debt	(141.1)	(109.3)

Average Net Debt as calculated on a daily basis for the year ended 31 December 2017, was £184.3m (2016: £119.4m), compared with the opening and closing positions of £109.3m and £141.1m respectively. Peak Net Debt was £242.7m (2016: £182.9m).

Treasury operations and risk management

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

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

Liquidity and funding

As at 31 December 2017, the Group had committed funding of £741m (2016: £770m), comprising £261m of private placement notes and a £480m revolving credit facility with a syndicate of banks, which was undrawn. In addition, the Group had a receivables financing facility of £30.0m which was unutilised at the year-end (2016: utilisation of £7.7m).

Following the further small disposals relating to the private sector BPO business, the Group was required to offer two thirds of the net disposal proceeds to the debt holders in prepayment. As a result of this process, £3.7m (\$4.9m) of private placement notes were repaid at par on 29 June 2017.

Interest rate risk

Given the nature of the Group's business, we have a preference for fixed rate debt to reduce the volatility of net finance costs. Our Treasury Policy requires us to maintain a minimum proportion of fixed rate debt as a proportion of overall Net Debt and for this proportion to increase as the ratio of EBITDA to interest expense falls. As at 31 December 2017, more than 100% of the Group's Net Debt was at fixed rates. Interest on the revolving credit facility is at floating rate, however it was undrawn.

Foreign exchange risk

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

Credit risk

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

Debt covenants

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

For the year ended 31 December	2017 £m	2016 £m
Operating profit before exceptional items on continuing and discontinued operations	49.6	95.2
Remove: Amortisation and impairment of intangibles arising on acquisition	4.4	5.1
Trading Profit	54.0	100.3
Exclude: Share of joint venture post-tax profits	(27.3)	(33.4)
Include: Dividends from joint ventures	28.2	40.0
Add back: Net non-exceptional charges to OCPs	19.0	–
Add back: Depreciation, amortisation and impairment of property, plant and equipment and non-acquisition intangible assets	45.6	47.3
Add back: Foreign exchange credit on investing and financing arrangements	0.4	1.2
Add back: Share based payment expense	11.4	9.7
Covenant EBITDA	131.3	165.1
Net finance costs on continuing and discontinued operations	11.6	12.6
Exclude: Net interest receivable on retirement benefit obligations	3.8	4.7
Exclude: Movement in discount on other debtors	1.2	1.0
Exclude: Foreign exchange on investing and financing arrangements	0.4	1.2
Add back: Movement in discount on provisions	(1.3)	(2.4)
Covenant net finance costs	15.7	17.1
Recourse Net Debt	141.1	109.3
Exclude: Disposal vendor loan note, encumbered cash and other adjustments	30.3	28.5
Covenant adjustment for average FX rates	7.8	(23.0)
CTNB	179.2	114.8
CTNB/covenant EBITDA (not to exceed 3.5x)	1.36x	0.70x
Covenant EBITDA/covenant net finance costs (at least 3.0x)	8.4x	9.7x

Finance Review continued

Net assets summary

As at 31 December	2017 £m	2016 £m
Non-current assets		
Goodwill	551.3	577.9
Other intangible assets	66.7	83.6
Property, plant and equipment	65.2	69.3
Other non-current assets	75.3	73.0
Deferred tax assets	55.0	50.8
Retirement benefit assets	41.8	150.4
	855.3	1,005.0
Current assets		
Inventories	17.4	22.4
Trade and other current assets	516.8	548.4
Current tax assets	11.2	11.0
Cash and cash equivalents	112.1	177.8
Total current assets	657.5	759.6
Total assets	1,512.8	1,764.6
Current liabilities		
Trade and other current liabilities	(464.0)	(525.1)
Current tax liabilities	(25.3)	(25.9)
Provisions	(148.5)	(172.3)
Obligations under finance leases	(8.5)	(12.3)
Loans	(31.8)	(9.7)
Total current liabilities	(678.1)	(745.3)
Non-current liabilities		
Other non-current liabilities	(28.7)	(16.8)
Deferred tax liabilities	(20.4)	(30.5)
Provisions	(211.5)	(249.4)
Obligations under finance leases	(11.7)	(15.9)
Loans	(239.7)	(290.2)
Retirement benefit obligations	(15.5)	(17.7)
	(527.5)	(620.5)
Total liabilities	(1,205.6)	(1,365.8)
Net assets	307.2	398.8

At 31 December 2017 the balance sheet had net assets of £307.2m, a movement of £91.6m from the closing net asset position of £398.8m as at 31 December 2016. The decrease in net assets is mainly due to the following movements:

- A decrease in the net retirement benefit assets of Group funded defined benefit pension schemes of £106.4m. In June 2017, the Trustees of the Group's primary defined benefit pension scheme entered into a bulk annuity purchase whereby an insurer will fund future benefit payments to the relevant members. The liability to pay the members remains with the pension scheme which continues to include the relevant pension liabilities, but an insurance asset is held which is an equal and opposite amount to the liability. This removes the risk of longevity and investment movements for this portion of the scheme on a funding basis, and also removes the accounting risk of movements in underlying assumptions on the liabilities. The transaction resulted in a significant reduction in the surplus of the pension scheme under IFRS accounting convention, but resulted in a reduction in the deficit that is actuarially assessed for funding purposes of approximately £12m. As at 31 December 2017 the estimated actuarial deficit of this scheme was £33.7m (2016: £42.6m).
- A decrease in provisions of £61.7m. Further details on provision movements is provided below.
- The combined position of trade and other current assets and trade and other current liabilities increased by £29.5m and Net Debt increased by £31.8m. Further details of these movements are provided in the cash flow and Net Debt sections above.
- A decrease in goodwill of £26.6m, caused by movements in foreign exchange rates.

Provisions

The total of current and non-current provisions has decreased by £61.7m since 31 December 2016. The movement is due to a decrease in onerous contract provisions of £52.0m, an increase in employee-related provisions of £10.6m, a decrease in property provisions of £0.9m and a reduction in other provisions of £19.4m.

The £10.6m increase in employee-related provisions is partly due to the ongoing Strategy Review restructuring programme and partly relating to obligations arising at the end of certain contracts. The decrease in other provisions is primarily due to the release of £10.3m of exceptional provisions relating to pensions, with the remaining movement comprised of contract settlements and releases for potential claims.

Movements in contract provisions since the 31 December 2016 balance sheet date, are as follows:

	Onerous Contract Provisions £m
At 1 January 2017	220.2
Charged to the income statement during the year-trading	62.0
Released to the income statement-trading	(43.0)
Released to the income statement-exceptional	(0.4)
Utilisation during the year	(69.3)
Unwinding of discount	1.3
Foreign exchange	(2.6)
At 31 December 2017	168.2

The balance of OCPs at 31 December 2017 was £168.2m (2016: £220.2m). OCP balances are subject to ongoing review and a full bottom-up assessment of the forecasts that form the basis of the OCPs is conducted as part of the annual budgeting process. The net non-exceptional charge to OCPs was £19.0m in 2017 and utilisation was £69.3m.

In 2017, additional charges have been made in respect of future losses on a number of onerous contracts totalling £62.0m. This increase related to revisions to existing OCPs of £61.5m and a new provision raised on one contract totalling £0.5m. The new contract has been operating for a number of years and is expected to be terminated in 2018.

Included within additional charges made to existing OCPs is £47.0m relating to the Caledonian Sleepers contract. This increase is partly due to revised assumptions for the higher costs of running the contract and the impact from delays in the delivery of new trains, which includes the higher cost of the running old trains for longer, associated penalties and the forecast benefit of revenue growth from the new trains being pushed back. In addition we have revised our revenue forecast for the contract based on the 2017 performance, where even a modest reduction in annual revenue can have a significant impact on a multi-year OCP. There continue to be a number of assumptions underpinning the provision that have a range of potential outcomes, including the train manufacturer delivering the new trains to the latest timetable and volume and pricing increases driven by the improved passenger service from the new trains. The position under the contract is expected to improve over time, as the terms of the Franchise Agreement provide a mechanism that requires Transport Scotland to bear 50% of contract losses from 1 April 2020.

Finance Review continued

In addition, from 1 April 2022, we have the right to seek adjustments to the financial terms of the Franchise Agreement that would result either in a small positive profit margin for Serco from that date, or allow us to exit the contract.

In addition to the Caledonian Sleepers contract, there have been net OCP releases of £16.4m in UK & Europe and £11.4m in AsPac.

Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC, for consideration of US Dollar \$20.5m in cash. Further details on this post year-end transaction are provided in Note 40 to the Consolidated Financial Statements.

The Group signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The portfolio has annual revenues of approximately £90m and a weighted average remaining term of 14 years. Upon the receipt by the Special Managers and Provisional Liquidators of the requisite third party consents, each individual contract will be transferred to Serco on a cash-free, debt-free basis, with the consideration to be paid in instalments and to be satisfied using Serco's existing financing facilities. If all the contracts are transferred to Serco under the revised BPA process, the total consideration payable would be £29.7m. The consideration payable is lower than the amount of £47.7m announced on 13 December 2017 in respect of substantially the same contracts that were subject to the initial BPA signed with Carillion plc at that date. The change in consideration reflects the Group's re-evaluation of potential liabilities, indemnities, warranties and the additional working capital investment required as a result of Carillion's liquidation. The financial effects of this transaction have not been recognised at 31 December 2017. As consents are required for each individual contract to be transferred and therefore acquired, at the time the financial statements were authorised for issue, no legal transfer or control of assets had taken place and so no disclosures have been made in respect of the assets and liabilities being acquired. The fair values of the

assets and liabilities will be determined at the date when contracts are acquired. It is also not yet possible to provide detailed information about each class of acquired receivables and any contingent liabilities in respect of the acquired contracts.

As noted in the overview of performance above, the Group obtained full control of Serco Sodexo Defence Services Pty Ltd by acquiring the remaining 50% of issued share capital for £1.6m.

IFRS15

The Group has undertaken a robust assessment to determine the impact of IFRS15 on the opening balance sheet at 1 January 2017 and for the year ended 31 December 2017. The impact on opening retained earnings will be a reduction of £32.8m and the impact on the opening OCP balance will be a reduction of £21.7m. Underlying Trading Profit will decrease by £0.3m and, as a result of a lower OCP release, Trading Profit will decrease by £8.7m for the year ended 31 December 2017. This low adjustment is reflective of the prudent accounting practices adopted by the Group following the Contract & Balance Sheet Review undertaken in 2014 and the repeat nature of the services provided. Further detail on the adjustment is provided in Note 2 of the Group's consolidated financial statements.



Angus Cockburn
Group Chief Financial Officer

21 February 2018

Corporate Responsibility

We deliver services to governments, serve the public and help to protect national interests. As a provider of public services we are committed to operate with a public service ethos and recognise our responsibilities.

Our commitment to corporate responsibility recognises evolving political and economic landscapes, public expectations, our broader impact as a company and how all of these align to the outcomes our customers seek to achieve.

In 2015/2016, we refreshed our Group strategy, clarified our purpose and established the new Corporate Responsibility Committee of the Board. In 2017, we have continued the refresh of our corporate responsibility agenda through development of a new corporate responsibility framework, to better reflect our strategy and the manner in which we conduct our business.

A good deal of care has been taken in the formulation of the framework and the elements addressed within. We have structured it around our key stakeholders – underpinned by our Values, purpose and public service ethos – focusing in particular on how we work to add sustainable value whilst delivering their requirements with accountability and transparency.

The framework defines our principal areas of responsibility and will help to guide future practice and behaviour whilst facilitating measurement of our performance, supporting us in our efforts to:

- set exemplary standards in public service delivery;
- execute brilliantly to deliver our stakeholders' expectations;
- meet or exceed the outcomes our customers seek to achieve;
- uphold relevant laws and regulatory requirements;
- honour our relationships with our internal and external stakeholders; and
- manage our impact on the environment and the economies and communities in which we operate.

It will form a foundation for enhancing how we conduct our business for years to come.

We have begun to embed the framework in our approach. We will continue to focus on this in 2018 as well as examining stakeholder priorities and expectations across our principal areas of responsibility in greater detail. We will also explore opportunities for richer corporate responsibility performance measurement.

For now, we share here a summary of our approach to managing corporate responsibility – of how we have delivered our public services and lived the principles recognised within the framework – along with our progress and performance in 2017.

We have continued to build momentum in long-term objectives for sustainable improvement – consolidating progress and maintaining our key strategies. At the same time, however, we recognise enduring challenges that, whilst not exclusive to Serco, are high priority issues for our business and customers.

For example:

- we continue seeking to safeguard our people and service beneficiaries whilst ensuring that we learn and move forward meaningfully from every experience; this includes building our health and safety influence across the broader context of our operations and – where applicable – confronting developing trends in violence and aggression with care and innovation; and
- we continue striving to strengthen gender balance at all levels of our organisation, which includes creating the conditions and catalysts for a more diverse and inclusive talent pipeline.

Examples of specific activities feature in this report.

We cannot claim to have met our expectations of progress in all areas, particularly where shifting climates, pressures and other causal factors remain beyond our control, but we firmly believe we can do better, and will continue our resistance of complacency and relentless pursuit of improvement.

More information, including a more detailed report for the year, is available on our website: www.serco.com

(See also: Corporate Responsibility Committee Report page 105 and Directors' Report page 144).

Corporate Responsibility continued

Our corporate responsibility framework

Our corporate responsibility (CR) framework is structured around:

Our Values: Our Values shape the way everyone in Serco works and behaves.

Behaving with integrity and treating people with respect: We operate morally and ethically, with respect for human rights.

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

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

Our world: We are responsible in how we impact the communities, economies and environments in which we operate.

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

Public service: Everything we do is motivated by our desire to be a trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens.

Our corporate responsibility governance

The Serco plc Board has ultimate responsibility for the Group's business strategy, including CR, and for setting the Group's culture, Values and ethical standards.

We have a Corporate Responsibility Committee (CRC) of the Board, chaired by Mike Clasper, the Senior Independent Director and Non-Executive Director, which has oversight of our approach to CR and focuses in four areas: health and safety, people, ethics and our CR framework.

Our Serco Management System

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

At the heart of the SMS are 16 Group policy statements and 23 Group standards. Group policies are signed by the Group Chief Executive and approved by the plc Board. They define our strategic commitments and apply across the Group.

Group standards reflect our Values and define the minimum standards we must achieve, focussing on mandatory requirements applicable across the Group.

Group, Country, Divisional and Local operating procedures build on these foundations within the SMS, providing direction on how to achieve mandatory requirements and comply with relevant laws and regulations in the countries where we operate. Operating procedures are sensitive to local customs, traditions and cultures.

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

In 2017, a new Privacy policy statement and new Group Standards for Insurance, Human Rights and Information and Data Privacy were published and the Insider Information and Share Dealing Standard was replaced with a more detailed Group Standard Operating Procedure and Share Dealing Code.

Our Code of Conduct

Our Code of Conduct helps us to drive continuous and consistent responsibility and behaviours across our organisation. Based on our Values it forms part of the SMS, clearly and concisely defining our expectations of operational and behavioural compliance. Everyone who works for and on behalf of Serco is expected to know, use and live our Code.

In 2017, we have updated our Code. Key changes include reflecting our position regarding human rights, in particular human trafficking and slavery, and adding detail on the importance of personal security. We have also added a behaviours section, aligned to our Values, enabling employees, people managers and leaders to better understand expected behaviours.

Our Values

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

In 2017, we have continued to embed our refreshed Values in our ways of working and the business consciousness. Our Divisions have driven the Values through local and regional initiatives, while from a Group perspective, the Values are being incorporated into the SMS, our Code of Conduct and all existing channels, publications and resources. For example:

- Our annual employee engagement survey, Viewpoint, and our premier programme of employee recognition, the Pulse Awards, are now aligned to our Values, enabling us to measure values-based engagement and celebrate values-based behaviour.
- Our Values are now integrated into our Code of Conduct, Leadership Model and annual Performance and Development Review process, enabling us to clearly define our expectations of values-based behaviour and ensure they are met.

Alongside our 'Speak Up' whistleblowing process, these elements also enable us to regularly assess and reinforce our culture. Our Viewpoint Culture Index comprises engagement levels for each of the four Values and provides insight into our culture as defined by our Values and perceived by our people. Culture Index results inform annual engagement action planning.

Corporate Responsibility continued

Behaving with integrity and treating people with respect

(See also: Fair competition page 75; Responsible relationships page 76).

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

We have zero tolerance for any form of corrupt behaviour or activity that breaks any law relating to human rights, either directly or indirectly, anywhere in the world. We recognise our obligations under the UK Modern Slavery Act 2015, publish an annual Modern Slavery Statement on www.serco.com and do not engage in any form of human trafficking or use forced, bonded, illegal or child labour, nor knowingly work with anyone who does.

We use international human rights standards as a framework to assess, monitor, mitigate and remedy any actual or potential adverse human rights impacts (AHRIs) that may affect our business.

In 2017, we have refreshed our human rights assessment and decision tree process, strengthening its coverage of slavery and human trafficking; published a new Group Standard for human rights; and refreshed our mandated ethics and compliance training with a new suite of courses ready for 2018, including modern slavery.

We have also improved our Speak Up (whistleblowing) programme by implementing an enhanced case management system, provided as before by an independent third party, to make the system more accessible and easier to use; updated our online gifts and hospitality register to enable approval as well as registration of items, helping ensure compliance with the UK Bribery Act; and undertaken further reviews of adequate procedures for Anti-Bribery and Corruption (ABC) in our Divisions, completing UK & Europe, Middle East and AsPac. Additionally, in the UK we piloted an ABC assessment tool to review contracts against required adequate procedures.

Safe and healthy operations

Our vision is zero harm. Wherever we work, we are committed to the promotion of wellbeing and the prevention of injury and ill health.

We strive to promote a 'just' health and safety culture based on active and caring leadership and mutual trust, innovation and pride; actively encourage input from employees and others to build sustainable solutions; identify and assess the health and safety hazards, impacts and risks that arise from our activities and services, investigating incidents and monitoring performance and systems; and regularly review, learn and identify opportunities for continual improvement.

In 2017, we reviewed our Group policy and strengthened supporting Group Standards with the definition of safety critical risks, whilst embedding Incident Management and Reporting standards to raise visibility of and improve consistency in related activities. We have launched a significant review of safety-related risks in support of the Group principal risk, 'catastrophic incident'. We have continued to build our health and safety influence across the broader context of our operations, for example in Transport, where our experiences have intensified our resolve to help improve road safety in the UAE – not just for our people but for all UAE citizens – and strengthen our aviation safety oversight and sharing of best practice – not just regionally but internationally through a global aviation safety forum. We also conducted a UK pilot of the Health and Safety Laboratory (HSL) 'Safety Climate' tool to evaluate and benchmark our safety culture.

Our CR in action

We celebrated 'Zero Harm Week' across our Divisions in October in support of our Group objective to improve health and safety engagement by promoting a culture of health, safety and wellbeing.

In the UK, we have won several Royal Society for the Prevention of Accidents Gold Awards in 2017, including at RAF Fylingdales and Forth Valley Royal Hospital.

We have driven continuous improvement in health and safety across our businesses, including new tools and training in Serco Americas to reduce risks and improve safety management in air traffic control and naval engineering, and new tools in Serco AsPac to improve roadside welfare safeguards for our road safety camera operators.

Inclusive workplace

Our business thrives because of our talented and diverse workforce, which we seek out, nurture and empower. We recognise, however, that we must continually challenge ourselves to ensure diversity and inclusion are embedded in our culture and ways of working.

Diversity and Inclusion (D&I) is prioritised in both our People Policy and Strategy. We strive to promote equality of opportunity and create an inclusive and enabling environment in which all our people are treated fairly and with respect, dignity and zero tolerance for any form of discrimination. We prioritise proactive management and regular analysis of our workforce diversity, seeking to attract, develop and retain employees from the broadest possible talent pool.

Our approach to D&I recognises that achievement of our overall goals needs to take account of business maturity, regional variations and local legislation. Implementation of our strategy therefore takes place at three levels:

- Group sets policy and the broad framework to ensure consistency of approach, as well as providing clarity on key areas of focus.
- Each Division maintains a D&I strategy aligned to the overall Group framework with priorities appropriate to their geographies, sectors, employee base and local legislation. Progress is reported through normal business review and governance frameworks.
- A further level of focus is appropriate for some Business Units or contracts within a Division, e.g. in businesses of a particular size, in particular geographies, or according to local customer specifications.

Following the launch of our refreshed approach to D&I in Q4 2016, we have been establishing regular monitoring and reporting of progress and delivery of targets at each level (Group/Division/Business Unit or Contract), whilst continuing our work towards achieving a minimum of 25% females in leadership roles by 2020, focusing in particular on improving gender balance in senior recruitment and our talent pipeline.

We have also established D&I as a standing agenda item for our Quarterly Talent Reviews (attended by the Group Human Resources Director (HRD) and Divisional Chief Executive Officers (CEOs) and HRDs), ensuring relevant actions are delivered and risks managed; incorporated D&I demographics into our employee engagement survey, as appropriate by Division, expanding options for gender identity, sexual orientation and disability; developed and launched an

Unconscious Bias e-learning programme; and continued to introduce, build and promote Divisional councils, committees, working groups and networks in support of strategy delivery.

In the UK, we have completed preparations for reporting pay gap information annually from April 2018, as required by the Equality Act 2010. We are committed to ensuring that all our employees are treated fairly, with dignity, and with an equality of opportunity throughout their careers with Serco. Measuring, understanding and reporting our Gender Pay Gap is a welcome and important step in this journey.

We have undertaken extensive analysis of what is behind our current median gender pay gap of 12.9% so that we can identify real opportunities to reduce this. This figure reflects the average paid to men and women across our UK businesses. It is not a comparison of pay rates for men and women doing work of equal value. The primary cause of the gender pay gap within Serco is the demography of our UK employee population, in which we currently have an imbalance in the number of men and women at the various levels within the organisational structure. We have fewer women than men in more senior positions and typically people in more senior positions receive the highest pay and bonus pay. This impacts the hourly pay and the bonus pay figures.

Complementing our strategic D&I focus on leadership gender, our analysis shows that an equal gender distribution at our manager level and above would reduce the overall pay gap to well below UK averages.

Our CR in action

In the UK, we have joined the Stonewall Diversity Champion programme and launched a network for LGBT+ employees and allies, sponsored by our UK & Europe CEO; established a disability network and signed up to the UK government's Disability Confident initiative; and our Serco Inspiring Women network has partnered with Everywoman, the world's largest network and learning and development platform for women in business.

In Americas, our Women at Serco Americas network has launched a learning programme designed to empower diversity through development of communication capability.

In Australia, we have received an Employer Support Award from the Defence Reserves Support Council

We have been awarded Platinum membership of the National Program for Emiratization by the United Arab Emirates Ministry of Human Resources & Emiratization.

Corporate Responsibility continued

Employee engagement and development

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

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

In 2017, we have achieved improvements in overall employee engagement whilst incrementally strengthening priority engagement drivers identified by our 2016 results (connection to Serco, taking action on employee feedback, recognition and resources). We have sustained momentum in building leadership engagement whilst also focussing on our people managers, prioritising contract managers; rolled our 'Engagement Insights' tool out beyond our leadership population, enabling immediate feedback and support for all employees completing our survey online; and launched a Steering Committee to improve engagement across our Group Functions and Corporate Shared Services, chaired by the Group Chief Financial Officer.

We have continued working to enhance and embed our core development programmes, including our Management Programme, designed in partnership with Oxford Saïd Business School to develop a cadre of managers aligned to driving our performance and strategy. A further 118 of our global management population have completed the programme in 2017, bringing the cumulative total to 208.

Our CR in action

We have been named one of 'Atlantic Canada's Top Employers' for 2017.

We have contributed to the improvement of healthcare service outcomes at Acacia Prison, Australia, by increasing employee engagement.

Our Learning and Development Team, Dubai Metro and Tram, have won both the Middle East Centre of Excellence and International Centre of the Year Lion Awards from City and Guilds.

We have led the development and deployment of the new Chartered Manager Degree Apprenticeship in partnership with the University of Wolverhampton.

Contributing to communities

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

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

In 2017, we enabled and facilitated efforts in fundraising and support for local communities across our businesses through our Divisional sponsorship programmes as well as other partnering with local governments, social enterprises and charity; continued to prioritise recruitment from local communities where appropriate; and continued seeking to expand and enrich the diversity of our supplier base through engagement with small and medium-sized suppliers across our businesses. We have also been preparing to relaunch the independent Serco Foundation with a new strategy centred on deploying funds to charitable partners focused on innovation to improve public service outcomes for citizens.

Our CR in action

We have continued to prioritise and facilitate recruitment from local communities where appropriate, including for our facilities management contract at the new NHS Dumfries and Galloway Royal Infirmary, UK, which opened in December 2017.

We have supported a variety of local and regional education and work experience initiatives across our businesses, including hosting educational site visits from schools at the Palm Jumeirah Monorail and Dubai Metro in the UAE.

Through our corporate sponsorship of the Armed Services YMCA annual 'Hearts for Heroes' event, we enable combat-wounded US Military servicemen in California and Virginia to engage in therapy respite.

In Grafton, New South Wales, we have partnered with the national charity Midnight Basketball Australia to help provide for the welfare of young people from the local community.

Protecting the environment

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

We strive to promote a commitment to the environment based on active and caring leadership and mutual trust, innovation and pride; actively encourage input from employees and others to build sustainable solutions; identify and assess the environmental hazards, impacts and risks that arise from our activities and services, investigating incidents and monitoring performance and systems; and regularly review, learn and identify opportunities for continual improvement.

We work to minimise adverse environmental impact through the implementation of environmental management systems that are proportional to each contract, aligned to customer specification and contractual requirements, and underpinned by our Group Standard Operating Procedure for Health, Safety and the Environment.

The SMS sets out how we will deliver our environmental commitment, aligned to the ISO14001:2015 standard on environmental management. Across more than two thirds of our business, we work on our customers' premises and are not in direct control of environmental impacts. In such cases we work collaboratively with our customers on environmental issues.

Where we have control, activities are managed locally, covering a wide range of initiatives focused on reducing our carbon emissions intensity, improving energy and fuel efficiency, improving our waste management processes and promoting biodiversity.

In 2017 we benchmarked our approach to climate change via the globally-recognised annual Carbon Disclosure Project (CDP) climate change questionnaire, achieving a score of B (of all participating companies 23.3% scored A, 24.4% scored B and 52.3% scored C or D, while within our sector 22% scored A, 21.6% scored B and 56.4% scored C or D). We have also undertaken an initial Scope 3 carbon emissions assessment to identify priority areas in our indirect carbon emissions and investigated the Science Based Target methodology to inform future carbon target setting.

Our CR in action

In New Zealand, we are partnering with Auckland Council and the New Zealand Department of Corrections to help plant one million trees in the region over three years.

We have helped to transform waste management at New York University, Abu Dhabi, by developing and implementing a new solution and working with our customer to educate university faculty and students.

We helped develop and now operate the Sentinels Data Access System for the European Space Agency, helping to monitor and measure how the Earth is affected by natural events and the underlying human contributions.

In the UK, we have helped Hertfordshire County Council achieve significant improvements in energy efficiency, equating to over £1m to date.

We have conducted a range of local and central environmental initiatives across our businesses, including joining the Adopt-a-Highway litter removal programme and renovating/re-using offices and furniture across contracts in Serco Americas.

Fair competition

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

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

In 2017, we have reviewed and refreshed training for managers, and developed a conflicts of interest register with approvals and action workflows. These will be launched across the business in 2018.

Corporate Responsibility continued

Responsible relationships

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

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

In 2017, we continued embedding our newly enhanced third party due diligence processes and commenced ongoing monitoring; refreshed our Supplier Code of Conduct and updated components in our supplier governance to meet modern slavery and human trafficking requirements, including the strengthening of contract terms; and engaged Anti-Slavery International to help us better understand related risks in our supply chain.

We have also worked to improve management of risk across our supply chain in our UK & Europe, Middle East and AsPac Divisions by implementing enhanced supplier onboarding (incorporating latest ABC and ethical due diligence requirements) and piloting a new supplier relationship management (SRM) programme in the UK, developed to deliver ongoing performance and innovation improvements with key suppliers.

Our CR in action

We are helping to drive improved supplier behaviour around human rights in the Middle East through the enhancements we have been making to our due diligence and supplier onboarding process.

We have continued seeking to expand and enrich the diversity of our supplier base through engagement with small and medium-sized suppliers across our businesses, including joining Supply Nation in Australia to improve our access to Indigenous businesses, and maintaining our Supplier Network Portal in the US to improve our access to small and minority-owned businesses.

In the UK, we engaged a small cross-section of our key suppliers in a trial to test and refine our new SRM supplier relationship management solution, selecting participants from a range of categories and lengths of relationship with Serco and working closely with them to baseline relationships, establish consistent governance and identify opportunities for improvement.

Duty of care

At the heart of the design and delivery of our services, we place the health, safety and wellbeing of our service users and citizens.

We strive to prioritise, protect and promote the health, safety and wellbeing of the recipients of our services, whether they are those for whom we are directly responsible, such as individuals in our prisons or travelling on our transport, or those who are the direct beneficiaries of our services, such as patients in the hospitals that we clean. We design and deliver services in ways that focus on the needs and experiences of service users as well as service-related outcomes; and work to ensure that service users are treated at all times with consideration, courtesy, compassion and respect, and that every provision and interaction exemplifies our value of Care.

Specific duty of care objectives are defined, managed and delivered at contract level, monitored by relevant business units. More broadly, our commitment to duty of care informs Divisional and sector-specific business strategies, overseen by Divisional Executive Management Teams and/or our sector Centres of Excellence (CoEs).

It is also a defining factor for activity across our CR framework, for example: improving our Speak Up system makes it easier for employees to report potential risks to service users, while improving the engagement levels of service user-facing employees contributes to a better service experience for service users.

Our CR in action

In the UK, we have received praise for advances in the reduction of prison violence, in reports by HM Chief Inspector of Prisons and the Independent Monitoring Board.

In Australia, we have contributed to a national study aiming to reduce healthcare associated infections through enhanced cleaning practices.

In the US, we helped citizens affected by the worst hurricane season on record gain more time to enrol for Medicaid and Medicare in 2018.

In Saudi Arabia, our colleague, Miko Baay, received a Global Pulse Award for helping to rescue 270 stranded train passengers on his day off.

Quality service delivery

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

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

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

In 2017, we have further developed our CoEs in Justice & Immigration, Healthcare and Transport to build differentiated capabilities, strengthen our sector propositions and maximise the benefits of our cross-regional experience; and planned the re-launch of the Serco Institute, which will be deployed to provide research for the improvement of public services.

Our CR in action

Our customer rated our service at the Space-Based Infrared System in Colorado, USA, 'exceptional' for the second year in a row.

At Wandoo Reintegration Facility, Western Australia, the Office of the Inspector of Custodial Services reported our Offender Management Model to be "the best in the state".

Our transport contracts in Dubai have been recognised externally for the highest level quality of customer service by The International Customer Service Institute.

Our collaboration with the UK Ministry of Defence to introduce the latest generation of tug to the UK enabled the successful arrival of HMS Queen Elizabeth into Portsmouth in August 2017.

Corporate Responsibility continued

Social outcomes

We aim to enhance social outcomes by designing and delivering frontline public services that make a real difference to people's lives.

We believe that the provision of public services around the world – for us, for our customers and for society – requires commitment to a social as well as a commercial contract. We strive to maintain our public service ethos and aspiration to do the best for citizens, not only for our customers. Aligned to our ambition for quality service delivery, we design citizen-centred public service solutions whilst maintaining a focus on delivering particularly complex and transformational services that are critical to the functioning of society.

In 2017, we have continued to enable the achievement of enhanced social outcomes through consistent, well-managed and continuously improving frontline services. For example:

- **Justice:** We have helped to safeguard society and reduce reoffending through the provision of prison management, police support and prisoner escorting services.
- **Immigration:** We have helped to protect borders and manage immigration through the provision of border control, detention centre and asylum seeker housing and welfare services.
- **Citizen Services:** We have contributed to local community wellbeing through the provision of leisure facilities and waste management services.
- **Health:** We have helped to enhance patient experiences and maintain safer environments in hospitals through the provision of facilities management services.
- **Defence:** We have contributed to the protection of national and international security through the provision of critical support services to defence organisations.
- **Transport:** We have helped to facilitate national travel, enabling local and regional economies and societies to function through the provision of air, sea, road and rail services.

Our CR in action

This year saw the public release of our Veterans Affairs Pressure Ulcer Resource (VAPUR) mobile app, to support outpatient US Veterans and their care givers in the treatment of their wounds.

Our partnership to maintain open spaces for the public with the City of Melbourne, Australia, has been recognised with the international Green Flag Award for Melbourne Gardens.

In the Middle East, we have continued our partnership with Road Safety UAE to improve road safety awareness for our people and the wider United Arab Emirates community.

In Billesley, UK, we have helped to improve local engagement in sport and fitness by 600% by driving awareness, access and affordability for children and adults.

Value for public money

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

We are committed to enabling governments to achieve the best value for money for the public services we deliver. To deliver efficiency to our customers, we strive to manage our business with commercial rigour; innovate at both the contract and corporate level; fully utilise our economies of scale and our international, transferable expertise; and drive a cost-effective supply chain.

In 2017, we have renewed our focus on innovation through our CoEs and made significant progress towards ensuring that our operating costs are as efficient as possible, including work undertaken on our operating model and overhead costs, from which we expect to realise benefits in forthcoming years. The decision to merge our two UK-based Divisions was the first step in this project.

Our CR in action

We have worked with our customers to reduce costs across our businesses, including at the Palm Jumeirah Monorail in Dubai and United Arab Emirates University in Al Ain where we have helped to create financial savings through improved energy, water and waste efficiency.

Our highway services contract with Peterborough City Council was named Contract Management Initiative of the Year 2017/18 at the GO Awards, which celebrate excellence in public procurement across the UK public sector, after saving £1.8m for local taxpayers.

Our non-clinical services at Fiona Stanley Hospital have helped the Western Australian government achieve \$550m in savings.

In the US, we have helped service users and our customer to save and reduce tax-penalty exemption application costs through service improvement at the Centers for Medicare and Medicaid Services.

Shareholder returns

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

We believe that in a free market system, and in the long-term, the preservation and growth of the business and the maximisation of shareholder value automatically coincide, even if there is some short-term divergence. Delivering sustainable, profitable growth is therefore central to appropriate delivery of shareholder returns, and our performance framework is structured accordingly. We will realise this by executing our strategy to achieve our purpose of becoming a trusted partner of governments, delivering superb public services, that transform outcomes and make a positive difference for our fellow citizens.

For 2017, we have delivered Underlying Trading Profit at the top end of the guidance we gave at the start of the year, and we expect profits to grow strongly over the next two years. Beyond 2019, our long-term ambitions for margins and revenue growth – as originally expressed with our Strategy Review announced in 2015 – remain intact, but the timing of achieving these continues to be subject to seeing improvements in the trading conditions across our markets. In the meantime we continue to deliver against our plans and make good progress against our strategy.

For more information and our progress and performance in 2017, as well as our guidance and outlook, see:

Strategic report: Key Performance Indicators, page 18
Strategic report: Chief Executive's Review, page 32.

Corporate Responsibility continued

Transparency

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

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

In 2017, we delivered our annual schedule of external reporting and shareholder engagement, including additional trading and contract news updates to ensure transparency of performance and around 200 meetings with institutional investors. We have hosted an extensive Capital Markets Event, featuring in particular the Justice & Immigration and Defence sectors as well as Transformation updates; and been recognised for our commitment to transparency with a 'Most Honoured Companies' award from Institutional Investor.

Managed risk

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

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

For more information and our progress and performance in 2017, see:

Strategic report: Principal risks and uncertainties, page 20
Directors' report: Group Risk Committee Report, page 93.

Our areas of focus in 2018

In addition to delivering standard schedules of activity across our CR framework, our areas of focus in 2018 will include:

Our corporate responsibility framework and governance

- Embedding our new CR framework in our approach to CR from both the Group and Divisional perspectives;
- examining stakeholder priorities and expectations across our principal areas of responsibility in greater detail; and
- exploring opportunities for richer CR performance measurement.

Behaving with integrity and treating people with respect

- Developing a condensed Code of Conduct for temporary workers;
- completing the review of ABC 'adequate procedures' in our Divisions; and
- applying elements of the UK ABC assessment toolkit across other Divisions to drive benefit and value.

Our people

- Developing a 'just' health and safety culture framework for adoption across the business and deploying the HSL Safety Climate tool globally;
- replicating the global aviation safety forum in other safety critical areas, completing a formal review of our online incident management tool and working to improve reporting of 'near miss' incidents;
- continuing our work to improve the gender balance of our leadership team by attracting more women into senior roles, supporting their development and providing more career progression opportunities for women; and
- developing our understanding of ethnicity as a strategic D&I focus in our different geographies.

Our world

- Finalising development of a new environmental strategy to consolidate performance to date and refocus our activities to address priority environmental issues by taking a broader lifecycle approach to our environmental impacts;
- launching our refreshed fair competition training and new conflicts of interest register across the business;
- improving guidance on ethical and human rights due diligence for new geography/market entry and selection and appointment of partners;
- deploying our new SRM solution whilst applying our enhanced onboarding to existing suppliers and exploring opportunities to address Tier 2 suppliers in high risk areas; and
- relaunching the Serco Foundation and the Serco Institute.

Corporate Responsibility continued

Corporate responsibility Key Performance Indicators

		2013	2014	2015	2016	2017	2016 v 2017	Var %	Notes
Behaving with integrity and treating people with respect									
Viewpoint Ethics and Integrity Index	%	66	70	69	69	69	0	-	1
Upheld cases of corrupt behaviour	Number	0	0	0	0	0	0	-	
Upheld cases of human rights violations	Number	0	0	0	0	0	0	-	
Speak Up cases:									
Investigated	%	-	95	96	97	90	-7	-7.3	2
Corrective action taken	%	-	56	63	53	42	-11	-20.8	
Disciplinary action taken against one or more individuals involved in a case	%	-	15	24	16	9	-7	-43.8	
Dismissal of one or more individuals involved in a case	%	-	9	6	6	5	-1	-16.7	
Closed within three months	%	-	70	48	64	89	25	39.1	
Our people									
Employee engagement and development:									
Employee engagement	%	42	51	53	54	56	2	3.7	
People manager engagement	%	49	58	59	62	65	3	4.8	
Leadership engagement	%	51	51	55	72	71*	-1	-1.4	* 3
Viewpoint Learning & Development Index	%	44	44	46	48	49	1	2.1	1
Inclusive workplace:									
Viewpoint D&I Index	%	67	75	67	69	70	1	1.4	4
Female Directors	%	16.7	30.0	30.0	22.2	30.0	7.8	35.1	1
Female senior managers	%	14.8	16.2	16.7	17.1	21.7	4.6	26.9	
Female employees	%	40.9	44.4	42.6	41.9	41.6	-0.3	-0.7	
People with disabilities	%	0.2	0.7	1.3	1.2	1.0	-0.2	-16.7	
Age profile:									
16-24	%	10.2	10.2	9.5	9.1	8.7	-0.4	-4.4	4
25-40	%	33.9	35.2	35.9	35.7	38.8	3.1	8.7	
41-54	%	28.9	29.8	29.2	29.2	31.4	2.2	7.5	
55-64	%	13.4	14.6	14.9	15.6	17.9	2.3	14.7	
65+	%	2.3	2.4	2.3	2.6	3.1	0.5	19.2	
Undisclosed	%	11.3	7.8	8.2	7.8	0.1*	7.7	98.7	* 5
Staff turnover	%	31.5	31.0	32.8	33.8	30.6	3.2	9.5	
Proportion of days lost to sickness	%	2.8	3.3	3.2	3.2	3.1	0.1	3.1	
Safe and healthy operations									
Viewpoint Safety Index	%	71	70	71	73	75	2	2.7	1
Lost Time Incident Frequency Rate	Per 1m hours worked	5.12	4.81	5.79	4.98	3.93	1.05	21.08	
Lost Time Incident Severity Rate	%	18.90	17.53	19.10	16.08	15.57	0.51	3.17	
Major Incident Frequency Rate	Per 1m hours worked	0.25	0.33	0.34	0.27	0.30	-0.03	-11.11	
Physical Assault Frequency Rate	Per 1m hours worked	5.11	7.04	7.19	6.92*	8.64	-1.72	-24.71	* 6
Serious Physical Assault Frequency Rate	Per 1m hours worked	-	0.38	0.49	0.93	1.40*	-0.47	-50.54	* 7
Prosecutions	Number	0	0	1*	0	0	0	-	* 8
Fines paid	£'000	0	50	200	0	116*	116	-	* 9

		2013	2014	2015	2016	2017	2016 v 2017	Var %	Notes
Our world									
Protecting the environment:									10
Carbon dioxide equivalent – Total Group (Scope 1+2)	Tonnes CO2 equivalent	398,519	343,717	298,986	291,883	253,655	38,228	13.1	
Electricity	%	53	54	46	37	31*	-6	-16.2	* 11
Gas	%	12	12	9	10	10	0	–	
Petrol	%	1	0	0	1	1	0	–	
Diesel	%	7	7	9	10	9	-1	-10.0	
Fuel oil	%	8	7	2	1	2	1	100.0	
Specialist marine fuel	%	19	20	34	40	46*	6	15.0	* 12
Fugitive emissions	%	0	0	0	0	0	0	–	
Headcount Intensity (Scope 1+2)	tCO ₂ e/FTE	7.27	6.32	5.16	5.98	5.56	0.42	7.0	
Scope 1 – Combustion of fuels and operation of facilities	Number	187,217	173,441	162,198	182,819	174,289	8,530	4.7	
Scope 2 – Grid electricity purchased for own use (location based)	Number	211,302	170,276	136,789	109,064	79,366	29,698	27.2	
Scope 2 – Grid electricity purchased for own use (market based)	Number	–	–	–	–	70,629	–	–	13
Scope 3 – Business travel	Number	–	–	–	–	7,621	–	–	14
Headcount Intensity (Scope 3)	tCO ₂ e/FTE	–	–	–	–	0.17	–	–	
Carbon Disclosure Project	Score	92%	97%	99%	B	B	–	–	15
Prosecutions	Number	0	0	0	0	0	0	–	
Fines paid	£'000	0	0	0	0	0	0	–	
Enforcement notices	Number	0	0	0	0	0	0	–	
Fair competition:									
Upheld cases of anti-competitive behaviour	Number	0	0	0	0	0	0	–	
Responsible relationships:									
Third party due diligence screening									16
Third parties validated	Number	–	–	–	–	28,066	–	–	
Third parties pending review	Number	–	–	–	–	1,143	–	–	
Third parties disqualified	Number	–	–	–	–	3*	–	–	* 17

Notes:

The performance analysis is based on data reported as at 21 February 2018. Additional data may arise after this date. Where this occurs, numbers will be corrected in the following year's table.

All data excludes JVs and historical BPO data to enable a like-for-like comparison. Our private sector offshore BPO business was sold in December 2015.

Current workforce KPI levels are in line with benchmark targets for the geographies and markets in which we operate, however we continue to try to improve them. Annual targets are managed at local and regional levels.

1. Historical Viewpoint Index data has been adjusted to reflect modifications to Index calculation methodology in 2017. An index comprises one or more related questions that cover a specific area of analysis. Scores are generated based on the % of survey respondents who 'agree' or 'strongly agree' to all questions within an Index.
2. Where anonymous cases provide insufficient information, we are unable to investigate.
3. We have maintained a healthy overall engagement profile and leadership engagement has remained stable while we have focused on improving employee and people manager engagement.
4. Inclusive workplace and age figures are representative only of employees for whom relevant data is available.
5. Reduction reflects improvements in data availability resulting from new D&I strategy and focus on developing clear and robust data.
6. Slight adjustment in rate due to late capture of incidents on reporting system.
7. Data includes incidents of spitting/potting as serious assaults in line with UK reporting requirements. When these are excluded the comparable rate is 0.88, a 5% improvement on 2016.
8. Relates to an incident in 2011.
9. Dubai Metro: February 2017 (500,000AED) public hazard relating to escalator maintenance by a sub-contractor – fine paid by sub-contractor and revised work instructions implemented, August 2017 (100,000AED) unsafe lifting operations relating to glass movement in station – revised work instructions implemented.

Corporate Responsibility continued

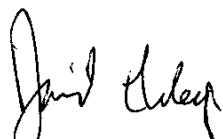
Corporate responsibility Key Performance Indicators continued

- 10 Our reporting year for greenhouse gas emissions is one quarter behind our financial year, namely 1 Oct 2016 to 30 Sept 2017. We quantify and report to ISO 14064-1:2012, using an operational control approach to defining our organisational boundary. The classification of reporting boundaries is set out in detail in our Basis of Reporting document, available on our website, www.serco.com. We report all material emission sources for which we consider ourselves responsible and have set our materiality threshold at 5%.
- 11 Sale of our private sector offshore BPO business (10,630,000 kgCO₂e in environmental reporting year 2015/16), ASPAC basis of estimation reduced due to loss of contracts (c.5,000,000 kgCO₂e); Hong Kong Cross Harbour Tunnel contract ended Q4 2016 (c.4,000,000 kgCO₂e), Leisure reductions (c.2,500,000 kgCO₂e); Statista – responsibility for paying electricity contract returned to client in 2016 (c.500,000 kgCO₂e), UK conversion factor down 15%.
- 12 Increased proportionally due to electricity reductions.
- 13 Expanded scope of measurement in 2017, market based measurement uses conversion factors from suppliers where available and is a metric asked for in the CDP submission.
- 14 Expanded scope of measurement in 2017, includes air, rail, private car, hire car and hotel stays.
- 15 New scoring mechanism introduced in 2015.
- 16 2017 numbers reflect implementation of new third party due diligence screening. All current and legacy suppliers and customers have been processed in 2017 – a total of 35,850 organisations.
- 17 An additional 6,634 organisations were disqualified because they are no longer used by Serco or there is a gap of two years or more in the relationship.

Health, Safety & Environment Targets 2018

Key Performance Indicator	2018 Performance Target
Viewpoint Safety Index	>75%
Major Incident Frequency Rate	Maintain at 2017 baseline
Lost Time Incident Frequency Rate	Maintain <4
Serious Physical Assault Frequency Rate	-10% against 2017 baseline
Physical Assault Frequency Rate	Maintain at 2017 baseline
Headcount Intensity (Scope 1+2) tonnes CO ₂ equivalent	-3% against 2017 baseline

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



David Eveleigh
Secretary

21 February 2018

Directors' Report

Corporate Governance Report	86
Board of Directors	86
Chairman's Governance Overview	88
Board and Governance	91
Group Risk Committee Report	93
Audit Committee Report	96
Nomination Committee Report	102
Corporate Responsibility Committee Report	105
Compliance with the UK Corporate Governance Code	108
Remuneration Report	110
Directors' Report	144
Directors' Responsibility Statement	150

Corporate Governance Report

Board of Directors

Sir Roy Gardner
Chairman

A N R C E GR

Appointed to the Board:
June 2015 (Chair since July 2015)

Key skills and experience:

Previously Chairman of Compass Group PLC, Chief Executive of Centrica plc, Managing Director of GEC-Marconi Limited and a Director of GEC plc, Non-Executive Director of Willis Group Holdings Limited and Laporte plc, Non-Executive Chairman of Manchester United, Plymouth Argyle Football Club and Connaught plc

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

Fellow of the Chartered Association of Certified Accountants, the Royal Aeronautical Society, the Royal Society of Arts and the City and Guilds Institute

Honorary Doctorate from Thames Valley University

Current External Commitments:

Senior Independent Director of Mainstream Renewable Power Limited

Senior Independent Director of William Hill plc

Rupert Soames
Group Chief Executive

A N R C E GR

Appointed to the Board:
May 2014

Key skills and experience:

Previously Chief Executive at Aggreko plc, and Chief Executive of Misys plc Banking and Securities Division

Rupert was also previously Senior Independent Director of Electrocomponents plc until July 2016 and a member of their Remuneration, Nomination and Audit Committees

Studied Politics, Philosophy and Economics at Oxford University and was President of the Oxford Union

Visiting Fellow at Oxford University

Current External Commitments:

None

Angus Cockburn
Group Chief Financial Officer

A N R C E GR

Appointed to the Board:
October 2014

Key skills and experience:

Previously Chief Financial Officer and Interim Chief Executive at Aggreko plc, Managing Director at Pringle of Scotland, senior finance positions at PepsiCo Inc including Regional Finance Director for Central Europe

Honorary Professor at the University of Edinburgh

Current External Commitments:

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

Edward J. Casey, Jr
Group Chief Operating Officer

A N R C E GR

Appointed to the Board:
October 2013 as Acting Chief Executive Officer. Group Chief Operating Officer from May 2014. Ed retired from the Board on 31 December 2017.

Key skills and experience:

Joined Serco in 2005 as Chief Executive Officer of the Americas Division

Prior to Serco, worked for nine years in the energy business and over ten years in investment banking and private equity

Until December 2016 a Director at Talen Energy Corporation and a member of their Audit Committee and the Compensation, Governance and Nominating Committee

Current External Commitments:

None

Mike Clasper CBE
Non-Executive Director and Senior Independent Director

A N R C E GR

Appointed to the Board:
March 2014. Mike was a member of the Remuneration Committee until December 2017.

Key skills and experience:

Previous roles have included Group Chief Executive of BAA plc, Chairman of Her Majesty's Revenue and Customs, Chairman of Which? Limited, Senior Independent Director of ITV plc and President of the Chartered Management Institute

MA in Engineering from Cambridge University

Honorary Doctorate from Sunderland University

Current External Commitments:

Chairman of Coats Group plc and BIOS International Limited

Trustee of the Chartered Management Institute

Governor of the Royal Shakespeare Company

Advisory Board Member for Arora International

Key to the Corporate Governance Report

A Appointed to the Board
N Non-Executive Director
R Retired from the Board

C Chief Executive Officer
E Executive Director
GR Group Chief Financial Officer

Other Board Members

Ralph D. Crosby, Jr. is a Non-Executive Director of V.Group Limited, having previously served as a Non-Executive Director of Standard Life Aberdeen plc.

Angie Risley is a Non-Executive Director of V.Group Limited, having previously served as a Non-Executive Director of Standard Life Aberdeen plc. She is also a Non-Executive Director of the National Audit Commission.

Rachel Lomax

Non-Executive Director

A N R C E G R

Appointed to the Board:
March 2014

Key skills and experience:

Rachel has deep experience of government and economic policy. Rachel's previous appointments include Deputy Governor, Monetary Stability, Bank of England, and a member of the Monetary Policy Committee, Permanent Secretary in the Department for Transport, Department for Work and Pensions and the Welsh Office, and senior posts at the Cabinet Office, HM Treasury and World Bank.

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

Current External Commitments:

Non-Executive Director of Heathrow Airport Holdings Limited

Director of SETL Development Limited

Governor of the Ditchley Foundation

Member of the Board of Breugel

John Rishton

Non-Executive Director

A N R C E G R

Appointed to the Board:
September 2016

Key skills and experience:

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

Fellow of the Chartered Institute of Management Accountants

Current External Commitments:

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

Non-Executive Director and Chairman-Elect of the Audit Committee of Informa plc

Non-Executive Director at Associated British Ports

Lynne Peacock

Non-Executive Director

A N R C E G R

Appointed to the Board:
1 July 2017

Key skills and experience:

Lynne is a Non-Executive Director of Standard Life Aberdeen plc and a member of its Nomination and Governance Committees, and Non-Executive Chair of Standard Life Assurance Limited. Lynne is also a Non-Executive Director and Senior Independent Director, Chair of the Remuneration Committee and member of the Audit, Risk and Nomination Committees of Nationwide Building Society.

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

Current External Commitments:

Non-Executive Chair of Standard Life Assurance Limited

Non-Executive Director and a member of the Nomination and Governance Committees of Standard Life Aberdeen Plc

Senior Independent Director, Chair of the Remuneration Committee and member of the Audit, Risk and Nomination Committees of Nationwide Building Society

Ian El-Mokadem

Non-Executive Director

A N R C E G R

Appointed to the Board:
1 July 2017

Key skills and experience:

Ian became the Chief Executive Officer of V.Group Limited in October 2017. Prior to joining V.Group, Ian was Chief Executive Officer of Exova Group plc and, before that, he was Group Managing Director, UK & Ireland of Compass Group plc, where he was also a member of the Group's Executive Committee. Ian's earlier career included positions with Centrica plc and the global management consultancy, Accenture.

Current External Commitments:

Chief Executive Officer of V.Group Limited

Kirsty Bashforth

Non-Executive Director

A N R C E G R

Appointed to the Board:
15 September 2017

Key skills and experience:

Kirsty was a senior executive at BP plc having spent over 24 years with the company in a variety of commercial roles, including Group Head of Organisational Effectiveness, where she led BP's global agenda on culture, diversity and change management. Subsequently, Kirsty has been running her own corporate advisory business, QuayFive Limited, since 2015.

Current External Commitments:

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

Governor of Leeds Beckett University and Ashville College

Director of QuayFive Limited

Corporate Governance Report

Chairman's Governance Overview

This report sets out how Serco is governed and the key activities of the Board of Directors in promoting effective governance during 2017. Further information on how the Company complied with the UK Corporate Governance Code during 2017 is set out on pages 108 and 109.

Dear Shareholder

On behalf of the Board, I am pleased to present the Corporate Governance Report for the year ended 31 December 2017. The Board believes that good governance is key to the long-term success of the Group and is committed to achieving high standards of governance.

As in previous years, we report against the UK Corporate Governance Code (the 'Code') issued by the Financial Reporting Council ('FRC'). During 2017, we have fully complied with the provisions of the Code, with the exception of provision B.6.2 concerning external evaluation of the Board.

Effectiveness

In 2016, we committed to undertake an external evaluation of the Board and its Committees during 2017. In the latter half of 2017, we appointed three new Non-Executive Directors and, in view of this, the Board agreed to defer its external evaluation until 2018 to provide opportunity for our new Board members to settle into their new roles. This year, the Board conducted an internal Board evaluation with support from the Group General Counsel and Company Secretary, taking into account the recommendations from the 2016 review and changes in the Code. A summary of the findings are set out on page 92.

Changes in the Board

The Board continued to review Board composition and succession planning with assistance from the Nomination Committee. In July 2017, Ralph Crosby stepped down from the Board. A considered selection process to appoint a successor to Ralph was undertaken and led to the appointment of both Lynne Peacock and Ian El-Mokadem in July.

In addition, Angie Risley notified the Board of her intention to step down with effect from 15 September. Angie joined the Board in April 2011 and in May 2012 was appointed as Chair of the Remuneration Committee. I would like to thank both Ralph and Angie for their valuable contributions since joining the Board in 2011.

Upon Angie's departure, Lynne succeeded Angie as Chair of the Remuneration Committee owing to her extensive experience of chairing other Remuneration Committees elsewhere. Following a further selection process, Kirsty Bashforth joined the Board. Details of the selection process in respect of all the new Non-Executive Director appointments are contained in the Nomination Committee Report on page 102. Each of the new Non-Executive Directors bring valuable experience and relevant skills to the Board.

Ed Casey, our Chief Operating Officer, retired from the Board at the end of December following 12 years of service at Serco. I would like to reiterate my sincere thanks to Ed for his contribution to Serco and wish him every success in the future. Following detailed discussion, the Board agreed there would be no need to find a successor for Ed and instead his role and responsibilities would be best achieved and delivered between Rupert, Angus and the other members of the Executive Committee.

Contract site visits

The most recent additions to our Board have visited a number of our contract sites as part of their induction programme and have enjoyed the opportunity to witness the excellent day-to-day service provided by our contract teams. The visits have given our newest Board members a deeper level of understanding of the risks and opportunities faced by our contract teams on a daily basis, together with the Group-wide challenges regarding the scale and variety of our operations. A number of our existing Non-Executive Directors have also visited our contract sites during the year.

Diversity


Further to our commitment to improve gender diversity at the Board, I am pleased to report that we have increased female representation on our Board from 22% to 30% in 2017. At the same time, through the work of the Nomination Committee, the Board reviewed and updated its Board Diversity Policy, taking into account the guidance of the Hampton-Alexander Review and the Parker Review along with any other factors, objectives and target dates. The Board is equally committed to ensuring the development of gender and ethnic diversity amongst Serco's senior management population and to that end will annually review its recommendations on gender and ethnic diversity for senior management roles.

Corporate Responsibility Framework

The Board has continued to refresh and strengthen Serco's corporate responsibility agenda through development of a new corporate responsibility framework – forming a foundation for how we conduct our business whilst ensuring its relevance to our strategy and governance. The new framework clearly defines our principal areas of responsibility – structured around our Values, purpose and key stakeholders – and will help to guide action and behaviour whilst facilitating measurement of our performance. For further information, please refer to our corporate responsibility update on page 69.

Shareholder engagement

The Board continued to engage in an open and meaningful way with its shareholders during the course of 2017. In particular, since her appointment as Chair of the Remuneration Committee, Lynne Peacock has met with each of our major shareholders, together with a number of advisory bodies and other institutional shareholders, to discuss our approach to Directors' Remuneration and the new policy we have proposed to shareholders from 2018 onwards, set out on pages 115 to 128. In addition, I attend the results announcements in the City and meet many of our stakeholders. I hope shareholders will take the opportunity to meet with Board members at the 2018 AGM.



Sir Roy Gardner
Chairman

21 February 2018

Corporate Governance Report

Chairman's Governance Overview

What the Board has achieved in 2017

- Reviewed and challenged the strategy of the Group and supported the Chief Executive and the other Executive Directors in the Group's strategic development.
- Received, discussed and reviewed regular reports from the Chief Executive, Chief Financial Officer and Chief Operating Officer.
- Regularly reviewed financial performance.
- Reviewed and agreed budgets.
- Focused on the ongoing performance of the Group.
- Reviewed employee engagement, as well as receiving regular HR reports.
- Reviewed Health and Safety and risk reports.
- Reviewed and began to embed the Corporate Responsibility Framework.
- Focused on further embedding the Corporate Renewal Programme.
- Reviewed and challenged management on the progress of the Group's business development pipeline.
- Received regular legal and governance reports, including diversity and governance developments and received training as a Board.
- Focused on and reviewed a number of key individual material bids and acquisitions over the year.
- Appointed three new Non-Executive Directors, including a new Remuneration Committee Chair, and re-allocated the duties of the Chief Operating Officer following the resignation of Edward J. Casey, Jnr.
- Spent time with the Divisional management teams and met regularly with senior management responsible for the delivery of the Group's key opportunities and existing contracts, including a number of contract visits in the UK.
- Received a number of operational deep dives from across the divisions.
- Reviewed the Operating Model and Finance Transformation plans.
- Reviewed and challenged the Centres of Excellence.
- Ensured that the introduction of the Group Risk Committee operated effectively to oversee and strengthen the Company's risk management processes and continued to receive appropriate attention at Board level.
- Considered succession planning both for the Board and the senior management team.
- Reviewed the Gender Pay position.
- Reviewed and updated the Board Diversity Policy.
- Reviewed, challenged and refreshed the Tax and Treasury Policy.
- A number of contract site visits were undertaken by Non-Executive Directors.
- Engagement with the Company's stakeholders.

Board priorities for 2018

- Continue to assess and challenge the Group's strategy.
- Continue to support and challenge improvements in contract execution and cost efficiency, together with seeking to ensure the utilisation of capabilities across the Group.
- Ongoing review and challenge of the bid pipeline and new business opportunities, together with the development of the Centres of Excellence.
- Continued focus on enhancing risk management.
- Focus on Board and Senior Management succession planning, including diversity.
- Implement an effective external Board evaluation process.
- Further embedding of the Serco Values within the culture of the Group.
- Continue to drive improvements in Health and Safety and, specifically, to challenge measures put in place to support the reduction in physical assaults in prisons.
- Further review of Divisional operations as the Board continues to focus its time on ensuring the ongoing transformation and strengthening of the Group.
- To support and challenge management on embedding the Group's transformation initiatives.
- Budget and financial performance reviews.
- Monitor changes to relevant legal, regulatory and governance areas.
- Continue to oversee employee engagement.
- Continued focus on governance developments and training.

Group Risk Committee Report

2017 Scheduled Committee Meetings	Attendance (eligibility)
Chairman	
Rachel Lomax	4(4)
Committee Members	
Mike Clasper	4(4)
Ian El-Mokadem ¹	2(2)
John Rishton	4(4)

¹ Ian El-Mokadem joined the Board on 1 July 2017

Dear Shareholder

The Board continues to attach great importance to improving risk management across the Group. The Committee's aim in 2017 was to challenge Serco's capabilities for assessing and managing risk. In particular, it has sought to understand and test the extent to which the formal Risk Management Framework ('RMF') has been effectively embedded throughout the Group. To that end, it has received and discussed presentations from each geographical division describing how, in practice, they are implementing the RMF and has sought to understand how the Group's principal risks are mapped to the risks that are being actively managed at divisional level. The Committee has also given in-depth consideration to the Group's principal risks focusing in particular on the effectiveness of mitigating actions and how any gap between the current risk status and the Group's risk appetite is being managed.

Following a comprehensive review of the Group's principal risks by the Executive Committee, the Committee considered and agreed the Executive Committee's proposals to:

- Include a new risk 'failure of business critical partners, suppliers and sub-contractors';
- Separate 'failure to build reputation or act with integrity' into two discrete risks;
- Combine the risk of 'contract non-compliance and non-performance' with the risk of 'misreporting of performance'; and
- Remove 'failure to attract and retain key resources and skills fit for the future' as a principal risk. This reflects the success of mitigation actions in this area.

The Committee is taking a continuing interest in the Group's ongoing review of its exposure to catastrophic risks and relevant mitigations.

In 2018, the Committee will continue to oversee the Group's efforts to upgrade its risk management capabilities and the way the RMF has been embedded at divisional level. In its regular review of principal risks, it intends to pay particular attention to monitoring progress in constructing and implementing effective risk mitigation plans.

I will be present at the 2018 AGM to answer any questions from shareholders on this report and the activities of the Committee.



Rachel Lomax
Chair of the Group Risk Committee

21 February 2018

Corporate Governance Report

Group Risk Committee Report continued

Committee's responsibilities

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

- Overseeing the effectiveness of the Group's risk management framework, including the assessment of the principal risks facing the Group and the action being taken by management to mitigate risks that are outside the Group's risk appetite;
- Challenging and advising the Board on the current risk exposures of the Group and future risk strategy, and reviewing regular risk management reports from management which enable the Committee to consider the process for risk identification and management;
- Assessing how key Group risks are controlled and monitored by management;
- In conjunction with the Audit Committee, reviewing the Group's overall risk assessment processes that inform the Board's decision-making, ensuring both qualitative and quantitative metrics are used; and
- Reviewing the Group's capability to identify and manage emerging risks, in conjunction with the other Board Committees as appropriate.

The Terms of Reference were reviewed and amended this year, materially to reflect the requirements of the UK Corporate Governance Code and the ICSA Guidance Note for Risk Committees (the 'ICSA Guidance Note'). The Terms of Reference for the Committee can be found on our corporate website, www.serco.com

Membership and attendees

The Committee consists solely of independent Non-Executive Directors. The Board considers that each member of the Committee is independent within the definition set out in the UK Corporate Governance Code (the 'Code'). Details of Committee membership and attendance at meetings are provided on page 93. Biographical details for each member of the Committee are provided on pages 86 and 87. The Committee met on four occasions during the year. All Committee meetings are held in advance of Board meetings, with the Committee Chair updating the Board directly on the outcomes of each meeting. Meetings of the Committee were attended by the Chairman of the Board, the Chief Operating Officer, the Group General Counsel and Company Secretary and the Group Risk and Compliance Director.

Activities of the Committee during 2017

During the year the Committee's key activities included:

- Receiving updates regarding the Group's principal risks, detailing key changes and trends, and emerging risks;
- Undertaking, as planned, an in-depth review of the following risks: failure to grow profitably, failure to attract and retain key resources and skills fit for the future, major information security breach, contract non-compliance and non-performance, and material legal and regulatory compliance failure;
- Reviewing and refining the definition of a catastrophic risk event to ensure the right level of understanding of this risk and assign appropriate focus on risk mitigation activities;
- Receiving presentations, as planned, from members of the Serco UK Central Government, Serco Middle East and Serco Asia Pacific Executive teams on their Divisional Risk Management process. These included a review on a safety critical event from Serco Middle East, failure/perceived failure of a critical national service from Serco UK Central Government and the underperformance of contracts due to sub-contractor management failures from Serco Asia Pacific; and
- On-going challenge and support of the Group Risk and Compliance Director in his work plan for improving, enhancing and embedding the risk management framework.

Performance review

The Group Risk Committee's performance was assessed as part of the Board's annual effectiveness review. Following that review, the Committee concluded that the Committee worked effectively with some areas of improvement in relation to its remit and allowing time for the Committee to report its deliberations to the Board.

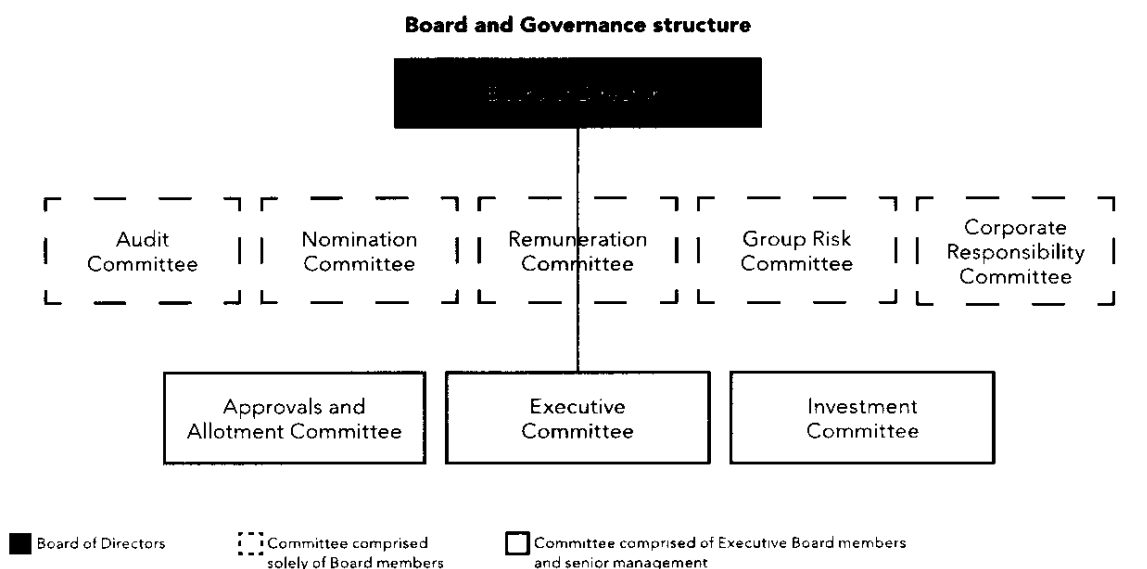
2018 priorities and focus

During 2018, the Committee will continue with a focus on undertaking detailed deep-dive reviews into other Group principal risks and meeting with the Divisional teams. Attention will be on the progression of mitigation actions and their effectiveness to drive the Risk Management agenda.

We will continue the development of our Risk Management Model, with a focus on refinements to our Key Risk Indicators, Corporate Risk Management Tool and the supporting policies and standards and reporting.

Board and Governance

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



Scheduled Board Meetings

	Attendance (eligibility) ¹	Notes
Kirsty Bashforth ²	3(3)	1 The Board held eight formal meetings during 2017 and a meeting to consider the strategic direction of the Group
Edward J. Casey, Jr ³	8(8)	2 Kirsty Bashforth was appointed to the Board, the Remuneration Committee and the Corporate Responsibility Committee on 15 September 2017
Mike Clasper	8(8)	3 Edward J. Casey, Jr stood down from the Board on 31 December 2017
Angus Cockburn	8(8)	4 Ralph D. Crosby Jr stood down from the Board on 1 July 2017
Ralph D. Crosby, Jr ⁴	4(4)	5 Ian El-Mokadem was appointed to the Board, the Group Risk Committee and the Corporate Responsibility Committee on 1 July 2017
Ian El-Mokadem ⁵	4(4)	6 Lynne Peacock was appointed to the Board, the Audit Committee and the Remuneration Committee on 1 July 2017. She was later appointed as Chair of the Remuneration Committee on 15 September 2017 and as a member of the Nomination Committee on 1 November 2017
Sir Roy Gardner	8(8)	7 John Rishton was unable to attend the September 2017 meeting due to an unavoidable scheduling conflict
Rachel Lomax	8(8)	8 Angie Risley stood down from the Board on 15 September 2017
Lynne Peacock ⁶	4(4)	In addition to the above, Rupert Soames, Angus Cockburn and Ed Casey attended all Executive Committee meetings held during 2017 and formed the quorum of Investment Committee and Approvals and Allotment Committee meetings as required. During the year, ten meetings of the Executive Committee were held
John Rishton ⁷	7(8)	
Angie Risley ⁸	5(5)	
Rupert Soames	8(8)	

Corporate Governance Report

Board and Governance continued

Board evaluation

An external evaluation of the Board and its Committees was due to take place in 2017 however, as stated on page 88, the Board determined that, due to the number of new Non-Executive Directors appointed in the latter half of 2017, it would be sensible to allow the new Directors time to settle into their new roles before arranging an external evaluation.

The 2017 Board evaluation process was conducted internally, led by the Chairman and facilitated by the Group General Counsel and Company Secretary. A comprehensive questionnaire evaluating the performance of the Board and each of its Committees was completed by all Directors. The evaluation covered a number of areas including: Board structure, Committees and their operation; induction and development; interaction with the business; and risk management and internal control. In addition, the Non-Executive Directors, led by the Senior Independent Director, together with views from the Executive Directors, conducted the performance evaluation of the Chairman who was found to be stewarding the Board effectively.

Following completion of the evaluation, the Board discussed the outcome of the questionnaire in detail. The results of the evaluation concluded that, overall, good progress had been achieved in most areas identified in previous evaluations and that the Board, together with its Committees, had continued to work effectively. However, the Board identified the following areas of improvement to be considered in 2018:

- Provide new members of the Board with additional background briefings ahead of discussions on strategy at Board meetings;
- Arrange more discussion at Board meetings in relation to medium and long term measures to be achieved from the Group's strategy and to improve the content of discussions focused on strategy and growth;
- Further discussion surrounding Executive succession plans (in particular the role of the Chief Executive) and ensuring the Board and its Committees continue to work effectively following the departure of the Chief Operating Officer;
- Review how the Board engage with shareholders; and,
- The Chairman, with the Group General Counsel and Company Secretary, to re-evaluate the Board training agenda.

In advance of the scheduled external evaluation of the Board in 2018, a number of options and priorities will be considered to support continued transparency and best practice.

Appointment, induction and training

The Chairman is responsible for ensuring that an appropriate induction is given to new Board members. The induction programme is specifically tailored to the needs of the incoming Director and includes circulation of the Board policies and procedures, meetings with senior management and contract site visits. During 2017, the Directors received advice and training on the following:

- Regulatory developments and changes to the UK Listing Rules and Corporate Governance;
- Training on inside information, including the Market Abuse Regulations (MAR) 2016;
- Anti-bribery and corruption;
- Money laundering;
- Crisis management; and,
- Update on new accounting standards i.e. IFRS 9, 15 and 16.

External Directorships

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

During the year, Angus Cockburn held the position of Non-Executive Director of GKN plc and was appointed as Senior Independent Director of GKN plc with effect from 20 February 2018.

Conflicts of interest

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

Serco's approach to managing business risks and internal control

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

Internal controls and key processes are defined within the Serco Management System (SMS) together with clear definitions of those individuals responsible for ensuring compliance. To provide management assurance that these controls are effective, a 'three lines of defence' compliance model has been implemented to test business compliance. The Group's Compliance Assurance Programme defines and reports on second line of defence compliance activity and the Internal Audit Programme defines and reports on Internal Audit activity which forms part of the third line of defence.

First line of defence – We seek to minimise the probability and impact of business risks through the consistent implementation of the SMS, seeking to ensure that appropriate processes and controls are in place, and that appropriately trained staff seek to ensure that customer, legal and regulatory requirements are being adhered to, and if not, that adequate plans are in place to mitigate. In 2017 we completed the annual SMS self-assessment process for the third time to enable Contract Managers and other Leaders across the Group to self-assess their compliance with SMS requirements. Self-assessment recipients are now working to address any gaps identified, through the completion of action plans. While SMS controls are designed to mitigate and minimise business risks, these risks cannot be completely eliminated. Consequently, while SMS controls can provide reasonable assurance against misstatement or loss, this cannot be absolute.

Roles and responsibilities – Functions, Divisions, Business Units and Contracts within the Group are responsible for identifying and managing risks in line with SMS policy and standards and for implementing associated controls.

Second line of defence – A Group Compliance Assurance Programme has been implemented which seeks to ensure that a consistent approach is applied across the Group in assuring compliance with key controls. There is a centrally mandated minimum requirement for each Division to include in their Compliance Assurance Plans, in order to address principal risks, which include a minimum sample of completed SMS self-assessments to be validated.

Roles and responsibilities – The Group Risk and Compliance Function is responsible for managing the SMS and for the development and implementation of policies and standards associated with Risk Management and Compliance Assurance. The Function is the custodian of the Group's Risk Register and provides risk management oversight, assurance and challenge. It is also custodian of the Group Compliance Assurance Programme, again providing oversight, assurance and challenge to ensure the Programme is risk-based and that material controls, mitigating the Group principal risks, are being effectively implemented.

Third line of defence – Together with external audits undertaken across the Group, Internal Audit provides an independent assessment of the design and operating effectiveness of the Group's governance, risk management and control frameworks that are in place to manage risk. The Internal Audit team carries out an annual programme of risk-based audits reporting findings to the Audit Committee. The audit programme is approved by the Audit Committee and is continually revised throughout the year to ensure it remains focused on appropriate areas. The in-house Internal Audit team uses PwC as a co-sourced resource where appropriate.

Roles and responsibilities – The Group Head of Internal Audit reports functionally to the Chair of the Audit Committee and is responsible for the delivery of the Internal Audit programme, ensuring that it is risk-based and aligned with the overall strategy of the Group.

The first and second line of defence is reviewed and challenged by the Executive Committee (and the Board), which undertake a review of the Group Risk Register and review individual risks as required.

The third line of defence is fully independent, with review and challenge carried out by the Audit Committee. The Board has overall responsibility for risk management and internal control (and is supported in these duties by the Group Risk Committee) and formally reviews the findings of the overall Internal Audit programme, via the Audit Committee.

The Board confirms that there has been a focus on the three lines of defence for the year under review and up to the date of approval of the 2017 Annual Report and Accounts.

Corporate Governance Report

Audit Committee Report

2017 Scheduled Committee Meetings	Attendance (eligibility)
Chairman	
John Rishton	5(5)
Committee Members	
Mike Clasper	5(5)
Rachel Lomax	5(5)
Lynne Peacock ¹	2(3)

¹ Lynne Peacock was unable to attend the August 2017 Committee Meeting due to an unavoidable scheduling conflict

Dear Shareholder

I am pleased to present the Committee's report for the year ended 31 December 2017 following my first full financial year as Chairman of the Committee. The Audit Committee has a fundamental role to play in reviewing, monitoring and challenging the effectiveness of the Group's financial reporting and internal control processes. Details of the work carried out by the Committee and in addressing significant issues are reported to the Board as a matter of course and are described in this report.

Committee's responsibilities

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

The Terms of Reference for the Committee were reviewed and amended this year to reflect the requirements of the UK Corporate Governance Code and the ICSA Guidance Note for Audit Committees. The Terms of Reference can be found on our corporate website www.serco.com

Membership and attendees

The Committee consists solely of Non-Executive Directors. The Board considers that each member of the Committee is independent within the definition set out in the UK Corporate Governance Code (the 'Code') and that, between them, the members of the Committee

In 2017, the Committee has continued to focus on the critical accounting judgements (especially Onerous Contract Provisions (OCPs), tax and pensions), the Finance Transformation programme, financial controls, the use of Alternative Performance Measures (APMs) and the reporting of exceptional items. In 2018, the Committee will continue to focus on the critical accounting judgements made (including OCPs) and financial controls, support the implementation of the Finance Transformation programme and will review the impact of new accounting standards, most notably IFRS 15 and IFRS 16.

I will be present at the 2018 AGM to answer any questions from shareholders on this report and the activities of the Committee.



John Rishton
Chair of the Audit Committee

21 February 2018

bring strong international, service and public sector expertise and experience which is highly relevant to the Company. John Rishton is a Fellow of the Chartered Institute of Management Accountants and has served as Chief Executive and Chief Financial Officer of large businesses, providing assurance to the Board that at least one member of the Committee has recent and relevant financial experience, as required by the Code. Biographical details for each member of the Committee are provided on pages 86 and 87.

The Committee met five times during the financial year. Attendance at these meetings is set out above. In addition to the members of the Committee, the Chairman, the Chief Financial Officer, the Group Financial Controller, the Head of Internal Audit, the Group General Counsel and Company Secretary and representatives of the Company's External Auditor, KPMG LLP, attended and received papers for each meeting. The Committee retain time at the end of each meeting to meet separately without management present and invite the Head of Internal Audit and KPMG LLP to attend for part of this session. The Committee also meet privately with the Chief Financial Officer.

Performance review

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

Activities of the Committee during the year

The Committee has an annual forward agenda developed from its Terms of Reference with standing items considered at each meeting in addition to any specific matters arising and topical business or financial items on which the Committee has chosen to focus. The work of the Committee in 2017 principally fell into three main areas:

Accounting, tax and financial reporting

- Reviewing the integrity of the half-year and annual financial statements and the associated significant financial reporting judgements and disclosures;
- Considering the liquidity risk and the basis for preparing the half-year and annual financial statements on a going concern basis, and reviewing the related disclosures in the Annual Report and Accounts;
- Considering the provisions of the Code regarding going concern and viability statements and reviewing emerging practice and investor comment;
- Reviewing updates on accounting matters and new accounting standards, including the new accounting standards on financial instruments (IFRS 9), revenue (IFRS 15) and leasing (IFRS 16);
- Reviewing the processes to assure the integrity of the Annual Report and Accounts as well as reviewing:
 - the management representation letter to the External Auditor;
 - the findings and opinions of the External Auditor;
 - the disclosures in relation to internal controls and the work of the Committee in discharging its responsibilities;
 - that the information presented in the Annual Report and Accounts, when taken as a whole, is fair, balanced and understandable and contains the information necessary for shareholders to assess the Group's position and performance, business model and strategy;

- the effectiveness of the disclosure controls and procedures designed to ensure that the Annual Report and Accounts complies with all relevant legal and regulatory requirements; and
- the process designed to ensure the External Auditor is aware of all 'relevant audit information', as required by Sections 418 and 419 of the Companies Act 2006.

Internal controls

- Assessing the effectiveness of the Group's internal control environment and making recommendations to the Board;
- Assessing the findings and directing the work of the Group's financial assurance function;
- Receiving reports from Internal Audit on the audit programme and resulting recommendations;
- In conjunction with the Group Risk Committee, considering the level of alignment between the Group's key risks and Internal Audit programme;
- Reviewing the proposed 2018 Internal Audit plan;
- Reviewing the adequacy of resources of the Internal Audit function and considering and approving the scope of the Internal Audit programme;
- Considering reports from the External Auditor on their assessment of the control environment.

External Auditor

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

Corporate Governance Report

Audit Committee Report continued

Financial controls and significant financial judgements

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

Financial control risk is monitored through one of the Group's Principal Risks, 'financial control failure'. The Committee has reviewed this risk during 2017 and has focused in particular on:

- The impact of the Group's ongoing Finance Transformation programme, with briefings received at every Committee meeting on the progress of the project;
- Updates to the risk mapping framework to document key financial control risks being managed by the Divisions and Business Units and the assurance activity undertaken to mitigate those risks;
- Reviews of the controls and judgements on the Group's balance sheet; and
- Management's review of the adequacy of the Group Finance function's first and second lines of defence.

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

During the year, the Financial Reporting Council ('FRC') wrote to the Company in relation to the thematic review of Alternative Performance Measures provided in the Company's annual report for the year ended 31 December 2016. No major financial reporting changes were identified however, some clarified descriptions and explanations have been included within the 2017 Annual Report and Accounts to provide greater transparency in relation to exceptional items, in particular the treatment and disclosure of restructuring costs.

The FRC's review only covered the specific disclosures relating to this thematic review and provides no assurance that the report and accounts are correct in all material respects; the FRC's role is not to verify the information provided but to consider compliance with reporting requirements.

Issue and Significance	How the Committee addressed this	Comments and Conclusion
Contract performance, including Onerous Contract Provisions (OCPs)		
As part of the 2014 Strategy Review, the Contract & Balance Sheet Review led to the establishment of material OCPs.	<p>The Committee has regularly reviewed and challenged Management's assumptions and main areas of judgement in relation to the performance of the Group's key contracts.</p> <p>The Audit Committee gives particular focus to material OCP positions and, with the support of the External Auditor, agreed that, while accounting for OCPs remained an area of judgement, the view formed by Management regarding each individual material OCP and the aggregate view was considered reasonable. As part of their review, the Committee also considered how the assessment of OCPs reflected other key judgements made by Management in respect of asset impairments, deferred tax asset recognition and future liquidity and viability</p>	<p>The Committee agreed with Management and the External Auditor that the overall level of provision was appropriate when taking into account the range of possible outcomes</p> <p>The Committee also concluded that the assumptions and judgements made by Management in the calculation of OCPs were consistent with those prepared by Management for forecasting future profitability and cash flows.</p>
Finance Transformation Programme		
Management has developed and commenced implementation of the Group's Finance Transformation programme. The new finance operating model relies on a new provider of finance function outsourcing and greater leveraging of centres of excellence using an outsourced finance model	<p>The Committee was briefed on the new finance operating model prior to implementation and has been updated on performance against the plan through the course of the year</p> <p>Through its oversight of the Finance Transaction programme the Committee considered the potential risks associated with the new finance operating model and challenged Management on the processes put in place to mitigate those risks.</p>	<p>The Committee concluded that the new finance operating model was appropriate and progress was in line with expectations</p> <p>The Committee were satisfied that Management has taken sufficient steps to mitigate the risks associated with the Finance Transformation programme.</p>

Issue and Significance	How the Committee addressed this	Comments and Conclusion
Use of Alternative Performance Measures (APMs)		
<p>The Group's performance measures continue to include some metrics which are not defined or specified under IFRS. In particular, following its introduction in 2015, Management continued to use Underlying Trading Profit, as a key measure to review current performance against the prior year by removing the impact of adjustments to OCPs, material charges and releases of other items identified during the 2014 Contract & Balance Sheet Review, together with other significant non-trading items.</p>	<p>The Committee considered whether the performance measures used by Management provided a meaningful insight into the results of the Company for its shareholders.</p> <p>The Committee reviewed the treatment of items considered as being exceptional and requiring separate disclosure.</p> <p>The Committee also reviewed the proposed disclosure of APMs in both the 2017 Half and Full Year results and the 2017 Annual Report ahead of their approval by the Board.</p>	<p>The Committee agreed with Management that Underlying Trading Profit continued to be a reasonable basis for the comparison of the performance of the business.</p> <p>The Committee also continued to support the judgements made by Management regarding the items considered as being exceptional and requiring separate disclosure. The Committee concluded that, in relation to the Half and Full Year 2017 results and the 2017 Annual Report, clear and meaningful descriptions had been provided for the APMs used. It was also concluded that the relationship between these measures and the statutory IFRS measures was clearly explained and supported the considered understanding of the financial statements.</p>
The Adoption of New Accounting Standards in 2018		
<p>During the year, Management performed an impact assessment of the two new accounting standards required to be adopted with effect from 1 January 2018. The new accounting standards are IFRS 9 regarding Financial instruments and IFRS 15 regarding Revenue from contracts with customers.</p> <p>Neither accounting standard is expected by Management to fundamentally change the presentation of the Group's previously published Financial Statements, but a detailed exercise was performed in order to arrive at this conclusion.</p>	<p>The Committee challenged the approach taken by Management and reviewed in detail with Management and the External Auditor the expected impact of the new accounting standards.</p> <p>Due to the significance of IFRS 15 the Committee members took part in an IFRS 15 education session held with the External Auditors and senior members of the Group Finance team.</p>	<p>The Committee were satisfied with the approach taken by Management and with the results of the impact assessment.</p> <p>The impact of IFRS 9 and IFRS 15 is disclosed within Note 2 of the Financial Statements.</p>
Goodwill Impairment		
<p>A key area of judgement made by Management in recent years has been in the assessment of the holding value of goodwill. In 2014, 2015 and 2016 Management proposed impairment charges and core to the assessment of the value of goodwill is Management's estimate of future cash flows. This estimate is dependent on circumstances both within and outside of their control, and discount rates that are adjusted to reflect the risks specific to individual assets. No impairment of goodwill has been identified in 2017.</p>	<p>The methodology and the results of the impairment testing were presented to the Committee and were subject to scrutiny and review. The Committee placed particular focus on changes in discount rates applied and ensuring that the underlying cash flows are consistent with the Board-approved forecasts.</p> <p>The Committee also reviewed the disclosures included in the financial statements to ensure that they provide an appropriate level of information to users.</p>	<p>The Committee were satisfied that the assumptions underlying the impairments made in the year were appropriate.</p> <p>Following review of the disclosures in the financial statements, the Committee concluded that the disclosures were transparent, appropriate and in compliance with financial reporting requirements.</p>

Corporate Governance Report

Audit Committee Report continued

Issue and Significance	How the Committee addressed this	Comments and Conclusion
Defined Benefit Pension Schemes		
The Group's defined benefit pension scheme obligations are an area of Management focus, in particular regarding the identification of obligations arising from customer contracts and the calculation of financial impact of any such liabilities.	The Committee considered both the process undertaken by Management to finalise the assumptions for the main schemes, and how these assumptions benchmark against the market. Advice was taken from independent actuaries on the appropriateness of the assumptions used	Following review, the Committee concluded that the process followed was appropriate and the resulting conclusions reached and calculations performed were appropriately balanced

Viability Statement

During the course of 2017, the Committee, along with the Board, has received general guidance from the FRC on preparing annual reports for the 2017/2018 reporting season, including suggestions regarding viability statements. The Committee has reviewed the 2017 Viability Statement in light of these comments and have addressed more specifically the justification of the time period over which the statement is based and the sensitivity and scenario testing performed.

The Viability Statement is set out on page 30.

Independent assurance

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

Internal Audit

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

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

Internal Audit gives particular regard to the ongoing evaluation of the efficacy of the Group's financial controls and reporting processes. Internal Audit is headed by the Group Head of Internal Audit who reports functionally to the Chair of the Audit Committee ensuring independence is maintained. Internal Audit work with a co-sourced partner, PwC, to supplement and enhance in-house skills and resources where required. During 2017, Internal Audit has delivered a full programme of audits making recommendations to management for improvements to risk, governance and controls. Reports have been discussed with the parts of business they relate to and management actions agreed have been tracked for progress. Key themes and management action progress have been included in regular written updates to the Audit Committee. Internal audits may focus on individual contracts, processes, functions or risk themes.

The 2018 Internal Audit programme will continue to focus on the key risks across the business including key risks around the Group's Finance Transformation programme as it progresses.

External Auditor

The Audit Committee manages the relationship with the Company's External Auditor on behalf of the Board. As a result of an external competitive tender process, KPMG LLP were appointed by the Board as the Company's external auditor for the 2016/2017 audit, the appointment being approved by shareholders at the 2017 AGM, and have served as the Company's auditor for one year. Since appointment, Stephen Wardell has served as audit engagement partner. In 2017, Stephen informed the Committee of his intention to retire from KPMG LLP and John Luke will replace him as the new audit partner in 2018. In accordance with the Audit Practices Board Ethical Standard 3, the Company will continue the practice of the rotation of the audit engagement partner at least every five years, and all other partners and senior management will be required to rotate at least every seven years.

The Audit Committee keep the assessment of the need to tender the auditor under ongoing review and the Company confirms that it complied with the provisions of the Competition & Markets Authority's 2014 Order on mandatory use of competitive tender processes and Audit Committee responsibilities. The Committee evaluates the effectiveness of the external audit annually, using feedback obtained from management associated with audits undertaken in Group Finance and in the Divisions and by assessing the performance of the External Auditor against a range of criteria including calibre of the audit team, knowledge of the Group, and the quality of planning, review, testing, feedback and reporting. The feedback received was reviewed by management and reported to the Committee. After taking these reports into consideration, the Committee concluded that the auditor demonstrated appropriate qualifications and expertise and remained independent of the Company, and that the audit process was effective.

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

It is proposed that KPMG LLP be re-appointed as External Auditor of the Company at the next AGM in May 2018 and, if so appointed, that they will hold office until the conclusion of the next general meeting of the Company at which accounts are laid. Further details are set out in the Notice of Annual General Meeting which is available on our corporate website www.serco.com

The Independent Auditor's report to shareholders is set out on pages 152 to 157.

Non-audit fees

The Committee believes that non-audit work may only be undertaken by the External Auditor in limited circumstances. The Committee monitors the non-audit fees. For the financial year ended 31 December 2017, the non-audit fees paid to KPMG LLP were £0.1m (2016: £1.3m, £0.5m of which arose prior to appointment). The majority of the fees related to either tax advisory, compliance services or other investigation-related matters. £36k of fees related to advisory services which had been engaged prior to KPMG LLP's appointment as auditors. An analysis of fees paid in respect of audit and non-audit services provided by the external auditor for the past two years is disclosed on page 190. The Committee regularly reviews the nature of non-audit work performed by the External Auditor and the volume of that work. Focus is given to ensuring that engagement for non-audit services does not (i) create a conflict of interest; (ii) place the auditor in a position to audit their own work; (iii) result in the auditor acting as a manager or employee; or (iv) put the auditor in the role of advocate for the Company.

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

Corporate Governance Report

Nomination Committee Report

2017 Scheduled Committee Meetings	Attendance (eligibility)
Chairman	
Sir Roy Gardner	5(5)
Committee Members	
Mike Clasper ¹	4(5)
Lynne Peacock ²	2(2)
Angie Risley ³	2(3)

1 Mike Clasper was unable to attend the January 2017 meeting due to an unavoidable scheduling conflict

2 Lynne Peacock joined the Committee with effect 1 November 2017.

3 Angie Risley was unable to attend the June 2017 Committee Meeting due to an unavoidable scheduling conflict and stepped down from the Board with effect from 15 September 2017

Dear Shareholder

The Committee led the process for Board appointments and made recommendations to the Board. In fulfilling this role, the Committee considered the diversity of and evaluated the balance of skills, experience, independence and knowledge on the Board.

During the year, the Committee reviewed the voluntary recommendations provided in the Hampton-Alexander Review on Women in Leadership Positions and the Parker Report into Ethnic Diversity and considered the voluntary recommendations when reviewing the Board Diversity Policy. Further details on our Board Diversity Policy are provided below.

Following the decision by Ralph Crosby, Tamara Ingram, and Angie Risley to stand down from the Board, I together with the Nomination Committee, continued to focus on refreshing the talent and experience on the Board and the search for new independent Non-Executive Directors which we commenced in 2016. Following that process, it led to the appointment of three new Non-Executive Directors. I am pleased to welcome Lynne Peacock, Ian El-Mokadem (appointed with effect from 1 July 2017) and Kirsty Bashforth (appointed with effect from 15 September 2017) to the Board. Lynne, Ian and Kirsty are settling in to their roles and have made valuable contributions to Board and Committee discussions. Lynne Peacock chairs the Remuneration Committee and is a member of the Audit and Nomination Committees. Ian El-Mokadem is a member of the Corporate Responsibility and Group Risk Committees and Kirsty Bashforth is a member of the Remuneration and Corporate Responsibility Committees. Further information concerning this process is provided in my report below.

I will be present at the 2018 AGM to answer any questions from shareholders on this report and the activities of the Committee.



Sir Roy Gardner
Chair of the Nomination Committee

21 February 2018

Committee's responsibilities

The Board values diversity and when recruiting new Board members the issue of diversity is addressed by the Committee, with particular regard to the percentage of women on the Board (which currently stands at 30% (2016: 22%)).

The key responsibilities of the Committee are:

- Reviewing the size, structure and composition of the Board;
- Recommending membership of Board Committees;
- Undertaking succession planning for the Chairman, Group Chief Executive and other Directors;
- Searching for candidates for the Board, and recommending Directors for appointment;
- Determining the independence of Non-Executive Directors;
- Assessing whether Directors are able to commit enough time to discharge their responsibilities;
- Reviewing induction and training needs of Directors; and
- Recommending the process and criteria for assessing the effectiveness of the Board and Board Committees and the contribution of the Chairman and individual Directors to the effectiveness of the Board and helping to implement these assessments.

The Terms of Reference for the Committee were reviewed and amended during the year to reflect the requirements of the UK Corporate Governance Code (the 'Code') and the ICSA Guidance Note for Nomination Committees. The Terms of Reference can be found on our corporate website www.serco.com

Membership and attendees

The Committee is comprised of solely independent Non-Executive Directors. The Board considers that each member of the Committee is independent within the definition set out in the Code. The Committee met on five occasions during the year and details of Committee membership and attendance at meetings is provided on page 102. Meetings of the Committee are normally attended by the Chief Executive, the Group HR Director and the Group General Counsel and Company Secretary. Biographical details for each member of the Committee are provided on pages 86 and 87.

Activities of the Committee during 2017

During the year the Committee's key activities included:

- The appointment of three new Non-Executive Directors – The Committee concluded the search for Non-Executive Directors commenced in 2016 following the resignation of Tamara Ingram and as part of the ongoing succession planning process for refreshing of the Board. Particular consideration was given to succession planning for the Remuneration Committee and for suitable candidates for succession of the Chair of the Remuneration Committee. The services of an external search consultant, Lygon Group, were retained to assist in identifying potential candidates. Lygon Group is independent and is also a signatory to the Voluntary Code of Conduct on Gender Diversity. The Committee agreed the specification and reviewed the proposed candidates against objective criteria (including diversity, ethnicity, cultural, professional and educational backgrounds) to ensure the selected candidates enhanced the skill set and strengthened the diversity of thought and experience on the Board. The Committee members then conducted interviews with shortlisted candidates before making recommendations to the Board. Lynne Peacock, Ian El-Mokadem and Kirsty Bashforth have all been through a comprehensive induction programme including contract visits and meetings with members of the Executive Committee and other key senior managers in Serco and its advisers.
- The appointment of a new Remuneration Committee Chair – During the search for new independent Non-Executive Directors, the Committee gave particular consideration to the search for, selection and appointment of a suitable successor for the position of Chair of the Remuneration Committee. The Committee as a whole agreed the specification and considered, after interviewing a number of candidates from an agreed short list, that Lynne Peacock, being a very experienced Chair of Remuneration Committees, would be a suitable successor to Angie Risley and unanimously recommended Lynne's appointment to the Board.

Corporate Governance Report

Nomination Committee Report continued

- **Developing the Board Diversity Policy** – Serco strongly supports the principle of boardroom diversity and values the benefits that diversity of thought can bring to its Board and throughout Serco and believes that a mix of expertise, experience, skills and backgrounds (including age, ethnicity, disability, gender, sexual orientation, religion, belief, culture, education and professional backgrounds) allows Serco to deliver a great service that is valued by our customers and meets the needs of those who use the services we provide. Serco will always seek to appoint board members and senior management on merit against objective criteria, including diversity. In developing the Board Diversity Policy, the Committee considered the voluntary recommendations provided in the Hampton-Alexander Review on Women in Leadership Positions and the Parker Report into Ethnic Diversity and recommended that the Board commit to improving gender and ethnic diversity on the Board and in the senior management roles within Serco. The Nomination Committee will review and assess the Board Diversity Policy annually and recommend any revisions to the Board for approval. Details of the Group's Gender Diversity Policy and how we support development of female talent within Serco are provided on page 73 of the 2017 Annual Report. The Board Diversity Policy is available on our corporate website, www.serco.com

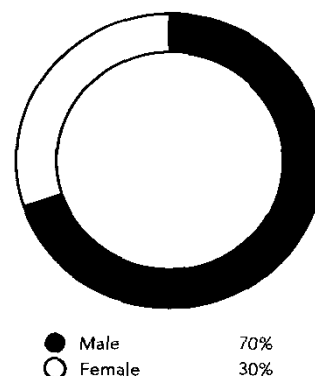
Performance review

The Committee's performance was assessed as part of the Board's annual effectiveness review. It was concluded that the Committee operated effectively however, it was felt that the Committee could improve its role around the following areas: to review the content of its annual agenda and training programme; further enhance the recruitment process for appointing new members of the Board and re-consider the format in which updates are provided to the Board following Committee meetings.

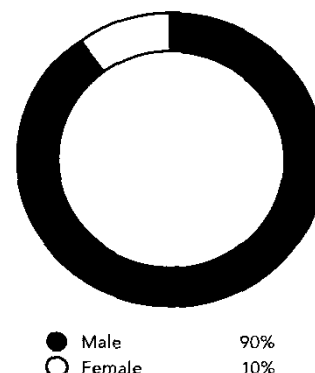
2018 priorities and focus

During 2018, the Committee will continue to focus on succession planning both at the Board and amongst senior management and continue to maintain the diverse composition of the Board.

Gender diversity: Board



Gender diversity: senior management



Corporate Governance Report

Corporate Responsibility Committee Report

2017 Scheduled Committee Meetings	Attendance (eligibility)
Chairman	
Mike Clasper	4(4)
Committee Members	
Sir Roy Gardner	4(4)
Ian El-Mokadem ¹	2(2)
Angie Risley ²	2(2)
Kirsty Bashforth ³	2(2)
Edward J. Casey Jr ⁴	4(4)

1 Ian El-Mokadem was appointed to the Committee on 1 July 2017.

2 Angie Risley resigned from the Committee on 15 September 2017.

3 Kirsty Bashforth was appointed to the Committee on 15 September 2017.

4 Edward Casey resigned from the Committee on 31 December 2017.

Dear Shareholder

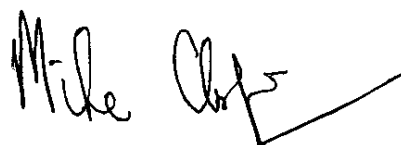
This year has been a busy year for the Corporate Responsibility Committee as we sought to align our Corporate Responsibility Framework (CRF) with the Group strategy and maintain engagement with the business to better understand some specific areas of safety and ethical risks.

During 2017, Serco's CRF has been redefined to better reflect the Group's strategy, what matters to us and the manner in which we conduct our business. The CRF defines our key corporate responsibility principles, reflects our inherent attitudes, guides our future behaviours and facilitates the measurement of our performance. The CRF is structured around Serco's key stakeholder groups and has at its core Our Values of Trust, Care, Innovation, and Pride which are central to everything we do. Agreeing the CRF is a significant step forward in providing

clarity in regards to corporate responsibility and its alignment to corporate strategy and will be the focus of future activities of the Committee.

Alongside this, the Committee has engaged with and received detailed briefings from Divisional CEOs on specific areas around safety and ethical risks. This included: the challenges faced by the Justice & Immigration business in regard to physical assaults and a range of positive initiatives being implemented by the business; Saudi Railways operations (with safety of the first passenger trains being a priority); the Anti-Bribery and Corruption toolkit trial in the UK; and, employee engagement around our Values following refinements to the culture index in our employee engagement survey, Viewpoint. During 2018, the Committee will continue to engage the business in all of these areas.

Finally, the year also witnessed a change in the membership of the Committee with the appointment of Ian El-Mokadem and Kirsty Bashforth. I would like to thank Angie Risley, who stepped down when she left the Board, for her valued contribution over a number of years.



Mike Clasper
Senior Independent Director and Chair of the
Corporate Responsibility Committee

21 February 2018

Corporate Governance Report

Corporate Responsibility Committee Report continued

Committee's responsibilities

The Committee is responsible for overseeing the Group's approach on all aspects of Corporate Responsibility. This includes the Group's ethics and business conduct; its treatment of its people; its contribution to the communities in which its people live and work; and its approach in managing its relationships with customers and suppliers.

The Committee also reviews and scrutinises the Group's continued approach to Corporate Renewal matters and also focuses on forward-looking corporate responsibility matters.

The Board has agreed that the Committee's focus will continue to be on the following four criteria:

- **Health and Safety** – while overall Health and Safety will remain a matter reserved by the Board, the Committee is charged with considering the Group's approach to Health and Safety in practice and will review in detail any key trends and patterns of behaviour that emerge, escalating any matters of importance to the Board.
- **People** – the Committee considers the Group's policies relating to its people and matters of relevance to its management of people, such as the Viewpoint survey and the Group's Human Rights policy.
- **Ethics** – the Committee reviews Speak Up reports; the Group's whistleblowing processes; and any relevant metrics or themes arising in relation to the Group's whistleblowing, bribery or fraud processes. Where relevant these matters will be considered in conjunction with the Group Audit Committee.
- **Corporate Responsibility Framework** – the Committee provides oversight, guidance and challenge on the implementation of the Group's Corporate Responsibility Framework and considers related policies and strategies on how the Group conducts its business and guards its reputation, including matters relating to human rights and slavery.

The Terms of Reference of the Committee were reviewed and amended during the year to reflect the requirements of the UK Corporate Governance Code and to update the Committee's reporting responsibilities. The Terms of Reference can be found on our corporate website, www.serco.com

Membership and Attendees

The Committee is comprised of both Executive and Non-Executive Directors. Details of Committee membership and attendance at meetings are provided on page 105. Biographical details for each member of the Committee are provided on pages 86 and 87. The Committee met on four occasions during the year. Meetings of the Committee are normally attended by the Group General Counsel and Company Secretary, the Director, Business Compliance and Ethics, and the Managing Director, Group Operations.

Activities of the Committee during 2017

During the year, the Committee's key activities included:

- **Changes to Committee membership** – The Committee concluded the search for Non-Executive Directors in 2017, and Ian El-Mokadem was appointed to the Committee on 1 July 2017 and Kirsty Bashforth was subsequently appointed to the Committee on 15 September 2017, following the resignation of Angie Risley;
- **The Committee reviewed and updated the Corporate Responsibility Framework** to ensure it reflected the Group's public purpose and responsibilities;
- **Health and Safety performance** – the Committee considered the Group's Health and Safety performance and reviewed health, safety and environment reports at each of its meetings. This included: lessons learnt and action plans from particular incidents; an overview of HSE governance and oversight; and specific initiatives to drive continuous improvement such as zero harm week, safety culture assessment and Just Culture;
- **HSE Deep Dives** – a series of deep analysis in the following areas: serious physical assaults, with a particular focus on UK Justice & Immigration; rail safety, the management of Saudi Arabia Railways where operations had expanded from running freight trains to running passenger trains; and aviation safety with a particular focus on operations within our FAA contracts in the US;
- **Ethics and Speak Up activities and performance** – the Committee reviewed reports detailing trends, resolution times, investigation outcomes, lessons learnt, implementation of the third party due diligence process. In addition, the Committee also considered the outcomes from the UK Anti-Bribery and Corruption toolkit and the Gifts and Hospitality and Conflicts of Interest registers;

- Corporate Renewal Programme – the Committee continued to review and progress its Corporate Renewal Programme including: the findings of the annual SMS self-assessment process; implementation and findings from compliance assurance; and ongoing contract management performance and reporting;
- Received a briefing on the Culture Index included within the Viewpoint engagement survey to monitor the ongoing culture of the Group; and
- Anti-Bribery and Corruption – the Committee reviewed the Anti-Bribery and Corruption procedures across the Middle East and UK & Europe Divisions.

Performance review

During the year, the Committee was assessed as part of the Board's annual effectiveness review. Following that review, the Committee concluded that the Committee was performing effectively however, it was felt that the Committee should review the content of its annual training programme, continue to consider the remit of the Committee and re-consider the format in which updates are provided to the Board following Committee meetings.

2018 priorities and focus

During 2018, the Committee will continue to focus on the embedding of the refreshed Corporate Responsibility Framework and undertake detailed deep-dive reviews into key areas within its remit to ensure that the appropriate focus, control and rigour remain in place throughout the Group.

Corporate Governance Report

Compliance with the UK Corporate Governance Code

For the year ended 31 December 2017, the Company has complied fully with the UK Corporate Governance Code with the exception of provision B.6.2. A copy of the Code can be found at www.frc.org.uk

The notes below are intended to assist with the evaluation of the Group's compliance during 2017 and forms part of the Corporate Governance Report as a whole.

A. Leadership

A.1 The Role of the Board

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

The Board meets formally on a regular basis. All Directors are expected to attend all Board and relevant Committee meetings in addition to general meetings of the Company, including the AGM. Details of the number of Board meetings held during 2017 and the Directors' attendance are shown on page 91

All Directors are covered by the Group's Directors' and Officers' Insurance policy

A.2 Division of responsibilities

The roles of the Chairman and Chief Executive are separate and full descriptions, including key responsibilities of each, are published on our corporate website www.serco.com

Sir Roy Gardner, the Chairman, leads and is responsible for the balance and composition of the Board and its Committees, and ensures its effectiveness in all aspects of its role. Rupert Soames, the Group Chief Executive, leads the business to develop and deliver the Group's strategy and business plans as agreed with the Board

A.3 The Chairman

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

A.4 Non-Executive Directors

Non-Executive Directors are urged to challenge constructively and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives, and monitor the reporting of performance. They are responsible for determining the remuneration of the Executive Directors and have a key role in the appointment and succession planning of Executive roles

Mike Clasper was Senior Independent Director throughout 2017. The responsibilities of the Senior Independent Director include meeting major shareholders as an alternative contact to the Chairman, Group Chief Executive or Group Chief Financial Officer. The role is clearly established and a description of the key responsibilities is published on our corporate website www.serco.com

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

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

B. Effectiveness

B.1 Composition of the Board

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

During the year as part of the Board's internal evaluation process, the Board reviewed the overall balance of skills, experience, independence and knowledge of Board and Committee members and their diversity, including gender.

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

B.2 Appointments to the Board

Lynne Peacock and Ian El-Mokadem were appointed as Non-Executive Directors on 1 July 2017. Kirsty Bashforth was appointed as a Non-Executive Director on 15 September 2017. The appointment was led by the Nomination Committee, who recommended all three appointments to the Board. Further details regarding the appointment process are available in the report of the Nomination Committee on page 102.

B.3 Commitment

The time commitment of Non-Executive Directors is defined on appointment and regularly evaluated. The Board is satisfied that the current external commitments of its Chairman, Senior Independent and other Non-Executive Directors do not conflict with their duties and time commitments as Directors of the Company. It is the Company's policy to allow each Executive Director to accept one non-executive directorship of another company

B.4 Development

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

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

During 2017, the Board received briefings from their advisers of relevant topics designed to update Directors' skills and knowledge in particular areas. A number of the Non-Executive Directors also undertook a programme of individual contract visits and Divisional management meetings to support familiarity with the Group's operations, and visit reports were shared with all Board members

B.5 Information and support

The Directors have full access to the advice and services of the Company Secretary and may obtain independent professional advice at the Company's expense if they believe it may be required in the furtherance of their duties.

The Company Secretary is responsible to the Board on a number of issues and full details on the Company Secretary's responsibilities are published on our corporate website www.serco.com. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

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

B.6 Evaluation

In 2017, performance evaluations of the Board, its Committees and individual Directors were carried out internally. Further details of the evaluation can be found on page 92.

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

External evaluation last took place in early 2015 and it is the Board's intention to carry out an externally facilitated evaluation in 2018.

B.7 Election/Re-election

Each Director is subject to election at the first AGM following their appointment, and re-election at each subsequent AGM. Accordingly Lynne Peacock, Ian El-Mokadem and Kirsty Bashforth will stand for election at the 2018 AGM. The Directors unanimously recommend the election/re-election of all Board members at the 2018 AGM. Full biographical details for all Directors can be found on pages 86 and 87.

C. Accountability

C.1 Financial and business reporting

A statement of the Directors' responsibilities regarding the financial statements, including the status of the Company as a going concern, is set out on page 150 with an explanation of the Group's strategy and business model together with the relevant risks and performance metrics set out on pages 13 to 29.

A further statement is provided on page 150 confirming that the Board considers that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

The Audit Committee report on pages 96 to 101 sets out the details of the Committee's responsibility for ensuring the integrity of the financial reporting process and the key matters considered during the year in respect of its oversight of financial and business reporting.

C.2 Risk management and internal control

The Board, through the Group Risk Committee, has carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. Further details about these risks and how they are managed and mitigated can be found on pages 20 to 29. The Viability Statement on page 30 explains how the Directors have assessed the prospects of the Company and concluded that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment.

The Board determines the Company's risk appetite and has established risk management and internal control systems. At least annually, the Board undertakes a review of their effectiveness. Further details are set out on pages 20 to 29 and 93 to 95.

C.3 Audit Committee and Auditors

The Audit Committee report on pages 96 to 101 sets out details of the composition of the Committee, including the expertise of members, and outlines how the Committee discharged its responsibilities during 2017.

The Board has delegated a number of responsibilities to the Audit Committee, including oversight of the Group's financial reporting processes and management of the External Auditor. Full details are set out in the terms of reference for the Committee, published on our corporate website www.serco.com.

D. Remuneration

D.1 The level and components of remuneration

The Remuneration Report on pages 110 to 143 outlines the activities of the Committee during 2017 and sets out the Directors' Remuneration Policy table, including relevant remuneration components and how they support the achievement of the strategic objectives of the Group. The Annual Remuneration Report outlines the implementation of remuneration during 2017 (including salary, bonus and share awards).

The Remuneration Policy will be put to a binding shareholder vote at the AGM in 2018 in accordance with the requirements of the UK Companies Act. The Board believes that the Group's proposed Remuneration Policy has a responsible approach to Directors' pay and that the Remuneration Policy as proposed is appropriate and fit for purpose.

D.2 Procedure

The Board has delegated a number of responsibilities to the Remuneration Committee, including the setting of the Group's overall remuneration policy and strategy, as well as the remuneration arrangements for the Executive Directors and the Executive Committee. Full details are set out in the terms of reference for the Committee published on our corporate website www.serco.com and the activities of the Committee are set out in the Directors' Remuneration Report on page 114.

No Director is involved in setting his or her own remuneration.

E. Relations with shareholders

E.1 Dialogue with shareholders

The Board recognises that meaningful engagement with its institutional and retail shareholders is integral to the continued success of the Group. The Executive Directors and the Investor Relations team regularly meet with analysts and major investors to maintain effective dialogue. The Chairman is available and has met with a number of major investors. Throughout 2017 there has been active engagement with shareholders through meetings, presentations and roadshows.

E.2 Constructive use of the AGM

The AGM will be held on Thursday 10 May 2018 and is an opportunity for shareholders to vote in person on certain aspects of Group business. The Board values the AGM as an opportunity to meet with those shareholders able to attend and to take their questions. The Notice of AGM is made available to all shareholders either electronically or, where requested, in hard copy and is available on our corporate website www.serco.com.

Remuneration Report

Report on Directors' remuneration

Remuneration linked to transformation for growth

Our revised remuneration policy aligns directors' reward with business performance and delivery of our strategic priorities.

Dear Shareholders

As the new Chair of the Remuneration Committee and on behalf of the Board, I am pleased to present my first Directors' Remuneration Report for Serco Group plc for 2017.

This report has been drafted in compliance with the disclosure requirements of the UK Corporate Governance Code and the requirements of the UKLA Listing Rules. This report also complies with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

Context to the Committee's decisions in the year

Since 2014 the business has been through a major transformation, with the setting of a new business strategy, a Rights Issue, disposal of several businesses, rationalisation of the portfolio and mitigation of loss making contracts. It is now a much stronger business, with a solid balance sheet and a restored reputation with customers.

Our overall remuneration framework has a number of specific objectives. It is designed to focus on value creation and share ownership to align the high calibre executives who were appointed in 2014, with the *completion of the transformation and the delivery of the outcomes committed to shareholders*. There are multiple considerations in the design of the overall framework. First and foremost is to ensure long term shareholder value creation and the Group's performance relative to sector peers. Second, is the balance of short-term and long-term incentives. Third, is the recognition of the Group performance and the *individual's specific contribution to this*, as well as the level of reward available to employees in the wider Group. Fourth, is to consider the precise numerical results through the lenses of both what management have contributed to what has been achieved and to the way this has been done, specifically ensuring the individuals embody the Serco Values of Trust, Care, Innovation and Pride in the way they do business.

Summary of key decisions for 2017

- Confirmation of 2017 vesting of the 2014 Performance Share Plan (PSP) elements which vested at nil as neither the EPS nor the relative TSR minimum performance requirements were met.
- Determination of vesting of Recruitment Awards granted to the CEO and CFO on joining Serco. The relative TSR elements did not vest as the minimum performance was not achieved. The Committee assessed each Director's performance against their Strategic Objectives and determined that, in each case, that element of the award should vest in full.
- Assessment of performance for the 2017 Annual Bonus. It was determined that the CEO should receive a bonus of 75.0% of maximum, the CFO a bonus of 75.3% of maximum, and the COO a bonus of 73.8% of maximum.
- Assessment of performance for the 2015 Deferred Bonus Plan (DBP) and 2015 PSP Awards with performance periods ending in FY17 and vesting in 2018.
- Determination of awards granted in April 2017 under the PSP and DBP Matching Share Awards granted in May 2017.
- Determination of nil salary increase for the CEO and CFO in 2018.
- Completion of a further review of Directors' Remuneration in conjunction with major shareholders.
- Determination of arrangements in connection with the cessation of employment of the COO from 31 December 2017. It was agreed that a bonus for 2017 would be paid on the normal date but that all unvested share awards would lapse in full.

Linkage of variable pay outcomes to performance measured in FY17

KPI	Plan	2017 performance	2017 incentive outcome
Trading Profit	Annual Bonus	£70.8m ¹	●
Revenue	Annual Bonus	2,832m ¹	○
Free Cash Flow	Annual Bonus	(£6.7m) ¹	●
Relative TSR	PSP	Below Median	○
Average ROIC	PSP	11.9%	●
Aggregate EPS	PSP & DBP	19.53p	●

Note

1 At constant currency.

○ Below Threshold
○ Between Threshold and Target
● Between Target and Max

In 2017 the Executive Team delivered a trading result in line with expectations, as well as over £3bn of order intake and a further improvement in employee engagement. The transformation of the business continues at pace and significant improvements have been delivered in efficiency and competitiveness. There was unanimous support for the decision to make awards to reflect the contribution that each member of the executive team has made to strengthening the business and position it for success.

Rationale for the 2018 remuneration policy requiring approval at the 2018 AGM

At the 2017 AGM, shareholders overwhelmingly supported the renewal of the current policy for a single year with a view to the Remuneration Committee undertaking a further review of policy during 2017. This allowed the new policy presented here to be aligned to the requirements of the third phase of our strategy implementation which begins in 2018. In undertaking the review the Committee took into consideration what was appropriate for the business as we move into the 'enabling growth' phase of the business transformation, as well as considering feedback from investors, best practice and market practice, and the key principles of good corporate governance. Our aim was to ensure remuneration remains aligned with our key corporate goals and shareholders' expectations, and that it motivates and compensates senior management fairly for their contribution to the business.

As a result of the review, and following consultation with our major shareholders, the Committee has made a number of changes to the remuneration framework.

The removal of the Deferred Bonus Plan (DBP) Share Matching Plan and revisions to the suite of performance conditions for PSP awards will:

- more closely align executive remuneration with that for sector peers by significantly reducing the overall quantum for variable pay (from 500% to 375% maximum opportunity for the CEO, with a similar reduction for the CFO);
- deliver a reduction of 20% in total maximum pay opportunity for the CEO and 19% for the CFO;

- strengthen alignment with the business strategy through the balance of short and long term reward and the choice of performance measures; and
- simplify our remuneration arrangements to one long-term incentive plan.

This reduction in maximum earnings opportunity is being made against the context of the fourth consecutive year of no change to base pay for the CEO or CFO. With the COO role not being replaced and the additional responsibility being taken on at Executive Director level by the CEO and CFO, the overall result is a significant reduction in total cost of Executive Director pay. Serco is fortunate to have not only a high calibre Executive team but also one which understands the context in which we operate and therefore support the changes.

PSP awards to be granted from 2018 onwards will maintain the emphasis on the achievement of financial metrics but permit up to 25% of the PSP to be linked to key non-financial, strategic, KPIs that are clearly aligned to our strategy and are crucial to the delivery of sustainable growth. These KPIs will represent core areas where achievement can be tested and evidence-based. For 2018, the first year of operation, the Committee has concluded that a weighting of 15% for strategic measures and 85% for financial measures is appropriate. A higher weighting of up to 25% may apply in future years of operation.

The introduction of mandatory three year deferral into shares of all bonus earned above 100% of salary (with no matched opportunity) further reinforces the link between reward and sustained long-term performance. In line with the policy approved at the 2017 AGM, under the 2018 remuneration policy all elements of variable pay are subject to clawback provisions.

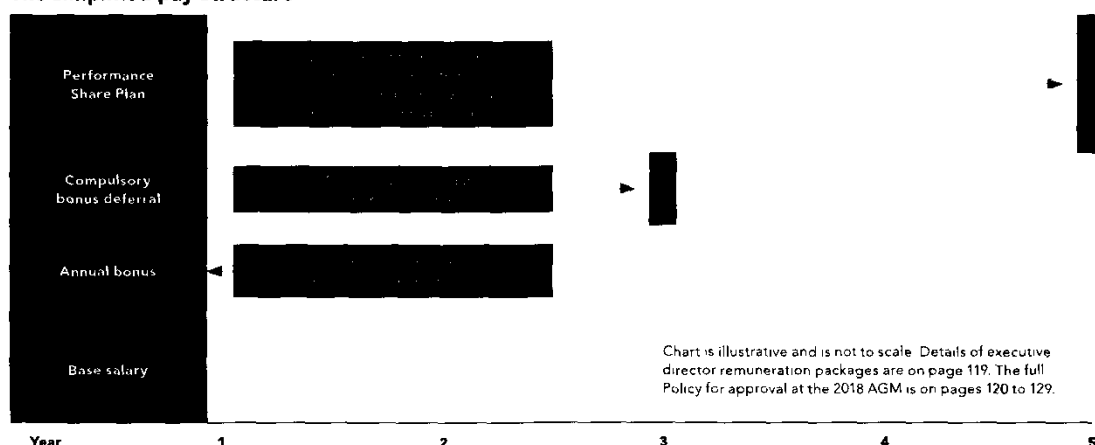
Remuneration Report continued

Rationale for the 2018 remuneration policy requiring approval at the 2018 AGM continued

Finally, to ensure continued good governance of remuneration, we will introduce further "best practice" measures, including the reduction of maximum pension contributions to 20% of salary for new Executive Directors.

Much thought was given to the balance of focus on short and long term delivery which are equally important to the Group's future success. A small increase in maximum opportunity under the short term incentive, combined with the introduction with mandatory deferral into shares for a further three years of any bonus earned over 100% of salary, strengthens the link between reward and achieving critical targets in the short term whilst maintaining a focus on longer term, sustainable, growth.

The simplified pay structure



How our simplified variable pay structure aligns to the core KPIs for 2018

Core KPIs		Annual bonus	PSP
Financial	Non-financial		
Trading Profit		•	
Revenue		•	
Free Cash Flow		•	
	In-year non-financial objectives	•	
Relative TSR			•
Average ROIC			•
Aggregate EPS			•
	Growth-aligned strategic objectives		•

Shareholders' approval is requested for the revised Remuneration Policy.

Concluding comments

On behalf of my colleagues on the Committee, we appreciate the input we have received from shareholders and representatives of institutional investors, whose comments have shaped the refresh of our Policy. The Committee believe that the recommended changes will ensure our arrangements are appropriate given the context in which Serco operates as a trusted partner of government; that our highly effective executive management team are rewarded for completing the transformation and are incentivised to move forward to restoring growth, margins and returns of the business.

On behalf of the Board

LM Peacock

Lynne Peacock

Chair of the Remuneration Committee

21 February 2018

The Remuneration Committee

The role of the Committee is to determine and recommend to the Board a fair and responsible remuneration framework for ensuring that the executive management team are rewarded and incentivised appropriately for their contribution to Group performance. The Committee's primary focus is to ensure a clear link between reward and performance. This means ensuring that the policy, structure and levels of remuneration for Executive Directors reinforce the strategic aims of the business and are appropriate given the market context in which Serco operates.

The Committee's composition, responsibilities and operation comply with the principles of good governance as set out in the UK Corporate Governance Code, with the Listing Rules and with the Companies Act 2006. The Terms of Reference of the Committee, a copy of which can be found on the Group's website at www.serco.com/about/the-board-and-governance, are reviewed annually to ensure that they remain appropriate. The Committee conducted an annual assessment of its own performance in accordance with the annual effectiveness review of the Board. Following that review, the Committee concluded that it is fully effective in respect of its Executive and Chairman Remuneration duties with consideration being given as to how it may widen the scope to include a greater understanding of employee benefits and to further collate employee views around pay and benefits at Serco.

Members of the Committee and attendees

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.

2017 Scheduled Committee Meetings	Attendance (eligibility)
Chairman of the Remuneration Committee	
Angie Risley ¹	4(4)
Lynne Peacock ²	3(3)
Committee Members	
Sir Roy Gardner ³	3(5)
Mike Clasper ⁴	2(4)
John Rishton ⁵	5(5)
Kirsty Bashforth ⁶	1(1)

Notes

- 1 Angie Risley resigned from the Board on 15 September 2017. Chair of the Remuneration Committee 14 May 2012 – 15 September 2017.
- 2 Lynne Peacock joined the Committee on 1 July 2017. Chair of the Remuneration Committee from 15 September 2017.
- 3 Sir Roy Gardner has been a Member of the Committee since 1 June 2015. He was unable to attend the September 2017 and December 2017 Committee Meetings due to unavoidable scheduling conflicts.
- 4 Mike Clasper was a Member of the Committee from 1 August 2016 until 4 December 2017. Mike was unable to attend the May 2017 and September 2017 Committee Meetings due to unavoidable scheduling conflicts.
- 5 John Rishton has been a Member of the Committee since 13 September 2016.
- 6 Kirsty Bashforth has been a Member of the Committee since 15 September 2017.

Remuneration Committee attendees during the year	Position	Comments
Rupert Soames	CEO	Attended by invitation
Angus Cockburn	CFO	Attended by invitation
Geoff Lloyd until August 2017/ Anthony Kirby from October 2017	Group HR Director	Attends as an executive responsible for advising on the People Strategy
Tara Gonzalez	Group Reward Director	Attends as an executive responsible for advising on the Remuneration Policy
David Eveleigh	Group General Counsel & Company Secretary	Attends as the secretary to the Committee
Elaine Richardson until May 2017	Deputy Company Secretary	Attends as the secretary to the Committee
Chandrika Kher from May 2017		
PricewaterhouseCoopers LLP	External advisor to the Remuneration Committee	Attends as the independent advisors to the Committee

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

Remuneration Report *continued*

Summary of the Committee's activities during the financial year

Meeting	Regular items	Ad hoc items
February	Considered feedback from the shareholder consultation on the 2016 Policy Review; considered base pay of Executive Directors and members of the Executive Committee; considered previous year's performance against targets and confirmation of any bonus payable; review of achievement of performance conditions for the LTI vesting in respect of awards granted in 2014; set performance targets and objectives for 2017; review the draft of the 2016 Remuneration Report.	Considered accelerated vesting of PSP awards for death in service case; considered Executive Committee terms and conditions for new hires; reviewed wider employee arrangements and conditions across the Group.
May	Considered administrative changes to the PSP Rules and the Share Dealing Code; considered basis for the Policy Review to inform the revised Remuneration Policy; considered AGM voting outcomes; reviewed the achievement of performance conditions for the Recruitment Awards granted in 2014.	Updates on Executive Committee appointments and exits.
August	Considered the 2017 Policy Review and recommendations for a new Remuneration Policy.	
September	Considered proposals for the revised Remuneration Policy; reviewed the achievement of performance conditions for the Recruitment Awards granted in 2014; considered the reporting requirement of the UK Gender Pay Gap regulations.	Considered amendments to the taxable benefits received by NEDs.
December	Reviewed proposed approach to structure of the Remuneration Report; reviewed its own Terms of Reference which were amended to reflect the UK Corporate Governance Code and the ICSA guidance note for effective remuneration committees; reviewed the Committee's annual programme of work.	Considered feedback from major shareholders and investor advisory bodies regarding proposed changes to the Remuneration Policy. Considered the detail of reporting under the UK Gender Pay Gap regulations. Considered the cessation of employment arrangements for COO Ed Casey.

Advisers to the Remuneration Committee

The Committee has been advised during the year by PricewaterhouseCoopers LLP (PwC). PwC were selected as advisers to the Committee through a competitive tendering process in 2012 and no conflicts of interest were identified. PwC have provided advice throughout the year mainly around the following key executive reward areas:

- advice on the review of the Remuneration Policy;
- support in reviewing the Directors' Remuneration Report;
- informing the Committee on market practice and governance issues; and
- assistance with general and technical reward queries.

The advisers attended each meeting of the Remuneration Committee. Consulting services have also been provided to the Group by PwC in relation to the 2017 Policy Review and pay and benefits data.

Fees paid to PwC as advisers to the Committee during the year totalled £69,100. Fees are charged on an hourly rate basis.

PwC are members of the Remuneration Consultants' Group, which oversees the voluntary code of conduct in relation to executive remuneration consulting in the UK.

The Committee reviews the objectivity and independence of the advice it receives from PwC each year. It is satisfied that PwC is providing robust and professional advice. In the course of its deliberations, the Committee considers the views of the Chief Executive on the remuneration and performance of the other members of the Executive Committee.

At a glance: implementation of the Remuneration Policy for 2018

The following charts illustrate the value that may be delivered to the Executive Directors under different performance scenarios for the year ending 31 December 2018. Also shown, for comparison, is the actual value delivered in the year ended 31 December 2017 (excluding the value received from Recruitment Awards vesting in the year) along with a comparison of the value that could have been delivered under the previous policy.


Rupert Soames (£'000s)**Angus Cockburn (£'000s)**

The scenarios in the above graphs are defined as follows:

- Fixed elements of remuneration
 - Base salary as applicable from 1 April 2018
 - Estimated value of benefits to be provided in 2018 in line with the Remuneration Policy (based on the value of actual benefits provided in 2017)
 - Pension contribution/cash supplement equal to 30% of salary
- Annual bonus and Performance Share Plan participation as set out in the Policy table. In all cases, Target performance results in delivery of 50% of maximum opportunity. The Performance Share Plan values reflect the "face value" at grant of shares that could be received for target and maximum performance.

Remuneration Report continued

Implementation of the Remuneration Policy for 2018 – Executive Directors

Element	CEO (Rupert Soames)	CFO (Angus Cockburn)
Base salary from 1 April 2018	£850,000	£500,000
Pension	30% of salary	30% of salary
Annual bonus	Max. 175% of salary On-target 87.5% of salary Compulsory three year deferral into Serco shares of bonus over 100% of salary	Max. 155% of salary On-target 77.5% of salary
Annual bonus measures¹	 <p>70% financial 30% non-financial</p>	
Performance Share Plan (PSP)	Maximum 200% of salary	Maximum 175% of salary
PSP measures² Assessed over the three year performance period	<p>Awards granted under the PSP in 2018 will be subject to Group performance over a three year period ending 31 December 2020:</p> <p>For 2018, 85% of the award will be based on financial measures split equally between:</p> <ul style="list-style-type: none"> • Aggregate EPS – Statutory Earnings Per Share (EPS) before exceptional items (adjusted to reflect tax paid on a cash basis), measured as an aggregate over the performance period. • Relative TSR – Total Shareholder Return (TSR) when ranked relative to companies in the FTSE250 (excluding investment trusts). • Average ROIC – Pre-tax Return on Invested Capital (ROIC), measured as an average over the performance period. <p>For 2018, the remaining 15% will be based on Strategic Objectives. Performance targets for the awards granted in 2018 will be based on improvements in order book and employee engagement, which are critical to delivering the business strategy over the next three years. For 2018, the first year of operation of strategic objectives within the PSP, the Committee has concluded that a weighting of 15% for strategic measures and 85% for financial measures is an appropriate balance.</p>	
Holding requirement	Vested shares from the PSP must be held for two years post vesting (after payment of tax).	
Shareholding guideline	200% of salary	150% of salary
Malus and clawback	<ul style="list-style-type: none"> • Malus provisions and clawback provisions apply to PSP awards during the three-year performance period prior to vesting and the two-year post-vesting holding period respectively. • Clawback provisions will apply to the annual bonus plan. 	

Notes

- 1 The Committee deems the specific details of the performance measures and targets to be commercially sensitive as they are intrinsically linked to the forward-looking strategic plans of the business. Full disclosure will be provided in the Annual Report on Remuneration for the year in which final performance is assessed provided these details are no longer considered sensitive.
- 2 The Committee sets the performance targets in respect of the PSP immediately prior to the grant of the award and therefore these are not yet determined. Details of the performance targets will be disclosed in the Annual Report on Remuneration for the year in which the awards are made to the extent that they are not deemed commercially sensitive at that time. Full retrospective disclosure will be made of any details that are withheld once this information is no longer deemed commercially sensitive by the Committee.

Implementation of the Remuneration Policy for 2018 – Non-Executive Directors

Role	Base fee to apply from 1 April 2018 £	Base fee 1 April 2017 £	Percentage change
Element – Annual Board and Committee fees			
Chairman	250,000	250,000	No change
Senior Independent Director	25,000	25,000	No change
Board fees	50,000	50,000	No change
Audit Committee Chairmanship	12,500	12,500	No change
Audit Committee Membership	5,000	5,000	No change
Corporate Responsibility Committee Membership ¹	5,000	N/A	New fees
Group Risk Committee Chairmanship	15,000	15,000	No change
Group Risk Committee Membership	8,000	8,000	No change
Remuneration Committee Chairmanship	10,000	10,000	No change
Remuneration Committee Membership	5,000	5,000	No change
Element – travel allowance			
Allowance for travel to international meetings	5,000	5,000	No change

Note

1 In line with the Policy approved at the 2017 AGM, a fee of £5,000 per annum will be introduced for Membership of the Corporate Responsibility Committee to apply from 1 April 2018

No additional fee is payable for Chair of the Corporate Responsibility Committee, or for the Chair or Membership of the Nomination Committee. In addition, in 2017 no fees were payable for Membership of the Corporate Responsibility Committee.

Remuneration Report continued

Directors' Remuneration Policy

For approval at the 2018 Annual General Meeting

The Directors' Remuneration Policy (the Policy) will take legal effect from the conclusion of the 2018 Annual General Meeting (AGM) subject to shareholder approval at the 2018 AGM.

As set out in the Chair's Letter, as we move into the 'enabling growth' phase of the business transformation the Committee has undertaken a complete review of Directors' remuneration with a view to ensuring that the Remuneration Policy is aligned to the strategic requirements of the business going forward. The Remuneration Policy review also sought to simplify the overall remuneration of Directors' and to address concerns from some shareholders in connection with the long term incentive arrangements in particular.

In the tables and narrative below, we have set out details of each element that may comprise the remuneration package of a Director, what the opportunity is under that element, and how each element supports the business and aligns the interests of the Directors' with the wider stakeholders, including shareholders, in the Company.

The approved Directors' Remuneration Policy as approved at the 2017 AGM is displayed on the Company's website, in the investor area.

The provisions in the Directors' Remuneration Policy as approved at the AGM in 2017 that relate to the Deferred Bonus Plan will continue to apply to all awards made under this plan prior to the approval of the new Policy at the AGM in 2018.

Remuneration Policy

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

- Support Serco's long-term future growth, strategy and values;
- Align the financial interests of executives and shareholders;
- Provide market-competitive reward opportunities for performance in line with expectations and deliver significant financial rewards for sustained out-performance;
- Enable Serco to recruit and retain the best executives with the required skills and experience in all our chosen markets; and
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

We approach Executive Directors' remuneration on a total reward basis to provide the Remuneration Committee with a view of total remuneration rather than just the competitiveness of the individual elements. Analysis is conducted by looking at each of the different elements of remuneration (including salary, annual bonus, performance share plan and pension) in this context. This ensures that in applying the Remuneration Policy executive pay is sufficient to achieve the goals of the Remuneration Policy without paying more than is necessary. The balance of fixed to variable pay also ensures that significant reward is only delivered for exceptional performance.

This remuneration framework is echoed throughout the organisation with the approach to pay for the wider workforce reflecting these core principles.

Features of the 2018 Remuneration Policy

The remuneration package for Executive Directors continues to consist of base salary, annual bonus, a long-term share-based incentive, pension and other benefits. The Group's policy remains to ensure that a significant proportion of the package is related to performance, with the relevant performance measures aligned to the core requirements of the Group's forward-looking strategy. As set out in the Chair's Letter, changes have been made to ensure alignment with the Group's strategy as we enter the enabling growth phase of the transformation; to address areas of concern and deviations to current accepted remuneration practice; and to ensure the new policy is fit for the future success of the business. A summary of the changes to the 2017 Policy (as approved at the 2017 AGM) is set out below:

Element in 2017 Executive Directors' Policy	Changes made for 2018
Base Salary	No change but we have restated the purpose and operation of this element for clarity.
Benefits	No change.
Annual Bonus	<p>Changes made to the maximum opportunity under this element and to introduce the compulsory deferral into shares of bonus earned over 100% of salary:</p> <p>CEO – increased from 150% of salary to 175%</p> <p>CFO – increased from 130% of salary to 155% of salary</p> <p>The performance framework has been restated for clarity.</p>
Deferred Bonus Plan	This element is no longer part of the Remuneration Policy for Executive Directors. This results in a reduction in the total variable pay opportunity of 125% of salary for the CEO (with a similar reduction for the CFO). The provisions of this element will continue to apply to Executive Directors' in respect of awards granted under this plan prior to approval of the 2018 Policy only (the last of which is anticipated to vest in May 2021).
Performance Share Plan	Formally rebalance the performance measures and introduction of Strategic Objectives to the suite of performance measures enabling a more holistic approach to ensuring reward is fully aligned to Company performance. Awards granted in 2018 will vest based on 85% equally weighted between TSR, EPS, ROIC and 15% on Strategic Objectives. The operation and other aspects of the performance framework have been restated for clarity.
Pension	Reduction in the maximum opportunity for new Executive Directors' from a maximum of 30% of salary to 20% of salary) and clarification of the operation of this element.
Shareholding guideline	No change.
Element in 2017 Non-Executive Directors' Policy	Changes made for 2018
Fees	No change.
Benefits and expenses	No change.

Remuneration Report continued

Future policy table – Executive Directors

For the avoidance of doubt it is intended that the new Directors' Remuneration Policy will apply in its entirety to all payments made to Directors' from the date of shareholder approval.

The following table sets out the proposed Executive Director Remuneration Policy to apply for three years following shareholder approval at the 2018 AGM. The 2018 Policy for Non-Executive Directors' can be found on page 128 and the table set out on page 124 provides further information of how pay policies are set for the broader employee population.

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
Base Salary			
To recognise an individual's experience, responsibility and performance of the role, and by providing the basis for a competitive remuneration package; to help recruit and retain executives of the necessary calibre to execute Serco's strategic objectives.	<p>Pay levels are designed to attract and retain experienced, skilled executives reflecting the skills and role of the individual.</p> <p>Base salaries are set by reference to:</p> <ul style="list-style-type: none"> the relevant experience and time in role of the individual; individual performance; compensation of similarly situated executives of companies in an appropriate peer group; and the wider economic environment. <p>In some circumstances an executive may start on a lower salary than would be competitive in the market, with a phased increase applying depending on performance in role and individual ability.</p> <p>Salaries are normally reviewed annually and any changes are usually effective from 1 April. Salary reviews take account of the individual's performance and contribution to the Company during the year.</p>	<p>Whilst there is no prescribed, formulaic maximum, over the policy period, base salaries for Executive Directors will be set at an appropriate level within the peer group and will normally increase at no more than the greater of inflation and salary increases made to the general workforce in the jurisdiction the Executive Director is based in.</p> <p>Higher increases may be made in exceptional circumstances. Such cases would include where there has been a significant change in role size or complexity which has resulted in the salary falling below a market competitive level given the enhanced responsibilities of the role.</p>	Review takes account of individual performance and contribution to the Company during the year.
Benefits			
To provide a competitive level of benefits.	<p>A range of benefits may be provided to Executive Directors. These include, but are not limited to, company car or car allowance, private medical insurance, permanent healthcare insurance, life cover, annual allowance for independent financial advice, and voluntary health checks every two years</p> <p>Relocation benefits will be provided in a manner that reflects individual circumstances and Serco's relocation benefits policy. For example, relocation benefits could include temporary accommodation for the executive and dependents, education costs for dependents and tax equalisation</p> <p>Benefits are reviewed annually against market practice and are designed to be competitive</p>	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	Opportunity	Performance framework
Annual Bonus			
<p>Incentivise Executives to achieve specific, predetermined goals that are aligned to the business strategy during a one-year period.</p> <p>Compulsory deferral into shares increases alignment of the short term incentive with shareholders</p> <p>Reward ongoing stewardship and contribution to core values.</p>	<p>The Committee sets objectives and their weightings at the start of each performance year. The annual performance measures and objectives are determined with reference to the Group's overall strategy and annual business plan and priorities for the year. At the end of the performance year the bonus result is determined by the Committee based on performance against the objectives and targets set.</p> <p>Annual bonuses are paid after the end of the financial year to which they relate. There is compulsory deferral into shares vesting after three years of any bonus earned over 100% of salary. The Committee has discretion to permit a dividend equivalent to accrue during the vesting period. Dividend equivalents are delivered to participants in the form of additional shares or cash to the extent that the award vests.</p> <p>Awards made to Executive Directors are subject to malus and clawback provisions. Further details are given below</p>	<p>Maximum bonus opportunity is 175% of salary for CEO and 155% of salary for other Directors. This represents the maximum bonus payable for exceptional/"stretch" performance.</p>	<p>Performance is assessed annually</p> <p>Both financial and non-financial measures are used, with a weighting of no less than 70% financial. Financial measures are based on the Company's Key Performance Indicators (KPIs) for the year such as Trade Profit, Cash Flow and Revenue and take into consideration analyst consensus and the Company's forecasts. Non-financial measures are based on personal performance against key strategic objectives for that year.</p> <p>Given the direct link of the performance measures and targets to the Group's strategic plan, the details of these are deemed by the Committee to be commercially sensitive and therefore are not disclosed in advance to shareholders. However, the Committee commits to full retrospective disclosure of the performance measures, targets and achievement of those targets following the end of the performance period and to the extent that this information is no longer commercially sensitive in respect of the non-financial strategic objectives.</p> <p>Awards for on-target performance are 50% of the maximum opportunity. At minimum (threshold) performance the award that may be received is 0% of the maximum opportunity.</p> <p>All bonus payments are ultimately at the discretion of the Committee, taking into consideration the Director's personal contribution to business performance over the relevant year and leadership behaviours demonstrated in making that contribution.</p> <p>Performance conditions do not apply to the deferred element.</p>

Remuneration Report continued

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
Performance Share Plan (PSP)			
Recognises achievement against the longer term objectives linked to the Group's strategy and aligns incentives with shareholder value creation.	<p>Awards under the PSP are usually made in the form of nominal cost options or conditional share awards, but may also take the form of nil-cost options or market value share options.</p> <p>Awards are normally granted on an annual basis. However, the Committee will consider awards under the PSP twice a year.</p> <p>Awards will be subject to performance conditions.</p> <p>Awards are typically settled in Ordinary Shares however, at the discretion of the Board awards may be converted to a cash equivalent based on the value of the shares at the vesting date (in cases where due to local law it is not possible to deliver shares), or subject to net settlement.</p> <p>The Committee has discretion to permit a dividend equivalent to accrue during the vesting period. Dividend equivalents are delivered to participants in the form of additional shares or cash to the extent that the award vests.</p> <p>Shares are subject to a two year post vesting holding period. During this time the shares must be retained but are not subject to forfeiture provisions. Shares may be sold in order to satisfy tax or other liabilities as a result of the vesting of the award.</p> <p>Awards made to Executive Directors are subject to malus and clawback provisions. Further details are given below</p>	<p>Maximum annual award of up to 200% of base salary for the CEO and 175% for other Directors.</p>	<p>Performance measures and weightings will be set by the Committee at the start of the three year performance period on the basis of the Group's strategic plan. At least 75% of the vesting of the LTIP is dependent on two or more financial performance conditions chosen from:</p> <ul style="list-style-type: none"> • EPS • TSR • ROIC <p>The Remuneration Committee has discretion to introduce additional financial measures aligned to the Group's strategy</p> <p>In addition, up to 25% of the LTIP vesting may be based on the achievement of strategic measures. The Remuneration Committee has discretion to restrict the vesting against the non-financial element if, on assessment of the Company's performance as a whole including the financial performance, the formulaic outcome of the non-financial measures is not reflective of this.</p> <ul style="list-style-type: none"> • EPS for these purposes is EPS before exceptionals and is an important measure of shareholder value which can also be influenced by executive decision-making. EPS targets are set in reference to analyst forecasts and Group business plans. <i>The Committee takes care to ensure that specific EPS targets are suitably stretching.</i> • Relative TSR reflects our performance relative to other companies in which investors could choose to invest. Relative TSR performance is measured against the constituents of the FTSE 250 as at the date of grant. As Serco is a constituent of the FTSE 250 it is felt that comparisons to the TSR performance of other companies in this index provides a good measure of the relative performance of Serco. • Maintaining an attractive return on capital is core to our business strategy therefore ROIC is included in the suite of financial measures for the PSP. Pre-tax ROIC targets are set in reference to analyst forecasts for cash flow and trade profit, and Group business plans, and are inclusive of joint ventures to more closely align management with shareholders. • Strategic Objectives must be measurable and capable of objective assessment. Strategic Objectives will be aligned to the achievement of key milestones in the implementation of the Group's strategy. The specific Strategic Objectives will be disclosed in the Annual Report on Remuneration following the grant of an award but, due to the direct link of the performance measures and targets to the Group's strategic plan, the details of these are deemed by the Committee to be commercially sensitive and therefore are not disclosed in advance to shareholders. However, the Committee commits to full retrospective disclosure of the performance measures, targets and achievement of those targets following the end of the relevant performance period and to the extent that this information is no longer commercially sensitive. <p>25% of the award vests for threshold performance rising on a straight-line basis to full vesting for maximum performance.</p> <p>The Committee (with input from the Audit and Group Risk Committees as appropriate) considers Serco's underlying performance and external market reference points as well as performance against the specific targets set in determining the overall outcome of the PSP</p>

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
Pension			
To provide pension related benefits to encourage executives to build savings for retirement.	<p>Executive Directors may participate in the Group defined contribution pension plan (or overseas Serco pension plan as appropriate).</p> <p>Employer contributions are reviewed against local market practices annually</p> <p>Executive Directors may choose to receive some or all of their employer pension contribution in cash to invest as they see fit.</p>	<p>Employer pension contributions (or the equivalent) and/or combined with a cash supplement of up to 30% of base salary</p> <p>The maximum employer pension contribution (or the equivalent), and/or combined with a cash supplement, for new Executive Directors will be up to 20% of base salary.</p>	None
Shareholding Guideline			
To support long-term commitment to the Company and the alignment of employee interests with those of shareholders.	<p>The Committee reviews the shareholding guideline with the Policy review to ensure the guidelines remain in line with market and best practice.</p> <p>Unvested awards that are subject to performance conditions are not taken into account in determining an Executive Director's shareholding for these purposes. Share price is measured as at end of the relevant financial year.</p> <p>Executives are required to retain in shares 50% of the net value of any performance shares vesting or options exercised until they satisfy the shareholding guideline.</p>	<p>The shareholding guidelines are 200% of salary for the CEO, and 150% of salary for other Executive Directors.</p> <p>The Committee has the discretion to increase the shareholding guideline of the Executive Directors.</p>	None

Malus and clawback

Malus and clawback provisions apply to awards under the annual bonus and PSP. Under the Policy, the Committee, at its discretion, may reduce or cancel (malus) or recover some or all of awards granted to Executive Directors in certain circumstances. Under the malus provisions the Committee may reduce or prevent vesting of an unvested Deferred Bonus or PSP award in circumstances including but not limited to: material misstatement of the Group's audited financial results; material or misleading results announcement prior to vesting; or a clear and material contravention of the Company's ethics and values on the part of the participant or a team member, team, business area or profit centre for which the participant is responsible.

In the most serious of these circumstances the Committee may also invoke the clawback provisions against vested awards under the PSP and annual bonus. The clawback must be implemented within five years of the grant of the relevant PSP award, and within two years in respect of bonus awards paid in cash, and five years from the grant date for the portion of the bonus delivered in shares.

Use of discretion

The Committee will operate the annual bonus plan and PSP according to their respective rules, as approved by shareholders, and in accordance with the Listing Rules, where applicable. The Committee retains discretion, consistent with market practice, in a number of areas with regard to the operation and administration of these plans.

Remuneration Report continued

Use of discretion continued

These include, but are not limited to:

- the participants;
- the timing of grant of an award;
- the vehicle of an award;
- the size of an award;
- the determination of vesting or bonus payment;
- discretion required when dealing with a change of control or restructuring of the Group;
- determination of the treatment of leavers based on the rules of the plan and the appropriate treatment chosen;
- adjustments required in certain circumstances (e.g. rights issues, corporate restructuring events and special dividends); and
- the annual review of performance measures and weighting, and determining the performance measures for the awards granted from year to year.

In relation to the PSP and annual bonus plan, the Committee retains the ability, in exceptional circumstances, to change performance measures, targets and/or the relative weighting of performance measures part-way through a performance period if there is a significant event (such as a major transaction or, in the case of the bonus only, a transition in role) which causes the Committee to believe the original performance conditions are no longer appropriate. In exercising this discretion the Committee will determine that the original conditions are no longer appropriate and the amendment is required so that the conditions achieve their original purpose and are not materially less difficult to satisfy. Any use of the above discretions would, where relevant, be explained in the Annual Report on Remuneration.

In exceptional circumstances the Committee also 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.

Considerations of employment conditions elsewhere in the Group

The Remuneration Policy described here 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 this philosophy has been cascaded below Executive Directors to achieve alignment with the remuneration strategy across the organisation.

Element	Difference in Remuneration Policy for other employees
Base salary	<ul style="list-style-type: none"> • The same principles and considerations that are applied to Executive Directors are, as far as possible, applied to all employees.
Benefits	<ul style="list-style-type: none"> • Serco has provisions for market-aligned benefits for all employees.
Pension	<ul style="list-style-type: none"> • The Group operates a number of defined benefit schemes and defined contribution schemes. Individuals who exceed certain pension tax allowances may be offered cash allowances in lieu of pension benefits.
Annual bonus	<ul style="list-style-type: none"> • Approximately 1,300 employees, including members of the Global Leadership Team, are eligible for a bonus award under Serco Bonus Plan.
Performance Share Plan (PSP)	<ul style="list-style-type: none"> • Annual awards under the PSP are made to approximately 370 employees in the Global Leadership Team.

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.

Consideration of shareholder views

As set out in the Chair's letter, we have consulted with our largest shareholders and received support and helpful comments which have been taken into consideration in shaping the future policy presented to you here. 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.

Approach to recruitment remuneration

Our overarching remuneration principles continue to apply in recruiting new hires or promotions to the Board – that is that we seek to offer a package that is sufficient to attract, retain and motivate while aiming to pay no more than is necessary. We take into account that, as a global business, Serco operates in diverse markets and geographies and many of its competitors for talent are outside the UK.

When hiring a new Executive Director, the Committee aligns the remuneration package on recruitment with the above Remuneration Policy incorporating all elements as set out above.

Base salary is set by the Committee taking into account all factors it considers relevant, including the Executive's 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.

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. Any new Executive Director would be offered either a pension contribution and/or a pension allowance equal to up to 20% of base salary.

As summarised below, the Remuneration Policy provides for a maximum combined total incentive under bonus and PSP of 375% of salary in any one year.

Element of remuneration	Maximum percentage of salary
Maximum variable pay:	375%
Normally comprising:	
• Annual bonus	175%
• PSP	200%

Note

1 Maximum percentage of salary for annual bonus and PSP excludes compensation for awards forfeited

This is the maximum level of incentives excluding any to compensate for entitlements forfeited 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).

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.

Remuneration Report continued

Approach to recruitment remuneration continued

Where a new Executive Director is an internal promotion, the Committee has discretion to allow the new Executive Director to continue to benefit from existing awards granted, or benefit entitlements (such as pension), that were in place 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.

The Committee will include in future Annual Reports on Remuneration details of the implementation of the recruitment policy in respect of any such recruitment to the Board.

Service contracts and loss of office payments

The policy for service contracts for new Directors is shown in the table below. Under this policy the Committee may 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 Executive Directors' service contracts and Chairman and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office. 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.

The date of appointment for each Director is shown in the table on page 129.

Provision for Executive Directors	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. 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 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' 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.

Provision for Executive Directors	Detailed terms
Treatment of annual bonus on termination	<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 unless in exceptional circumstances (e.g. in the case of death of the Executive) when the Committee determines to make the payment early. The Committee has discretion to reduce the entitlement of a 'good leaver' in line with performance and the circumstances of the termination. For new Executive Directors unvested deferred bonus share awards will lapse on cessation of employment except for 'good leavers'. 'Bad leaver' provisions will not apply to the existing Executive Directors in respect of unvested deferred bonus share awards on cessation of employment except in the event of termination relating to misstatement of results, misconduct or poor performance.
Treatment of unvested awards granted under the PSP¹	<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. Awards vest on the normal vesting date except in the case of the death of the participant when the Committee may accelerated the vesting to the date of death. 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. Bonuses may be paid on a pro-rata basis measured on performance up to the date of change of control. Unvested PSP awards and unvested share awards in respect of deferred annual bonus vest pro-rata for time and performance up to the date of change of control. For existing Executive Directors the unvested share awards in respect of deferred annual bonus will vest without time pro-rating.
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.

Notes

¹ 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 prorated 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 clawback provisions would continue to apply in the event that such discretion were exercised.

Remuneration Report continued

Service contracts and loss of office payments continued

Provision for NEDs	Detailed terms
Letters of appointment	<ul style="list-style-type: none"> Appointed for initial three-year term. Appointment may be terminated on three months' written notice. All Non-Executive Directors are subject to annual re-election.
Loss of office policy	<ul style="list-style-type: none"> No compensation or other benefits are payable on early termination.

Remuneration Policy for the Chairman and Non-Executive Directors

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
Fees 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 the 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"> Senior Independent Director 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>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 on page 117.</p>	Non-Executive Director fees are not performance-related.
Benefits and expenses	<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, all reasonable travel and business related expenses incurred in connection with carrying out their duties are reimbursed.</p>	The maximum travel allowance is £5,000 per occasion requiring inter-continental travel.	N/A

Non-Executive Directors are not entitled to receive incentives and pension. Non-Executive Directors are encouraged to hold shares in the Group but are not subject to a shareholding guideline.

Dates of Directors' service contracts/letters of appointment

Director	Date of appointment to the Board
Rupert Soames	8 May 2014
Angus Cockburn	27 October 2014
Ed Casey ¹	25 October 2013
Sir Roy Gardner	1 June 2015
Angie Risley ²	1 April 2011
Ralph D. Crosby Jnr ³	30 June 2011
Mike Clasper	3 March 2014
Rachel Lomax	3 March 2014
John Rishton	13 September 2016
Lynne Peacock	1 July 2017
Ian El-Mokadem	1 July 2017
Kirsty Bashforth	15 September 2017

Notes:

- 1 Ed Casey stepped down from the Board and left the Company on 31 December 2017
- 2 Angie Risley stepped down from the Board and left the Company on 15 September 2017
- 3 Ralph Crosby stepped down from the Board and left the Company on 1 July 2017

All Directors are put forward annually for re-election at the AGM.

Remuneration Report continued

Annual Report on Remuneration

The implementation of the Remuneration Policy for year ended 31 December 2017

The Remuneration Policy for the year ended 31 December 2017 was consistent with the policy approved by shareholders at the AGM in 2017.

Single Figure – Directors' remuneration (audited information)

Executive Directors' single figure

The following table shows a single total figure of remuneration in respect of qualifying services for 2017 for each Executive Director, together with comparative figures for 2016. Details of NEDs' fees are set out in the next section.

All figures in £	Rupert Soames		Angus Cockburn		Ed Casey ⁵	
	2017	2016	2017	2016	2017	2016
Salary	850,000	850,000	500,000	500,000	826,717	771,552
Taxable benefits ¹	33,126	24,258	37,624	40,310	106,887	102,541
Pension ²	255,000	255,000	150,000	150,000	243,210	228,376
Total Fixed Remuneration	1,138,126	1,129,258	687,624	690,310	1,176,814	1,102,469
Bonus ³	956,505	1,049,325	489,580	530,075	912,287	926,440
Long Term Incentives ⁴	1,710,294	37,983	580,968	30,559	–	–
Total Variable Remuneration	2,666,799	1,087,308	1,070,548	560,634	912,287	926,440
Total	3,804,924	2,216,566	1,758,172	1,250,944	2,089,101	2,028,909

Notes

- The value of the UK taxable benefits relate to the provision of independent financial advice, provision of a car or car allowance (fully inclusive of all scheme costs including insurance and maintenance), health care, private medical assessments and expatriate benefits. Ed Casey's 2017 benefits relate primarily to his expatriate status, including costs of £87,489 for accommodation while in the UK. Where Serco settles the PAYE and NIC liability in respect of benefits provided, the value of the benefit has been grossed up at the individual's marginal tax rate.
- 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. Ed Casey's value includes the Serco contribution to his 401K plan.
- Performance bonuses earned in the period under review, but not paid until the following financial year. During the year Rupert Soames and Angus Cockburn participated in the DBP by deferring 50%, and Ed Casey by deferring 35.6%, of their 2016 bonuses via the purchase of Investment Shares. Any deferral by Rupert and Angus of their 2017 bonuses, payable in 2018, will take place during 2018 and be reported in the 2018 DRR.
- This is the estimated or actual value of Long-Term Incentives for which the performance period ended in the year. Also included is the gain on vesting of Recruitment Awards vesting in 2017 for Rupert Soames and Angus Cockburn for which there were no performance conditions but which were not included in the single figure value for the year of grant. These awards were granted in compensation for non-performance based awards forfeited by Rupert and Angus on joining Serco, therefore no performance conditions applied to the vesting of these awards. The 2014 PSP Award, and the performance related Recruitment Awards granted to Rupert and Angus, that were subject to TSR performance (for which the performance period ended 22 February 2017) did not meet the minimum criteria and therefore these awards lapsed in full. Further details are provided on page 134.
- Ed Casey's remuneration is paid in US dollars and has been converted into GBP using the average exchange rate over the relevant financial year. For the purpose of the 2017 single figure USD 1 = GBP 0.77601. For the purpose of the 2016 single figure USD 1 = GBP 0.72672. The increase in the GBP value of Ed Casey's base salary and pension is due to the exchange rate difference between 2016 and 2017. His 2017 base salary and pension cash alternative were unchanged from 2016 (salary USD 1,061,690 and cash alternative of USD 306,306), with a small reduction in his employer 401K contribution to USD 7,103 in 2017 (USD 7,950 in 2016). His 2017 bonus is USD 1,175,609 (USD 1,274,824 in 2016).

The annual base salaries of the Executive Directors for the year ended 31 December 2017 were:

Director	Base salary	Effective Date	Increase
Rupert Soames	£850,000	8 May 2014	N/A
Angus Cockburn	£500,000	27 October 2014	N/A
Ed Casey	USD 1,061,690	1 April 2014	N/A

Variable pay outcomes (audited information)

Performance-related annual bonus

For 2017, the Executive Director bonus was based on achieving a mix of financial and non-financial objectives which were weighted 70:30 respectively. The financial measures were based on Trading Profit (40%), Free Cash Flow (40%) and Revenue (20%) and the non-financial measures were individually set and based on key strategic goals. Payments under the 2017 annual bonus were subject to an Underlying Trading Profit underpin (after adjustment for in-year Onerous Contract Provisions (OCP) items) of £60.4m at constant currency rates.

The Remuneration Committee reviewed the achievements against the targets for the year and the proposed annual incentive payments for the Executive Directors. The tables below show the achievement against the financial and non-financial measures.

Financial performance

Performance Measure	Weighting for 2017 (% maximum bonus opportunity)	Threshold target (£m)	Maximum target (£m)	Actual performance ¹ (£m)	Achievement against measure (% maximum opportunity for this measure)
Revenue	14%	£2,866	£3,073	£2,832	0%
Free Cash Flow	28%	£(38.2)	£(8.7)	£(6.7)	100%
Trading Profit	28%	£60.4	£72.4	£70.8	94%

Note

1 At constant currency

Non-financial performance

Weighting for 2017 (% maximum opportunity)	30%
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	Rupert Soames	Angus Cockburn	Ed Casey
Achievement against measure (% maximum opportunity for this measure)	69%	70%	65%

Overall 2017 bonus outcome

	Rupert Soames	Angus Cockburn	Ed Casey
Total bonus payable as % of maximum	75.0%	75.3%	73.8%
Bonus opportunity as % of salary	150%	130%	150%
Bonus amount achieved as % of salary	112.5%	97.9%	110.7%
Bonus amount earned	£956,505	£489,580	USD 1,175,609

For FY17, the Serco Bonus Plan in which Executive Directors participate was focused on three core measures which comprised 70% of the overall opportunity: Group Revenue, Group Trading Profit and Group Free Cash Flow. The remaining 30% of the opportunity is based on role-specific objectives related to the delivery of the business transformation.

Financial performance has been strong; on both Trading Profit and Free Cash Flow the achievements of the business over the year were in excess of the stretching targets set by the Committee at the beginning of the year and therefore these components have paid out at 94% and 100% of maximum respectively. The level of Revenue achieved over the period was below threshold and as such none of this component of the bonus was awarded.

The financial bonus outcomes have been calculated after appropriate adjustments, which were agreed at the beginning of the year as part of the target-setting process and in line with the approach disclosed in respect of 2016. The Committee has once again spent considerable time reviewing the Trading Profit calculation for bonus purposes, initially working with management to determine a robust approach to decision-making, informed by a review of each individual contract and with cross-referencing to information shared with the Audit Committee. The Company's external auditors verified the extraction of figures appearing in the accounts and those tabled for bonus purposes, followed by a formal sign-off by the Audit Committee on the numbers used to determine bonus payments prior to decisions being made by the Committee. As a result of the rigour applied to this process, the Committee is satisfied that the annual bonus out-turn fairly reflects management performance in the year.

Trading Profit of £54.0m is adjusted by the Committee to arrive at a figure for Trading Profit for bonus purposes; shareholders were consulted on the principles behind these adjustments in early 2015, and the bonus outcome for both 2015 and 2016 reflected these principles, the purpose of which is to ensure that management are measured against their in-year performance and are not given credit for gains for which they have not materially influenced. The Committee has applied 2017 in a consistent manner the principles established in 2015 and 2016.

Remuneration Report continued

Variable pay outcomes (audited information) continued

The first adjustment is to put Trading Profit into constant currency, so that it is consistent with the targets set at the beginning of the year; this is a £6.8m reduction. The Committee then considers items to properly reflect management effort and in-year operational performance. The Committee has concluded that a total of £23.6m should be added to Trading Profit in constant currency to arrive at a calculation of Trading Profit for bonus purposes in 2017; this compares with the £20.9m which was subtracted from Trading Profit in 2016. The main difference between the two years is that in 2016 there was an £11.8m net credit to Trading Profit related to Onerous Contract Provisions charges and releases which were excluded from Trading Profit for bonus purposes, whilst in 2017 there was a debit of £19.5m similarly excluded.

For the purposes of comparison the table below sets out the adjustments made by the Committee between Trading Profit and Trading Profit for bonus purposes in 2015, 2016 and 2017.

£'m	2017	2016	2015
Trading profit	54.0	100.3	137.6
Constant currency adjustment	(6.8)	(5.7)	7.7
Trading profit at constant currency	47.2	94.6	145.3
Adjustment for bonus purposes	23.6	(20.9)	(32.9)
Trading profit for bonus purposes	70.8	73.7	112.4
Underlying Trading Profit at constant currency	63.4	73.4	95.9

Non-Financial Performance

Rupert Soames

Rupert's objectives included:

- | | |
|---|---|
| <ul style="list-style-type: none"> • Improving Business
Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions. • Supporting Divisions in dealing with commercial issues and managing key relationships. • Supporting the Chairman to ensure the effective working of the Board. | <p>The Committee deemed performance to be very strong. Rupert has continued to show highly effective and visible leadership throughout 2017 and over the course of the last 12 months has delivered significant further progress in implementing the strategy and transformation. The Group signed contracts with a total value of £3.4bn during the year delivering a strong performance with the largest order intake since 2012. Over 30 contract awards were worth more than £10m each and the large value of the new business won resulted in this being approximately 70% of the total value signed, with the balance represented by secured extensions or re-bids of existing work. The Committee continue to monitor the successful embedding of values through the annual employee engagement survey "Viewpoint" which has shown the fourth successive year of improvement; engagement is a key determinant of the future success of the business. The Chairman regards the support Rupert has provided to him in ensuring the effective operation of the Board to continue to be first class. Based on Rupert's achievement the Committee has awarded an above target but below maximum performance for the non-financial element relating to these objectives.</p> |
|---|---|

Angus Cockburn

Angus's objectives included:

- Improving Business Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions.
- The development of a new Finance Operating Model.
- Improving the effectiveness and efficiency of the finance function through the Global Finance Transformation with a number of key milestones agreed at the start of the year which built on progress made in the previous year.

The Committee deemed Angus's performance to be very strong against all objectives. With profits at top end of expectations we set out some 15 months ago, net debt lower than we expected, fully funded pension schemes, and strong order intake, Angus made a critical contribution to delivering a solid performance in 2017 in a difficult market. Contract and Balance Sheet Onerous Contract Provision liability now stands at £168m, down from £220m in 2016 and £447m in 2014. Significant work has been undertaken to stress-test the Group's financial plan against key sensitivities within the Group's principal risks. The Global Finance Transformation has gathered pace and significant improvements have been made against the key milestones agreed at the start of the year. In terms of the Transformation Plan, operating costs reduced in proportion to the scale of revenue reduction; further shared services and overhead savings of around £20m were achieved, taking total overhead savings over the last three years to over £100m. Based on Angus's achievement the Committee has awarded an above target but below maximum performance for the non-financial element relating to these objectives.

Ed Casey

Ed's objectives focused on:

- Improving Business Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions.
- Continue to refine and embed Risk Management process and work to embed as part of our operational approach to running the business.
- Continue to strengthen "zero harm" HS&E culture and implement necessary changes to effect change. Deliver consistent measures across the Group, and achieve targeted reduction in accident rates.

The Committee deemed Ed's performance to be very strong. Ed made a significant positive impact on the development of the pipeline with £3bn of pipeline opportunities added over the course of 2017. The acquisition of BTP Systems was completed for USD 20m, bringing deep skills in defence satellite communication and radar engineering technical services, together with a pipeline of USD 200m. Significantly improved risk management processes and consistently improved reporting to the Group Risk Committee. In 2017 the policies relating to safe and healthy operations were reviewed and strengthened Group Standards with definitions of safety critical risks. Ed continued to build our health and safety focus across the Group; examples include in the UK, several Royal Society for the Prevention of Accidents Gold Awards won in 2017, including at RAF Fylingdales and Forth Valley Royal Hospital. Continuous improvement has been driven in health and safety across our businesses, including new tools and training in Serco Americas to reduce risks and improve safety management in air traffic control and naval engineering, and new tools in Serco AsPac to improve roadside welfare safeguards for our road safety camera operators. Based on Ed's achievement the Committee has awarded an above target but below maximum performance for the non-financial element relating to these objectives.

Note

- 1 Rupert Soames and Angus Cockburn are entitled to participate in the Deferred Bonus Plan (the DBP) in 2018, up to a maximum of 50% of the bonus determined in respect of 2017 performance. Ed Casey is unable to participate following the cessation of his employment on 31 December 2017.

Remuneration Report continued

Performance Share Plan (PSP)

The LTI amount included in the 2017 single total figure of remuneration includes the element of the 2014 Performance Share Plan (PSP) awards subject to TSR performance in the period to the announcement of the Company's 2016 results on 22 February 2017, and the elements of the 2015 PSP awards subject to EPS and ROIC performance in the period to 31 December 2017. The awards granted to Rupert Soames and Angus Cockburn were in the form of nominal cost options. Ed Casey's awards are in the form of conditional share awards.

The performance assessment and vesting outcome for each award is as follows:

Award	Performance condition	Relative weighting	Threshold ² – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max. achieved
2014 PSP	Relative TSR ¹	1/3	Median ranking	Upper Quartile ranking	Below Median	0%
2015 PSP	Adjusted EPS	1/3	10.3p	12.5p	19.53p	100%
2015 PSP	Average pre-tax ROIC	1/3	8.4%	10.2%	11.9%	100%

Notes:

- The Company's TSR performance was assessed relative to the constituents of the FTSE 250, excluding investment trusts, over the period starting on the 27 June 2014 and ending on 22 February 2017 with the announcement of the Company's results for the 2016 financial year
- In all cases 25% of the award vests at threshold performance, rising on a straight-line basis to 100% vesting at maximum performance

Executive Director	Award	Date of grant	No. of shares awarded	No. of shares vesting	Vesting date	Share price at vest	Value of vesting
Rupert Soames	2014 PSP (TSR)	27 June 2014	192,132 ¹	–	27 June 2017	£1.159	£0
	2015 PSP (EPS)	29 May 2015	413,928	413,928	29 May 2018	£1.0552 ²	£428,486
	2015 PSP (ROIC)	29 May 2015	413,927	413,927	29 May 2018	£1.0552 ²	£428,485
Angus Cockburn	2014 PSP (TSR)	31 October 2014	121,746 ¹	–	31 October 2017	£1.166	£0
	2015 PSP (EPS)	29 May 2015	213,051	213,051	29 May 2018	£1.0552 ²	£220,544
	2015 PSP (ROIC)	29 May 2015	213,050	213,050	29 May 2018	£1.0552 ²	£220,543
Ed Casey	2014 PSP (TSR)	27 June 2014	141,116 ¹	–	27 June 2017	£1.159	£0
	2015 PSP (EPS)	29 May 2015	294,829	–	29 May 2018	£1.0552 ²	£0 ³
	2015 PSP (ROIC)	29 May 2015	294,829	–	29 May 2018	£1.0552 ²	£0 ³

Notes:

- The number of shares under award was adjusted on the Rights Issue in 2015. These are the adjusted number of shares awarded.
- As these awards are still to vest at the time of reporting the share price used is the Q4 average closing share price to 31 December 2017
- Ed Casey's unvested awards lapsed in full on his cessation of employment therefore the value in connection with his 2015 PSP awards with a performance period ending in 2017 is £nil

Deferred Bonus Plan (DBP)

The performance period for the 2015 Deferred Bonus Plan (DBP) Matching Share Award (a conditional share award) wholly subject to EPS performance ended on 31 December 2017. 25% of this award vested for threshold performance of an Adjusted EPS of 10.3p rising on a straight-line basis to 100% vesting for at or above maximum performance of an Adjusted EPS of 12.5p. The Adjusted EPS for the period was measured as 19.53p therefore the 2015 DBP Matching Share Award will vest in full.

Executive Director	Date of grant	No. of shares awarded	No. of shares vesting	Vesting date	Share price at vest	Value of vesting
Rupert Soames	29 May 2015	658,288	658,288	29 May 2018	£1.0552 ¹	£694,606

Note:

- As these awards are still to vest at the time of reporting the share price used is the Q4 average closing share price to 31 December 2017

Recruitment Awards

The 2017 LTI value includes the elements of the Recruitment Awards (in the form of nominal cost options) with performance periods ending in the relevant year which were granted in 2014 to Rupert Soames and Angus Cockburn in respect of unvested performance awards forfeited on joining Serco. These elements of the Recruitment Awards were (i) subject to relative TSR performance in the period to the announcement of the Company's 2016 results on 22 February 2017 (40% of the award), and (ii) Strategic Objective performance (20% of the award) in the period ending 27 June 2017 (in respect of Rupert's award) and 31 October 2017 (in respect of Angus's award). The remaining 40% of these awards is subject to an Absolute Share Price performance condition for which the performance period will end in 2018.

For the TSR element, 25% of the award would vest for median ranking compared to the comparator group rising on a straight-line basis to 100% vesting for upper quartile or better ranking when compared to the comparator group. The comparator group for the TSR performance was the constituents of the FTSE 250 excluding investment trusts. The relative TSR performance assessed was below median and therefore this element lapsed in full.

The Remuneration Committee made the following assessment of performance against the Strategic Objectives and determined that in both cases the award should vest in full.

Executive Director	Strategic Objectives set	Assessment of performance
Rupert Soames	<p>Rupert's objectives focused on:</p> <ul style="list-style-type: none"> Improving cash conversion; Implementing transparent KPI reporting; Development of strong management talent within the finance function; and Improving operating margin. 	<ul style="list-style-type: none"> Significant progress has been made in improving cash conversion and minimising net debt. Rupert has ensured that the Company now has a comprehensive management accounts pack and has been instrumental in introducing standardised and transparent Divisional reports. The Finance function has been transformed with the recruitment of Angus Cockburn, whom Rupert has supported in the recruitment of additional core talent into this team. Since the year of grant (2014) there has been a significant improvement in operating margin. <p>Based on Rupert's achievement the Committee determined that 100% of this award should vest.</p>
Angus Cockburn	<p>Angus's objectives focused on:</p> <ul style="list-style-type: none"> Implementing the Company's corporate plan; Rebuilding the Senior Management Team; Improving cash conversion; and Improving operating margin. 	<ul style="list-style-type: none"> Angus has been central to the development and implementation of our corporate plan, and most specifically around the Rights Issue, the assessment of the write-downs and provisions in November 2014, and the subsequent implementation of an effective reporting process. Angus has completely overhauled the Finance Team, including the recruitment of a number of high-class individuals, transforming it into an effective global team. Since the year of grant (2014) there has been a significant improvement in operating margin. <p>Based on Angus's achievement the Committee determined that 100% of this award should vest.</p>

Remuneration Report continued

Recruitment Awards continued

Executive Director	Performance condition and relative weighting	Date of grant	No. of shares Awarded ¹	No. of shares vesting	Vesting date	Share price at vest	Value at vest
Rupert Soames	TSR (40%)	27 June 2014	153,953	–	27 June 2017	£1.192	£0
	Strategic Objectives (20%)		76,977	76,977			£90,232
Angus Cockburn	TSR (40%)	31 October 2014	112,714	–	31 October 2017	£1.166	£0
	Strategic Objectives (20%)		56,356	56,356			£64,584

Note:

1 The number of shares under award was adjusted on the Rights Issue in 2015. These are the adjusted number of shares awarded.

Also included is the value of Recruitment Awards in the form of conditional share awards granted in 2014 to Rupert and Angus in respect of unvested awards forfeited on joining Serco that were not subject to performance conditions. These awards vested in full in 2017 and were not previously included in the single figure value for the year of grant.

Executive Director	Date of grant	No. of shares Awarded ¹	No. of shares vesting	Vesting date	Share price at vest	Value at vest
Rupert Soames	27 June 2014	58,988	58,988	10 April 2017	£1.161	£68,485
Angus Cockburn	31 October 2014	39,849	39,849	10 April 2017	£1.161	£46,265
		25,899	25,899	18 April 2017	£1.121	£29,033

Note:

1 The number of shares under award was adjusted on the Rights Issue in 2015. These are the adjusted number of shares awarded.

Single Figure – Non-Executive Directors' remuneration (audited information)

Non-Executive Directors' remuneration consists of cash fees paid monthly with increments for positions of additional responsibility. In addition, an inter-continental travel allowance and reasonable travel and related business expenses are paid. No bonuses are paid to Non-Executive Directors. Non-Executive Directors' fees are not performance-related.

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

The fees and terms of engagement of Non-Executive Directors are reviewed on an annual basis, taking into consideration market practice and are approved by the Board.

	Board fee (including Chairmanship fees) (£)		Allowances ¹⁰ (£)		Taxable benefits ¹¹ (£)		Total (£)	
	2017	2016	2017	2016	2017	2016	2017	2016
Sir Roy Gardner ¹	250,000	250,000	–	–	1,688	21,600	251,688	271,600
Mike Clasper ²	92,603	90,083	–	–	–	–	92,603	90,083
Ralph D. Crosby Jnr ³	25,000	50,000	25,000	30,000	10,229	8,954	60,229	88,954
Rachel Lomax ⁴	70,000	70,000	–	–	–	–	70,000	70,000
Angie Risley ⁵	42,619	60,000	–	–	–	–	42,619	60,000
John Rishton ⁶	73,227	19,583	–	–	3,468	–	76,695	19,583
Ian El-Mokadem ⁷	29,000	–	–	–	–	–	29,000	–
Lynne Peacock ⁸	31,468	–	–	–	–	–	31,468	–
Kirsty Bashforth ⁹	16,151	–	–	–	426	–	16,577	–
Total	630,068	539,667	25,000	30,000	15,811	30,554	670,879	600,220

Single Figure – Non-Executive Directors' remuneration (audited information) continued

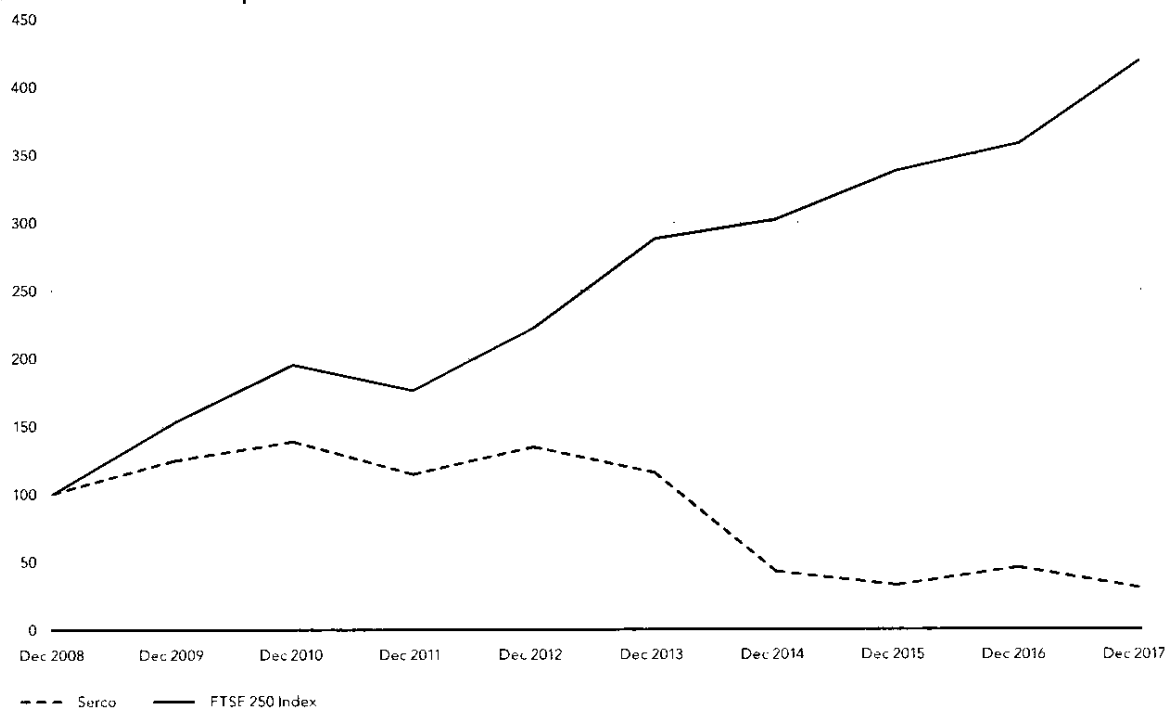
Notes:

- 1 Sir Roy Gardner is Chairman of the Board, Chairman of the Nomination Committee and a Member of the Remuneration and Corporate Responsibility Committees.
- 2 Mike Clasper is Senior Independent Director, Chairman of the Corporate Responsibility Committee and a Member of Audit, Remuneration (until 4 December 2017), Nomination and Group Risk Committees
- 3 Ralph Crosby stepped down from the Board on 1 July 2017
- 4 Rachel Lomax is Chairman of the Group Risk Committee and a Member of Audit Committee
- 5 Angie Risley is Chairman of Remuneration Committee and a Member of Nomination and Corporate Responsibility Committees. She stepped down from the Board on 15 September 2017
- 6 John Rishton is Chairman of the Audit Committee and a Member of the Remuneration Committee and Group Risk Committees.
- 7 Ian El-Mokadem joined the Board on 1 July 2017 and is a Member of the Group Risk and Corporate Responsibilities Committees
- 8 Lynne Peacock joined the Board on 1 July 2017 and is Chairman of Remuneration Committee and a Member of the Audit Committee
- 9 Kirsty Bashforth joined the Board on 15 September 2017 and is a Member of the Remuneration and Corporate Responsibility Committees
- 10 Up to £5,000 is payable for each occasion that requires inter-continental travel outside of the director's country of residence.
- 11 Taxable benefits in 2016 and 2017 relate to reimbursed taxable travel and subsistence business expenses. Sir Roy Gardner also received secretarial services in 2016 of £21,600

Performance graph and table

This graph shows the value as at 31 December 2017, 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. The Company chose the FTSE250 index as the comparator for this graph as Serco has been a constituent of that index throughout the period.

Serco Performance Graph



Remuneration Report continued

CEO's pay in last nine financial years

Year ended 31 December	Group CEO	CEO single figure remuneration (£)	Annual bonus outcome (as % of maximum opportunity)	LTI vesting outcome (as % of maximum opportunity)
2009	Christopher Hyman	3,625,830	90%	295%
2010	Christopher Hyman	2,646,894	91%	169%
2011	Christopher Hyman	2,826,038	81%	80%
2012	Christopher Hyman	2,582,185	72%	64%
2013	Christopher Hyman	893,451	N/A	0%
	Ed Casey	294,782	74%	0%
2014	Ed Casey	1,605,064	71%	0%
	Rupert Soames	747,655	0%	N/A
2015	Rupert Soames	2,255,493	87%	100%
2016	Rupert Soames	2,216,566	82%	24%
2017	Rupert Soames	3,804,924	75%	91%

Percentage change in CEO's remuneration

The table below shows the percentage change in the salary, benefits and bonus of the CEO compared to that for the average UK employee. The UK employee sub-set of the Company's global employee population has been chosen as the group which provides the most appropriate comparator; this comprises some 21,000 of the 42,700 employees Serco employs worldwide. Inflation and local pay practices form a key driver in the salary and benefits provided in each location, and as the CEO is based in the UK we have chosen employees within the same country.

	Salary	Benefits ²	Bonus ³
CEO	0%	37%	(9%)
Average change for all other UK employees	1.28% ¹	(5%)	(18%)

Notes:

- 1 This represents the average pay increase for all UK employees that was applied in the 2017 annual pay review cycle.
- 2 The nature of benefits provided to the CEO and to employees in 2017 compared to 2016 remains the same. The percentage change represents a reduction in the cost to the Company of the benefits over the period. The increase in the CEO's taxable benefit value (with the increase equivalent to 1% of salary) relates to taxable travel which was provided in line with the approved Remuneration Policy.
- 3 The bonus element is shown for those employees eligible for such payments. The figures shown here relate to a calculation of the bonus earned, but not yet paid, related to performance in 2017 compared to the 2016 bonuses paid in April 2017. The reduction in the average employee bonus is due to the different performance outcomes at Divisional and Business Unit levels compared to 2016 which impacts the bonuses for the comparator population.

Relative importance of spend on pay

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

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

	2017 vs 2016	2017	2016
Dividend per share	0%	nil	nil
Overall expenditure on wages and salaries	(0.2%)	£1,513.6m	£1,517.2m

Dividend per share, and overall expenditure on wages and salaries have the same meaning as in the Notes to the Group Financial Statements.

Pensions (audited information)

As at 31 December 2017, 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)

The Committee determined that Ed Casey would not receive any additional payments on the termination of his employment. In recognition of his contribution to the Company throughout the whole performance year the Committee determined that he would remain entitled to receive his 2017 Annual Bonus as disclosed in the single figure table and accompanying notes, which will be paid in March 2018. All unvested share awards lapsed in full on cessation of employment. In line with his expatriate arrangement Ed will receive UK and US tax return assistance for the final year of his assignment. No further payments will be made.

Payments to Past Directors (audited information)

No payments were made in the year to past Directors.

Remuneration Report continued

Awards made in 2017

Performance Share Plan (PSP) (audited information)

In 2017 the Executive Directors received awards equivalent to 200% of salary for the CEO and COO and 175% of salary for the CFO.

The awards will vest at the end of the performance period, if the Executive Directors are still in employment with Serco and to the extent that the performance conditions have been met as measured over the three year performance period ending 31 December 2019.

Performance Measure	Weighting of Measure	Performance Target
Aggregate EPS	1/3rd	Statutory Earnings Per Share (EPS) before exceptional items (adjusted to reflect tax paid on a cash basis) of 13.5p (threshold, 25% vesting) to 16.5p (maximum, 100% vesting), measured as an aggregate over the three-year performance period.
Relative TSR	1/3rd	Total Shareholder Return (TSR) of median (threshold, 25% vesting) to upper quartile (maximum, 100% vesting) when ranked relative to companies in the FTSE250 (excluding investment trusts), measured over the three year performance period.
Average ROIC	1/3rd	Pre-tax Return on Invested Capital (ROIC) of 8.4% (threshold, 25% vesting) to 10.2% (maximum, 100% vesting), measured as an average over the three-year performance period.

The structure for vesting is the same for all measures, with straight-line vesting between threshold and maximum, and no shares vest where performance is below threshold.

Each element of the PSP award is subject to a post-vesting holding requirement that takes the total term of the award (ie performance period plus holding period) to a minimum of five years. Pre-vesting malus and post-vesting clawback is also applicable to these awards.

Directors	Type of interest awarded ¹	Basis of award (% salary)	Grant date	Market price at award (p) ²	Face value (£) ³	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	Nominal cost option	200%	06 April 2017	113.00	1,700,000	25%	1,504,424	31 December 2019
Angus Cockburn	Nominal cost option	175%	06 April 2017	113.00	875,000	25%	774,336	31 December 2019
Ed Casey ⁴	Conditional share award	175%	06 April 2017	113.00	1,500,761	25%	1,328,107	31 December 2019

Notes.

- 1 Rupert Soames and Angus Cockburn received grants in the form of nominal cost options with a 2 pence per share exercise price. Due to US tax treatment of discounted options Ed Casey's award was made in the form of a conditional share award
- 2 Closing share price on 5 April 2017
- 3 Calculated using the closing share price on the trading day immediately prior to the grant date
- 4 All unvested PSP awards for Ed Casey lapsed on the cessation of his employment

Deferred Bonus Plan (DBP) (audited information)

The table below summarises the Matching Share Awards granted to Executive Directors' in 2017 in relation to their participation in the DBP.

Executive Directors received a Matching Share Award (in the form of a conditional share award) on a 2:1 basis in respect of their gross bonus deferred (i.e. for every one Investment Share that could have been purchased from the gross bonus deferred, two Matching Shares are granted). Matching Share Awards granted in 2017 vest subject to Aggregate EPS over the three year performance period ending 31 December 2019. 25% of the Matching Share Award will vest for threshold performance (Aggregate EPS of 13.5p), rising on a straight-line basis to 100% vesting for maximum performance (Aggregate EPS of 16.5p or above).

The definition of EPS is statutory Earnings Per Share before exceptional items (adjusted to reflect tax paid on a cash basis).

Directors	Basis of award (% salary)	Grant date	Face value (£) ¹	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	123%	09 May 2017	1,049,323	25%	873,926	31 December 2019
Angus Cockburn	106%	09 May 2017	530,073	25%	441,470	31 December 2019
Ed Casey ⁴	84%	09 May 2017	693,837	25%	577,860	31 December 2019

Notes

- 1 The face value has been determined using the share price on 8 May 2017 of 120.07p per share (being the price paid by the Directors to acquire their Investment Shares in connection with this award of DBP Matching Shares). This share price was used to determine the number of shares granted under the Matching Share Award.
- 2 The Investment Shares that Ed Casey invested into the DBP in respect of 2016 bonus earned will be released to him. The Matching Share Award lapsed in full on cessation of his employment.

Pre-vesting malus and post-vesting clawback is applicable to these awards.

Statement of voting at the general meeting

At the previous AGMs, votes on the Remuneration Report were cast as follows:

	For % Number	Against % Number	Withheld % Number ¹
2016 Remuneration Policy	93.39%	6.61%	N/A%
	736,257,238	52,086,742	29,512
2016 Annual Report on Remuneration	96.30%	3.70%	N/A%
	759,195,936	29,155,876	21,680
2015 Annual Report on Remuneration	96.68%	3.32%	N/A
	814,337,337	27,947,300	610,006
2014 Annual Report on Remuneration	98.87%	1.13%	N/A
	760,294,709	8,671,241	24,080
2013 Annual Report on Remuneration	99.61%	0.39%	N/A
	367,080,126	1,442,674	2,302,116
2013 Remuneration Policy	98.08%	1.92%	N/A
	358,418,242	7,033,412	5,373,262
2012 Remuneration Report	95.82%	4.18%	N/A
	346,071,397	15,084,901	5,923,160
2011 Remuneration Report	93.72%	6.28%	N/A
	351,474,463	23,547,217	8,299,355

Note

- 1 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

Remuneration Report continued

External appointments

The Board believes that the Group can benefit from its Executive Directors holding appropriate Non-Executive Directorships of companies or independent bodies. Such appointments are subject to the approval of the Board. Fees are retained by the Executive Director concerned.

During the year Angus Cockburn served as a Non-Executive Director of GKN plc. Fees payable in the year were £63,000. Since the end of the year, Angus has been appointed (with effect from 20 February 2018) as the Senior Independent Director of GKN plc following which, in addition to his Non-Executive Director fees, he will receive additional fees of £10,000 per annum for this additional responsibility.

No other fee-paying external positions were held by the Executive Directors during the year ending 31 December 2017.

Directors' shareholding and share interests (audited information)

Current shareholdings are summarised in the table below. Shares are valued for shareholding guideline purposes at the year-end price, which was 98.90p per share at 29 December 2017 (being the last trading day of the financial year).

Executive Directors

Name	Share ownership requirements (% of salary) ²	Number of shares owned outright (including connected persons) at 31 December 2017 (or date of cessation) ³	Value invested ⁴ (£)	Shares	Share options ⁶		Total share interests at 31 December 2017 (or date of cessation) ⁵
				Subject to performance conditions ⁵	Subject to performance conditions ⁷	Exercised during the year ⁸	
Rupert Soames	200%	1,368,417	2,070,653	2,686,754	4,958,268	76,977	9,013,439
Angus Cockburn	150%	516,926	604,684	1,030,059	2,619,823	56,356	4,166,808
Ed Casey ¹	150%	283,965	571,648	4,370,912	–	–	4,654,877

Notes:

- 1 All of Ed Casey's interests in shares subject to performance conditions were unvested at the point of cessation of employment on 31 December 2017 and were lapsed in full as of this date
- 2 The CEO, Rupert Soames, and CFO, Angus Cockburn, are expected to have met their shareholding guidelines during the course of 2018.
- 3 Includes shares owned by connected persons. There were no changes in Directors' interests in the period 1 January 2018 and the date of this report
- 4 Based on the share price at the point of acquisition of each tranche of shares held outright at 31 December 2017 by the Executive Director and/or their connected persons
- 5 Includes awards made to Ed Casey under the Performance Share Plan and awards made to Rupert Soames, Angus Cockburn and Ed Casey under the Deferred Bonus Plan. All awards are in the form of conditional share awards. There are no interests in the form of conditional share awards that are not subject to performance conditions
- 6 All options are in the form of nominal cost options subject to a 2 pence per share exercise price. There are no interests in the form of share options that are not subject to performance conditions, nor are there any share options that are vested but unexercised
- 7 Includes awards under the Performance Share Plan and the special Recruitment Awards that were made to Rupert Soames and Angus Cockburn in compensation for performance-based awards that were forfeited in connection with them joining Serco (as disclosed in the 2014 DRR). These are all nominal cost options with a 2 pence per share exercise price
- 8 Rupert Soames and Angus Cockburn exercised vested options in respect of their Recruitment Awards that were subject to Strategic Objective performance conditions for which the performance period ended, and vesting occurred, in the year

Non-Executive Directors

Non-Executive Directors do not participate in any share-based incentives and do not hold any interests in shares other than shares owned outright.

Name	Number of shares owned outright (including connected persons) at 31 December 2017 (or date of resignation) ¹
Sir Roy Gardner	75,000
Mike Clasper	56,000
Ralph D. Crosby Jnr	–
Rachel Lomax	40,000
Angie Risley	20,508
John Rishton	43,086
Ian El-Mokadem	50,000
Lynne Peacock	15,000
Kirsty Bashforth	–

Notes

- 1 Includes shares owned by connected persons. There were no changes in Directors' interests in the period 1 January 2018 and the date of this report.
- 2 Non-Executive Directors do not have shareholding guidelines and there are no interests in shares held by Non-Executive Directors where the individual does not own those shares outright

Other shareholding information

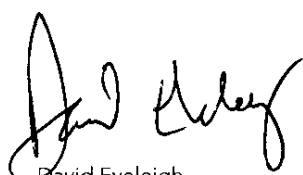
Shareholder dilution

Awards granted under the Company share plans are met either by the issue of new shares or by shares held in trust when awards vest. The Committee monitors the number of shares issued under its various share plans and their impact on dilution limits. The relevant dilution limits established by the Investment Association (formerly the ABI) in respect of all share plans is 10% in any rolling ten-year period and in respect of discretionary share plans is 5% in any rolling ten-year period. Based on the Company's issued share capital at 31 December 2017, our dilution level was within these limits.

The Group has an employee share ownership trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet various obligations under the share plans.

The Trust held 9,864,986 and 8,728,497 ordinary shares at 1 January 2017 and 31 December 2017 respectively.

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



David Eveleigh
Secretary

21 February 2018

Directors' Report

Annual Report and Accounts

The Directors present the Annual Report and Accounts of the Group for the year ended 31 December 2017. Comparative figures used in this report are for the year ended 31 December 2016 unless otherwise stated. The Corporate Governance Report, including the Remuneration Report, set out on pages 86 to 143, forms part of the Directors' Report.

The Chairman's Statement on pages 6 to 8 and the Chief Executive's Review and Divisional Reviews on pages 32 to 49 report on the activities during the year and likely future developments. The information in these reports, which is required to fulfil the requirements of the Business Review, is incorporated in this Directors' Report by reference.

Articles of Association

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

Share capital

The issued share capital of the Company, together with the details of shares issued during the year, is shown in Note 34 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.

At the Annual General Meeting in May 2017, pursuant to Section 570 of the Companies Act 2006, shareholders approved the issue of shares for cash up to 5% of the existing issued share capital and an additional 5% (only to be used in connection with an acquisition or specified capital investment) in each case without the application of pre-emption rights. The authority granted continues until the earlier of the AGM planned to be held in May 2018 or close of business on 30 June 2018.

Rights attaching to shares

Each ordinary share of the Company carries one vote at general meetings of the Company. There are no restrictions on the transfer of ordinary shares in the capital of the Company other than certain restrictions which may from time to time be imposed by law. In accordance with the Listing Rules of the Financial Conduct Authority, certain employees are required to seek the approval of the Company to deal in its shares.

The Company is not aware of any agreement between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Authority for the purchase of shares

As at the date of this report authority granted at the Company's AGM in May 2017 remains in force, as set out in the 2017 Notice of Meeting which is available on our corporate website www.serco.com

Dividends

No interim dividend was paid in respect of the 2017 financial year (2016: nil). The Directors' do not recommend a final dividend to be paid for 2017 (2016: nil).

Directors'

The current members of the Board together with biographical details of each Director are set out on pages 86 and 87.

On 24 May 2017, the Company announced that Ralph Crosby, Jr would retire as Non-Executive Director of the Company with effect from 1 July 2017. Lynne Peacock and Ian El-Mokadem were appointed as Non-Executive Directors of the Company with effect from 1 July 2017. On appointment, Lynne Peacock became a member of the Audit, Remuneration and Nomination Committees and Ian El-Mokadem became a member of the Group Risk and Corporate Responsibility Committees. On 4 July 2017, the Company announced that Angie Risley would also be retiring from her position as Non-Executive Director with effect from 15 September 2017. Lynne Peacock was appointed as Chair of the Remuneration Committee on 15 September 2017 and was appointed a member of the Nomination Committee on 1 November 2017. Kirsty Bashforth subsequently joined the Board as a Non-Executive Director with effect from 15 September 2017. She became a member of the Remuneration and Corporate Responsibility Committees on appointment. On 20 October, it was announced that Ed Casey, would retire as Chief Operating Officer with effect from 31 December 2017.

As in previous years, and in accordance with the UK Corporate Governance Code, all other Directors' will stand for annual re-election at the AGM in May 2018.

Directors' interests

With the exception of the Executive Directors' service contracts and the Non-Executive Directors' letters of appointment, there are no contracts in which any Director has an interest.

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

Details of the Directors' interests in the ordinary shares and options over the ordinary shares of the Company as at 31 December 2017 are set out in the Directors' Remuneration Report on pages 142 and 143. Between 1 January 2018 and the date of this report there were no changes in the Directors' interests in ordinary shares and options over ordinary shares.

Directors' indemnities

Directors' and officers' insurance cover has been established for all Directors to provide cover against their reasonable actions on behalf of the Company. As permitted under the Articles of Association and in accordance with best practice, deeds of indemnity have been executed indemnifying each of the Directors' and Company Secretary of the Company in respect of their positions as officers' of the Company as a supplement to the Directors' and officers' insurance cover. The indemnities, which constitute a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006, remain in force for all current Directors' and the Company Secretary of the Company.

Branch offices

In certain jurisdictions, the Group will operate through a branch of one of its subsidiary companies. These include the following countries: Abu Dhabi, Bahrain, Belgium, Dubai, France, Germany, Greenland, Guam, Iraq, Italy, Luxembourg, Qatar, Singapore and South Africa.

Significant agreements that take effect, alter or terminate upon a change of control

Given the business-to-government nature of many of the services provided by the Company and its subsidiaries, many agreements contain provisions entitling the other parties to terminate them in the event of a change of control, which can be triggered by a takeover of the Company. The following agreements are those individual agreements which the Company considers to be significant to the Group as a whole that contain provisions giving the other party a specific right to terminate if the Company is subject to a change of control:

Material contracts

- **New Grafton Correctional Centre:** On 14 June 2017, NorthernPathways Project Trust (of which Serco Australia Pty Limited is a member) entered into a Project Deed with the Australian State of New South Wales to design, construct and operate a new build prison named the New Grafton Correctional Centre. The prison is expected to become operational in 2020. Also, on 14 June 2017, Serco Australia Pty Limited entered into an operator sub-contract with NorthernPathways. The operator sub-contract will

expire 20 years from the date of acceptance of the completed New Grafton Correctional Centre by the State. Both the project deed and the operator sub-contract contain change of control provisions that provide that any change of control to an unrelated third-party that has not been approved by the State of New South Wales would be a major default. A major default under either the project deed or operator sub-contract, if not cured, could result in a termination of that contract.

- **Australian Immigration Services:** On 11 December 2014, Serco Australia Pty Limited entered into a contract with the Commonwealth of Australia (acting through the Department of Immigration and Border Protection) for the provision of detention services at all onshore immigration facilities in Australia. The contract has an initial five-year term, with two two-year extension options available. In the event of a change in control or ownership of Serco Australia Pty Limited, which in the reasonable opinion of the Commonwealth adversely affects the Company's ability to perform the services, the contract may be terminated by the Commonwealth.
- **AWE:** Serco Holdings Limited is a shareholder in AWE Management Limited (the 'AWE JV'). Serco Holdings Limited's joint venture partners and the other shareholders in the AWE JV are UK subsidiary companies of Lockheed Martin Corporation and Jacobs Engineering Group. The AWE JV oversees the design, development, maintenance and manufacture of warheads for the UK's strategic nuclear deterrent. This work is carried out by the AWE JV under a management and operation contract with the Secretary of State for Defence (the 'AWE Contract'). The AWE Contract was entered into on 1 December 1999 and has a 25-year term. Under the terms of the AWE Contract, any change in shareholding or the identity of a shareholder in the AWE JV requires the consent of the Secretary of State for Defence. In the event that there is a change of control of Serco Holdings Limited, it is required to transfer its entire shareholding in the AWE JV to the Serco Group or another wholly owned subsidiary of the Serco Group prior to such change of control. In the event that there is a change of control of Serco Holdings Limited without its entire shareholding in the AWE JV first being transferred to another member of the Serco Group or if there is a change of control of the Serco Group then the other shareholders in the AWE JV are entitled (subject to the approval of the Secretary of State and applicable regulatory approvals) to purchase the AWE JV shares and loans held by Serco Holdings Limited and any other member of the Serco Group.

Directors' Report continued

- CMS Eligibility Support Services (ESS): On 1 July 2013, Serco Inc. entered into a contract with the United States of America (acting through the Centers for Medicare and Medicaid Services (CMS)) for the *provision of support for the Exchanges implemented to provide affordable health insurance and insurance affordability programmes*. The contract had an initial base term of one year, with four options of one year each. In the event of a change in control or ownership of Serco Inc., which in the reasonable opinion of the U.S. Government adversely affects the Company's ability to perform the services, the contract may be terminated by the U.S. Government.
- SSA: In order to bid and perform on certain classified contracts involving US national security, Serco Inc. was required to mitigate its foreign ownership through a Special Security Agreement (SSA) between the US Government, Serco Inc., and Serco Group plc. The effective date of the SSA is 18 June 2008. The U.S. Department of Defense may terminate Serco's SSA in the event of the sale of the Corporation to a company or person not under Foreign Ownership, Control or Influence (FOCI).

Financing facilities

- Revolving credit facility: the Company has a £480,000,000 revolving credit facility dated 28 March 2012 (amended and restated 12 March 2015) with the Bank of America Securities Limited, Barclays Bank PLC, Commonwealth Bank of Australia, Credit Agricole Corporate and Investment Bank, DBS Bank Limited, HSBC Bank PLC, J.P. Morgan Limited, Lloyds TSB Bank PLC, The Bank of Tokyo-Mitsubishi UFJ Limited and The Royal Bank of Scotland PLC as mandated lead arrangers, and Barclays Bank PLC as Facility Agent. The facility provides funds for *general corporate and working capital purposes*, and bonds to support the Group's business needs. The facility agreement provides that in the event of a change of control of the Company each lender may, within a certain period, call for the prepayment of the amounts owed to it and cancel its commitments under the facility.
- US notes: the Company has notes outstanding under three US Private Placement Note Purchase Agreements (the 'USPP Agreements') dated 9 May 2011, 20 October 2011 and 13 May 2013, respectively. The total amount of the notes outstanding under the three USPP Agreements was \$352,192,038 at 31 December 2017, and their maturity is between 9 May 2018 and 14 May 2024. Under the terms of the USPP

Agreements, if a change of control of the Company occurs it is required to offer to prepay the entire principal amount of the notes together with interest to the prepayment date but without payment of any make-whole amount.

Share plans

The Company's share plans contain provisions in relation to a change of control. Outstanding options and awards may vest and become exercisable on a change of control of the Company, in accordance with the rules of the plans.

Annual General Meeting

The Annual General Meeting (AGM) of the Company will be held at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London, E14 5JJ on Thursday 10 May 2018 at 11.00am.

Financial risk policies

A summary of the Group's treasury policies and objectives relating to financial risk management, including exposure to associated risks, is on pages 207 to 212.

Employment policies

The Board is committed to maintaining a working environment where staff are individually valued and recognised. Group companies and Divisions operate within a framework of human resources policies, practices and regulations appropriate to their own market sector and country of operation, whilst subject to Group-wide policies and principles.

Diversity

The Group is committed to ensuring equal opportunity, honouring the rights of the individual, and fostering partnership and trust in every working relationship. Policies and procedures for recruitment, training and career development promote diversity, respect for human rights, and equality of opportunity regardless of gender, sexual orientation, age, marital status, disability, race, religion or other beliefs and ethnic or national origin.

The Group promotes diversity so that all employees are able to be successful regardless of their background. The Group gives full consideration to applications for employment, career development and promotion received from the disabled, and offers employment when suitable opportunities arise. If employees become disabled during their service with the Group, arrangements are made wherever practicable to continue their employment and training.

The Group recognises the importance of protecting human rights. We seek to respect and uphold the human rights of individuals in all aspects of our operations wherever we operate. Our Human Rights Group Standard demonstrates this commitment and the significance of human rights for a diverse global organisation. It also sets out expectations for individual and corporate behaviour across our business in regards to human rights. We use International Human Rights Standards such as the United Nations Guiding Principles on Business and Human Rights (2011) (UN Guiding Principles) as frameworks to assist our decision-making and constructive engagement; to identify, assess, and manage adverse human rights impacts; and to integrate and act on findings, track responses, monitor effectiveness and communicate how impacts are addressed.

Employee Engagement

The Group 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 employment terms and conditions. Where employees choose not to belong to a trade union, employee communication forums such as works councils exist to ensure involvement of staff within the business. The Group has been proactive in providing employees with information on matters of concern to them as employees. These mechanisms ensure employees' views are considered in decision-making and that they have a common awareness of Group strategy, matters of concern to them and the financial and economic factors affecting the performance of the Company.

Participation by staff in the success of the Group is encouraged by the availability of long-term incentive arrangements for senior management, which effectively aligns their interests with those of shareholders by requiring that Company-level financial performance criteria are achieved as a condition of vesting.

Corporate responsibility

The Group recognises that operating in a responsible manner helps drive Serco's success. Our commitment to corporate responsibility is supported by defined policies embedded in our Serco Management System. More information on Corporate Responsibility, including greenhouse gas emission reporting, can be found in the Strategic Report on pages 69 to 84.

Research and development

Serco undertakes a limited amount of research and development (R&D), given that our primary business model is the delivery of public services through our people. In 2017, we spent £1.7m on R&D on IT-related projects, compared to £3.6m in 2016.

Political donations

During the year neither the Company nor the Group made political donations and they intend to continue with this policy. However, it is possible that certain routine activities may unintentionally fall within the broad scope of the Companies Act provisions relating to political donations and expenditure. As in previous years, the Company will therefore propose to shareholders that the authority granted at the AGM in May 2017 regarding political donations be renewed. Details will be included in the Notice of AGM.

Within the US business there exists a Political Action Committee (PAC), which is funded entirely by employees 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 Auditor is unaware. Each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Group's Auditor is aware of that information.

Auditor

The Company undertook a formal competitive tender exercise for external audit services during 2016, as detailed in the 2016 Notice of Annual General Meeting. As a result of this tender process KPMG LLP was appointed as the Company's External Auditor by the Board on 27 May 2016 and Deloitte LLP resigned as Auditor on the same date.

The appointment of KPMG LLP for the 2018 financial year will be subject to shareholder approval at the next AGM in May 2018. Further details are set out in the Notice of Meeting sent to shareholders.

Directors' Report continued

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2017, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014; namely assessing the applicability of the going concern basis, the review period and disclosures. The Group's principal debt facilities at the year-end comprised a £480m revolving credit facility, and £261m of US private placement notes. As at 31 December 2017, the Group had £741m of committed credit facilities and committed headroom of £588m.

Assessment of going concern

The Directors have undertaken a rigorous assessment of going concern and liquidity taking into account financial forecasts. In order to satisfy ourselves that we have adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities.

Review period

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2019. The Directors have also reviewed the principal risks considered on pages 20 to 29 of the Strategic Report and taken account of the results of sensitivity testing.

Assessment

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.

Interests in voting rights

At 31 December 2017, the Company had been notified under Rule 5 of the Disclosure and Transparency Rules of the Financial Conduct Authority of the following holdings of voting rights in its shares:

Notifying person	Number of shares (millions) at date of notification	% held at date of notification	Nature of holding
Azvalor Asset Management S.G.I.I.C., S.A	54.9	5.00	Direct
Blackrock Inc	34.8	3.17	Indirect
	5.5	0.50	Securities Lending
	45.3	4.12	Contract for Difference
	85.6	7.79	Total
FIL Limited	73.2	6.66	Indirect
	0.2	0.01	Stock Loan
	73.4	6.67	Total
Lancaster Investment Management LLP	70.0	6.37	Swap
Majedie Asset Management Limited	56.0	5.09	Direct
Marathon Asset Management LLP	58.3	5.31	Indirect
MSD Partners, L.P.	109.9	10.0	Indirect
Orbis Group	54.5	4.96	Indirect
Tameside MBC re: Greater Manchester Pension Fund	34.1	3.11	Direct
UBS Asset Management (Traditional and IFS), UBS Group AG	55.3	5.04	Indirect

Notes:

Between 1 January 2018 and the date of this report, the Company has been advised of the following changes of interests in shares

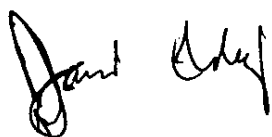
- on 25 January 2018 UBS Asset Management (Traditional and IFS), UBS Group AG notified that their interest in voting rights had fallen below the notifiable threshold

Index of Directors' Report disclosures

The information required to be disclosed in the Directors' Report can be found in this Annual Report on the pages listed below. Pursuant to Listing Rule 9.8.4C, the information required to be disclosed in the Annual Report under Listing Rule 9.8.4R is marked with an asterisk (*).

Amendment of the Articles	Page 144
Appointment and replacement of Directors	Page 144
Board of Directors	Pages 86 and 87
Change of control	Pages 145 and 146
Community	Page 74
Corporate responsibility	Pages 69 to 84
Directors' insurance and indemnities	Page 145
Directors' inductions and training	Page 92
Directors' responsibilities statement	Page 150
Disclosure of information to Auditor	Page 156
Diversity	Page 73 and 104
Dividends	Pages 36 and 144
Employee involvement	Page 147
Employees with disabilities	Page 73
Financial risk management	Pages 207 to 212
Future developments of the business	Page 9 to 17
Going concern	Pages 148 and 163
Greenhouse gas emissions	Page 83
Independent Auditors' Report	Pages 152 to 157
Long-term incentive plans under Listing Rule 9.4.3*	Pages 122 to 140
Political donations	Page 147
Powers for the Company to issue or buy back its shares	Page 144
Powers of the Directors	Page 108
Research and development activities	Page 147
Restrictions on transfer of securities	Page 144
Rights attaching to shares	Page 144
Risk management and internal control	Pages 20 to 29 and 95
Share capital	Page 144
Significant agreements	Pages 145 and 146
Significant related party agreements*	Page 224
Significant shareholders	Page 148
Statement of corporate governance	Pages 108 and 109
Strategic Report	Pages 4 to 84
Viability Statement	Page 30 to 31
Voting rights	Page 144

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



David Eveleigh

Group General Counsel and Company Secretary

21 February 2018

Directors' Responsibility Statement

The Directors are responsible for preparing the Annual Report and the Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Company financial statements for each financial year. Under that law, the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRSs as adopted by the EU') and applicable law, and have elected to prepare the Company financial statements in accordance with UK accounting standards, including FRS 101, Reduced Disclosure Framework. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of their profit or loss for that period.

In preparing each of the Group and Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the Company financial statements, state whether applicable UK accounting statements have been followed, subject to any material departures disclosed and explained in the Company financial statements;
- assess the Group and Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal controls as they determine is necessary to enable the preparation of the financial statements that are free from material

misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Governance Statement that complies with that law and those regulations.

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

Responsibility statement of the Directors in respect of the Annual Report and Accounts

We confirm that to the best of our knowledge:

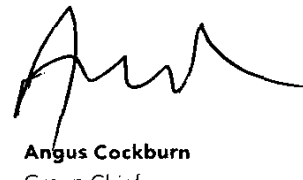
- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report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

We consider, the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

By order of the Board



Rupert Soames
Group Chief
Executive



Angus Cockburn
Group Chief
Financial Officer

21 February 2018

Financial Statements

Independent Auditor's Report	152
Consolidated Income Statement	158
Consolidated Statement of Comprehensive Income	159
Consolidated Statement of Changes in Equity	160
Consolidated Balance Sheet	161
Consolidated Cash Flow Statement	162
Notes to the Consolidated Financial Statements	163
Company Balance Sheet	228
Notes to the Company Financial Statements	230
Appendix: List of Subsidiaries	234
Appendix: Supplementary Information	237
Shareholder Information	238
Useful Contacts	239

Independent Auditor's Report

to the members of Serco Group plc

Our opinion is unmodified	<p>We have audited the financial statements of Serco Group Plc ("the Company") for the year ended 31 December 2017 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Statement of Changes in Equity, the Consolidated and Company Balance Sheet, the Consolidated Cash Flow Statement, and the related notes, including the accounting policies in Note 2.</p> <p>In our opinion,</p> <ul style="list-style-type: none">• the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;• the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;• the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and• the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.
Basis for opinion	<p>We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.</p> <p>We were appointed as auditor by the directors on 27 May 2016. The period of total uninterrupted engagement is for the 2 financial years ended 31 December 2017. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.</p>
Key audit matters: our assessment of risks of material misstatement	<p>Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2016), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.</p>

Revenue and margin recognition

Revenue £2,953.6m (2016: £3,011.0m), **operating profit £30.0m** (2016: £42.2m) and **Onerous Contract Provisions of £168.2m** (2016: £220.2m)

Assessment of risk vs. prior year: Unchanged

Refer to page 98 (Audit Committee Report), page 168 and 174 (accounting policy), page 176 (key judgements) and page 205 (provisions note in the financial statements)

The risk	Our response
<p>Subjective estimate</p> <p>The contractual arrangements that underpin the measurement and recognition of revenue by the group can be complex, with significant judgements involved in the assessment of current and future financial performance of those contracts. The key judgements impacting the recognition of revenue and resulting operating profit include:</p> <ul style="list-style-type: none"> • Interpretations of terms and conditions in relation to the required service obligations in accordance with contractual arrangements; • The allocation of revenue and costs to performance obligations where multiple deliverables exist; • Assessment of stage of completion and cost to complete, where percentage completion accounting is used; • Consideration of the Group's performance against contractual obligations and the impact on revenue and costs of delivery; • The recognition and recoverability assessments of contract related assets, including those recognised as direct incremental costs prior to service commencement <p>Where an onerous contract provision is required, judgement is required in assessing the level of provision, including estimated cost to complete taking into account contractual obligations to the end of the contract, extension periods and customer negotiations</p>	<p>Our audit procedures included the following:</p> <p>Contracts were selected for substantive audit procedures based on qualitative factors, such as commercial complexity, and quantitative factors, such as financial significance and profitability that we considered to be indicative of risk. Our audit testing for the contracts selected included the following:</p> <ul style="list-style-type: none"> • Assessing policy application: We inspected the contract agreements to challenge the method of revenue recognition adopted by the Group including, where relevant, the allocation of revenue across contractual obligations and compared the specific method used to Group policy • Independent performance: Where percentage of completion is used, we re-calculated the stage of completion on the basis of actual costs and latest cost forecasts to inform our assessment of the appropriate amount of revenue and profit to recognise and compared this to the amounts recorded by the Group • Accounting analysis: We assessed whether the revenue recognition methodology applied was consistent with accounting standards. We also inspected accounting papers prepared by the Group to understand the support provided in respect of key contract judgements and onerous contract provisions • Tests of details: We inspected a sample of correspondence with customers and third parties, in instances where contractual variations and claims have arisen, to inform our assessment of the revenue and costs recorded up to the balance sheet date • Site visits: We visited key contract locations and attended a sample of monthly Divisional and Business Unit Performance Reviews used to assess business performance to inform our assessment of operational and financial risks <p>For onerous and potentially onerous contracts identified through application of quantitative selection criteria, our procedures also included:</p> <ul style="list-style-type: none"> • Benchmarking assumptions: We compared contract level forecast revenues and costs to Group budgets and forecasts approved by the directors. We challenged key assumptions made by the Group in preparing these forecasts, including those in relation to revenue growth and cost reductions, vouching to external evidence where possible and obtaining supporting plans where appropriate • Our sector experience: We assessed the contractual terms and conditions to identify the key obligations of the contract to inform our challenge of completeness of forecast costs and cost accruals recorded at the balance sheet date • Historical comparisons: We compared the contract forecasts to historic and in year performance to assess the historical accuracy of the forecasts • Tests of details: We assessed the mathematical accuracy of the models used to forecast contract revenues and costs • Independent performance: We compared the forecast margin to the cumulative margin recognised up to the balance sheet date to assess whether provisions for loss-making contracts had been appropriately recorded and, in the case of profitable contracts, that margin recognised to date did not exceed the forecast. <p>For selected contract related assets, representing capitalised bid and phase in costs, our procedures included:</p> <ul style="list-style-type: none"> • Assessing application: We assessed whether these had been recognised in accordance with the Group's accounting policy and relevant accounting standards • Comparing valuations: We inspected actual and forecast contractual cash flows and profits to assess whether these supported the carrying value of the assets • Historical comparisons: We inspected the underlying contracts to inform our assessment of the forecast cash flows, and compared actual cash flows to forecasts to assess reasonableness • Independent performance: We compared the amortisation period with the duration of the contract and checked that the amortisation had been calculated correctly <p>Assessing transparency: We also assessed whether the Group's disclosures about the estimates and judgements applied reflected the risks related to revenue and margin recognition</p> <p>Our results</p> <p>The results of our testing were satisfactory and we considered the revenue and margin recognised, and the level of onerous contract provisioning, to be acceptable.</p>

Independent Auditor's Report continued

to the members of Serco Group plc only

Recoverability of group goodwill and of parent's investment in subsidiaries

Group: £551.3m (2016: £577.9m); **Parent company: £2,010.5m** (2016: £2,001.3m)

Assessment of risk vs. prior year: Unchanged

Refer to page 99 (Audit Committee Report), page 170 (accounting policy), page 176 (key judgements) and page 196 (Goodwill note in the financial statements)

The Risk	Our response
<p>Forecast-based valuation</p> <p>Goodwill in the group and the carrying amount of the parent company's investments in subsidiaries are significant and at risk of irrecoverability due to uncertainty regarding contract attrition and new contract wins and extension rates, and the impact of the Group's transformation programme to reduce operating costs.</p> <p>The estimated recoverable amount of these balances is subjective due to the inherent uncertainty involved in forecasting and discounting future cash flows.</p> <p>In the year ended 31 December 2016, the Health and Americas cash generating units presented the lowest headroom, and as a result the carrying value of goodwill for these CGUs may be particularly sensitive to a deterioration in the divisions' projections or an increase in discount rate</p>	<p>Our procedures included the following:</p> <ul style="list-style-type: none"> • Benchmarking assumptions: With the assistance of our valuation specialists, we challenged the growth rate and discount rate for each CGU used in the value in use calculation by comparing the Group's assumptions to external data. We challenged forecast assumptions around new contract wins or extensions, contract attrition, cost reductions and the allocation of central costs • Historical comparisons: We compared the forecast cash flows against budgets and historic actual performance to test for historic accuracy. • Sensitivity analysis: We tested the sensitivity of the impairment calculation to changes in the underlying assumptions to inform our assessment of the significant assumptions. • Comparing valuations: We considered whether the forecast cash flow assumptions used in the value in use calculation were consistent with the assumptions used to calculate the expected loss on onerous contract provisions, the recognition of deferred tax assets and the Director's assessment of going concern and viability. The value in use derived was compared to the appropriate goodwill and investments carrying value to identify any impairment. • Assessing transparency: We also assessed whether the Group's and parent Company's disclosures about the sensitivity of outcomes reflected the risks inherent in the valuation of goodwill and investment in subsidiaries. <p>Our results:</p> <p>We found the group's assessment of the recoverable amount of goodwill in the group and the parent company's investment in subsidiaries to be acceptable.</p>

Retirement benefit surplus £41.8m (2016: £150.4m)

Assessment of risk vs. prior year: unchanged

Refer to page 100 (Audit Committee Report), page 172 (accounting policy), page 177 (key judgements) and page 212 (Retirement benefit schemes note in the financial statements)

The Risk	Our response
<p>Subjective valuation</p> <p>Significant estimates are made in valuing the Group's retirement benefit surplus in respect of the Serco Pension Life Assurance Scheme (SPLAS), including mortality, price inflation, discount rates and future increases in salary and pension. Small changes in the assumptions and estimates used to value the Group's net pension surplus would have a significant effect on the Group's financial position.</p> <p>Accounting treatment</p> <p>As the Group's main defined benefit scheme is in a net surplus of £41.8 million at 31 December 2017 (2016: £150.4m), judgement is required to determine if it is appropriate to recognise an asset.</p> <p>The application of specific accounting treatments in respect of transactions undertaken in the period, including the impact of curtailments, settlements and the purchase of a bulk annuity insurance policy require careful analysis with regards to the application of IAS 19</p> <p>Judgement is also required to determine if pension obligations associated with contract arrangements meet the definition of defined benefit or defined contribution schemes, and whether an associated asset or liability is required to be accounted for by the Group.</p>	<p>Our procedures in respect of the SPLAS included the following:</p> <ul style="list-style-type: none"> • Tests of details: We performed procedures to test the accuracy of data provided by the Group to the scheme actuaries. This involved selecting a sample of scheme participants to compare data provided to the actuaries to underlying employment records held by the Group and the Scheme Administrator. • Benchmarking assumptions: We challenged the key assumptions used to calculate the valuation of the Group's net pension surplus with input from our actuarial specialists, comparing the discount rate, inflation rate, salary increases, pension increase rates and life expectancy assumptions used against externally derived data. • Accounting analysis: We challenged the basis of the Group's judgement that it has an unconditional right of refund based on our assessment of the scheme rules and advice provided by external actuaries. We have also considered the application of accounting standards with regards to specific changes in the scheme during the period, including the effect of curtailments. • Accounting analysis: We have also considered the application of accounting standards with regards to specific changes in the scheme during the period, including the effect of curtailments. <p>Assessing principles: In respect of contract related pension obligations, we challenged the judgements made by the Group in assessing whether defined benefit liabilities have been recognised in accordance with contractual terms. Our procedures included assessment of the underlying contract agreements and consideration of legal advice obtained by the Group</p> • Assessing transparency: We assessed the Group's disclosure in respect of the sensitivity of the surplus to changes in the key assumptions. <p>Our results</p> <p>We found the valuation of the retirement benefit surplus to be acceptable</p>

Our application of materiality and an overview of the scope of our audit
Materiality

Materiality for the group financial statements as a whole was set at £5 million (2016: £5 million), determined with reference to a normalised benchmark of Group Profit Before Tax and Exceptional Items taking into account historic financial performance and the Group's current profit margins in light of the Group's ongoing Strategy Review. This represents 12.9% (2016: 5.8%) of Group Profit Before Tax and Exceptional Items of £38.7 million (2016: £85.9 million) and 0.2% (2016: 0.2%) of Group Revenue of 2,953.6 million (2016: £3,011 million)

Materiality for the parent company financial statements as a whole was set at £4.5 million (2016: £4.5 million), determined with reference to a benchmark of company total assets, of which it represents 0.2% (2016: 0.2%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.25 million (2016: £0.25 million), in addition to other identified misstatements that warranted reporting on qualitative grounds

Scope of our audit

Of the group's 8 (2016: 9) reporting components, we subjected 6 (2016: 7) to full scope audits for group purposes.

These 6 (2016: 7) components represent approximately 99.8% (2016: 98.6%) of the Group's Revenue, 99.4% (2016: 98.7%) of Group profit before tax and 98.4% (2016: 99.1%) of Group total assets.

The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materiality levels, which ranged from £2.0 million to £3.6 million (2016: £2.0 million to £3.6 million) having regard to the mix of size and risk profile of the Group across the components. The work on 4 of the 6 components (2016: 5 of the 7 components) was performed by component auditors and the rest, including the audit of the parent company, was performed by the Group team. The Group team visited all (2016: all) component locations to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors. At these visits, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

We have nothing to report on going concern

We are required to report to you if:

- we have anything material to add or draw attention to in relation to the directors' statement in Note 2 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 148 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects.

We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report,
- in our opinion the information given in those reports for the financial year is consistent with the financial statements, and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006

Independent Auditor's Report continued

to the members of Serco Group plc only

We have nothing to report on the other information in the Annual Report continued

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the directors' confirmation within the Viability Statement on page 30 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks and Uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and
- the directors' explanation in the Viability Statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions

Under the Listing Rules we are required to review the Viability Statement. We have nothing to report in this respect.

Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Report does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

We have nothing to report in respect of the matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects

Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 150, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern, and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities

Respective responsibilities continued*Irregularities – ability to detect*

Our audit aimed to detect non-compliance with relevant laws and regulations (irregularities) that could have a material effect on the financial statements. In planning and performing our audit, we considered the impact of laws and regulations in the specific area of anti-bribery and corruption, recognising the Governmental nature of many of the group's customers. We identified these areas through discussion with the directors and other management (as required by auditing standards), from our sector experience, and from inspection of the group's regulatory, licensing and legal correspondence. In addition we had regard to laws and regulations in other areas including financial reporting, and company and taxation legislation.

We considered the extent of compliance with those laws and regulations that directly affect the financial statements, being anti-bribery and corruption as part of our procedures on the related financial statement items. For the remaining laws and regulations, we made enquiries of directors and other management (as required by auditing standards), and inspected correspondence with regulatory and licensing authorities, as well as legal correspondence.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the group to component audit teams of relevant laws and regulations identified at group level, with a request to report on any indications of potential existence of irregularities in these areas, or other areas directly identified by the component team.

As with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

The purpose of our audit work and to whom we owe our responsibilities

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.



Stephen Wardell
(Senior Statutory Auditor) for and
on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square,
London, E14 5GL

21 February 2018

Consolidated Income Statement

For the year ended 31 December

		2017 £m	2016 (restated*) £m
Continuing operations	Note		
Revenue	10	2,953.6	3,011.0
Cost of sales*		(2,704.7)	(2,724.6)
Gross profit*		248.9	286.4
Administrative expenses*			
General and administrative expenses		(222.2)	(216.2)
Exceptional profit on disposal of subsidiaries and operations	9	0.3	2.9
Other exceptional operating items	11	(19.9)	(59.2)
Other expenses – amortisation and impairment of intangibles arising on acquisition		(4.4)	(5.1)
Total administrative expenses*		(246.2)	(277.6)
Share of profits in joint ventures and associates, net of interest and tax	7	27.3	33.4
Operating profit		30.0	42.2
Operating profit before exceptional items		49.6	98.5
Investment revenue	14	7.6	9.3
Finance costs	15	(19.2)	(21.9)
Total net finance costs		(11.6)	(12.6)
Other gains	8	0.7	–
Profit before tax		19.1	29.6
Tax on profit before exceptional items	16	(14.0)	(15.8)
Exceptional tax	16	(5.0)	3.1
Tax charge		(19.0)	(12.7)
Profit for the year from continuing operations		0.1	16.9
Loss for the year from discontinued operations	4	–	(18.0)
Profit/(loss) for the year		0.1	(1.1)
Attributable to:			
Equity owners of the Company		(0.2)	(1.2)
Non-controlling interests		0.3	0.1
Earnings per share (EPS)			
Basic EPS from continuing operations	18	(0.02p)	1.55p
Diluted EPS from continuing operations	18	(0.02p)	1.50p
Basic EPS from discontinued operations	18	–	(1.66p)
Diluted EPS from discontinued operations	18	–	(1.66p)
Basic EPS from continuing and discontinued operations	18	(0.02p)	(0.11p)
Diluted EPS from continuing and discontinued operations	18	(0.02p)	(0.11p)

* Costs included within cost of sales and general and administrative expenses have been reallocated, resulting in a restatement. See Note 2.

Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2017 £m	2016 £m
Profit/(loss) for the year		0.1	(1.1)
Other comprehensive income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial (loss)/gain on defined benefit pension schemes*	33	(106.5)	9.0
Actuarial (loss)/gain on reimbursable rights*	33	(0.6)	2.9
Tax relating to items not reclassified*	16	18.1	(1.7)
Share of other comprehensive income in joint ventures and associates	7	0.9	14.8
Items that may be reclassified subsequently to profit or loss:			
Net exchange (loss)/gain on translation of foreign operations**		(14.6)	80.3
Fair value (loss)/gain on cash flow hedges during the year**		(0.2)	2.3
Tax relating to items that may be reclassified		–	–
Share of other comprehensive income in joint ventures and associates	7	–	1.0
Total other comprehensive income for the year		(102.9)	108.6
Total comprehensive income for the year		(102.8)	107.5
Attributable to			
Equity owners of the Company		(102.9)	107.1
Non-controlling interest		0.1	0.4

* Recorded in retirement benefit obligations reserve in the Consolidated Statement of Changes in Equity

** Recorded in hedging and translation reserve in the Consolidated Statement of Changes in Equity

Consolidated Statement of Changes in Equity

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Retirement benefit obligations reserve £m	Share based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total shareholders' equity £m	Non-controlling interest £m
At 1 January 2016	22.0	327.9	0.1	68.5	(101.3)	80.9	(59.8)	(57.7)	280.6	1.5
Total comprehensive income for the year	–	–	–	14.6	10.2	–	–	82.3	107.1	0.4
Shares transferred to option holders on exercise of share options	–	–	–	–	–	(7.7)	7.7	–	–	–
Expense in relation to share based payments	–	–	–	–	–	9.7	–	–	9.7	–
Change in non-controlling interest	–	–	–	–	–	–	–	–	–	(0.5)
At 1 January 2017	22.0	327.9	0.1	83.1	(91.1)	82.9	(52.1)	24.6	397.4	1.4
Total comprehensive income for the year	–	–	–	0.6	(89.0)	–	–	(14.5)	(102.9)	0.1
Shares transferred to option holders on exercise of share options	–	–	–	–	–	(6.0)	6.0	–	–	–
Expense in relation to share based payments	–	–	–	–	–	11.4	–	–	11.4	–
Change in non-controlling interest	–	–	–	–	–	–	–	–	–	(0.2)
At 31 December 2017	22.0	327.9	0.1	83.7	(180.1)	88.3	(46.1)	10.1	305.9	1.3

Consolidated Balance Sheet

	Note	At 31 December 2017 £m	At 31 December 2016 £m
Non-current assets			
Goodwill	19	551.3	577.9
Other intangible assets	20	66.7	83.6
Property, plant and equipment	21	65.2	69.3
Interests in joint ventures and associates	7	14.3	14.4
Trade and other receivables	23	57.3	44.4
Derivative financial instruments	32	3.7	14.2
Deferred tax assets	17	55.0	50.8
Retirement benefit assets	33	41.8	150.4
		855.3	1,005.0
Current assets			
Inventories	22	17.4	22.4
Trade and other receivables	23	506.5	543.5
Current tax assets		11.2	11.0
Cash and cash equivalents	25	112.1	177.8
Derivative financial instruments	32	10.3	4.9
		657.5	759.6
Total assets		1,512.8	1,764.6
Current liabilities			
Trade and other payables	26	(462.9)	(524.5)
Derivative financial instruments	32	(1.1)	(0.6)
Current tax liabilities		(25.3)	(25.9)
Provisions	29	(148.5)	(172.3)
Obligations under finance leases	27	(8.5)	(12.3)
Loans	28	(31.8)	(9.7)
		(678.1)	(745.3)
Non-current liabilities			
Trade and other payables	26	(28.7)	(16.8)
Deferred tax liabilities	17	(20.4)	(30.5)
Provisions	29	(211.5)	(249.4)
Obligations under finance leases	27	(11.7)	(15.9)
Loans	28	(239.7)	(290.2)
Retirement benefit obligations	33	(15.5)	(17.7)
		(527.5)	(620.5)
Total liabilities		(1,205.6)	(1,365.8)
Net assets		307.2	398.8
Equity			
Share capital	34	22.0	22.0
Share premium account	35	327.9	327.9
Capital redemption reserve		0.1	0.1
Retained earnings		83.7	83.1
Retirement benefit obligations reserve		(180.1)	(91.1)
Share based payment reserve		88.3	82.9
Own shares reserve		(46.1)	(52.1)
Hedging and translation reserve		10.1	24.6
Equity attributable to owners of the Company		305.9	397.4
Non-controlling interest		1.3	1.4
Total equity		307.2	398.8

The financial statements were approved by the Board of Directors on 21 February 2018 and signed on its behalf by

Rupert Soames
Group Chief Executive

Angus Cockburn
Group Chief Financial Officer

Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2017 £m	2016 £m
Net cash inflow/(outflow) from operating activities before exceptional items		16.7	(22.4)
Exceptional items		(32.5)	(39.9)
Net cash outflow from operating activities	39	(15.8)	(62.3)
Investing activities			
Interest received		0.5	1.4
Increase/(decrease) in security deposits		0.2	(0.4)
Dividends received from joint ventures and associates		28.2	40.0
Proceeds from disposal of property, plant and equipment		1.5	0.6
Proceeds from disposal of intangible assets		0.1	0.1
Net cash (outflow)/inflow on disposal of subsidiaries and operations	9	(7.1)	19.4
Acquisition of subsidiaries, net of cash acquired	8	1.5	(0.2)
Proceeds from loans receivable		0.6	–
Purchase of other intangible assets		(18.4)	(15.1)
Purchase of property, plant and equipment		(17.8)	(17.2)
Net cash (outflow)/inflow from investing activities		(10.7)	28.6
Financing activities			
Interest paid		(17.5)	(20.1)
Exceptional finance costs paid		–	(0.3)
Capitalised finance costs paid		–	(0.3)
Repayment of loans		(3.8)	(135.5)
Decrease in loans to joint ventures and associates		–	1.1
Capital element of finance lease repayments		(12.6)	(17.0)
Cash movements on hedging instruments		(2.5)	47.0
Net cash outflow from financing activities		(36.4)	(125.1)
Net decrease in cash and cash equivalents		(62.9)	(158.8)
Cash and cash equivalents at beginning of year		177.8	323.6
Net exchange (loss)/gain		(2.8)	7.8
Cash reclassified to assets held for sale		–	5.2
Cash and cash equivalents at end of year	25	112.1	177.8

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 comprise the Company and its subsidiaries (together referred to as the Group) and are presented in pounds Sterling because this is the currency of the primary economic environment in which Serco operates. All amounts have been rounded to the nearest one hundred thousand pounds, foreign operations are included in accordance with the policies set out in Note 2.

2. Significant accounting policies

Basis of accounting

These consolidated financial statements on pages 152 to 239 have been prepared in accordance with International Financial Reporting Standards adopted for use in the European Union (IFRS) and therefore comply with the requirements set out in Article 4 of the EU IAS regulation

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. The following principal accounting policies adopted have been applied consistently in the current and preceding financial year except as stated below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company up to 31 December each year. Control is achieved when the Company:

- (i) has the power over the investee;
- (ii) is exposed, or has rights to variable returns from its involvement with the investee; and
- (iii) has the ability to use its power to affect the returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring accounting policies into line with those used by the Group. All intra-Group transactions, balances, income and expenses are eliminated on consolidation

Non-controlling interests represent the portion of profits or losses and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separate from equity of shareholders of Serco Group plc.

Going concern

The Directors have a reasonable expectation that the Company and the Group will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

In assessing the basis of preparation of the financial statements for the year ended 31 December 2017, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014', namely assessing the applicability of the going concern basis, the review period and disclosures. The Directors have undertaken a rigorous assessment of going concern and liquidity, taking into account financial forecasts, which indicate sufficient capacity in our financing facilities and associated covenants to support the Group. In order to satisfy themselves that they have adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities and working capital requirements. The Group's current principal debt facilities at the year-end comprised a £480m revolving credit facility, and £261m of US private placement notes. As at 31 December 2017, the Group had £741m of committed credit facilities and committed headroom of £588m.

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2019. The Directors have also reviewed the principal risks considered on pages 20 to 29 of the Strategic Report and taken account of the results of sensitivity testing.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued**Prior year restatement**

The Group has undergone a programme of work on its financial data structures to appropriately allocate and charge costs to the relevant divisions and between cost of sales and administrative expenses. As a result of the activities performed in this area, the Group's classification of cost items in the income statement has changed. The prior periods' results have been restated to reflect the cost items identified which should have been reallocated in 2016.

Cost of sales are considered to be the direct costs of operating ongoing contracts. This includes the unavoidable costs of servicing contracts and all costs that a contract would incur purely on its own without a parent company, regardless of how those services are delivered within the wider Group, such as IT or Human Resource management services provided centrally.

The impact on the relevant line items in the consolidated income statement for the year ended 31 December 2016 is as follows

Impact on consolidated income statement	Year ended 31 December 2016 as previously stated £m	Adjustment £m	Year ended 31 December 2016 as restated £m
Cost of sales	(2,767.6)	43.0	(2,724.6)
Gross profit	243.4	43.0	286.4
General and administrative expenses	(173.2)	(43.0)	(216.2)

Adoption of new and revised standards

None of the changes to IFRS that became effective in the current reporting period have had a significant impact on the Group's financial statements.

New standards and interpretations not applied: IFRS15 Revenue from Contracts with Customers

IFRS15 *Revenue from Contracts with Customers* (effective 1 January 2018), provides a single, principles-based five step model to be applied to all sales contracts, based on the transfer of control of goods and services to customers. It replaces existing revenue recognition guidance for goods, services and construction contracts currently included in IAS11 *Construction Contracts* and IAS18 *Revenue*.

Under the transition rules IFRS15 will be applied retrospectively to the prior period in accordance with IAS8 Accounting policies, changes in accounting estimates and errors, subject to the following expedients.

- contracts completed prior to 1 January 2018 and that begin and end within the same annual reporting period will not be restated;
- for contracts that have variable consideration and which have completed prior to 1 January 2018, the revenues recognised will reflect the actual outcome, rather than being estimated and trued up, and
- the disclosures required for comparative periods in respect of amount of revenue allocated to the remaining performance obligations and an explanation of when that amount is expected to be recognised will not be made.

The cumulative effect of initially applying the standard will be shown as an adjustment to brought forward retained earnings as at 1 January 2017

Below is set out the expected revenue recognition policy under IFRS15 together with the estimated impact of adopting the standard.

Revenue recognition: Repeat service based contracts

The majority of the Group's contracts are repeat service based contracts where value is transferred to the customer over time as the core services are delivered and therefore in most cases revenue will be recognised on the output basis, with revenue linked to the deliverables provided to the customer. Where any price step downs are required in a contract accounted for under the output basis and output is not decreasing, revenue will require deferral from initial years to subsequent years in order for revenue to be recognised on a consistent basis.

There are some contracts where a separate performance obligation has been identified for services where the pattern of delivery differs to the core services and are capable of being distinct. In these instances, where the transfer of control is most closely aligned to our efforts in delivering the service, then the input method is used to measure progress, and revenue is recognised in direct proportion to costs incurred. Where deemed appropriate, the Group will utilise the practical expedient within IFRS15, allowing revenue to be recognised at the amount which the Group has the right to invoice, where that amount corresponds directly with the value to the customer of the Group's performance completed to date.

Under IFRS15, unless upfront fees received from customers including transition payments can be clearly attributable to a distinct service the customer is obtaining, then such payments do not constitute a separate performance obligation and instead are deferred and spread over the life of the core services.

Any changes to the enforceable rights and obligations with customers and/or an update to the transaction price will not be recognised as revenue until there is evidence of customer agreement in line with the Group's policies

Any variable amounts will only be recognised where it is highly probable that a significant reversal will not occur

Where the Group is required to assess whether it is acting as principal or as an agent in respect of goods or services procured for customers, the Group is acting as principal if it is in control of a good or a service prior to transferring to the customer and an agent where it is arranging for those goods or services to be provided to the customer without obtaining control.

Revenue recognition: Long-term project based contracts

The Group has a limited number of long-term contracts for the provision of complex, project-based services. When control of such a deliverable is passed onto the customer at the final stage of a contract, the recognition of revenue is delayed until control has been passed. However, where the customer has control over the life of the deliverable or where the Group has a legally enforceable right to remuneration for the work completed to date, or at milestone periods, revenue will be recognised in line with the associated transfer of control or milestone dates.

Revenue recognition: Other

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued for on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the right to receive payment has been established

Contract costs

Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

Contract costs are charged to the income statement as incurred, including the necessary accrual for costs which have not yet been invoiced, unless the expense relates to a specific time frame covering future periods.

Contract costs can only be capitalised when the expenditure meets all of the following three criteria and are not within the scope of another accounting standard, such as inventories, intangible assets, or property, plant and equipment

- The costs relate directly to a contract. These include: direct labour, being the salaries and wages of employees providing the promised services to the customer; direct materials such as supplies used in providing the promised services to a customer, and other costs that are incurred only because an entity entered into the contract, such as payments to subcontractors
- The costs generate or enhance the resources used in satisfying performance obligations in the future. For initial contract costs capitalised, such costs only fall into one of the following two categories: the mobilisation of contract staff, being the costs of moving existing contract staff to other Group locations; or directly incremental costs incurred in meeting contractual obligations incurred prior to contract delivery, which are required to ensure a proper handover from the previous contractor. Redundancy costs are never capitalised.
- The costs are expected to be recovered, i.e. the contract is expected to be profitable after amortising the capitalised costs.

Estimated impact of the adoption of IFRS15

The estimated impact for the Group of adopting IFRS15 is as follows:

	Year ended 31 December 2017 as reported £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Revenue	2,953.6	(3.0)	2,950.6
Underlying Trading Profit	69.8	(0.3)	69.5
Operating profit before exceptional items	49.6	(8.7)	40.9
Profit before tax	19.1	(8.7)	10.4
Tax	(19.0)	0.4	(18.6)
Profit after tax	0.1	(8.3)	(8.2)
	As at 1 January 2017 £m		
Retained earnings at 1 January 2017 as reported	83.1		
Adjustment to retained earnings before the impact of onerous contract provisions	(54.5)		
Impact of onerous contract provisions	21.7		
Retained earnings at 1 January 2017 as restated	50.3		

The Group will continue to work to design, implement and refine procedures to apply the new requirements of IFRS15 and to finalise accounting policy choices, including in its subsidiaries and joint ventures. As a result of this ongoing work, it is possible that there may be some changes to the impact above prior to the 30 June 2018 results being issued. However, at this time these are not expected to be significant.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued**New standards and interpretations not applied: IFRS15 Revenue from Contracts with Customers** continued**Estimated impact of the adoption of IFRS 15** continued

The total adjustment to the opening balance of the Group's equity at 1 January 2017 is a decrease of £32.8m. The principal components of the estimated adjustment are as follows:

- A decrease of £14.4m due to revenues being recognised at a constant amount over the life of the contract where the level of services provided is broadly consistent.
- A decrease of £11.4m due to a change in the basis of measuring progress for asset maintenance and replacement services, including dry docking. Where the resources used to fulfil the performance obligations best depicts how control is passed to the customer, the input method of accounting has been applied.
- A decrease of £6.8m due to upfront fees and transition payments being deferred and spread in line with delivery of the core services.

The following table details the specific areas impacted as a result of the adoption of IFRS15 and cross-referenced below the table are Serco's policies in adopting the requirements of the standard:

Impact on retained earnings as at 1 January 2017 and the consolidated income statement for the year ended 31 December 2017	Retained earnings £m	Revenue £m	Operating profit before exceptional items £m
Under current accounting standards	83.1	2,953.6	49.6
IFRS15 adjustments:			
(i) Upfront fees	(2.6)	0.9	0.8
(ii) Transition, transformation and other mobilisation activities	(4.2)	2.1	(3.0)
(iii) Asset maintenance and replacement, including vessel dry docking	(11.4)	1.3	(0.8)
(iv) Percentage of completion accounting	(0.2)	0.5	0.1
(v) Pass through revenues and procurement arrangements	–	(12.6)	–
(vi) Consideration payable to a customer	–	(0.5)	(0.4)
(vii) Variable pricing	(14.4)	5.3	3.0
(viii) OCP charges and releases	–	–	(8.4)
Adjusted under IFRS15	50.3	2,950.6	40.9

- (i) Upfront fees. For some contracts, the Group receives non-refundable amounts at the start of the contract to cover initial costs. Under IFRS15, unless upfront fees are attributable to a good or a service the customer is in control of, such fees do not constitute a separate performance obligation and instead are allocated to the performance obligations of the contract, therefore being spread over the life of the other services. In some instances such upfront fees were recognised as revenue under IAS18 but are deferred under IFRS15. Upfront payments are analysed to determine whether they constitute a material financing arrangement under IFRS15.
- (ii) Transition, transformation and other mobilisation activities. Transition activities which are administrative in nature are not treated as separate performance obligations. Transition and transformation activities which are more than administrative in nature are assessed to determine whether they form a separate performance obligation. Where it can be demonstrated that the transition activities benefit the customer without future activities being provided then the transition phase is accounted for as a separate performance obligation under the contract and revenue recognised accordingly. Where it is concluded that the transformation, transition or mobilisation activity does not form a separate performance obligation under the contract, any payments received from the customer are allocated to the performance obligations of the contract and recognised over the life of the other services. In some instances revenue recognised under IAS18 is deferred under IFRS15.
- (iii) Asset maintenance and replacement, including vessel dry docking. In many of the contracts the Group enters into, the provision of maintenance and replacement services are capable of being distinct and therefore these have been accounted for as separate performance obligations. The input method of accounting is used to reflect the pattern of delivery to the customer and the enhancement of customer owned assets. In some instances the output method of accounting is used due to the ongoing repetitive nature and frequency of the services. Adopting IFRS15 will result in the deferral of revenue recognised under IAS18 on certain contracts.
- (iv) Percentage of completion accounting. Changes to the Group's current accounting policy arise when the percentage of completion model under IAS11 is replaced by the output method of accounting. The output method is used where the customer simultaneously receives and consumes the benefits in direct proportion to the deliverable performed rather than the level of expense incurred to date.
- (v) Pass through revenues and procurement arrangements. A pass through arrangement is where goods or services are provided by a third party, but sourced by the Group on behalf of the customer. In this instance, the Group does not recognise revenue for the amount received from the customer as compensation of the cost of the good or service but rather only the margin element (if any) is recorded as revenue. Recognition of such revenues under IFRS15 is linked directly to whether the Group has control of the deliverable prior to transfer rather than an assessment of the risks and rewards associated with the services as was the case under IAS18. For certain procurement arrangements the Group does not have control prior to transfer, but does have a level of risk associated with the activity, and therefore these arrangements are not recognised on a net basis instead of the gross basis under IAS18.

- (vi) Consideration payable to a customer. Under IFRS15 all amounts payable to a customer (including all payments to the customer and all reductions to amounts paid by the customer) are recorded as a reduction in revenue. In 2017, an element of reductions have been recorded as costs.
- (vii) Variable pricing. It is not uncommon in outsourcing arrangements for the payment terms to be set to decline over the future periods (i.e. a 5% reduction in fees is built into years five to six, 6% reduction in years seven to eight and so on). However, where revenue recognition under IFRS15 is based on the output method and the service remains consistent over the contract life, the reduction in the amounts paid by the customer should not be reflected in declining revenues, even if this was appropriate under IAS18. As a result, revenue recognised in prior years for certain contracts will be deferred under IFRS15.
- (viii) OCP charges and releases. Where an adjustment is required by IFRS15 and the relevant contract is loss making, the deferral of revenue from prior years can result in a decrease in the level of OCP needed under IFRS15, as future losses will reduce by the level of deferred revenue. During the year one contract recorded a release against the OCP balance held under current accounting standards. As a result of IFRS15, revenues on this contract have been deferred, reducing the opening OCP balance, increasing deferred revenue and therefore the release of the relevant OCP balance is lower under IFRS15.

In addition to the areas where a financial impact has been identified as a result of adoption of IFRS15 as identified above, there are certain accounting policies which are new or change existing policies applied by the Group and may have an impact on the future financial performance of the Group. The policies in these areas to be adopted by the Group are set out below.

- (ix) Contract variations. Contract modifications such as change orders, variations, change notices and amendments could be approved in writing, by oral agreement or implied by customary business practices. Under IFRS15 contract modifications are changes in the scope or price (or both) of a contract that is approved by the parties to the contract. If the parties to the contract have not approved a contract modification, revenue should be recognised in accordance with the existing contractual terms and associated cash payments are deferred until the contract modification is approved. The judgements historically applied have been consistent with this policy.
- (x) Variable revenues requiring estimation. IFRS15 provides clear guidance on variable income unlike IAS18 and two areas may be impacted as a result. First, if the consideration paid by a customer includes a variable amount requiring judgement, it is only recognised where it is highly probable that a significant reversal will not occur. Second, service penalties or any claims made by us against the customer which must be recognised in revenue unless it is highly probable that they will not result in future settlement. However, judgements taken historically are consistent with the requirements of IFRS15 and there is no impact of these changes on the Group.
- (xi) Capitalised redundancy costs. Under certain contracts there is an obligation to make redundancies and the Group is compensated for these costs. Historically, the Group may have recognised revenues as and when the customer makes payments or the Group may have capitalised the expense to match with payments being made in the future. Under IFRS15, all redundancy costs must be expensed in the period they are incurred and revenue is not recognised on these redundancy transactions, with any cash payments deferred over the contract in line with the other services being delivered. No adjustment was required in respect of this difference.
- (xii) Licence income. Where the Group receives income for software licences and maintenance services provided through ongoing support and operational functionality, this licence revenue is recognised over the period when the maintenance obligation exists. There are currently no significant licencing arrangements entered into by the Group with its customers which are impacted by IFRS15.
- (xiii) Extension periods granted or other options. Providing the option for a customer to obtain extension periods or other services may lead to a separate performance obligation where a material right exists. If a separate performance obligation exists then there would be an allocation of the transaction price from the original contract in addition to any revenues earned through the option period. A separate performance obligation exists for options under a contract if both of the following conditions are met. First, if the customer is unable to obtain the right to acquire the additional goods or services on the same or similar terms without entering into the original contract (for example they cannot get the option without first entering into the main contract, which would be the case for any extension period). Second, the option does not simply give the customer the right to acquire additional goods or services at a price that reflects the stand alone selling price for those goods or services (for example if the pricing of the option is consistent with what the pricing would have been in any case there is no separate PO, as the customer gains no incremental benefit from the existence of the option). No differences were noted under IFRS15 in this area.
- (xiv) Work in progress. Revenue is only recognised when control is passed to a customer and therefore where revenue is recognised over time no work in progress is created unlike under current accounting standards. None of the contracts with revenues recognised over time have work in progress balances.
- (xv) Significant financing component. Where the timing of payments agreed with the customer provides either party with a significant benefit of financing (either explicitly or implicitly), the associated asset/liability is adjusted for the time value of money and an interest charge or income is recognised and a corresponding offset in revenue. The Group's policy under IFRS15 is to consider "significant" to be greater than 5% of the total transaction price of the contractual arrangement and no such arrangements are in place.
- (xvi) Non-cash consideration. If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate the fulfilment of the contract, the Group assesses whether control is obtained for those contributed goods or services. If the Group obtains control of the contributed goods or services, then the estimated fair value of these would be recognised as revenue. No such transactions have been noted.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Other new standards and interpretations not applied

At the date of authorisation of these financial statements, the following changes to IFRS have not been applied but could potentially have a significant impact:

- (i) IFRS9 *Financial Instruments* has been endorsed by the EU and will be effective from 1 January 2018.

This standard replaces IAS39 and introduces new requirements for classifying and measuring financial instruments and puts in place a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

The impact of IFRS9 on the regular trading activities of the Group is expected to be immaterial. The key areas of focus for the Group under IFRS9 are:

- External loan receivables, including those from equity accounted entities.
- Debt refinancing not accounted for as a significant modification under IAS39
- Expected credit losses being recognised on trade debtors and contract assets recognised under IFRS15.
- Intercompany loan recoverability.

IFRS9 replaces the 'incurred loss' model in IAS39 with an 'expected credit loss' model. The new model applies to financial assets that are not measured at FVTPL (fair value through profit and loss), including loans, lease and trade receivables, debt securities, contract assets under IFRS15 and specified financial guarantees and loan commitments issued. It does not apply to equity investments.

Under the expected credit loss model, the Group is required to calculate the allowance for credit losses by considering on a discounted basis the cash shortfalls it would incur in various default scenarios for prescribed future periods and multiplying the shortfalls by the probability of each scenario occurring. The allowance is the sum of these probability weighted outcomes. Because every loan and receivable carries with it some risk of default, it is expected that every such asset has a loss attached to it from the moment of its origination.

The financial assets held on the balance sheet have been reviewed in order to determine whether any loss is required to be recorded based on these expected credit losses. However, given the fact that the Group's customers are governments it is unlikely that there will be a default as a result of credit risk and any provision for bad debts is more likely to be related to a contractual dispute. In most cases, each amount receivable has specific risk attached to recoverability which is most likely based on the services provided under the terms of the contract and, given the majority of receivables are backed by organisations with a sovereign credit rating, a general view on recoverability based on the counterparty credit risk could be misleading.

- (ii) IFRS16 *Leases* is pending EU endorsement, which is expected prior to the effective date of 1 January 2019.

The standard replaces IAS17 *Leases* and has been introduced in order to improve the comparability of financial statements through developing an approach that is more consistent with the conceptual framework definitions of assets and liabilities.

The key change will be in respect of leases currently classified as operating leases. Under the new standard leases will be recognised on the balance sheet as liabilities with corresponding assets being created, grossing up the balance sheet but with no net effect on net assets at the start of the lease. The income statement impact will be a new interest charge arising from the rate implicit in the liability and as currently the full impact is a charge to operating profit, the change will result in an improvement to operating results.

We have not quantified the likely impact of the new standard, the transition approach to be taken or concluded whether it will be adopted early, which is allowed from the date IFRS15 is adopted. The quantitative impact of the adoption of IFRS16 will be disclosed prior to the adoption of this new standard.

Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date, regardless of whether that price is directly observable or is estimated using another valuation technique. There are certain transactions in these financial statements which are similar to fair value, but are determined by the treatment set out in their respective standards. These are share based payment transactions that are within the scope of IFRS2 *Share based Payment*, leasing transactions that are within the scope of IAS17 *Leases*, or the calculation of net realisable value under IAS2 *Inventories* or value in use under IAS36 *Impairment of Assets*.

Revenue recognition

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. Calculating the fair value of revenue typically does not require a high level of judgement, the exceptions to this are the following areas:

- Uncontracted variations or claims Where work has been performed outside of the normal contracting framework at the request of the customer or a claim has been made for work performed but is in dispute, judgement is required in order to determine whether there is sufficient certainty that the Group will be financially compensated. Revenue is only recognised to the extent that they have been orally agreed by the customer or are virtually certain of being received and revenue recognised in this manner is not considered to be significant to the Group's results
- Payments by results contracts When returns are directly linked to performance, through cost savings or other customer driven key performance indicators over a period of time an estimate is made of the likelihood of achieving the necessary level of performance when the period covers a financial year end. Revenue is only recognised when we can be reasonably certain of achieving the required level of performance and such payment mechanisms do not represent a significant proportion of annual revenue
- Long term 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 compared to the estimated whole life contract costs, except where whole life contract costs exceed the contract value, in which case the excess is expensed immediately.

While each of these areas requires a high level of judgement, only long term contract accounting could have a significant impact on the Group's financial results or position. However, the only revenues associated with these contracts are earned on loss making contracts with onerous loss provisions and as a result we do not identify this as a separate item for disclosure in Note 3.

Revenue recognition: Repeat service based contracts

Revenue on repeat service based contracts is recognised as services are provided in line with the transfer of control to the customer. 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 limited 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 IAS18 *Revenue* and IAS11 *Construction Contracts*. This is normally measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs, but where a more accurate basis is available that alternative methodology is used. Contract costs include a rational allocation of overheads.

Where the outcome of a long term project based contract cannot be estimated reliably, contract revenue is recognised to the extent that it is probable that contract costs will be recovered. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. Such amounts are not discounted.

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 right to receive payment has 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 has at least reached 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 in line with the associated revenue.

Determining whether bid and phase in costs are recoverable involves a high level of judgement as it requires a forecast to be prepared for the expected future profitability of the contract, taking into account the likely future costs and revenues associated with the services not yet performed. The level of bid and phase in costs can be seen in Note 23.

Operating profit

Operating profit is not a measure defined by IFRS and the Group considers this to include the profits and losses from continuing operations prior to corporation tax, interest revenue and finance costs.

Foreign currencies

Transactions in currencies other than Sterling are recorded at the rates of exchange on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Gains and losses arising on retranslation are included in the net profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity through the consolidated statement of comprehensive income (SOC).

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

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. Acquisition related costs are recognised in profit or loss as incurred.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition date fair value. Subsequent changes in fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (which is subject to a maximum of one year). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with the relevant accounting standards. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS3 (2008) *Business Combinations* are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

Investments in joint ventures and associates

A joint venture is an arrangement whereby the owning parties have joint control and rights over the net assets of the arrangement. The Group's investments in joint ventures are incorporated using the equity method of accounting.

Under the equity method, an investment in an associate or a joint venture is initially recognised in the consolidated balance sheet at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate or joint venture. Any excess of the cost of acquisition over the Group's share of net fair value of the identifiable assets, liabilities and contingent liabilities of the joint venture recognised at the date of acquisition is recognised as goodwill. Goodwill is included within the carrying value amount of the investment and is assessed for impairment as part of that investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss. Where the Group entity transacts with a joint venture, profits and losses are eliminated to the extent of the Group's interest in the arrangement.

Determining whether joint control exists requires a level of judgement, based upon specific facts and circumstances which exist at the year end. Details of the unconsolidated joint ventures are provided in notes 6 and 7.

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control. The results and assets and liabilities of associates are also incorporated in these financial statements using the equity method of accounting.

Goodwill

Goodwill is measured as the excess of the fair value of purchase consideration over the fair value of the net assets acquired and is recognised as an intangible asset when control is achieved. Negative goodwill is recognised immediately in the income statement. Fair value measurements are based on provisional estimates and may be subject to amendment within one year of the acquisition, resulting in an adjustment to goodwill.

Goodwill itself does not generate independent cash flows and therefore, in order to perform required tests for impairment, it is allocated at inception to the specific cash generating units (CGUs) or groups of CGUs which are expected to benefit from the acquisition.

On the disposal of a business which includes all or part of a CGU, any attributable goodwill is included in the determination of the profit or loss on disposal. Where part of a CGU with goodwill is sold, the attributable amount is calculated based on the future discounted cash flows leaving the Group as a proportion of the total CGU future discounted cash flows.

The fair values associated with material business combinations are valued by external advisers and any amount of consideration which is contingent in nature is evaluated at the end of each reporting period, based on internal forecasts.

Other intangible assets

Material intangible assets are grouped into classes of similar nature and use and separately disclosed. Other intangible assets are amortised from the date of completion.

Customer relationships can arise on the acquisition of subsidiaries and represent the incremental value expected to be gained as a result of existing contracts in the purchased business. These assets are amortised over the average length of the related contracts.

Licences comprise premiums paid for the acquisition of licences, while franchises represent costs incurred in obtaining franchise rights arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the respective licence or franchise.

Software and IT represent computer systems and processes used by the Group in order to generate future economic value through normal business operations. The underlying assets are amortised over the period from which the Group expects to benefit, which is typically between three to eight years.

Development expenditure is capitalised as an intangible asset only if all of certain conditions are met, with all research costs and other development expenditure being expensed when incurred. The period of expected benefit, and therefore period of amortisation, is typically between three and eight years. The capitalisation criteria are as follows:

- an asset is created that can be separately identified, and which the Group intends to use or sell,
- the finalisation of the asset is technically feasible and the Group has adequate resources to complete its development for use or sale;
- it is probable that the asset created will generate future economic benefits, and
- the development cost of the asset can be measured reliably.

Property, plant and equipment

Assets held for use in the rendering of services, or for administrative purposes, are stated in the balance sheet at cost, net of accumulated depreciation and any provision for impairment. Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

Depreciation is provided on a straight line basis at rates designed to reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:

Freehold buildings	2.5%
Short leasehold assets	The higher of 10% or the rate produced by the lease term
Machinery	15% – 20%
Motor vehicles	10% – 50%
Furniture	10%
Office equipment	20% – 33%
Leased equipment	The higher of the rate produced by the lease term or useful life

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement. Given that there is limited history of material gains or losses on disposal of fixed assets, the level of judgement involved in determining the depreciation rates is not considered to be significant.

Asset impairment

The Group reviews the carrying amounts of its tangible and intangible assets (including goodwill) at each reporting period, together with any other assets under the scope of IAS36 *Impairment of Assets*, in order to assess whether there is any indication that those assets have suffered an impairment loss. As the impairment of assets has been identified as both a key source of estimation uncertainty and a critical accounting judgement, further details around the specific judgements and estimates can be seen in Note 3.

If any indication of impairment exists, the recoverable amount of the asset is estimated in order to determine if there is any impairment loss. Goodwill is assessed for impairment annually, irrespective of whether there are any indicators of impairment. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs.

Recoverable amount is defined as the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value with reference to pre-tax discount rates that reflect the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount is estimated to be less than the carrying amount of the asset, the carrying amount is impaired to its recoverable amount. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amount of the other assets in the CGU on a pro-rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for indications that the loss has decreased or no longer exists. Where an impairment loss subsequently reverses, the carrying amount is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised in prior years.

Impairment losses and reversals are recognised immediately within administrative expenses within the income statement unless it is considered to be an exceptional item.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Retirement benefit costs

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

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit actuarial cost method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and are presented in the SOCI.

Both current and past service costs are the amounts recognised in the income statement, reflecting the expense associated with the individuals. Current service cost represents the increase in the present value of the scheme liabilities expected to arise from employee service in the current period. Past service cost is recognised immediately to the extent that the benefits are already vested. Gains and losses on curtailments or settlements are recognised in the income statement in the period in which the curtailment or settlement occurs.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds (which is only recognised to the extent that the Group has an unconditional right to receive it) and reductions in future contributions to the scheme. To the extent that an economic benefit is available as a reduction in future contributions and there is a minimum funding requirement required of the Group, the economic benefit available as a reduction in contributions is calculated as the present value of the estimated future service cost in each year, less the estimated minimum funding contributions required in respect of the future accrual and benefits in that year.

Calculation of the amounts recognised in the consolidated financial statements in respect of defined benefit pension schemes requires a high level of judgement, as further explained in Note 3.

Defined benefit obligations arising from contractual obligations

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract, the Group's share of the defined benefit obligation less its share of the pension scheme assets that it will fund over the period of the contract is recognised as a liability at the start of the contract with a corresponding amount being recognised as an intangible asset. The intangible asset, which reflects the Group's right to manage and operate the contract, is amortised over the contract period. The Group's share of the scheme assets and liabilities is calculated by reducing the scheme assets and liabilities by a franchise adjustment. The franchise adjustment represents the estimated amount of scheme deficit that will be funded outside the contract period. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised within Other Comprehensive Income.

Derivative financial instruments and hedging activities

The Group enters into a variety of derivative financial instruments to manage the exposure to interest rate, foreign exchange risk and price risk, including currency swaps, foreign exchange forward contracts, interest rate swaps and commodity future contracts. Further details of derivative financial instruments are given in Note 32.

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).

At the inception of the hedge relationship, the Group documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Both at the inception of the hedge and on a periodic basis, the Group assesses whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Derivatives, which mature within 12 months, are presented as current assets or current liabilities.

Details of the fair values of the derivative instruments used for hedging purposes and movements in the hedging and translation reserve in equity are detailed in the SOCI and described in Note 32.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Hedge accounting is discontinued when the Group de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss, in the same line of the income statement as the recognised hedged item.

Hedge accounting is discontinued when the Group de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

Tax

The tax expense represents the sum of current tax expense and deferred tax expense.

Current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for accounting purposes.

Deferred tax assets are generally recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which these items can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of an asset and liability in a transaction other than a business combination and, at the time of the transaction, affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be utilised.

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same tax authority where the Group intends to settle its current tax assets and liabilities on a net basis.

Share based payment

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of Binomial Lattice, Black-Scholes or Monte Carlo Simulation models depending on the type of scheme, as set out in Note 37. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

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.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Trade receivables

Trade receivables are recognised initially at cost (being the same as fair value) and subsequently at amortised cost less any provision for impairment, to ensure that amounts recognised represent the recoverable amount.

A provision for impairment arises where there is evidence that the Group will not be able to collect amounts due, which is achieved by creating an allowance for doubtful debts recognised in the income statement within administrative expenses. Determining whether a trade receivable is impaired requires judgement to be applied based on the information available at each reporting date. Key indicators of impairment include disputes with customers over commercial positions, or where debtors have significant financial difficulties such as historic default of payments or information that suggests bankruptcy or financial reorganisation are a reasonable possibility. The majority of contracts entered into by the Group are with government organisations and therefore historic levels of default are relatively low and as a result the risks associated with this judgement are not considered to be significant.

When a trade receivable is expected to be uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously provided for or written off are credited against administrative expenses.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant changes in value and have a maturity of three months or less from the date of acquisition. This definition is also used for the consolidated cash flow statement.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Group at fair value or, if lower, at the present value of minimum lease payments determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to the income statement, unless they are directly attributable to a qualifying asset, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

Total rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

Loans

Loans are stated at amortised cost using the effective interest-rate method. Accrued interest is recorded separately from the associated borrowings within current liabilities.

Loans are described as non-recourse loans and classified as such only if no Group company other than the relevant borrower has an obligation, under a guarantee or other arrangement, to repay the debt.

Borrowing costs

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

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

Provisions

Provisions are recognised when the Group has an obligation to make a cash outflow as a result of a past event. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the balance sheet date when settlement is considered to be likely.

Onerous contract provisions (OCPs) arise when the unavoidable costs of meeting contractual obligations exceed the remuneration expected to be received. Unavoidable costs include total contract costs together with a rational allocation of shared costs that can be directly linked to fulfilling contractual obligations which have been systematically allocated to OCPs on the basis of key cost drivers except where this is impracticable, where contract revenue is used as a proxy to activity. The provision is calculated as the lower of the termination costs payable for an early exit and the expected net cost to fulfil the Group's unavoidable contract obligations. Where a customer has an option to extend a contract and it is likely that such an extension will be made, the expected net cost arising during the extension period, is included within the calculation. However, where a profit can be reasonably expected in the extension period, no credit is taken on the basis that such profits are uncertain given the potential for the customer to either not extend or offer an extension under lower pricing terms. Further details of the judgements can be seen in Note 3.

Net investments in foreign operations

Exchange differences arising on monetary items that form part of the Group's net investment in foreign operations are initially recognised in equity and accumulated in the hedging and translation reserve and reclassified from equity to profit or loss on disposal of the net investment.

Dividends payable

Dividends are recorded in the Group's consolidated financial statements in the period in which they are declared, appropriately authorised and no longer at the discretion of the Company.

Segmental information

Segmental information is based on internal reports about components of the Group that are regularly reviewed by the Group's Chief Operating Decision Maker (CODM) in order to allocate resources to the segments and to assess their performance. The CODM is considered to be the Board of Directors as a body.

Segmental revenue is analysed on an external basis. Inter-segment revenue is not presented as it is not significant in the context of revenue as a whole. Net finance costs are not presented for each operating segment as they are reviewed on a consolidated basis by the CODM.

Specific corporate expenses are allocated to the corresponding segments. Segment assets comprise goodwill, other intangible assets, property, plant and equipment, inventories, trade and other receivables (excluding corporation tax recoverable) and any retirement benefit asset. *Segment liabilities comprise trade and other payables and retirement benefit obligations.*

3. Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, which are described in Note 2 above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements. As described below, many of these areas of judgement also involve a high level of estimation uncertainty.

Prior year restatement: Change in accounting policy

The accounting policy regarding the classification of cost items within cost of sales and administrative expenses was changed in the year. Judgement was applied in reaching the conclusion that it provides more relevant financial results to exclude these amounts from the underlying transactions of trading operations. Further details are provided in Note 2.

Use of Alternative Performance Measures: Operating profit before exceptional items

IAS1 requires material items to be disclosed separately in a way that enables users to assess the quality of a company's profitability. In practice, these are commonly referred to as 'exceptional' items, but this is not a concept defined by IFRS and therefore there is a level of judgement involved in arriving at an Alternative Performance Measure which excludes such exceptional items. We consider items which are material and outside of the normal operating practice of the company to be suitable for separate presentation. Further details can be seen in Note 11.

The segmental analysis of continuing operations in Note 5 includes the additional performance measure of Trading Profit on continuing operations which is reconciled to reported operating profit in that note. The Group uses Trading Profit as an alternative measure to reported operating profit by making several adjustments. Firstly, Trading Profit excludes exceptional items, being those we consider material and outside of the normal operating practice of the company to be suitable of separate presentation and detailed explanation. Secondly, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgments about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice. The CODM reviews the segmental analysis for continuing operations together with discontinued operations.

Notes to the Consolidated Financial Statements continued

3. Critical accounting judgements and key sources of estimation uncertainty continued

Provisions for onerous contracts

Determining the carrying value of onerous contract provisions requires assumptions and complex judgements to be made about the future performance of the Group's contracts. The level of uncertainty in the estimates made, either in determining whether a provision is required, or in the calculation of a provision booked, is linked to the complexity of the underlying contract and the form of service delivery. Due to the level of uncertainty and combination of variables associated with those estimates there is a significant risk that there could be material adjustment to the carrying amounts of onerous contract provisions within the next financial year.

Major sources of uncertainty which could result in a material adjustment within the next financial year are:

- The ability of the company to maintain or improve operational performance to ensure costs or performance related penalties are in line with expected levels.
- Volume driven revenue and costs being within the expected ranges.
- The outcome of matters dependent on the behaviour of the customer, such as a decision to extend a contract where it has the unilateral right to do so.
- The outcome of open claims made by or against a customer regarding contractual performance.
- The ability of suppliers to deliver their contractual obligations on time and on budget.

In the current year material revisions have been made to historic provisions, which have led to a charge to contract provisions of £62.0m, including £0.5m in relation to new provisions, and releases of £43.4m. Further details are provided in the Finance Review within the Strategic Report. All of these revisions have resulted from triggering events in the current year, either through changes in contractual positions or changes in circumstances which could not have been reasonably foreseen at the previous balance sheet date. To mitigate the level of uncertainty in making these estimates Management regularly compares actual performance of the contracts against previous forecasts and considers whether there have been any changes to significant judgements. A detailed bottom up review of the provisions is performed as part of the Group's formal annual budgeting process.

The future range of possible outcomes in respect of those assumptions and significant judgements made to determine the carrying value of onerous contracts could result in either a material increase or decrease in the value of onerous contract provisions in the next financial year. The extent to which actual results differ from estimates made at the reporting date depends on the combined outcome and timing of a large number of variables associated with performance across multiple contracts.

The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. Rates applied are in the range of 0.72% and 1.95%.

Investigation by the Serious Fraud Office

In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and/or the Serco entities involved. This was a critical matter in our assessment of the group's going concern and viability statements and in considering the necessary disclosure of contingent liabilities in Note 31.

Impairment of assets

Identifying whether there are indicators of impairment for assets involves a high level of judgement and a good understanding of the drivers of value behind the asset. At each reporting period an assessment is performed in order to determine whether there are any such indicators, which involves considering the performance of our business and any significant changes to the markets in which we operate.

We seek to mitigate the risk associated with this judgement by putting in place processes and guidance for the finance community and internal review procedures.

Determining whether assets with impairment indicators require an actual impairment involves an estimation of the expected value in use of the asset (or CGU to which the asset relates). The value in use calculation involves an estimation of future cash flows and also the selection of appropriate discount rates, both of which involve considerable judgement. The future cash flows are derived from approved forecasts, with the key assumptions being revenue growth, margins and cash conversion rates. Discount rates are calculated with reference to the specific risks associated with the assets and are based on advice provided by external experts. Our calculation of discount rates are performed based on a risk free rate of interest appropriate to the geographic location of the cash flows related to the asset being tested, which is subsequently adjusted to factor in local market risks and risks specific to Serco and the asset itself. Discount rates used for internal purposes are post tax rates, however for the purpose of impairment testing in accordance with IAS36 *Impairment of assets* we calculate a pre-tax rate based on post tax targets.

A key area of focus in recent years has been in the impairment testing of goodwill as a result of the pressure on the results of the Group. However, no impairment of goodwill was noted in the year ended 31 December 2017.

Deferred tax

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits. Recognition has been based on forecast future taxable profits

Further details on taxes are disclosed in Note 17.

Current tax

Liabilities for tax contingencies require management judgement and estimates in respect of tax audits and also tax exposures in each of the jurisdictions in which we operate. Management is also required to make an estimate of the current tax liability together with an assessment of the temporary differences that arise as a consequence of different accounting and tax treatments. Key judgement areas include the correct allocation of profits and losses between the countries in which we operate and the pricing of intercompany services. Where management conclude that a tax position is uncertain, a current tax liability is held for anticipated taxes that are considered probable based on the current information available.

These liabilities can be built up over a long period of time but the ultimate resolution of tax exposures usually occurs at a point in time, and given the inherent uncertainties in assessing the outcomes of these exposures, these estimates are prone to change in future periods. It is not currently possible to estimate the timing of potential cash outflow, but on resolution, to the extent this differs from the liability held, this will be reflected through the tax charge/(credit) for that period. Each potential liability and contingency is revisited on an annual basis and adjusted to reflect any changes in positions taken by the company, local tax audits, the expiry of the statute of limitations following the passage of time and any change in the broader tax environment.

On the basis of the currently available information, the Group does not anticipate a material change to the estimated liability in the short term

Retirement benefit obligations

Identifying whether the Group has a retirement benefit obligation as a result of contractual arrangements entered into requires a level of judgement, largely driven by the legal position held between the Group, the customer and the relevant pension scheme. The Group's retirement benefit obligations and other pension scheme arrangements are covered in Note 33.

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates.

In accounting for the defined benefit schemes, the Group has applied the following principles.

- The asset recognised for the Serco Pension and Life Assurance Scheme is based on the assumption that the full surplus will ultimately be available to the Group as a future refund of surplus
- No foreign exchange item is shown in the disclosures as the non-UK liabilities are not material.
- No pension assets are invested in the Group's own financial instruments or property
- Pension annuity assets are remeasured to fair value at each reporting date based on the share of the defined benefit obligation covered by the insurance contract.

Notes to the Consolidated Financial Statements continued

4. Discontinued operations

The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015 and 2016. The most significant part of this business was disposed in 2015, and the disposal of one of the two remaining elements of the offshore business was completed in March 2016 and the final element completed in December 2016. The residual UK onshore private sector BPO operations were sold or exited in 2016 with the exception of one business consisting of a single contract, where disposal was completed in July 2017. Total revenues for the remaining operations were £5.4m and the loss before exceptional items was £0.6m up to the point of disposal, therefore the results have been included in continuing operations in 2017 on the grounds of materiality. The final contract was sold with no profit or loss on disposal, with a net cash outflow of £0.5m.

The results of the discontinued operations were as follows:

For the year ended 31 December	2016 £m
Revenue	36.8
Expenses	(40.1)
Operating loss before exceptional items	(3.3)
Exceptional loss on disposal of subsidiaries and operations	(2.8)
Other exceptional operating items	(11.4)
Operating loss	(17.5)
Exceptional finance costs	(0.4)
Loss before tax	(17.9)
Tax charge on loss before exceptional items	(0.1)
Net loss attributable to discontinued operations presented in the income statement	(18.0)
Attributable to:	
Equity owners of the Company	(18.1)
Non-controlling interests	0.1

Included above are items classified as exceptional as they are considered to be material and outside of the normal course of business. These are summarised as follows:

For the year ended 31 December	2016 £m
Exceptional items arising on discontinued operations	
Exceptional loss on disposal	(2.8)
Other exceptional operating items	
Restructuring costs	(1.1)
Impairment of goodwill	—
Movements in indemnities provided on business disposals	(13.7)
Movement in the fair value of assets transferred to held for sale	3.4
Other exceptional operating items	(11.4)
Exceptional operating items arising on discontinued operations	(14.2)

In 2016 a charge of £1.1m arose in discontinued operations in relation to the restructuring programme resulting from the Strategy Review. This included redundancy payments, provisions and other charges relating to the exit of the UK private sector BPO business, external advisory fees and other incremental costs.

A charge of £13.7m arose in 2016 in relation to the movement in the value of indemnities provided on business disposals made in previous years. These relate to changes in exchange rates where indemnities were provided in foreign currencies and increases to provisions for interest and penalties on any indemnities. There were no changes in the value of these indemnities in 2017.

A charge of £0.4m was incurred in 2016 as a result of early payments to the US Private Placement (USPP) Noteholders following the disposal of the offshore private sector BPO business. These charges were treated as exceptional finance costs as they were directly linked to the restructuring resulting from the Strategy Review.

The net cash flows resulting from the discontinued operations were as follows

For the year ended 31 December	2016 £m
Net cash inflow from operating activities before exceptional items	5.5
Exceptional items	–
Net cash inflow from operating activities	5.5
Net cash inflow from investing activities	12.5
Net cash outflow from financing activities	(11.4)
Net increase in cash and cash equivalents attributable to discontinued operations	6.6

5. Segmental information

The Group's operating segments reflecting the information reported to the Board in 2017 under IFRS8 *Operating Segments* are as set out below

Reportable segments	Operating segments
UK & Europe	Services for sectors including Citizen Services, Defence, Health, Justice & Immigration and Transport delivered to UK Government, UK devolved authorities and other public sector customers in the UK and Europe;
Americas	Services for sectors including Defence, Transport and Citizen Services delivered to US federal and civilian agencies, selected state and municipal governments and the Canadian Government;
AsPac	Services for sectors including Defence, Justice & Immigration, Transport, Health and Citizen Services in the Asia Pacific region including Australia, New Zealand and Hong Kong;
Middle East	Services for sectors including Defence, Transport and Health in the Middle East region; and
Corporate	Central and head office costs.

Each operating segment is focused on a narrow group of customers in a specific geographic region and is run by a local management team which report directly to the CODM on a regular basis. As a result of this focus, the sectors in each region have similar economic characteristics and are aggregated at the operating segment level in these financial statements

During the year two existing divisions, UK Central Government and UK & Europe Local & Regional Government, were merged to form the new UK & Europe division (UK&E) with the management team structure and responsibilities altered to match the segment. This note has been adjusted to reflect the impact of this, which has been to add together the results of the two former divisions in the comparative period

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 2017 £m	Non-current assets* 2017 £m	Revenue 2016 £m	Non-current assets* 2016 £m
United Kingdom	1,185.2	340.3	1,244.9	444.7
United States	623.6	273.3	632.9	309.1
Australia	559.3	143.2	593.1	146.0
Middle East	351.9	18.0	324.8	19.7
Other countries	235.3	21.7	215.3	20.4
Total	2,953.6	796.5	3,011.0	939.9

* Non-current assets exclude financial instruments, deferred tax assets and loans to joint ventures and associates

Revenues from external customers are attributed to individual countries on the basis of the location of the customer

Notes to the Consolidated Financial Statements continued

5. Segmental information continued**Information about major customers**

The Group has four major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were £1,102.9m for the UK Government within the UK & Europe segment, £569.7m for the US Government within the Americas segment, £522.1m for the Australian Government within the AsPac segment and £238.4m for the Government of the United Arab Emirates within the Middle East segment.

In 2016 the Group had three major governmental customers which each represented more than 10% of Group revenues. The customers' revenues were £1,233.7m for the UK Government within the UK & Europe segment, £623.1m for the US Government within the Americas segment and £581.4m for the Australian Government within the AsPac segment

The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment.

Year ended 31 December 2017	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Revenue	1,334.7	688.0	579.0	351.9	–	2,953.6
Result						
Trading profit/(loss) from continuing operations*	4.5	39.8	35.1	16.2	(41.6)	54.0
Amortisation and impairment of intangibles arising on acquisition	–	(3.0)	(1.4)	–	–	(4.4)
Operating profit/(loss) before exceptional items	4.5	36.8	33.7	16.2	(41.6)	49.6
Exceptional profit/(loss) on disposal of subsidiaries and operations	0.3	–	–	–	–	0.3
Other exceptional operating items**	11.9	(0.3)	(7.4)	0.1	(24.2)	(19.9)
Operating profit/(loss)	16.7	36.5	26.3	16.3	(65.8)	30.0
Investment revenue						7.6
Finance costs						(19.2)
Other gains						0.7
Profit before tax						19.1
Tax charge						(14.0)
Tax on exceptional items						(5.0)
Profit for the year from continuing operations						0.1

* Trading profit/(loss) is defined as operating profit/(loss) before exceptional items and amortisation and impairment of intangible assets arising on acquisition

** Exceptional items incurred by the Corporate segment are not allocated to other segments. Such items may represent costs that will benefit the wider business

Year ended 31 December 2017	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Supplementary information						
Share of profits in joint ventures and associates, net of interest and tax	26.6	–	0.8	–	(0.1)	27.3
Depreciation of plant, property and equipment	(14.0)	(3.2)	(4.9)	(0.8)	(1.4)	(24.3)
Impairment of plant, property and equipment	0.1	–	–	–	–	0.1
Total depreciation and impairment of plant, property and equipment	(13.9)	(3.2)	(4.9)	(0.8)	(1.4)	(24.2)
Amortisation of intangible assets arising on acquisition	–	(3.0)	(1.4)	–	–	(4.4)
Exceptional impairment and write down of intangible assets arising on acquisition	–	–	(6.1)	–	–	(6.1)
Amortisation of other intangible assets	(1.1)	(1.5)	(4.8)	(0.2)	(13.8)	(21.4)
Exceptional impairment of other intangible assets	–	–	–	–	(2.8)	(2.8)
Total amortisation and impairment of intangible assets	(1.1)	(4.5)	(12.3)	(0.2)	(16.6)	(34.7)
Segment assets						
Interests in joint ventures and associates	13.5	–	0.4	0.4	–	14.3
Other segment assets***	445.9	391.3	223.4	112.0	133.2	1,305.8
Total segment assets	459.4	391.3	223.8	112.4	133.2	1,320.1
Unallocated assets						192.7
Consolidated total assets						1,512.8
Segment liabilities						
Segment liabilities***	(368.5)	(128.6)	(148.5)	(80.7)	(142.0)	(868.3)
Unallocated liabilities						(337.3)
Consolidated total liabilities						(1,205.6)

*** The Corporate segment assets and liabilities include balance sheet items which provide benefit to the wider Group, including defined benefit pension schemes and corporate intangible assets.

Notes to the Consolidated Financial Statements continued

5. Segmental information continued

Year ended 31 December 2016 (restated***)	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Revenue	1,375.1	691.4	619.7	324.8	–	3,011.0
Result						
Trading profit/(loss) from continuing operations*	84.5	6.4	34.2	18.8	(40.3)	103.6
Amortisation and impairment of intangibles arising on acquisition	(0.3)	(2.8)	(2.0)	–	–	(5.1)
Operating profit/(loss) before exceptional items	84.2	3.6	32.2	18.8	(40.3)	98.5
Exceptional profit/(loss) on disposal of subsidiaries and operations	4.4	–	0.4	–	(1.9)	2.9
Other exceptional operating items**	(25.9)	–	(0.9)	–	(32.4)	(59.2)
Operating profit/(loss)	62.7	3.6	31.7	18.8	(74.6)	42.2
Investment revenue						9.3
Finance costs						(21.9)
Profit before tax						29.6
Tax charge						(15.8)
Tax on exceptional items						3.1
Profit for the year from continuing operations						16.9

* Trading profit/(loss) is defined as operating (loss)/profit before exceptional items and amortisation and impairment of intangible assets arising on acquisition

** Exceptional items incurred by the Corporate segment are not allocated to other segments. Such items may represent costs that will benefit the wider business

*** During the year two existing divisions, UK Central Government and UK & Europe Local & Regional Government, were merged to form the new UK & Europe division. This note has been adjusted to reflect the impact of this, which has been to add together the results of the two former divisions.

Supplementary information

Share of profits in joint ventures and associates, net of interest and tax	31.3	–	2.0	–	0.1	33.4
Depreciation of plant, property and equipment	(15.0)	(3.1)	(4.5)	(0.9)	(1.3)	(24.8)
Impairment of plant, property and equipment	(0.3)	–	(0.4)	–	–	(0.7)
Total depreciation and impairment of plant, property and equipment	(15.3)	(3.1)	(4.9)	(0.9)	(1.3)	(25.5)
Amortisation of intangible assets arising on acquisition	(0.3)	(2.8)	(1.3)	–	–	(4.4)
Impairment and write down of intangible assets arising on acquisition	–	–	(0.7)	–	–	(0.7)
Amortisation of other intangible assets	(0.6)	(1.5)	(3.3)	(0.7)	(15.7)	(21.8)
Total amortisation and impairment of intangible assets	(0.9)	(4.3)	(5.3)	(0.7)	(15.7)	(26.9)
Segment assets						
Interests in joint ventures and associates	12.3	–	1.7	0.4	–	14.4
Other segment assets****	467.0	428.8	252.1	108.7	228.6	1,485.2
Total segment assets	479.3	428.8	253.8	109.1	228.6	1,499.6
Unallocated assets, including assets held for sale						265.0
Consolidated total assets						1,764.6
Segment liabilities						
Segment liabilities****	(442.9)	(140.7)	(182.8)	(79.3)	(139.7)	(985.4)
Unallocated liabilities, including liabilities held for sale						(380.4)
Consolidated total liabilities						(1,365.8)

**** The Corporate segment assets and liabilities include balance sheet items which provide benefit to the wider Group, including defined benefit pension schemes and corporate intangible assets

6. List of principal undertakings

The following are considered to be the principal undertakings of the Group as at the year end:

Principal subsidiaries		2017	2016
United Kingdom	Serco Limited	100%	100%
Australia	Serco Australia Pty Limited	100%	100%
USA	Serco Inc.	100%	100%
Principal joint ventures and associates		2017	2016
United Kingdom	AWE Management Limited	24.5%	24.5%
United Kingdom	Merseyrail Services Holding Company Limited	50%	50%
United Kingdom	Northern Rail Holdings Limited	50%	50%

A full list of subsidiaries and related undertakings is included in the Appendix on pages 234 to 236 which form part of the financial statements.

7. Joint ventures and associates

AWE Management Limited (AWEML), Merseyrail Services Holding Company Limited (MSHCL) and Northern Rail Holdings Limited (NRHL) were the only equity accounted entities which were material to the Group during the year or prior year. Dividends of £17.1m (2016: £19.6m), £7.3m (2016: £7.3m) and £1.8m (2016: £10.0m) respectively were received from these companies in the year. The Northern Rail franchise ended on 31 March 2016.

Summarised financial information of AWEML, MSHCL, NRHL and an aggregation of the other equity accounted entities in which the Group has an interest is as follows:

31 December 2017

Summarised financial information	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Revenue	951.8	155.7	0.3	311.2	45.5	356.7
Operating profit	90.8	17.8	3.8	33.0	1.4	34.4
Net investment revenue/(finance costs)	0.2	(0.2)	–	(0.1)	–	(0.1)
Income tax charge	(19.2)	(3.9)	(0.5)	(6.9)	(0.1)	(7.0)
Profit from continuing operations	72.2	13.7	3.3	26.0	1.3	27.3
Other comprehensive income	–	2.0	–	1.0	(0.1)	0.9
Total comprehensive income	72.2	15.7	3.3	27.0	1.2	28.2
Non-current assets	665.6	8.7	–	167.5	2.2	169.7
Current assets	197.3	43.5	5.2	72.7	14.5	87.2
Current liabilities	(179.0)	(37.0)	(2.0)	(63.4)	(13.0)	(76.4)
Non-current liabilities	(664.3)	(1.6)	–	(163.5)	(2.7)	(166.2)
Net assets	19.6	13.6	3.2	13.3	1.0	14.3
Proportion of group ownership	24.5%	50.0%	50.0%	–	–	–
Carrying amount of investment	4.8	6.8	1.6	13.3	1.0	14.3

* Total results of the entity multiplied by the respective proportion of Group ownership

Notes to the Consolidated Financial Statements *continued***7. Joint ventures and associates** *continued***31 December 2017** *continued*

	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	77.2	33.6	6.0	38.7	2.5	41.2
Current financial liabilities excluding trade and other payables and provisions	(8.3)	(1.9)	0.1	(2.9)	(0.6)	(3.5)
Non-current financial liabilities excluding trade and other payables and provisions	—	—	—	—	(2.7)	(2.7)
Depreciation and amortisation	—	(2.2)	—	(1.1)	(1.4)	(2.5)
Interest income	0.2	0.1	—	0.1	—	0.1
Interest expense	—	(0.3)	—	(0.2)	—	(0.2)

* Total results of the entity multiplied by the respective proportion of Group ownership

The financial statements of MSHCL are for a period which is different from that of the Group, being for the 52 week period ended 6 January 2018 (2016: 52 week period ended 7 January 2017). The 52 week period reflects the joint venture's internal reporting structure and is sufficiently close so as to not require adjustment to match that of the Group. The NRHL franchise ended on 31 March 2016, with the results reflected in year ended 31 December 2017 reflecting the ongoing post contract negotiations.

Certain employees of the groups headed by AWEML and MSHCL are members of sponsored defined benefit pension schemes. Given the significance of the schemes to understanding the position of the entities the following key disclosures are made:

Main assumptions: 2017	AWEML	MSHCL
Rate of salary increases (%)	2.2%	3.1%
Inflation assumption (CPI %)	2.2%	2.2%
Discount rate (%)	2.6%	2.5%
Post-retirement mortality		
Current male industrial pensioners at 65 (years)	22.9	N/A
Future male industrial pensioners at 65 (years)	25.2	N/A

Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(2,233.3)	(304.4)
Fair value of scheme assets	1,569.1	193.9
Net amount recognised	(664.2)	(110.5)
Members' share of deficit	—	44.2
Franchise adjustment*	—	66.3
Related asset, right to reimbursement	664.2	—
Net retirement benefit obligation	—	—

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

31 December 2016

Summarised financial information	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Revenue	968.1	150.3	132.7	437.5	43.3	480.8
Operating profit	72.9	18.9	13.2	37.4	3.3	40.7
Net investment revenue/(finance costs)	0.2	(1.3)	0.1	(0.5)	(0.1)	(0.6)
Income tax (charge)/credit	(11.3)	(3.7)	(3.4)	(6.8)	0.1	(6.7)
Profit from continuing operations	61.8	13.9	9.9	30.1	3.3	33.4
Other comprehensive income	–	34.0	0.8	17.4	(1.6)	15.8
Total comprehensive income	61.8	47.9	10.7	47.5	1.7	49.2
Non-current assets	1,097.0	12.5	–	275.1	3.2	278.3
Current assets	149.3	32.8	14.2	60.1	16.0	76.1
Current liabilities	(133.9)	(31.9)	(10.7)	(54.2)	(14.0)	(68.2)
Non-current liabilities	(1,095.2)	(0.9)	–	(268.7)	(3.1)	(271.8)
Net assets	17.2	12.5	3.5	12.3	2.1	14.4
Proportion of group ownership	33%/24.5%	50%	50%	–	–	–
Carrying amount of investment	4.2	6.3	1.8	12.3	2.1	14.4

* Total results of the entity multiplied by the respective proportion of Group ownership

	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	72.4	21.1	14.5	35.4	4.7	40.1
Current financial liabilities excluding trade and other payables and provisions	(7.0)	(2.3)	(0.5)	(3.1)	(0.9)	(4.0)
Non-current financial liabilities excluding trade and other payables and provisions	–	(0.6)	–	(0.3)	(3.0)	(3.3)
Depreciation and amortisation	–	(2.3)	(1.7)	(2.1)	(1.0)	(3.1)
Interest income	0.2	–	0.1	0.2	–	0.2
Interest expense	–	(1.3)	–	(0.6)	(0.1)	(0.7)

* Total results of the entity multiplied by the respective proportion of Group ownership

Key disclosures with respect of the defined benefit pension schemes of material joint ventures and associates:

Main assumptions: 2016	AWEML	MSHCL
Rate of salary increases (%)	2.3%	2.3%
Inflation assumption (CPI %)	2.3%	2.3%
Discount rate (%)	2.7%	2.7%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.8	N/A
Future male industrial pensioners at 65 (years)	24.9	N/A

Retirement benefit funding position (100% of results)	AWEML £m	MSHCL £m
Present value of scheme liabilities	(2,556.0)	(275.7)
Fair value of scheme assets	1,460.9	171.1
Net amount recognised	(1,095.1)	(104.6)
Members' share of deficit	–	62.8
Franchise adjustment*	–	41.8
Related asset, right to reimbursement	1,095.1	–
Net retirement benefit obligation	–	–

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

Notes to the Consolidated Financial Statements continued

8. Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC, for consideration of US Dollar \$20.5m in cash. Further details on this post year-end transaction are provided in Note 40.

The Group signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The portfolio has annual revenues of approximately £90m and a weighted average remaining term of 14 years. Upon the receipt by the Special Managers and Provisional Liquidators of the requisite third party consents, each individual contract will be transferred to Serco on a cash-free, debt-free basis, with the consideration to be paid in instalments and to be satisfied using Serco's existing financing facilities. If all the contracts are transferred to Serco under the revised BPA process, the total consideration payable would be £29.7m. The consideration payable is lower than the amount of £47.7m announced on 13 December 2017 in respect of substantially the same contracts that were subject to the initial BPA signed with Carillion plc at that date. The change in consideration reflects the Group's re-evaluation of potential liabilities, indemnities, warranties and the additional working capital investment required as a result of Carillion's liquidation. The financial effects of this transaction have not been recognised at 31 December 2017. As consents are required for each individual contract to be transferred and therefore acquired, at the time the financial statements were authorised for issue no legal transfer or control of assets had taken place and so no disclosures have been made in respect of the assets and liabilities being acquired. The fair values of the assets and liabilities will be determined at the date when contracts are acquired. It is also not yet possible to provide detailed information about each class of acquired receivables and any contingent liabilities in respect of the acquired contracts.

On 24 August 2017 the Group acquired 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd (SSDS) for £1.6m, obtaining full control. SSDS was previously a 50% owned joint venture accounted for on an equity accounting basis. The business has a contract with the Australian Defence Forces Joint Logistics Command relating to the operation of the Defence Forces national clothing stores and strengthens the financial performance of the AsPac division. As a result of the increase in ownership from 50% to 100% the Group fair valued the existing 50% shareholding held at £0.2m, with the resulting uplift in value of £0.7m being recorded in Other gains, outside of operating results. The amounts recognised in respect of the identifiable assets acquired and the liabilities assumed are as set out in the table below:

	Provisional fair value £m
Intangible assets, excluding goodwill	0.9
Trade and other receivables	1.6
Deferred tax assets	1.0
Cash and cash equivalents	3.1
Trade and other payables	(3.3)
Provisions	(1.7)
Acquisition date fair value of consideration transferred	1.6
Satisfied by:	
Cash	0.4
Deferred consideration	1.2
Total consideration	1.6

The net cash inflow as a result of the acquisition was £2.7m, being £3.1m cash acquired less £0.4m consideration paid.

No acquisition related costs were incurred.

The additional stake in SSDS contributed £3.8m and £0.7m to operating profit before exceptional items in the period from acquisition to 31 December 2017. Had the acquisition taken place on 1 January 2017 Group revenue and operating profit before exceptional items for the year would have increased by £4.2m and £0.6m respectively, taking total Group revenue to £2,957.8m and total Group operating profit before exceptional items to £50.2m.

Cash payments were made in the year relating to historic acquisitions. The total impact of acquisitions in the year to the Group's cash flow position was as follows:

	£m
Cash and cash equivalents in SSDS	3.1
Cash payments in respect of SSDS consideration	(0.4)
Deferred consideration paid in respect of Anglia Support Partnership	(1.2)
Net cash inflow arising on acquisitions in the year	1.5

9. Disposals

A summary of the disposals taking place in the year ended 31 December 2017 were as follows:

	Profit/(loss) on disposal £m	Cash flow £m
Disposal of Service Glasgow LLP	–	(6.7)
Disposal of final remaining UK onshore private sector BPO contract	–	(0.5)
Impact of historic transactions	0.3	0.1
	0.3	(7.1)

There were no disposals of continuing operations in 2016, the profit on disposal of £2.9m related to transactions completing in prior years

In December 2017 the Group's interest in Service Glasgow LLP was disposed of, resulting in a net cash outflow of £6.7m with no profit or loss on disposal. Further details are provided below.

	Service Glasgow LLP £m
Inventories	0.9
Trade and other receivables	4.7
Cash and cash equivalents	6.7
Trade and other payables	(9.9)
Provisions	(0.5)
Net assets disposed	1.9

No profit or loss was made on the disposal:

	Service Glasgow LLP £m
Consideration	1.6
Less:	
Net assets disposed	(1.9)
Non-controlling interests disposed of	0.3
Income statement impact of disposal	–

The net cash inflow arising on disposal of discontinued operations and the impact on Net Debt is as follows:

	Service Glasgow LLP £m
Consideration	1.6
Less:	
Deferred consideration	(1.6)
Cash and cash equivalents disposed	(6.7)
Net cash flow on disposal and movement in Net Debt	(6.7)

10. Revenue

An analysis of the Group's revenue is as follows

Year ended 31 December	2017 £m	2016 £m
Revenue from service contracts, being revenue as disclosed in the consolidated income statement	2,953.6	3,011.0
Investment revenue (Note 14)	7.6	9.3
Operating lease income	2.4	0.8
Total revenue as defined in IAS18	2,963.6	3,021.1

Notes to the Consolidated Financial Statements continued

11. Exceptional items

Exceptional items are items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the underlying performance of the Group.

Exceptional items arising on discontinued operations are disclosed on the face of the income statement within the loss attributable to discontinued operations, of which there are none in 2017 (2016: charge of £3.4m), whereas those arising on continuing operations are disclosed on the face of the income statement within exceptional operating items. Further information regarding the exceptional items arising on discontinued operations in 2016 can be seen in Note 4.

Exceptional gain on disposal of subsidiaries and operations

The exceptional net gain on disposals is included in Note 9.

Other exceptional operating items arising on continuing operations

For the year ended 31 December	2017 £m	2016 £m
Impairment of goodwill	–	(17.8)
Restructuring costs	(28.6)	(17.2)
Aborted transaction costs	–	(0.1)
Costs associated with UK Government review	(0.4)	(0.1)
Release of UK frontline clinical health contract provisions	0.4	0.6
Settlement of defined benefit pension obligations	10.3	(10.7)
Impairment of interest in joint venture and related loan balances	4.5	(13.9)
Impairment of AsPac customer lists	(6.1)	–
Other exceptional operating items	(19.9)	(59.2)

Goodwill is tested for impairment annually or more frequently if there are indications that there is a risk that it could be impaired. The recoverable amount of each cash generating unit (CGU) is based on value in use calculations derived from forecast cash flows based on past experience, adjusted to reflect market trends, economic conditions, the Group's strategy and key risks. These forecasts include an estimated level of new business wins and contract attrition and an assumption that the final year forecast continues into perpetuity at a CGU specific terminal growth rate. The terminal growth rates are provided by external sources and are based on the long-term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long-term growth rates forecast for the individual markets.

In 2016, goodwill of £17.8m arose following the acquisition of Orchard & Shipman (Glasgow) Limited, the Group's subcontractor on the COMPASS contract, providing accommodation to asylum seekers in Scotland and Northern Ireland on behalf of the Home Office. This goodwill was then immediately impaired as the CGU is forecast to be loss making and therefore the asset cannot be supported. The annual impairment testing of CGUs in 2017 has identified no other impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions, external advisory fees and other incremental costs, including in 2017 £2.8m of intangible asset impairment (2016: £nil). Due to the nature and scale of the impact of the transformation phase of the Strategy Review the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non-business as usual costs. In 2017, a charge of £28.6m (2016: £17.2m) arose in relation to the restructuring programme resulting from the Strategy Review. The Strategy Review is discussed in more detail in the Strategic Report on page 16. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £11.1m (2016: £6.7m). We expect restructuring costs of approximately £35m to be incurred in 2018 which will be treated as exceptional.

The disposal of the Environmental and Leisure businesses was aborted in 2015 and during 2016 costs related to the aborted transaction were finalised, resulting in a charge of £nil (2016: £0.1m).

In 2017, there were exceptional costs totalling £0.4m (2016: £0.1m) associated with the UK Government reviews and the programme of Corporate Renewal. These costs were treated as exceptional when the matter first arose and consistent treatment is applied in 2017.

In 2017 there were releases of provisions of £0.4m (2016: £0.6m) which were previously charged through exceptional items in relation to the exit of the UK Frontline Clinical Health contracts.

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items.

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

As a result of contracts coming to the end of their natural lives and no significant new contracts being awarded by the customer, the remaining customer relationship intangible assets of the DMS Maritime Pty Limited business acquired in 2012 were impaired, totalling £6.1m.

Tax impact of above items

Exceptional tax for the year was a tax charge of £5.0m (2016: £3.1m credit) comprising a £2.3m credit on exceptional items within operating profit and a £7.3m charge in respect of other exceptional tax items.

Exceptional costs of £19.6m only gave rise to a credit of £2.3m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

The other exceptional tax items relate to two matters, the first is the impact on tax of the pension buy-in disclosed in Note 33 which led to a £95.0m reduction in the IFRS valuation of the Group's defined benefit pension schemes and consequently a deferred tax charge to the income statement of £16.1m. Movements in the valuation of the Group's defined benefit pension schemes and the associated deferred tax impact are reported in the Statement of Comprehensive Income (SOC) and do not flow through the income statement, therefore do not impact profit before tax or the tax charge. However, the net amount of deferred tax recognised in the balance sheet relates to both the pension accounting and other timing differences, such as recoverable losses. As the net deferred tax balance sheet position is at the level supported by future profit forecasts, the decrease in the deferred tax liability associated with the pension scheme (with the benefit reported in the SOC) leads to a corresponding decrease in the deferred tax asset to match the future profit forecasts. Such a reduction in the deferred tax asset therefore leads to a charge to tax in the income statement. Where deferred tax charges or releases are the result of movements in the pension scheme valuations rather than trading activity, these are excluded from the calculation of tax on underlying profit and the underlying effective tax rate, with the prior periods being restated to reflect this. These amounted to £1.9m for 2017 (2016: £nil).

The second element is a credit of £8.8m related to legislative changes in the UK and the US which have impacted the value of deferred tax held on the balance sheet. There is a reduction in the deferred tax liability that is held in connection with our US operations of £12.5m, as future US tax liabilities are expected to crystallise at lower US tax rates. The fall in future expected US rates is primarily due to the enactment of the Tax Cuts & Jobs Act in December 2017 which reduces the corporate income tax rate in the US from 35% to 21% effective from 1 January 2018. In addition, there was a change in UK tax law in 2017. This UK change will reduce the quantum of loss brought forward that can be used to offset taxable profits arising in a year, and will also enable losses carried forward in one company to be used to offset profits in another. The combined impact of these UK law changes results in a tax charge of £3.7m.

12. Operating profit

Operating profit is stated after charging/(crediting):

Year ended 31 December	2017 £m	2016 £m
Research and development costs	17	36
Exceptional goodwill impairment (Note 11)	–	17.8
Exceptional impairment of intangible assets	8.9	–
Loss on disposal of property, plant and equipment	0.2	0.4
Loss on disposal of intangible assets	0.3	0.8
Depreciation and impairment of property, plant and equipment	24.2	25.5
Amortisation and impairment of intangible assets – arising on acquisition	4.4	5.1
Amortisation, write down and impairment of intangible assets – other	21.4	21.8
Exceptional net gain on disposal of subsidiaries and operations (Note 9)	(0.3)	(2.9)
Staff costs (Note 13)	1,525.0	1,526.8
Allowance for doubtful debts charged/(credited) to income statement	0.7	(0.1)
Net foreign exchange charge	1.2	0.7
Movement on non-designated hedges and reclassified cash flow hedges	(0.2)	(0.6)
Lease payments recognised through operating profit	99.6	99.5
Operating lease income from sub-leases (Note 10)	(2.4)	(0.8)

Notes to the Consolidated Financial Statements continued**12. Operating profit** continued

Amounts payable to by the Company and its subsidiary undertakings in respect of audit and non-audit services to the Company's Auditor are shown below.

Year ended 31 December	2017 £m	2016 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	1.0	0.8
Fees payable to the Company's Auditor and their associates for other services to the Group:		
– audit of the Company's subsidiaries pursuant to legislation	0.2	0.5
Total audit fees	1.2	1.3
– Audit-related assurance services	0.1	0.2
– Tax compliance services	–	0.1
– Tax advisory services	–	0.2
– Other services	0.1	0.3
Total non-audit fees	0.2	0.8

The 2016 non-audit fees represent those paid to the current Auditor subsequent to appointment in May 2016. During 2016, prior to appointment, non-audit fees of £0.5m (tax advisory services £0.2m, internal audit services £0.1m and other services £0.2m), were paid to KPMG LLP, bringing the total non-audit fees paid to KPMG LLP during the year to £1.3m.

Fees payable to the Company's Auditor for non-audit services to the Company are not required to be disclosed separately because the consolidated financial statements are required to disclose such fees on a consolidated basis.

Details of the Company's policy on the use of auditors for non-audit services and how the auditor's independence and objectivity was safeguarded are set out in the Audit Committee Report on page 101. No services were provided pursuant to contingent fee arrangements.

13. Staff costs

The average number of persons employed by the Company (including Executive Directors) was:

Year ended 31 December	2017 number	2016 number (restated*)
UK & Europe	21,222	20,931
Americas	7,421	8,459
AsPac	8,739	9,514
Middle East	4,428	4,347
Unallocated	954	946
	42,764	44,197

* Headcount reported in the prior year has been restated from providing full time equivalent data to the monthly average number of persons employed at each month end

The average number of persons employed includes all permanent employees and those with fixed term contracts. It excludes self employed contractors and other casual workers.

Aggregate remuneration of all employees based on the average number of employees reported above was:

Year ended 31 December	2017 £m	2016 £m
Wages and salaries	1,326.5	1,332.3
Social security costs	102.9	100.3
Other pension costs (Note 33)	84.2	84.6
	1,513.6	1,517.2
Share based payment expense (Note 37)	11.4	9.7
	1,525.0	1,526.9

14. Investment revenue

Year ended 31 December	2017 £m	2016 £m
Interest receivable on other loans and deposits	2.6	3.6
Net interest receivable on retirement benefit obligations (Note 33)	3.8	4.7
Movement in discount on other debtors	1.2	1.0
	7.6	9.3

15. Finance costs

Year ended 31 December	2017 £m	2016 £m
Interest payable on obligations under finance leases	1.3	1.6
Interest payable on other loans	14.0	15.6
Facility fees and other charges	3.0	3.5
Movement in discount on provisions	1.3	2.4
	19.6	23.1
Foreign exchange on financing activities	(0.4)	(1.2)
	19.2	21.9

Notes to the Consolidated Financial Statements continued

16. Tax

16 (a) Income tax recognised in the income statement

Year ended 31 December	Before exceptional items 2017 £m	Exceptional items 2017 £m	Total 2017 £m	Before exceptional items 2016 £m	Exceptional items 2016 £m	Total 2016 £m
Current income tax						
Current income tax charge/(credit)	14.6	(2.3)	12.3	12.1	(1.3)	10.8
Adjustments in respect of prior years	(0.8)	–	(0.8)	3.6	–	3.6
Deferred tax						
Current year charge/(credit)	2.1	7.3	9.4	1.2	(1.8)	(0.6)
Adjustments in respect of prior years	(1.9)	–	(1.9)	(1.1)	–	(1.1)
	14.0	5.0	19.0	15.8	(3.1)	12.7

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 2017 £m	Exceptional items 2017 £m	Total 2017 £m	Before exceptional items 2016 £m	Exceptional items 2016 £m	Total 2016 £m
Profit before tax	38.7	(19.6)	19.1	85.9	(56.3)	29.6
Tax calculated at a rate of 19.25% (2016: 20.00%)	7.5	(3.8)	3.7	17.1	(11.2)	5.9
Expenses not deductible for tax purposes*	5.9	0.3	6.2	5.7	9.2	14.9
UK unprovided deferred tax**	(4.6)	2.9	(1.7)	(3.9)	–	(3.9)
Other unprovided deferred tax	2.3	0.1	2.4	0.3	1.0	1.3
Effect of the use of unrecognised tax losses	(1.2)	(0.5)	(1.7)	(3.1)	–	(3.1)
Impact of changes in statutory tax rates on current income tax	1.3	(2.2)	(0.9)	–	–	–
Change in deferred tax as a result of legislative changes	–	(8.8)	(8.8)	–	–	–
Overseas rate differences	9.6	(0.8)	8.8	4.6	–	4.6
Other non-taxable income	(0.9)	(0.5)	(1.4)	(0.7)	(0.4)	(1.1)
Adjustments in respect of prior years	(2.9)	–	(2.9)	2.5	–	2.5
Adjustments in respect of deferred tax on pensions	2.2	18.3	20.5	–	(1.7)	(1.7)
Adjustments in respect of equity accounted investments	(5.2)	–	(5.2)	(6.7)	–	(6.7)
Tax charge	14.0	5.0	19.0	15.8	(3.1)	12.7

* Relates to costs that are not allowable for tax deduction under local tax law. Non-deductible expenses in relation to exceptional items relate mainly to capital expenses, such as the impairments that are not deductible for tax.

** Arises due to timing differences between when an amount is recognised in the income statement and when the amount is subject to UK tax. In the current year, the Group has received tax deductions for amounts which have been charged to the income statement in previous periods in connection with items such as fixed assets.

The income tax charge for the year is based on the blended UK statutory rate of corporation tax for the period of 19.25% (2016: 20.00%). Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

16 (b) Income tax recognised in the SOCI

Year ended 31 December	2017 £m	2016 £m
Current tax		
Taken to retirement benefit obligations reserve	–	–
Deferred tax		
Taken to retirement benefit obligations reserve	18.1	(1.7)
	18.1	(1.7)

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 net deferred tax assets during the year was as follows.

	2017 £m	2016 £m
At 1 January – asset	(20.3)	(19.9)
Income statement charge/(credit)	7.6	(2.0)
Items recognised in equity and in other comprehensive income	(18.1)	1.7
Arising on acquisition of subsidiary	(1.0)	–
Exchange differences	(2.8)	(0.1)
At 31 December – asset	(34.6)	(20.3)

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

	Temporary differences on assets/intangibles £m	Share based payment and employee benefits £m	Retirement benefit schemes £m	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2017	36.5	(12.0)	17.6	(17.8)	(10.3)	(34.3)	(20.3)
(Credited)/charged to income statement (Note 16a)	(6.7)	0.3	2.8	9.2	(8.4)	10.4	7.6
Items recognised in equity and in other comprehensive income (Note 16b)	–	–	(18.1)	–	–	–	(18.1)
Arising on acquisition of subsidiary	(0.1)	(0.9)	–	–	–	–	(1.0)
Exchange differences	(3.9)	0.4	0.2	0.7	–	(0.2)	(2.8)
At 31 December 2017	25.8	(12.2)	2.5	(7.9)	(18.7)	(24.1)	(34.6)

Of the amount charged to the income statement, £0.1m (2016: credit of £0.3m) has been taken to cost of sales in respect of the R&D Expenditure credit. Other temporary differences include a deferred tax asset of £nil in respect of derivative financial instruments (2016: £0.1m).

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

	Temporary differences on assets/intangibles £m	Share based payment and employee benefits £m	Retirement benefit schemes £m	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2016	26.8	(9.7)	17.8	(28.3)	(10.8)	(15.7)	(19.9)
(Credited)/charged to income statement (Note 16a)	0.9	(0.5)	(1.5)	14.7	0.6	(16.2)	(2.0)
Items recognised in equity and in other comprehensive income (Note 16b)	–	–	1.7	–	–	–	1.7
Exchange differences	8.8	(1.8)	(0.4)	(4.2)	(0.1)	(2.4)	(0.1)
At 31 December 2016	36.5	(12.0)	17.6	(17.8)	(10.3)	(34.3)	(20.3)

Notes to the Consolidated Financial Statements continued

17. Deferred tax continued

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:

	2017 £m	2016 £m
Deferred tax liabilities	20.4	30.5
Deferred tax assets	(55.0)	(50.8)
	(34.6)	(20.3)

As at the balance sheet date, the UK has a potential deferred tax asset of £177m (2016: £147m) available for offset against future profits. A deferred tax asset has currently been recognised of £17.4m. Recognition has been based on forecast future taxable profits. No deferred tax asset has been recognised in respect of the remaining asset (net £160m) based on current forecasts; additional asset recognition is contingent on further improvement in the UK profit forecast. In the summer of 2016, UK Government announced a reduction in the UK corporation tax rate from 20% to 19% effective from April 2017. Further measures enacted during 2016 cut the rate further from April 2020 to 17%. These measures have reduced the UK 2017 current tax credit and will reduce the Group's future current tax charge accordingly. The deferred tax balance at 31 December 2017 has been calculated reflecting these rates. In addition, the fall in the future expected US tax rates due to the enactment of the Tax Cuts & Jobs Act in December 2017 has generated a £12.5m deferred tax credit in 2017 due to the calculation of the US deferred tax liability at 31 December 2017 using these reduced rates.

Losses of £0.1m (2016: £0.1m) expire within 5 years, losses of £0.1m (2016 £0.2m) expire within 6–10 years, losses of £4.1m (2016 £8.6m) expire within 20 years and losses of £998.4m (2016 £884.6m) may be carried forward indefinitely.

18. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS33 Earnings per Share

The calculation of the basic and diluted EPS is based on the following data:

Number of shares	2017 millions	2016 millions
Weighted average number of ordinary shares for the purpose of basic EPS	1,089.7	1,088.3
Effect of dilutive potential ordinary shares: Share options	44.9	37.3
Weighted average number of ordinary shares for the purpose of diluted EPS	1,134.6	1,125.6

At 31 December 2017 options over 236,616 (2016: 246,818) 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.

Due to the loss making position of the combined continuing and discontinued operations in 2016 and for continuing in 2017, the dilutive impact has not been separately disclosed for those measures of profitability.

Earnings per share for continuing and discontinued operations

	Earnings 2017 £m	Per share amount 2017 pence	Earnings 2016 £m	Per share amount 2016 pence
Basic EPS				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	(1.2)	(0.11)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	(1.2)	(0.11)
Add back exceptional items	19.6	1.80	70.9	6.51
Add back tax on exceptional items	5.0	0.46	(3.1)	(0.28)
Earnings excluding exceptional operating items for the purpose of basic EPS	24.4	2.24	66.6	6.12

Earnings per share for continuing operations

	Earnings 2017 £m	Per share amount 2017 pence	Earnings 2016 £m	Per share amount 2016 pence
Basic EPS				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	16.9	1.55
Effect of dilutive potential ordinary shares	–	–	–	(0.05)
Diluted EPS	(0.2)	(0.02)	16.9	1.50
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	16.9	1.55
Add back exceptional items	19.6	1.80	56.3	5.17
Add back tax on exceptional items	5.0	0.46	(3.1)	(0.28)
Earnings excluding exceptional operating items for the purpose of basic EPS	24.4	2.24	70.1	6.44

Earnings per share discontinued

	Earnings 2017 £m	Per share amount 2017 pence	Earnings 2016 £m	Per share amount 2016 pence
Basic EPS				
Earnings for the purpose of basic EPS	–	–	(18.1)	(1.66)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	–	–	(18.1)	(1.66)
Add back exceptional items	–	–	14.6	1.34
Earnings excluding exceptional operating items for the purpose of basic EPS	–	–	(3.5)	(0.32)

Notes to the Consolidated Financial Statements *continued***19. Goodwill**

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2016	799.1	(289.2)	509.9
Exchange differences	109.6	(41.6)	68.0
Acquisitions	17.8	–	17.8
Impairment (exceptional)	–	(17.8)	(17.8)
At 1 January 2017	926.5	(348.6)	577.9
Exchange differences	(48.5)	21.9	(26.6)
At 31 December 2017	878.0	(326.7)	551.3

Movements in the balance since the prior year-end can be seen as follows:

	Goodwill balance 1 January 2017 £m	Additions 2017 £m	Exchange differences 2017 £m	Impairment 2017 £m	Goodwill balance 31 December 2017 £m	Headroom on impairment analysis 2017 £m	Headroom on impairment analysis 2016 £m
UK & Europe							
Justice & Immigration	49.6	–	–	–	49.6	127.4	126.3
Health	60.6	–	–	–	60.6	19.4	3.2
Direct Services & Europe	66.5	–	0.8	–	67.3	71.5	99.0
Americas	277.9	–	(24.9)	–	253.0	151.8	66.5
AsPac	112.4	–	(1.6)	–	110.8	231.6	203.2
Middle East	10.9	–	(0.9)	–	10.0	145.6	114.7
	577.9	–	(26.6)	–	551.3	747.3	612.9

Included above is the detail of the headroom on the CGUs existing at the year-end which reflects where future discounted cash flows are greater than the underlying assets and includes all relevant cash flows, including where provisions have been made for future costs and losses.

The key assumptions applied in the impairment review are set out below:

	Discount rate 2017 %	Discount rate 2016* %	Terminal growth rates 2017 %	Terminal growth rates 2016 %
UK & Europe				
Justice & Immigration	10.4	11.2	2.0	2.0
Health	10.4	11.2	2.0	2.0
Direct Services & Europe	11.7	12.5	2.0	2.0
Americas	10.5	12.3	2.4	2.4
AsPac	9.7	11.2	2.4	2.4
Middle East	10.8	10.7	2.5	2.2

* Restated based on rates applied in impairment testing in the prior year

Discount rate

Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital have been used in discounting the projected cash flows. These rates are reviewed annually with external advisers and are adjusted for risks specific to the market in which the CGU operates.

Short-term growth rates

The annual impairment test is performed immediately prior to the year end, based initially on five year cash flow forecasts approved by senior management. Short-term revenue growth rates used in each CGU five year plan are based on internal data regarding our current contracted position, the pipeline of opportunities and forecast growth for the relevant market.

Short-term profitability and cash conversion is based on our historic experiences and a level of judgement is applied to expected changes in both. Where businesses have been poor performers in recent history, turnaround has only been assumed where a detailed and achievable plan is in place and all forecasts include cash flows relating to contracts where onerous contract provisions have been made.

Terminal growth rates

The calculations include a terminal value based on the projections for the fifth year of the short-term plan, with a growth rate assumption applied which extrapolates the business into perpetuity. The terminal growth rates are based on long-term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long-term growth rates forecast for the individual markets. These are provided by external sources.

Sensitivity analysis

Sensitivity analysis has been performed for each key assumption, a 1% movement in discount rates and a 1% movement in terminal growth rates are considered to be reasonably possible. The only CGU impacted by a reasonably possible change in a key assumption is Health where a 1% increase in discount rates and a 1% decrease in terminal growth rates would result in an impairment of £4.2m. The breakeven point of Health goodwill impairment is a 0.8% increase in discount rate combined with a 0.8% decrease in terminal growth rate. A reduction of £2.0m in the terminal year cash flows for the Health CGU would lead to the recoverable amount no longer exceeding the carrying value. Any additional reduction in terminal year cash flows would result in an impairment of the goodwill of this CGU.

Notes to the Consolidated Financial Statements continued

20. Other intangible assets

	Acquisition related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	
Cost					
At 1 January 2017	67.6	0.3	120.6	55.7	244.2
Arising on acquisition	0.9	–	0.9	–	1.8
Eliminated on disposal	–	–	(1.2)	–	(1.2)
Additions from internal development	–	–	9.9	0.9	10.8
Additions from external acquisition	–	–	7.6	–	7.6
Disposals	–	(0.1)	(13.4)	(0.1)	(13.6)
Reclassification from/(to) other intangible asset categories	–	–	0.2	(0.2)	–
Reclassification to property, plant and equipment	–	–	0.4	–	0.4
Research and development expenditure credit	–	–	–	0.7	0.7
Exchange differences	(3.4)	–	(2.2)	(0.4)	(6.0)
At 31 December 2017	65.1	0.2	122.8	56.6	244.7
Accumulated amortisation and impairment					
At 1 January 2017	50.4	0.3	71.6	38.3	160.6
Arising on acquisition	–	–	0.9	–	0.9
Eliminated on disposal	–	–	(1.1)	–	(1.1)
Impairment charge	6.1	–	2.8	–	8.9
Amortisation charge – internal development	–	–	11.8	5.7	17.5
Amortisation charge – external	4.4	–	3.9	–	8.3
Disposals	–	(0.1)	(13.0)	(0.1)	(13.2)
Reclassification to property, plant and equipment	–	–	0.4	–	0.4
Exchange differences	(2.4)	(0.1)	(1.5)	(0.3)	(4.3)
At 31 December 2017	58.5	0.1	75.8	43.6	178.0
Net book value					
At 31 December 2017	6.6	0.1	47.0	13.0	66.7

	Acquisition related			Other	
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	Total £m
Cost					
At 1 January 2016	51.9	1.0	110.2	59.1	222.2
Additions from internal development	–	–	14.0	1.1	15.1
Disposals	–	(0.7)	(12.9)	(2.6)	(16.2)
Reclassification from held for sale assets	6.2	0.1	–	–	6.3
Reclassification from/(to) other intangible asset categories	0.3	(0.1)	3.3	(3.5)	–
Research and Development expenditure credit	–	–	–	(0.2)	(0.2)
Exchange differences	9.2	–	6.0	1.8	17.0
At 31 December 2016	67.6	0.3	120.6	55.7	244.2
Accumulated amortisation and impairment					
At 1 January 2016	33.1	0.9	62.9	35.5	132.4
Impairment charge	0.7	–	–	–	0.7
Amortisation charge ~ internal development	–	–	17.0	4.8	21.8
Amortisation charge ~ external	4.4	–	–	–	4.4
Disposals	–	(0.7)	(12.0)	(2.6)	(15.3)
Reclassification from held for sale assets	6.2	0.1	–	–	6.3
Exchange differences	6.0	–	3.7	0.6	10.3
At 31 December 2016	50.4	0.3	71.6	38.3	160.6
Net book value					
At 31 December 2016	17.2	–	49.0	17.4	83.6

Included in Software and IT and other internally generated development expenditure is an amount of £6.1m (2016: £8.7m) in respect of leased intangibles.

Customer relationships are amortised over the average length of contracts acquired. The Group is carrying £6.6m (2016: £17.2m) in relation to Customer relationships. Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £4.4m (2016: £4.4m).

The net book value of internally generated intangible assets as at 31 December 2017 was approximately £13.0m (2016: £17.4m) in development expenditure and £34.3m (2016: £36.9m) in software and IT.

Notes to the Consolidated Financial Statements continued

21. Property, plant and equipment

	Freehold land and buildings £m	Short- leasehold assets £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2017	4.0	32.4	209.2	245.6
Arising on acquisition	–	–	0.4	0.4
Additions	0.5	2.0	20.8	23.3
Reclassification to other intangible assets	–	(0.4)	–	(0.4)
Disposals	–	(2.5)	(30.6)	(33.1)
Exchange differences	0.1	(1.2)	(2.2)	(3.3)
At 31 December 2017	4.6	30.3	197.6	232.5
Accumulated depreciation and impairment				
At 1 January 2017	2.5	22.8	151.0	176.3
Arising on acquisition	–	–	0.4	0.4
Charge for the year – impairment	–	–	(0.1)	(0.1)
Charge for the year – depreciation	0.2	3.2	20.9	24.3
Reclassification to other intangible assets	–	(0.4)	–	(0.4)
Disposals	–	(1.0)	(29.7)	(30.7)
Exchange differences	–	(0.8)	(1.7)	(2.5)
At 31 December 2017	2.7	23.8	140.8	167.3
Net book value				
At 31 December 2017	1.9	6.5	56.8	65.2

	Freehold land and buildings £m	Short- leasehold assets £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2016	4.0	29.8	209.7	243.5
Additions	–	1.8	15.6	17.4
Reclassification from held for sale assets	–	0.9	0.2	1.1
Disposals	–	(3.2)	(31.8)	(35.0)
Exchange differences	–	3.1	15.5	18.6
At 31 December 2016	4.0	32.4	209.2	245.6
Accumulated depreciation and impairment				
At 1 January 2016	2.3	20.7	147.3	170.3
Charge for the year - impairment	–	–	0.7	0.7
Charge for the year - depreciation	0.2	3.0	21.6	24.8
Reclassification to held for sale assets	–	(0.2)	(0.2)	(0.4)
Disposals	–	(2.9)	(30.9)	(33.8)
Exchange differences	–	2.2	12.5	14.7
At 31 December 2016	2.5	22.8	151.0	176.3
Net book value				
At 31 December 2016	1.5	9.6	58.2	69.3

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £23.4m (2016: £27.9m) in respect of assets held under finance leases.

The carrying amount of the Group's Short-leasehold assets includes an amount of £0.1m (2016: £0.2m) in respect of assets held under finance leases.

22. Inventories

	2017 £m	2016 £m
Service spares	13.0	17.0
Parts awaiting installation	1.9	1.0
Work in progress	2.5	4.4
	17.4	22.4

23. Trade and other receivables

Trade and other receivables: Non-current	2017 £m	2016 £m
Loans receivable (Note 28)	25.7	22.4
Other investments	10.0	0.6
Other receivables	21.6	21.4
	57.3	44.4

Trade and other receivables: Current	2017 £m	2016 £m
Trade receivables	188.8	192.8
Accrued income and other unbilled receivables	213.3	228.4
Prepayments	49.8	56.3
Amounts recoverable on long-term contracts (Note 24)	–	2.7
Amounts owed by joint ventures and associates	0.6	0.6
Loans receivable (Note 28)	–	0.5
Security deposits	0.3	0.1
Other receivables	53.7	62.1
	506.5	543.5

Total trade and other receivables held by the Group at 31 December 2017 amount to £563.8m (2016: £587.9m).

The Group has a receivables financing facility of £30.0m (2016: £30.0m), which was un-utilised at 31 December 2017 (31 December 2016: £7.7m utilised). The unwinding of the facility by £7.7m in 2017 is reflected through a negative working capital movement in the year.

The management of trade receivables is the responsibility of the operating segments, although they report to Group on a monthly basis on debtor days, debtor ageing and significant outstanding debts. The average credit period taken by customers is 23 days (2016: 23 days) and no interest is charged on overdue amounts.

Each customer has an external credit score which determines the level of credit provided. However, the majority of our customers have a sovereign credit rating as a result of being government organisations. Of the trade receivables balance at the end of the year, £54.1m is due from agencies of the UK Government, the Group's largest customer, £33.1m from the Australian Government, £47.9m from the Government of the United Arab Emirates, and £13.8m from the US Government. There are no other customers who represent more than 5% of the total balance of trade receivables. Of the trade receivables balance at the end of 2016, £71.4m was due from agencies of the UK Government. The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

As at 31 December 2017, a total of £1.6m (2016: £2.8m) of trade receivables held by the Group were considered to be impaired. Impairments to trade receivables are based on specific estimated irrecoverable amounts and provisions on outstanding balances greater than a year old unless there is firm evidence that the balance is recoverable. The total amount of the provision for the Group was £3.6m as of 31 December 2017 (2016: £3.6m).

Notes to the Consolidated Financial Statements continued

23. Trade and other receivables continued

Ageing of trade receivables	2017 £m	2016 £m
Neither impaired nor past due	144.3	143.0
Not impaired but overdue by less than 30 days	29.6	34.2
Not impaired but overdue by between 30 and 60 days	8.2	4.0
Not impaired but overdue by more than 60 days	8.7	12.4
Impaired	1.6	2.8
Allowance for doubtful debts	(3.6)	(3.6)
	188.8	192.8

Of the total overdue trade receivable balance, 38% (2016: 53.2%) relates to the UK, US or Australian governments, and a further 38% (2016: 15.7%) relates to the government of the United Arab Emirates. The total allowance for doubtful debts is greater than the assets identified as impaired due to provision being made for partial impairment of balances held within one of the ageing categories.

Movements on the Group allowance for doubtful debts	2017 £m	2016 £m
At 1 January	3.6	11.3
Net charges and releases to income statement	0.7	(0.1)
Utilised	(0.5)	(8.2)
Exchange differences	(0.2)	0.6
At 31 December	3.6	3.6

Included in the current other receivables balance is a further £10.2m (2016: £19.2m) due from agencies of the UK Government.

Contingent assets of £5.5m (2016: £5.6m) are held within current other receivables in relation to insurance claims where it is probable that the Group will receive future payments.

Also included within current other receivables are capitalised bid costs of £6.2m (2016: £7.8m) and phase in costs of £13.8m (2016: £13.8m) that are realised as a part of the normal operating cycle of the Group. These assets represent up-front investment in contracts which are expected to provide benefits over the life of those contracts. Movements in the period were as follows:

Capitalised bid and phase in costs	2017 £m	2016 £m
At 1 January	21.6	28.6
Additions	5.0	4.7
Amortisation	(6.5)	(13.8)
Exchange differences	(0.1)	2.1
At 31 December	20.0	21.6

24. Long-term contracts

Contracts in progress at the balance sheet date	2017 £m	2016 £m
Amounts due from long-term project-based contract customers included in trade and other receivables	—	2.7
Amounts due to long-term project-based contract customers included in provisions	(13.6)	(10.0)
	(13.6)	(7.3)
Long-term project-based contract costs incurred plus recognised profits less recognised losses to date	153.5	226.3
Less: progress payments	(167.1)	(233.6)
	(13.6)	(7.3)

As at 31 December 2017, the Group had £nil (2016: £nil) of contract retentions held by customers.

25. Cash and cash equivalents

	Sterling 2017 £m	Other currencies 2017 £m	Total 2017 £m	Sterling 2016 £m	Other currencies 2016 £m	Total 2016 £m
Customer advance payments*	–	0.2	0.2	–	1.0	1.0
Other cash and short-term deposits	79.6	32.3	111.9	149.4	27.4	176.8
Total cash and cash equivalents	79.6	32.5	112.1	149.4	28.4	177.8

* Customer advance payments totalling £0.2m (2016: £1.0m) 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

26. Trade and other payables

Trade and other payables: Current	2017 £m	2016 £m
Trade payables	78.4	84.7
Other payables	71.1	92.9
Accruals	259.1	292.2
Deferred income	54.3	54.7
	462.9	524.5

The average credit period taken for trade purchases is 33 days (2016: 32 days).

Trade and other payables: Non-current	2017 £m	2016 £m
Other payables	28.7	16.8

Total trade and other payables held by the Group at 31 December 2017 amount to £491.6m (2016: £541.3m).

27. Obligations under finance leases

Amounts payable under finance leases	Minimum lease payments 2017 £m	Present value of minimum lease payments 2017 £m	Minimum lease payments 2016 £m	Present value of minimum lease payments 2016 £m
Within one year	9.1	8.5	13.1	12.3
Between one and five years	11.0	10.4	16.8	15.9
After five years	1.4	1.3	–	–
	21.5	20.2	29.9	28.2
Less: future finance charges	(1.3)	–	(1.7)	–
Present value of lease obligations	20.2	20.2	28.2	28.2
Less: amount due for settlement within one year (shown within current liabilities)	(8.5)	(8.5)	(12.3)	(12.3)
Amount due for settlement after one year	11.7	11.7	15.9	15.9

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

Notes to the Consolidated Financial Statements *continued***28. Loans**

	Total 2017 £m	Total 2016 £m
Loans are repayable as follows:		
On demand or within one year*	31.8	9.2
Between one and two years	19.7	34.2
Between two and five years	105.0	137.5
After five years	89.3	96.1
	245.8	277.0
Less: amount due for settlement within one year (shown within current liabilities)	(31.8)	(9.7)
Less: amounts shown in receivables (Note 23)	25.7	22.9
Amount due for settlement after one year	239.7	290.2

* Included in loans repayable on demand or within one year are loan receivable amounts of £nil (2016: £0.5m)

	Carrying amount 2017 £m	Fair value 2017 £m	Carrying amount 2016 £m	Fair value 2016 £m
Other loans	271.5	263.1	299.9	289.7
Loan receivables	(25.7)	(25.7)	(22.9)	(22.9)
	245.8	237.4	277.0	266.8

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

The analysis below provides a reconciliation between the opening and closing positions in the balance sheet for liabilities arising from financing activities together with movements in cash loan receivables and derivatives relating to the items included in Net Debt. There were no changes in fair value noted in either the current or prior year.

	At 1 January 2017 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non-cash movements £m	At 31 December 2017 £m
Loans payable	(299.9)	3.8	–	–	–	25.4	(0.8)	(271.5)
Obligations under finance leases	(28.2)	12.6	–	–	–	0.1	(4.7)	(20.2)
Liabilities arising from financing activities	(328.1)	16.4	–	–	–	25.5	(5.5)	(291.7)
Cash and cash equivalents	177.8	(57.3)	–	1.5	(7.1)	(2.8)	–	112.1
Loan receivables	22.9	(0.6)	–	–	–	–	3.4	25.7
Derivatives relating to Net Debt	18.1	–	–	–	–	(5.3)	–	12.8
Net Debt	(109.3)	(41.5)	–	1.5	(7.1)	17.4	(2.1)	(141.1)

	At 1 January 2016 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non-cash movements £m	At 31 December 2016 £m
Loans payable	(381.9)	135.8	–	–	–	(52.8)	(1.0)	(299.9)
Obligations under finance leases	(43.8)	16.7	(0.2)	–	–	(0.4)	(0.5)	(28.2)
Liabilities arising from financing activities	(425.7)	152.5	(0.2)	–	–	(53.2)	(1.5)	(328.1)
Cash and cash equivalents	323.6	(153.7)	–	0.1	–	7.8	–	177.8
Loan receivables	19.9	–	–	–	–	0.1	2.9	22.9
Derivatives relating to Net Debt	14.6	–	–	–	–	3.5	–	18.1
Net Debt	(67.6)	(1.2)	(0.2)	0.1	–	(41.8)	1.4	(109.3)

* Acquisitions represent the net cash/(debt) acquired on acquisition.

29. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2017	45.1	15.2	220.2	141.2	421.7
Arising on acquisition	1.7	–	–	–	1.7
Eliminated on disposal of subsidiary	–	–	–	(0.5)	(0.5)
Charged to income statement – exceptional	4.5	2.7	–	0.1	7.3
Charged to income statement – other	17.5	2.4	62.0	8.6	90.5
Released to income statement – exceptional	(0.9)	(1.3)	(0.4)	(10.5)	(13.1)
Released to income statement – other	(4.9)	(1.4)	(43.0)	(9.0)	(58.3)
Utilised during the year	(4.9)	(3.1)	(69.3)	(5.0)	(82.3)
Unwinding of discount	–	–	1.3	–	1.3
Exchange differences	(2.4)	(0.2)	(2.6)	(3.1)	(8.3)
At 31 December 2017	55.7	14.3	168.2	121.8	360.0
Analysed as:					
Current	17.1	4.4	68.0	59.0	148.5
Non-current	38.6	9.9	100.2	62.8	211.5
	55.7	14.3	168.2	121.8	360.0

Contract provisions relate to onerous contracts which will be utilised over the life of each individual contract, up to a maximum of 7 years from the balance sheet date. The present value of the estimated future cash outflow required to settle the contract obligations as they fall due over the respective contracts has been used in determining the provision. The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. In 2017, additional charges have been made in respect of future losses on a number of onerous contracts totalling £62.0m. This increase related to revisions to existing OCPs of £61.5m and a new provision raised on one contract totalling £0.5m.

A full analysis is performed at least annually of the future profitability of all contracts with marginal performances and of the balance sheet items directly linked to these contracts.

Due to the significant size of the balance and the inherent level of uncertainty over the amount and timing of the related cash flows upon which onerous contract provisions are based, if the expected operational performance varies from the best estimates made at the year end, a material change in estimate may be required. The key drivers behind operational performance is the level of activity required to be serviced, which is often directed by the actions of the UK Government, and the efficiency of Group employees and resources.

Employee related provisions are for long-term service awards and terminal gratuity liabilities which have been accrued and are based on contractual entitlement, together with an estimate of the probabilities that employees will stay until retirement and receive all relevant amounts. There are also amounts included in relation to restructuring. The provisions will be utilised over various periods driven by local legal or regulatory requirements, the timing of which is not certain.

Property provisions relate to leased properties which are either underutilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be generated in the future. The provision has been calculated based on the discounted cash outflow required to settle the lease obligations as they fall due, with the longest running lease ending in April 2039.

Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome and will be utilised with reference to the specific facts and circumstances, with the majority expecting to be settled by 31 December 2021.

Notes to the Consolidated Financial Statements *continued***30. Capital and other commitments**

	2017 £m	2016 £m
Capital expenditure contracted but not provided		
Property, plant and equipment	0.9	10.4
Intangible assets	0.2	5.6

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2017 £m	2016 £m
Within one year	69.6	66.9
Between one and five years	148.0	127.6
After five years	130.7	126.1
	348.3	320.6

31. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £4.3m (2016: £20.4m). The actual commitment outstanding at 31 December 2017 was £4.3m (2016: £17.9m).

The Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2017 was £227.1m (2016: £252.1m).

As we have disclosed before, we are under investigation by the Serious Fraud Office. In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and/or the Serco entities involved.

The Group is 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.

32. Financial risk management

32 (a) Fair value of financial instruments

i) Hierarchy of fair value

The classification of the fair value measurement falls into three levels, based on the degree to which the fair value is observable. The levels are as follows.

Level 1: Inputs derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable inputs for the asset or liability

Based on the above, the derivative financial instruments held by the Group at 31 December 2017 and the comparison fair values for loans and finance leases, are all considered to fall into Level 2. Market prices are sourced from Bloomberg and third party valuations. The valuation models incorporate various inputs including foreign exchange spot and forward rates and interest rate curves. There have been no transfers between levels in the year.

The Group held the following financial instruments which fall within the scope of IAS39 *Financial Instruments: Recognition and Measurement* at 31 December:

	Carrying amount (measurement basis)		Comparison fair value	Carrying amount (measurement basis)		Comparison fair value
	Amortised cost 2017 £m	Fair value – Level 2 2017 £m	Level 2 2017 £m	Amortised cost 2016 £m	Fair value – Level 2 2016 £m	Level 2 2016 £m
Financial assets						
Financial assets – current						
Cash and bank balances	112.1	–	112.1	177.8	–	177.8
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	4.5	–	–	4.5	–
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	5.7	–	–	–	–
Forward foreign exchange contracts	–	0.1	–	–	0.4	–
Loans and receivables						
Trade receivables (Note 23)	188.8	–	188.8	192.8	–	192.8
Loan receivables (Note 23)	–	–	–	0.5	–	0.5
Security deposits (Note 23)	0.3	–	0.3	0.1	–	0.1
Amounts owed by joint ventures and associates (Note 23)	0.6	–	0.6	0.6	–	0.6
Financial assets – non-current						
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	3.6	–	–	14.2	–
Forward foreign exchange contracts	–	0.1	–	–	–	–
Loans and receivables						
Loan receivables (Note 23)	25.7	–	25.7	22.4	–	22.4
Other investments (Note 23)	10.0	–	10.0	0.6	–	0.6

Notes to the Consolidated Financial Statements continued

32. Financial risk management continued**32 (a) Fair value of financial instruments** continued**i) Hierarchy of fair value** continued

	Carrying amount (measurement basis)		Comparison fair value	Carrying amount (measurement basis)		Comparison fair value
	Amortised cost 2017 £m	Fair value - Level 2 2017 £m	Level 2 2017 £m	Amortised cost 2016 £m	Fair value - Level 2 2016 £m	Level 2 2016 £m
Financial liabilities – current						
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	(1.1)	–	–	(0.6)	–
Financial liabilities at amortised cost						
Trade payables (Note 26)	(78.4)	–	(78.4)	(84.7)	–	(84.7)
Loans (Note 28)	(31.8)	–	(31.8)	(9.7)	–	(9.7)
Obligations under finance leases (Note 27)	(8.5)	–	(8.5)	(12.3)	–	(12.3)
Financial liabilities – non-current						
Derivative instruments in designated hedge accounting relationships						
Forward foreign exchange contracts	–	(0.1)	–	–	–	–
Financial liabilities at amortised cost						
Loans (Note 28)	(239.7)	–	(231.3)	(290.2)	–	(280.1)
Obligations under finance leases (Note 27)	(11.7)	–	(11.7)	(15.9)	–	(15.9)

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 asset of £12.8m (2016: net assets of £18.5m) comprising non-current assets of £3.7m (2016: £14.2m), current assets of £10.3m (2016: £4.9m), current liabilities of £1.1m (2016: £0.6m) and non-current liabilities of £0.1m (2016: £nil)

	1 January 2017 £m	Movement in fair value of derivatives designated in hedge accounting relationships £m	Movement in fair value of derivatives not designated in hedge accounting relationships £m	31 December 2017 £m
Currency swaps	14.2	(4.9)	–	9.3
Forward foreign exchange contracts	4.3	(0.3)	(0.5)	3.5
	18.5	(5.2)	(0.5)	12.8

	1 January 2016 £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 2016 £m
Currency swaps	10.4	3.8	–	14.2
Forward foreign exchange contracts	4.4	0.2	(0.3)	4.3
	14.8	4.0	(0.3)	18.5

The fair value of financial liabilities at fair value through profit and loss is £1.1m (2016: £0.6m) and relates to derivatives that are not designated in hedge accounting relationships. The fair value of the derivatives and their credit risk adjusted fair value are not materially different, and are approximately equal to the amount contractually payable at maturity due to the short tenor of the instruments.

32 (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.

32 (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 2017 £m	Drawn 2017 £m	Utilised for bonding facility 2017 £m	Total facility available 2017 £m
Syndicated revolving credit facility	Sterling	480.0	–	–	480.0

	Currency	Amount 2016 £m	Drawn 2016 £m	Utilised for bonding facility 2016 £m	Total facility available 2016 £m
Syndicated revolving credit facility	Sterling	480.0	–	–	480.0

On 31 March 2016, £368m of the Group's £480m revolving credit facility was extended to April 2020. The remaining £112m matures in April 2019.

In addition to the banking facility the Group has outstanding US private placements of £260.7m (2016: £290.2m) which will be repaid as bullet repayments between 2018 and 2024.

In addition to the bank and private placement facilities the Group has a £30.0m receivables financing facility (2016: £30.0m) of which £nil (2016: £7.7m) was drawn at year end.

ii) Maturity of financial liabilities

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

At 31 December 2017	On demand or within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Total £m
Trade payables (Note 26)	78.4	–	–	–	78.4
Obligations under finance leases (Note 27)	8.5	5.6	4.8	1.3	20.2
Loans* (Note 28)	31.8	20.7	131.0	89.4	272.9
Future loan interest	12.3	22.4	20.6	1.2	56.5
Derivatives settled on gross basis:					
Outflow	897.8	22.1	–	–	919.9
Inflow	(907.1)	(26.0)	–	–	(933.1)
	121.7	44.8	156.4	91.9	414.8

* Loans are stated gross of capitalised finance costs

Notes to the Consolidated Financial Statements continued

32. Financial risk management continued**32 (c) Liquidity risk continued****ii) Maturity of financial liabilities continued**

At 31 December 2016	On demand or within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Total £m
Trade payables (Note 26)	84.7	–	–	–	84.7
Obligations under finance leases (Note 27)	13.1	8.9	7.9	–	29.9
Loans* (Note 28)	9.7	34.2	139.5	118.7	302.1
Future loan interest	15.0	14.2	35.9	12.4	77.5
Derivatives settled on gross basis:					
Outflow	392.0	25.8	17.8	–	435.6
Inflow	(396.9)	(34.3)	(23.1)	–	(454.3)
	117.6	48.8	178.0	131.1	475.5

* Loans are stated gross of capitalised finance costs

Gross cash flows in the table above relating to forward foreign exchange contracts total £875.5m (inflow) and £871.9m (outflow) on demand or within one year and £4.7m (inflow) and £4.4m (outflow) between one and two years (2016: £394.6m (inflow) and £390.1m (outflow) on demand or within one year and £nil (inflow) and £nil (outflow) between one and two years).

32 (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 2017, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or highly probable forecast transactions.

ii) Translational

Where possible the Group will raise external funding to match the currency profile of its foreign operations, in order to mitigate translation exposure. If matched funding is not possible, currency derivatives may be used to protect against movements in foreign exchange.

iii) Hedge accounting

For the purposes of hedge accounting, hedges are classified as either of fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Detail the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS39 can be seen in Note 2.

At 31 December 2017, the Group held cross currency swaps designated as cash flow hedges against \$69.5m of the US Dollar private placements. Fixed interest cash flows denominated in US Dollars are exchanged for fixed interest cash flows denominated in Sterling.

The profile of these cross currency swaps held by the Group in the current and prior year is as follows

Maturity	2017 Receivable			2016 Receivable		
	Notional amount US Dollar m	US Dollar interest rate %	Payable Sterling interest rate %	Notional amount US Dollar m	US Dollar interest rate %	Payable Sterling interest rate %
May 2018	41.0	4.4	4.9	41.0	4.4	4.9
October 2019	28.5	3.8	4.1	28.5	3.8	4.1

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges. These derivatives are hedging highly probable forecast foreign currency trade payments in the UK business. The net notional amounts are summarised by currency below:

	2017 £m	2016 £m
Sterling	(9.4)	(7.0)
US Dollar	0.6	3.2
Euro	–	4.2
Indian Rupee	9.2	–

All derivatives designated as cash flow hedges are highly effective and as at 31 December 2017 a net fair value loss of £0.7m (2016: £0.5m) has been deferred in the hedging reserve. During the course of the year to 31 December 2017, £0.1m (2016: £3.4m) of fair value gains were transferred to the hedging reserve and £0.2m (2016: £1.1m) reclassified to the consolidated income statement

The Group has entered into a net investment hedge. This uses a portion of the USD denominated loans payable as a hedging instrument against movements in the value of the assets and liabilities of Serco North America (Holdings), Inc. All loans payable are recorded at amortised cost, and movements in value due to foreign exchange in the portion designated as hedging instruments are taken to reserves. The value of loans used in the hedging relationship at 31 December 2017 was £151.8m (2016: £nil).

iv) Currency sensitivity

The Group's currency exposures in respect of monetary items at 31 December 2017 that result in net currency gains and losses in the income statement and equity arise principally from movement in US Dollar and Euro exchange rates. The impact of a 10% movement is summarised below:

	Pre-tax profits gain/(loss) 2017 £m	Equity gain/(loss) 2017 £m	Pre-tax profits gain/(loss) 2016 £m	Equity gain/(loss) 2016 £m
US Dollar	–	(0.1)	(0.1)	–
Euro	–	–	–	(0.5)
Indian Rupee	–	(1.0)	–	–
	–	(1.1)	(0.1)	(0.5)

32 (e) Interest rate risk

The Group's policy is to minimise the impact of interest rate volatility on earnings to provide an appropriate level of certainty to cost of funds. Exposure to interest rate risk arises principally on changes to US Dollar and Sterling interest rates.

i) Interest rate management

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

	Floating rate 2017 £m	Fixed rate 2017 £m	Weighted average interest rate 2017 %	Floating rate 2016 £m	Fixed rate 2016 £m	Weighted average interest rate 2016 %
Financial assets						
Cash and cash equivalents	112.1	–	–	177.8	–	–
Other loan receivables	–	25.7	7.0	0.5	22.4	7.0
	112.1	25.7		178.3	22.4	
	Floating rate 2017 £m	Fixed rate 2017 £m	Weighted average interest rate 2017 %	Floating rate 2016 £m	Fixed rate 2016 £m	Weighted average interest rate 2016 %
Financial liabilities						
US Dollar loans	–	260.7	5.2	–	290.2	5.2
Other loans	12.2	–	–	11.8	–	–
	12.2	260.7		11.8	290.2	

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 £20.2m (2016: £28.2m) of amounts payable under finance leases, which are subject to fixed rates of interest

ii) Interest rate sensitivity

The effect of a 100 basis point increase in LIBOR rates on the net financial liability position at the balance sheet date, with all other variables held constant, would have resulted in an increase in pre-tax profit for the year to 31 December 2017 of £1.0m (2016: £1.7m)

Notes to the Consolidated Financial Statements continued

32. Financial risk management continued**32 (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 principal exposure is to cash and cash equivalents, derivative transactions and trade receivables.

The Group's trade receivables credit risk is relatively low given that a high proportion of our customer base are Government bodies with strong sovereign, or sovereign like, credit ratings. However, where the assessed 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 credit risk on loans receivable is relatively low. The balance is comprised of a single loan, which was subject to a fair value assessment by an independent specialist in 2016. This assessment included the determination of a synthetic credit rating of the issuer, using industry-standard methodology. We monitor the results and financial position of the issuer on an annual basis to determine whether the risk of default has changed, and therefore whether the assumptions used in the valuation remain appropriate.

The Group's treasury function only transacts with counterparties that comply with Board policy. The credit risk is measured by way of a counterparty credit rating from any two recognised rating agencies. Pre-approved limits are set based on a rating matrix and exposures monitored accordingly. The Group also employs the use of set-off rights in some agreements.

The Group's policy is to provide guarantees for joint ventures and associates only to the relevant proportion of support provided by the partners. At 31 December 2017, the Company has issued guarantees in respect of certain joint ventures and associates as per Note 31.

32 (g) Capital risk

The Board's objective is to maintain a capital structure that supports the Group's strategic objectives, including but not limited to reshaping the portfolio through mergers, acquisitions and disposals. In doing so the Board seeks to manage funding and liquidity risk, optimise shareholder return and maintain an implied investment grade credit position. This strategy is unchanged from the prior year.

The Board reviews and approves at least annually a treasury policy document which covers, inter alia, funding and liquidity risk, capital structure and risk management. This policy details targets for committed funding headroom, diversification of committed funding and debt maturity profile.

The Group plans to maintain sufficient funds and distributable reserves to allow payments of projected dividends to shareholders.

The following table summarises the capital of the Group:

	2017 £m	2016 £m
Cash and cash equivalents	(112.1)	(177.8)
Loans	245.8	277.0
Obligations under finance leases	20.2	28.2
Equity	310.9	398.8
Capital	464.8	526.2

33. Retirement benefit schemes**33 (a) Defined benefit schemes****i) Characteristics and risks**

The Group contributes to defined benefit schemes for qualifying employees of its subsidiaries in the UK and Europe. The normal contributions expected to be paid during the financial year ending 31 December 2018 are £7.1m (2017: £9.7m).

Among our non-contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2015 and resulted in an actuarially assessed deficit of £4.0m for funding purposes. Pension obligations are valued separately for accounting and funding purposes and there is often a material difference between these valuations. As at 31 December 2017 the estimated actuarial deficit of SPLAS was £33.7m (2016: £42.6m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £41.8m. The primary reason a difference arises is that pension scheme accounting requires the valuation to be performed on the basis of a best estimate whereas the funding valuation used by the trustees makes more prudent assumptions. A revised schedule of contributions for SPLAS was agreed during the year, with 29% of pensionable salaries due to be paid from 1 November 2017 to 31 October 2018 and 28% from 1 November 2018 to 18 December 2022. An additional shortfall contribution of £1.0m is due by 30 April 2018 and four further payments of £0.5m payable at the end of each April through to 2022.

The assets of funded schemes are held independently of the Group's assets in separate trustee administered schemes. The trustees of each pension scheme are required by law to act in the interest of the scheme and of all relevant stakeholders in the scheme. The trustees of the pension fund are responsible for the investment policy with regard to the assets of the scheme. The Group's major schemes are valued by independent actuaries annually using the projected unit credit actuarial cost method for accounting purposes. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions including discount rates to determine the present value of benefits; projected rates of salary growth; and life expectancy of pension plan members. Discount rates are based on the market yields of high-quality corporate bonds in the country concerned. Pension assets and liabilities in the different defined benefit schemes are not offset.

The schemes typically expose the Group to risks that impact the financial performance and position of the Group and may affect the amount and timing of future cash flows. The key risks are set out below:

- **Investment risk.** The schemes hold assets with which to discharge the future liabilities of these schemes. Any decline in the value of these investments directly impacts on the ability of the scheme to meet its commitments and could require the Group to fund this shortfall in future years. As a result of the SPLAS's investment strategy, which aims to reduce volatility risk by better matching assets to liabilities, 45% of the scheme's assets are annuity policies and 55% are Liability Driven Investments (LDIs). The annuity policies result in an insurer funding the future benefit payments to the relevant members and therefore eliminate the risk of changes in the future value of the benefits to the scheme. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays and are therefore linked to the key drivers of the schemes' liabilities. The value of these investments vary in line with gilt yields, which has decreased from 2.65% p.a. to 2.53% p.a. during 2017 resulting in a decrease in these assets. SPLAS previously identified an investment strategy consisting of Multi-Asset Absolute Return (MAAR), Buy and Maintain credit (B&M) and LDI. SPLAS began to wind down its previous investment strategy in late 2016, with assets transferred to a passive LDI portfolio managed by BlackRock, over the course of late 2016 and early 2017. This ensures that the scheme remains protected against changes to interest rates and long term inflation expectations, with the funding level therefore being relatively stable. As explained in section (a) ii), in the first half of 2017 the Trustee secured a buy-in of the majority of the pensioner members, resulting in a significant de-risking of the scheme's position, which has provided a secure match of that significant proportion of the scheme's liabilities. Since the buy-in was completed the scheme has been developing a revised investment strategy which will aim to invest in private debt instead of MAAR to enable the scheme to reach full funding on the self sufficiency basis within an acceptable time period.
- **Interest 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 and therefore a decrease in the bond interest rate will increase the scheme liability. 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.

The defined benefit schemes are grouped together as follows:

- **Contract specific.** These are pre-funded defined benefit schemes. The Group has obligations to contribute variable amounts to the pension schemes over the terms of the related contracts as defined by the contract and scheme rules. At rebid, any deficit or surplus would be expected to transfer to the next contractor. At the start of these relevant contracts the Group recognised the defined benefit obligation less the fair value of scheme assets with a corresponding amount recognised as an intangible asset. Subsequent actuarial gains and losses in relation to the Group's share of the pension obligations have been recognised in the SOCI. The intangible assets are amortised over the initial term of the contracts with none remaining at the current or prior year end. Where the relevant scheme has a deficit which is not required to be fully funded by Group an adjustment is made to limit the amount recognised in the Group's balance sheet by way of a 'franchise adjustment'. Under contractual arrangements the Group sponsors a section of an industry wide defined benefit scheme, the Railways Pension Scheme (RPS), paying contributions in accordance with a Schedule of Contributions. There is no residual liability to fund a deficit at the end of the franchise period and any costs are shared 60% by the employer and 40% by the members. The Group also makes contributions under Admitted Body status to a number of sections of the Local Government Pension Scheme for the period to the end of the relevant customer contracts. The Group will only participate in the Local Government Pension Schemes for a finite period up to the end of the contracts. The Group is required to pay regular contributions as decided by the respective Scheme Actuary and as detailed in each scheme's Schedule of Contributions. In addition, the Group may be required to pay some or all of any deficit (as determined by the respective Scheme Actuary) that is remaining at the end of the contract. In respect of this, the Group recognises a sufficient level of provision in these financial statements based on the IAS19 valuation at the reporting date and contractual obligations.
- **Non-contract specific.** These do not relate to any specific contract and consist of two pre-funded defined benefit schemes and an unfunded defined benefit scheme. Any liabilities arising are recognised in full and the liabilities in relation to unfunded scheme amount to £0.4m (2016: £0.2m). The unfunded scheme is the only non-UK scheme in which the Group participates. The funding policy for the pre-funded schemes is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis. One of these schemes is SPLAS and the other is a non-contract specific section of the RPS.

Notes to the Consolidated Financial Statements *continued***33. Retirement benefit schemes** *continued***33 (a) Defined benefit schemes** *continued***ii) Events in the year**

In June 2017 the Trustees of SPLAS entered into a bulk annuity purchase whereby an insurer will fund future benefit payments to the relevant members, commonly referred to as a "buy-in". The liability to pay the members remains with SPLAS and therefore the pension scheme will continue to include the relevant pension liabilities. However, an insurance asset is held at fair value, which, in line with IAS19 for qualifying insurance policies, is deemed to be equal to the present value of the related obligations. This removes the risk of longevity and investment movements for this portion of the scheme on a funding basis, and also removes the accounting risk of movements in underlying assumptions on the liabilities. Of the total remeasurements recognised in the statement of other comprehensive income in the year ended 31 December 2017 of £106.5m, £95.0m related to the revaluation of the assets and liabilities as a result of this transaction. Whilst the impact substantially reduced the asset on an IAS19 valuation basis, on an actuarial basis the transaction decreased the deficit of the scheme by approximately £12m. As a result of the transaction, the scheme also exited a longevity swap arrangement early, at a cost borne by the scheme of £7.5m.

In 2016, certain active former members of SPLAS on a specific contract were transferred back to a Government backed pension scheme they had previously been members of. This resulted in contribution savings due to lower rates required under the Government Serco scheme and a curtailment gain of £1.9m was recognised in 2016. In 2017 certain of these deferred members transferred their accrued benefits from SPLAS to the Government scheme. The arrangements for this process had been made by a planned transfer on a bulk basis, which resulted in settlement accounting being applied in 2016 and an exceptional charge booked at the time. However, it was subsequently agreed that the Government would allow the transfer of members on an individual basis and as the members are taking an existing option to take an individual transfer out of the scheme, settlement accounting was no longer applicable following the change of arrangements in 2017. The impact of the individuals transferring out is now treated as a change in actuarial assumptions and impacts on reserves, not through the income statement. The remaining provision of £10.3m was therefore reversed through exceptional items in 2017. The impact of the transfer resulted in a charge to other comprehensive income of £5.1m, included within the effect of experience assumptions.

In November 2017 certain members of SPLAS agreed to transfer their active membership to defined contribution schemes and a curtailment gain of £2.0m is recognised in the year in the Group's income statement.

iii) Values recognised in total comprehensive income in the year

The amounts recognised in the financial statements for the year are analysed as follows:

	Contract specific 2017 £m	Non-contract specific 2017 £m	Total 2017 £m
Recognised in the income statement			
Current service cost – employer	1.0	7.6	8.6
Past service cost	–	0.3	0.3
Curtailment loss recognised	–	(2.0)	(2.0)
Administrative expenses and taxes	–	5.3	5.3
Recognised in arriving at operating profit	1.0	11.2	12.2
Interest income on scheme assets – employer	(0.4)	(41.4)	(41.8)
Interest on franchise adjustment	(0.1)	–	(0.1)
Interest cost on scheme liabilities – employer	0.5	37.6	38.1
Finance income	–	(3.8)	(3.8)

	Contract specific 2017 £m	Non-contract specific 2017 £m	Total 2017 £m
Included within the SOCI			
Actual return on scheme assets	11.0	(50.7)	(39.7)
Less: interest income on scheme assets	(0.4)	(41.4)	(41.8)
	10.6	(92.1)	(81.5)
Effect of changes in demographic assumptions	–	1.0	1.0
Effect of changes in financial assumptions	(10.3)	(21.3)	(31.6)
Effect of experience adjustments	0.8	4.8	5.6
Remeasurements	1.1	(107.6)	(106.5)
Change in franchise adjustment	(0.2)	–	(0.2)
Change in members' share	(0.4)	–	(0.4)
Actuarial losses on reimbursable rights	(0.6)	–	(0.6)
Total pension gain recognised in the SOCI	0.5	(107.6)	(107.1)

	Contract specific 2016 £m	Non-contract specific 2016 £m	Total 2016 £m
Recognised in the income statement			
Current service cost – employer	0.4	7.4	7.8
Past service cost	–	0.4	0.4
Curtailment loss recognised	–	(1.9)	(1.9)
Administrative expenses and taxes	–	5.4	5.4
Recognised in arriving at operating profit	0.4	11.3	11.7
Interest income on scheme assets – employer	(0.1)	(49.0)	(49.1)
Interest on franchise adjustment	(0.1)	–	(0.1)
Interest cost on scheme liabilities – employer	0.2	44.3	44.5
Finance income	–	(4.7)	(4.7)

	Contract specific 2016 £m	Non-contract specific 2016 £m	Total 2016 £m
Included within the SOCI			
Actual return on scheme assets	0.9	285.2	286.1
Less: interest income on scheme assets	(0.2)	(49.0)	(49.2)
	0.7	236.2	236.9
Effect of changes in demographic assumptions	–	26.2	26.2
Effect of changes in financial assumptions	(3.5)	(279.3)	(282.8)
Effect of experience adjustments	–	28.7	28.7
Remeasurements	(2.8)	11.8	9.0
Change in franchise adjustment	1.7	–	1.7
Change in members' share	1.2	–	1.2
Actuarial losses on reimbursable rights	2.9	–	2.9
Total pension gain recognised in the SOCI	0.1	11.8	11.9

Notes to the Consolidated Financial Statements continued

33. Retirement benefit schemes continued**33 (a) Defined benefit schemes** continued**iv) Balance sheet values**

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

	Contract specific 2017 £m	Non-contract specific 2017 £m	Total 2017 £m
Scheme assets at fair value			
Equities	99	46.3	56.2
Bonds except LDIs	2.9	20.8	23.7
LDIs	–	709.8	709.8
Gilts	0.2	–	0.2
Property	1.6	–	1.6
Cash and other	2.8	3.2	6.0
Annuity policies	–	587.5	587.5
Fair value of scheme assets	17.4	1,367.6	1,385.0
Present value of scheme liabilities	(23.4)	(1,341.3)	(1,364.7)
Net amount recognised	(6.0)	26.3	20.3
Franchise adjustment*	3.6	–	3.6
Members' share of deficit	2.4	–	2.4
Net retirement benefit asset	–	26.3	26.3
Net pension liability	–	(15.5)	(15.5)
Net pension asset	–	41.8	41.8
Net retirement benefit asset	–	26.3	26.3
Deferred tax liabilities	–	(2.5)	(2.5)
Net retirement benefit asset (after tax)	–	23.8	23.8

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

	Contract specific 2016 £m	Non-contract specific 2016 £m	Total 2016 £m
Scheme assets at fair value			
Equities	3.3	43.3	46.6
Bonds except LDIs	0.7	20.2	20.9
LDIs	–	1,390.6	1,390.6
Gilts	–	72.4	72.4
Property	0.6	–	0.6
Cash and other	1.2	4.2	5.4
Annuity policies	–	20.0	20.0
Fair value of scheme assets	5.8	1,550.7	1,556.5
Present value of scheme liabilities	(12.0)	(1,418.0)	(1,430.0)
Net amount recognised	(6.2)	132.7	126.5
Franchise adjustment*	3.7	–	3.7
Members' share of deficit	2.5	–	2.5
Net retirement benefit asset	–	132.7	132.7
Net pension liability	–	(17.7)	(17.7)
Net pension asset	–	150.4	150.4
Net retirement benefit asset	–	132.7	132.7
Deferred tax liabilities	–	(17.6)	(17.6)
Net retirement benefit asset (after tax)	–	115.1	115.1

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

The SPLAS Trust Deed gives the Group an unconditional right to a refund of surplus assets, assuming the full settlement of plan liabilities in the event of a plan wind-up. As such, the Group recognises the surplus of scheme assets over liabilities on the balance sheet

As required by IAS19, the Group has considered the extent to which the pension plan assets should be classified in accordance with the fair value hierarchy of IFRS13. Virtually all equity and debt instruments have quoted prices in active markets. Annuity policies and property assets can be classified as Level 3 instruments, and LDIs are classified as Level 2.

	Contract specific £m	Non-contract specific £m	Total £m
Changes in the fair value of scheme liabilities			
At 1 January 2016	7.7	1,188.7	1,196.4
Current service cost – employer	0.4	7.4	7.8
Current service cost – employee	0.3	–	0.3
Past service costs	–	0.4	0.4
Scheme participants' contributions	–	0.5	0.5
Interest cost – employer	0.2	44.3	44.5
Interest cost – employee	0.1	–	0.1
Benefits paid	(0.1)	(45.9)	(46.0)
Effect of changes in demographic assumptions	–	(26.2)	(26.2)
Effect of changes in financial assumptions	3.4	279.4	282.8
Effect of experience adjustments	–	(28.7)	(28.7)
Plan curtailments	–	(1.9)	(1.9)
At 1 January 2017	12.0	1,418.0	1,430.0
Current service cost – employer	1.0	7.6	8.6
Current service cost – employee	0.4	–	0.4
Past service costs	–	0.3	0.3
Scheme participants' contributions	0.1	0.5	0.6
Interest cost – employer	0.5	37.6	38.1
Interest cost – employee	0.1	–	0.1
Benefits paid	(0.2)	(77.6)	(77.8)
Effect of changes in demographic assumptions	–	(1.0)	(1.0)
Effect of changes in financial assumptions	10.3	21.3	31.6
Effect of experience adjustments	(0.8)	(4.8)	(5.6)
Plan curtailments	–	(2.0)	(2.0)
Settlement payments from plan assets	–	(58.6)	(58.6)
At 31 December 2017	23.4	1,341.3	1,364.7

Notes to the Consolidated Financial Statements continued

33. Retirement benefit schemes continued**33 (a) Defined benefit schemes** continued**iv) Balance sheet values** continued

	Contract specific £m	Non-contract specific £m	Total £m
Changes in the fair value of scheme assets			
At 1 January 2016	4.6	1,304.3	1,308.9
Interest income on scheme assets – employer	0.1	49.0	49.1
Interest income on scheme assets – employee	0.1	–	0.1
Administrative expenses and taxes	–	(5.4)	(5.4)
Employer contributions	0.3	11.9	12.2
Contributions by employees	0.2	0.5	0.7
Benefits paid	(0.1)	(45.9)	(46.0)
Return on scheme assets less interest income	0.6	236.3	236.9
At 1 January 2017	5.8	1,550.7	1,556.5
Interest income on scheme assets – employer	0.4	41.4	41.8
Interest income on scheme assets – employee	0.1	–	0.1
Administrative expenses and taxes	–	(5.3)	(5.3)
Employer contributions	0.5	8.7	9.2
Contributions by employees	0.2	0.4	0.6
Benefits paid	(0.2)	(77.6)	(77.8)
Return on scheme assets less interest income	10.6	(92.1)	(81.5)
Settlement payments from plan assets	–	(58.6)	(58.6)
At 31 December 2017	17.4	1,367.6	1,385.0
Changes in the franchise adjustment			Total £m
At 1 January 2016			1.9
Interest on franchise adjustment			0.1
Taken to SOCI			1.7
At 1 January 2017			3.7
Interest on franchise adjustment			0.1
Taken to SOCI			(0.2)
At 31 December 2017			3.6

v) Actuarial assumptions: SPLAS

The assumptions set out below are for SPLAS, which reflects 92% of total liabilities and 94% of total assets of the defined benefit pension scheme in which the Group participates. The significant actuarial assumptions with regards to the determination of the defined benefit obligation are set out below

The average duration of the benefit obligation at the end of the reporting period is 17.9 years (2016: 17.7 years).

Main assumptions	2017 %	2016 %
Rate of salary increases	2.70	2.80
Rate of increase in pensions in payment	2.30 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.30 (RPI)
Rate of increase in deferred pensions	2.30 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.30 (RPI)
Inflation assumption	2.20 (CPI) and 3.20 (RPI)	2.30 (CPI) and 3.30 (RPI)
Discount rate	2.50	2.70

Post retirement mortality	2017 years	2016 years
Current pensioners at 65 – male	22.5	22.5
Current pensioners at 65 – female	25.1	25.0
Future pensioners at 65 – male	24.3	24.2
Future pensioners at 65 – female	26.9	26.9

Sensitivity analysis is provided below, based on reasonably possible changes of the assumptions occurring at the end of the reporting period, assuming all other assumptions are held constant. The sensitivities have been derived in the same manner as the defined benefit obligation as at 31 December 2017 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 2017 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.

	2017 £m	2016 £m
Discount rate – 0.5% increase	(107.9)	(116.5)
Discount rate – 0.5% decrease	122.0	132.5
Inflation – 0.5% increase	83.4	106.1
Inflation – 0.5% decrease	(78.0)	(87.6)
Rate of salary increase – 0.5% increase	3.6	7.8
Rate of salary increase – 0.5% decrease	(3.5)	(7.4)
Mortality – one year age rating	41.6	44.2

Management acknowledges that the method used of presuming that all other assumptions remaining constant has inherent limitation given that it is more likely for a combination of changes, but highlights the value of each individual risk and is therefore a suitable basis for providing this analysis.

Assumptions in respect of the expected return on scheme assets are required when calculating the franchise adjustment for the contract-specific plans. These assumptions are based on market expectations of returns over the life of the related obligation. Due consideration has been given to current market conditions as at 31 December 2017 in respect to inflation, interest, bond yields and equity performance when selecting the expected return on assets assumptions.

The expected yield on bond investments with fixed interest rates is derived from their market value. The yield on equity investments contains an additional premium (an 'equity risk premium') to compensate investors for the additional anticipated risks of holding this type of investment, when compared to bond yields. The Group applies an equity risk premium of 4.6% (2016: 4.6%).

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by the scheme.

Notes to the Consolidated Financial Statements continued

33. Retirement benefit schemes continued**33 (b) Defined contribution schemes**

The Group paid employer contributions of £75.0m (2016: £73.9m) into UK and other defined contribution schemes and foreign state pension schemes.

Serco accounts for certain pre-funded defined benefit schemes relating to contracts as defined contribution schemes because the contributions are fixed until the end of the current concession and at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

34. Share capital

Issued and fully paid	2017 £m	Number 2017 millions	2016 £m	Number 2016 millions
1,098,564,237 (2016: 1,098,559,781) ordinary shares of 2p each at 1 January	22.0	1,098.6	22.0	1,098.6
Issued on the exercise of share options	–	–	–	–
1,098,564,237 (2016: 1,098,564,237) ordinary shares of 2p each at 31 December	22.0	1,098.6	22.0	1,098.6

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

35. Share premium account

	2017 £m	2016 £m
At 1 January and 31 December	327.9	327.9

36. Reserves**36 (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.

36 (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.

36 (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 2017, the ESOT held 8,728,497 (2016: 9,864,986) shares equal to 0.8% of the current allotted share capital (2016: 0.9%). The market value of shares held by the ESOT as at 31 December 2017 was £8.6m (2016: £14.1m).

36 (d) Hedging and translation reserve

The hedging and translation reserve represents foreign exchange differences arising on translation of the Group's overseas operations and movements relating to cash flow hedges.

	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2016	(2.8)	(54.9)	(57.7)
Total comprehensive income for the year	2.3	80.0	82.3
At 1 January 2017	(0.5)	25.1	24.6
Total comprehensive income for the year	(0.2)	(14.3)	(14.5)
At 31 December 2017	(0.7)	10.8	10.1

37. Share based payment expense

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

	2017 £m	2016 £m
Performance Share Plan	9.9	8.9
Deferred Bonus Plan	1.5	0.8
	11.4	9.7

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 2017 thousands	Weighted average exercise price 2017 £	Number of options 2016 thousands	Weighted average exercise price 2016 £
Outstanding at 1 January	93	4.16	187	3.77
Lapsed during the year	–	–	(94)	3.39
Outstanding at 31 December	93	4.16	93	4.16

Of these options, 92,540 (2016: 92,540) were exercisable at the end of the year, with a weighted average exercise price of £4.16 (2016: £4.16).

The options outstanding at 31 December 2017 had a weighted average contractual life of 0.87 years (2016: 1.87 years).

The exercise prices for options outstanding at 31 December 2017 ranged from £3.88 to £4.55 (2016: £3.88 to £4.55).

The weighted average share price at the date of exercise approximates to the weighted average share price during the year, which was £1.17 (2016: £1.13).

The fair value of options granted under the EOP is measured by use of the Binomial Lattice model. The Binomial Lattice model is considered to be most appropriate for valuing options granted under this scheme as it allows exercise over a longer period of time between the vesting date and the expiry date. There were no new options granted under Executive Option Plan during the year and all shares are now vested.

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 2017 thousands	Weighted average exercise price 2017 £	Number of options 2016 thousands	Weighted average exercise price 2016 £
Outstanding at 1 January	116	nil	240	nil
Exercised during the year	(24)	nil	(54)	nil
Lapsed during the year	(92)	nil	(70)	nil
Outstanding at 31 December	–	nil	116	nil

Of these options, nil (2016: 115,818) were exercisable at the end of the year. The options outstanding at 31 December 2017 had a weighted average contractual life of nil years (2016: 0.65 years).

There were no new options granted under either LTIS or LTIP during the year.

Notes to the Consolidated Financial Statements continued

37. Share based payment expense continued**Performance Share Plan (PSP)**

Under the PSP, eligible employees have been granted options with an exercise price of two pence. Awards vest after the performance period of three to five years and are subject to the achievement of four performance measures with the exception of new non-performance awards granted in 2014. These non-performance options are only subject to continued employment on vesting dates which vary from six months to three years after the grant dates.

On the performance related awards, the primary performance measure is TSR and the second performance measure is based on EPS growth. Two additional measures on new grants in 2014 were Absolute Share Price and Strategic Objectives.

If the options remain unexercised after a period of ten years from the date of grant, the options expire

	Number of options 2017 thousands	Weighted average exercise price 2017 £	Number of options 2016 thousands	Weighted average exercise price 2016 £
Outstanding at 1 January	34,485	0.02	23,771	0.02
Granted during the year	15,936	0.02	18,419	0.02
Exercised during the year	(1,123)	0.02	(666)	0.02
Lapsed during the year	(8,297)	0.02	(7,039)	0.02
Outstanding at 31 December	41,001	0.02	34,485	0.02

Of these options, 1,040,066 (2016: 133,470) were exercisable at the end of the year. The options outstanding at 31 December 2017 had a weighted average contractual life of 7.7 years (2016: 7.5 years).

In the year, ten grants were made, of which five were non-performance conditional share awards and two non-performance nominal share awards. The remaining three performance based awards are with Earnings per Share (EPS), Total Shareholder Return (TSR) and Return on Invested Capital (ROIC) performance conditions each attached to 33.3% of options. The options subject to market-based performance conditions (such as the TSR condition for these awards), were valued using the Monte Carlo Simulation model. The options subject only to non-market based performance conditions (such as the EPS and ROIC conditions) a Black-Scholes model has been used. This approach has also been used for the Awards made with no performance conditions attached to them.

The Monte Carlo Simulation model is considered to be the most appropriate for valuing options granted under schemes where there are changes in performance conditions by which the options are measured, such as for the Absolute Share Price or TSR based awards.

The Monte Carlo and Black-Scholes Models used the following inputs:

	2017
Weighted average share price	£1.161
Weighted average exercise price	£0.02
Expected volatility	44.8%
Expected life	3 years
Risk free rate	0.184%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

The weighted average fair value of options granted under this scheme in the year is £0.99 (2016: £0.89).

Deferred Bonus Plan (DBP)

Under the DBP, eligible employees are entitled to use up to 50% of their earned annual bonus to purchase shares in the Group at market price. Provided they remain in employment for this period, the shares are retained for that period and the performance measures have been met, the Group will make a matching share award, up to a maximum of two times the gross bonus deferred

	Number of options 2017 thousands	Weighted average exercise price 2017 £	Number of options 2016 thousands	Weighted average exercise price 2016 £
Outstanding at 1 January	2,945	Nil	906	Nil
Granted during the year	2,549	Nil	2,186	Nil
Lapsed during the year	(600)	Nil	(147)	Nil
Outstanding at 31 December	4,894	Nil	2,945	Nil

None of these options were exercisable at the end of the year (2016: none). The options outstanding at 31 December 2017 had a weighted average contractual life of 1.6 years (2016: 2.1 years)

There were 2,549,262 new options granted under the Deferred Bonus Plan in the year, with 100% of the deferred bonus subject to the same EPS performance conditions as the PSP

The portion subject to EPS performance conditions was deemed to have a fair value equal to their face value less the present value of any dividend payments not received over the vesting period.

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

The assumptions for options granted during the year with EPS performance conditions are:

	2017
Weighted average share price	£1.20
Weighted average exercise price	Nil
Expected volatility	43.9%
Expected life	3 years
Risk free rate	0.20%

The weighted average fair value of options granted under this scheme in the year is £1.20 (2016: £0.95).

Notes to the Consolidated Financial Statements continued

37. 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 2017 thousands	Weighted average exercise price 2017 £	Number of options 2016 thousands	Weighted average exercise price 2016 £
Outstanding at 1 January	–	–	2,051	5.14
Lapsed during the year	–	–	(2,051)	5.14
Outstanding at 31 December	–	–	–	–

Of these options, none (2016: none) were exercisable at the end of the year. There were no outstanding options at 31 December 2017 (2016: none). 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.

There were no new options granted under Sharesave Plan in the year.

38. Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings and associates are disclosed below

Transactions

During the year, Group companies entered into the following transactions with joint ventures and associates:

	Transactions 2017 £m	Current outstanding at 31 December 2017 £m	Non-current outstanding at 31 December 2017 £m
Sale of goods and services			
Joint ventures	0.5	0.1	–
Associates	7.1	0.5	–
Other			
Dividends received – joint ventures	11.1	–	–
Dividends received – associates	17.1	–	–
Receivable from consortium for tax – joint ventures	2.4	5.3	–
Total	38.2	5.9	–

Joint venture receivable and loan amounts outstanding have arisen from transactions undertaken during the general course of trading, are unsecured, and will be settled in cash. Interest arising on loans is based on LIBOR, or its equivalent, with an appropriate margin. No guarantee has been given or received. The only loan amounts owed by joint ventures or associates related to a single entity which have been provided for in full (see Note 11)

	Transactions 2016 £m	Current outstanding at 31 December 2016 £m	Non-current outstanding at 31 December 2016 £m
Sale of goods and services			
Joint ventures	0.5	0.1	–
Associates	6.2	0.5	–
Other			
Dividends received – joint ventures	20.4	–	–
Dividends received – associates	19.6	–	–
Receivable from consortium for tax – joint ventures	3.2	7.7	–
Total	49.9	8.3	–

Remuneration of key management personnel

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance.

The remuneration of the key management personnel of the Group is set out below in aggregate for each of the categories specified in IAS24 *Related Party Disclosures*:

	2017 £m	2016 £m
Short-term employee benefits	12.5	11.9
Share based payment expense	6.2	4.7
	18.7	16.6

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2017: 23 individuals, 2016: 20 individuals).

Aggregate directors' remuneration

The total amounts for directors' remuneration in accordance with Schedule 5 to the Accounting Regulations were as follows:

	2017 £m	2016 £m
Salaries, fees, bonuses and benefits in kind	5.5	5.6
Amounts receivable under long-term incentive schemes	6.3	5.6
Gains on exercise of share options	0.1	–
	11.9	11.2

None of the directors are members of the company's defined benefit pension scheme

One director is a member of the money purchase scheme

Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on pages 110 to 112.

Notes to the Consolidated Financial Statements continued

39. Notes to the consolidated cash flow statement

Year ended 31 December	2017 Before exceptional items £m	2017 Exceptional items £m	2017 Total £m	2016 Before exceptional items £m	2016 Exceptional items £m	2016 Total £m
Operating profit for the year – continuing operations	49.6	(19.6)	30.0	98.5	(56.3)	42.2
Operating loss for the year – discontinued operations	–	–	–	(3.3)	(14.2)	(17.5)
Operating profit for the year	49.6	(19.6)	30.0	95.2	(70.5)	24.7
Adjustments for:						
Share of profits in joint ventures and associates	(27.3)	–	(27.3)	(33.4)	–	(33.4)
Share based payment expense	11.4	–	11.4	9.7	–	9.7
Exceptional impairment of goodwill	–	–	–	–	17.8	17.8
Exceptional impairment of property, plant and equipment	–	–	–	–	(0.8)	(0.8)
Exceptional impairment of intangible assets	–	8.9	8.9	–	0.3	0.3
Impairment and write down of intangible assets	(0.1)	–	(0.1)	0.7	–	0.7
Impairment of property, plant and equipment	–	–	–	0.7	–	0.7
Depreciation of property, plant and equipment	24.3	–	24.3	24.8	–	24.8
Amortisation of intangible assets	25.8	–	25.8	26.2	–	26.2
Exceptional profit on disposal of subsidiaries and operations	–	(0.3)	(0.3)	–	(0.1)	(0.1)
Loss on disposal of property, plant and equipment	0.3	–	0.3	0.4	–	0.4
Loss on disposal of intangible assets	0.3	–	0.3	0.8	–	0.8
Non-cash R&D expenditure offset against intangible assets	(0.7)	–	(0.7)	0.2	–	0.2
Decrease in provisions	(46.4)	(9.6)	(56.0)	(118.4)	(1.1)	(119.5)
Other non-cash movements	0.1	–	0.1	0.4	–	0.4
Total non-cash items	(12.3)	(1.0)	(13.3)	(87.9)	16.1	(71.8)
Operating cash inflow/(outflow) before movements in working capital	37.3	(20.6)	16.7	7.3	(54.4)	(47.1)
Decrease in inventories	3.7	–	3.7	1.3	–	1.3
Decrease in receivables	8.1	4.5	12.6	59.0	13.9	72.9
Decrease in payables	(20.8)	(16.4)	(37.2)	(84.0)	0.6	(83.4)
Movements in working capital	(9.0)	(11.9)	(20.9)	(23.7)	14.5	(9.2)
Cash generated by operations	28.3	(32.5)	(4.2)	(16.4)	(39.9)	(56.3)
Tax paid	(11.4)	–	(11.4)	(5.6)	–	(5.6)
Non-cash R&D expenditure	(0.2)	–	(0.2)	(0.4)	–	(0.4)
Net cash (outflow)/inflow from operating activities	16.7	(32.5)	(15.8)	(22.4)	(39.9)	(62.3)

Additions to property, plant and equipment during the year amounting to £4.7m (2016: £0.5m) were financed by new finance leases.

40. Post balance sheet events

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC (BTP), for consideration of US Dollar \$20.5m/£14.5m in cash. BTP provides satellite communications (SATCOM), radar modernization, operations and maintenance and sustainment services that enable customers to extend the lives of existing systems and achieve phased upgrades with new technology to enhance operational capability. BTP specializes in areas including obsolescence engineering, systems engineering services, test equipment and design, and field engineering services, and maintains a near-field and compact antenna test range at their Ludlow, MA headquarters. BTP's expertise spans shipboard and submarine SATCOM antenna systems, MILSTAR command post antennas and radar antennas. No acquisition related costs were incurred. The acquisition is expected to increase the Group's market share. The financial results and impact of this transaction have not been recognised in these Consolidated Financial Statements, the operating results, assets and liabilities will be recognised with effect from 26 January 2018.

	Provisional fair value US Dollar \$m	Provisional fair value £m
Goodwill	13.6	9.6
Acquisition related intangible assets	4.4	3.1
Property, plant and equipment	0.4	0.3
Inventories	0.5	0.4
Trade and other receivables	2.3	1.6
Cash and cash equivalents	1.7	1.2
Trade and other payables	(2.4)	(1.7)
Acquisition date fair value of consideration transferred	20.5	14.5

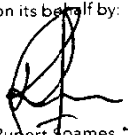
The Group signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The portfolio has annual revenues of approximately £90m and a weighted average remaining term of 14 years. Upon the receipt by the Special Managers and Provisional Liquidators of the requisite third party consents, each individual contract will be transferred to Serco on a cash-free, debt-free basis, with the consideration to be paid in instalments and to be satisfied using Serco's existing financing facilities. If all the contracts are transferred to Serco under the revised BPA process, the total consideration payable would be £29.7m. The consideration payable is lower than the amount of £47.7m announced on 13 December 2017 in respect of substantially the same contracts that were subject to the initial BPA signed with Carillion plc at that date. The change in consideration reflects the Group's re-evaluation of potential liabilities, indemnities, warranties and the additional working capital investment required as a result of Carillion's liquidation. The financial effects of this transaction have not been recognised at 31 December 2017. As consents are required for each individual contract to be transferred and therefore acquired, at the time the financial statements were authorised for issue, no legal transfer or control of assets had taken place and so no disclosures have been made in respect of the assets and liabilities being acquired. The fair values of the assets and liabilities will be determined at the date when contracts are acquired. It is also not yet possible to provide detailed information about each class of acquired receivables and any contingent liabilities in respect of the acquired contracts.

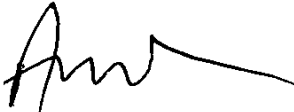
Financial Statements

Company Balance Sheet

At 31 December	Note	2017 £m	2016 £m
Fixed assets			
Investments in subsidiaries	42	2,010.5	2,001.3
Current assets			
Debtors: amounts due within one year	43	3.4	4.5
Debtors: amounts due after more than one year	43	291.2	275.1
Derivative financial instruments due within one year	45	10.1	4.3
Derivative financial instruments due after more than one year	45	3.6	14.2
Current tax asset	43	–	3.7
Cash at bank and in hand		138.2	126.7
		446.5	428.5
Total assets		2,457.0	2,429.8
Creditors: amounts falling due within one year			
Trade and other payables	44	(50.9)	(66.9)
Borrowings	45	(31.8)	(9.7)
Provisions	46	(3.5)	(3.2)
Corporation tax liability		(0.2)	(0.1)
Derivative financial instruments	47	(1.0)	(0.6)
		(87.4)	(80.5)
Net current assets		359.1	348.0
Creditors: amounts falling due after more than one year			
Borrowings	45	(227.6)	(278.4)
Amounts owed to subsidiary companies		(1,106.0)	(1,043.5)
Deferred tax liability	48	–	–
Provisions	46	(41.1)	(41.1)
		(1,374.7)	(1,363.0)
Total liabilities		(1,462.1)	(1,443.5)
Net assets		994.9	986.3
Capital and reserves			
Called up share capital	49	22.0	22.0
Share premium account	50	327.9	327.9
Capital redemption reserve		0.1	0.1
Profit and loss account	51	624.1	633.8
Share based payment reserve	52	74.0	68.5
Own shares reserve		(46.1)	(52.1)
Hedging and translation reserve	54	(7.1)	(13.9)
Total shareholders' funds		994.9	986.3

The financial statements (registered number 02048608) were approved by the Board of Directors on 21 February 2018 and signed on its behalf by:


Rupert Soames *
Group Chief Executive


Angus Cockburn
Group Chief Financial Officer

Company Statement of Changes in Equity

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m	Share based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total shareholders' equity £m
At 1 January 2016	22.0	327.9	0.1	673.6	66.3	(59.8)	7.9	1,038.0
Total comprehensive income for the year	–	–	–	(39.8)	–	–	(21.8)	(61.6)
Shares transferred to option holders on exercise of share options	–	–	–	–	(7.7)	7.7	–	–
Options over parent's shares awarded to employees of subsidiaries	–	–	–	–	6.4	–	–	6.4
Expense in relation to share based payments	–	–	–	–	3.5	–	–	3.5
At 1 January 2017	22.0	327.9	0.1	633.8	68.5	(52.1)	(13.9)	986.3
Total comprehensive income for the year	–	–	–	(9.7)	–	–	6.8	(2.9)
Shares transferred to option holders on exercise of share options	–	–	–	–	(6.0)	6.0	–	–
Options over parent's shares awarded to employees of subsidiaries	–	–	–	–	9.2	–	–	9.2
Expense in relation to share based payments	–	–	–	–	2.3	–	–	2.3
At 31 December 2017	22.0	327.9	0.1	624.1	74.0	(46.1)	(7.1)	994.9

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. The Company has not presented its own profit and loss account as permitted by Section 408 of the Companies Act 2006. The total loss for the year was £9.7m (2016: £39.8m), and loss in total comprehensive income for the year was a loss of £2.9m (2016: loss of £61.6m).

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

Shares in subsidiary companies at cost	£m
At 1 January 2016	1,994.9
Options over parent's shares awarded to employees of subsidiaries	6.4
At 1 January 2017	2,001.3
Options over parent's shares awarded to employees of subsidiaries	9.2
At 31 December 2017	2,010.5

The Company directly owns 100% of the ordinary share capital of the following subsidiaries:

Name	% ownership
Serco Holdings Limited	100%

43. Debtors

	2017 £m	2016 £m
Amounts due within one year		
Current tax asset	–	3.7
Other debtors	3.4	4.5
	3.4	8.2
Amounts due after more than one year		
Amounts owed by subsidiary companies	291.2	275.1

44. Trade and other payables

	2017 £m	2016 £m
Amounts owed to subsidiary companies	35.6	51.6
Trade creditors	0.1	0.6
Accruals and deferred income	12.9	12.5
Other creditors including taxation and social security	2.3	2.2
	50.9	66.9

45. Borrowings

	2017 £m	2016 £m
Loans	259.4	288.1
Less: Amounts included in creditors falling due within one year – loans	(31.8)	(9.7)
Amounts falling due after more than one year	227.6	278.4

Loans:

Within one year or on demand	31.8	9.7
Between one and two years	19.7	34.2
Between two and five years	118.6	125.8
After five years	89.3	118.4
	259.4	288.1

46. Provisions

	Employee related £m	Other £m	Total £m
At 1 January 2017	0.1	44.2	44.3
Released to income statement	(0.1)	–	(0.1)
Utilised	0.4	–	0.4
At 31 December 2017	0.4	44.2	44.6
Analysed as:			
Current	0.4	3.1	3.5
Non-current	–	41.1	41.1
	0.4	44.2	44.6

Employee related provisions relate to restructuring. Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

Appendix: List of subsidiaries

Company name	Serco Group Interest	Registered office address
Aeradio Technical Services WLL ⁴	49%	Headquarters Building, Building # 1605, Road # 5141, Askar # 951, PO Box 26803 Manama, Kingdom of Bahrain
Antab Operations & Contracting LLC	60%	Office No. 31, 4th Floor, Amar 40 Building (No. 2444), 6987 King Abdulaziz Road, Al Masif, PO Box 50025, Riyadh 11523, Kingdom of Saudi Arabia
AWE Management Limited ³	24.5%	Atomic Weapons Establishment, Aldermaston, Reading, Berkshire, RG7 4PR United Kingdom
BAS-Serco Limited	10%	Clarendon House, 2 Church Street, Hamilton, HM11, Bermuda
CCM Software Services Ltd ²	100%	135 Hillside, Greystones, Co Wicklow 216410, Ireland
Confluent Innovations LLC	49%	5880 Innovation Drive, Dublin, OH 43016, United States
Djurgårdens Farjetrafik AB Sweden	50%	Svensksundsvägen 17, 111 49 Stockholm
DMS Maritime Pty Limited	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Equity Aviation Holdings (Pty) Ltd ²	50%	691 Umgeni Road, Durban 4001, South Africa
Equity Aviation Investment Holdings (Pty) Ltd	50%	Block F, 1st Floor, Gilloolys View, Osborn Lane, Bedfordview, Johannesburg 2000, South Africa
Hong Kong Parking Limited	40%	Room 2601, World Trade Centre, 280 Gloucester Road, Causeway Bay, Hong Kong
International Aeradio (Emirates) LLC – Abu Dhabi	49%	Office No. 503, 5th Floor, Al Muhairy Building, Zayed The First Street, PO Box 3164 Abu Dhabi, United Arab Emirates
International Aeradio (Emirates) LLC – Dubai	49%	19th Floor, Rolex Tower, Sheikh Zayed Road, PO Box 9197 Dubai, United Arab Emirates
JBI Properties Services Company LLC	49%	Al Jazira Club, 303, Tower A, Muroor Road (4th Street), PO Box 63737 Abu Dhabi, United Arab Emirates
Khadamat Facilities Management LLC	49%	The United Arab Emirates University, Al Jamea Street, Al Maqam District, PO Box 15551 Al Ain, United Arab Emirates
LOGTEC Inc	100%	Suite 1000, 1818 Library Street, Reston VA 201901 United States
Merseyrail Services Holding Company Limited ³	50%	Eversheds House, 70 Great Bridgewater Street, Manchester, Lancashire, M1 5ES United Kingdom
Northern Rail Holdings Limited ³	50%	Eversheds House, 70 Great Bridgewater Street, Manchester, Lancashire, M1 5ES United Kingdom
Northern Pathways Holding Pty Limited	10%	John Laing, Level 16, 15 Castlereagh St, Sydney NSW 2000, Australia
COMPASS SNI Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Priority Properties North West Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco (Jersey) Limited	100%	13 Castle Street St Helier Jersey JE4 5UT, Jersey
Serco Australia Pty Limited ³	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Belgium S.A.	100%	Avenue de Cortenbergh 60–1000 Brussels, Belgium
Serco Caledonian Sleepers Limited	100%	Basement And Ground Floor Premises, 1–5 Union Street, Inverness, IV1 1PP, Scotland, United Kingdom
Serco Canada Inc.	100%	330 Bay Street, Suite 400, Toronto, Canada M5H 2S8
Serco Citizen Services Pty Ltd	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Corporate Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Defence SA	100%	Avenue de Cortenbergh 60–1000 Brussels, Belgium
Serco Environmental Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Ferries (Guernsey) Crewing Limited	100%	4th Floor, West Wing, Trafalgar Court, Admiral Park, St Peter Port, GY1 2JA, Guernsey

52. Share based payment reserve

	2017 £m	2016 £m
At 1 January	68.5	66.3
Options over parent's shares awarded to employees of subsidiaries	9.2	6.4
Share based payment charge	2.3	3.5
Share options to holders on exercise	(6.0)	(7.7)
At 31 December	74.0	68.5

Details of the share based payment disclosures are set out in Note 37 of the Group's consolidated financial statements

53. 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 2017, the ESOT held 8,728,497 (2016: 9,864,986) shares equal to 0.8% of the current allotted share capital (2016: 0.9%). The market value of shares held by the ESOT as at 31 December 2017 was £8.6m (2016: £14.1m).

54. Hedging and translation reserve

	2017 £m	2016 £m
At 1 January	(13.9)	7.9
Fair value gain on cash flow hedges during the period	0.1	0.4
Net exchange gain/(loss) on translation of foreign operations	6.7	(22.2)
At 31 December	(7.1)	(13.9)

55. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £4.3m (2016: £20.4m). The actual commitment outstanding at 31 December 2017 was £4.3m (2016: £17.9m).

Both the Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2017 was £210.4m (2016: £234.3m).

The Company also provides parent company guarantees in respect of trading performance and/or recovery of liabilities owed to customers by its subsidiaries. These are not expected to result in any material financial loss to the company.

The Group is aware of claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

56. Related parties

The Directors of Serco Group plc had no material transactions with the Company or its subsidiaries during the year other than service contracts and Directors' liability insurance. Details of the Directors' remuneration are disclosed in the Remuneration Report for the Group.

The Company is exempt under the terms of FRS 101 from disclosing related party transactions with entities that are 100% owned by Serco Group plc.

Appendix: List of subsidiaries

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Equity Aviation Investment Holdings (Pty) Ltd	50%	Block F, 1st Floor, Gilloolys View, Osborn Lane, Bedfordview, Johannesburg 2000, South Africa
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Serco Corporate Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Defence SA	100%	Avenue de Cortenbergh 60–1000 Brussels, Belgium
Serco Environmental Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Ferries (Guernsey) Crewing Limited	100%	4th Floor, West Wing, Trafalgar Court, Admiral Park, St Peter Port, GY1 2JA, Guernsey

Company name	Serco Group Interest	Registered office address
Serco Ferries (HR) Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Geografix Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Gestion de Negocios SL	100%	Calle Ayala, 13 1 ^o Dr, 28001 Madrid, Spain
Serco Group (HK) Limited	100%	Suite No. 1, 11 F., Sino Plaza, 255-257 Gloucester Road, Causeway Bay, 255257, Hong Kong
Serco Group Consultants (Shanghai) Company Limited ²	100%	1206-A23, 12/F Shui On Plaza, No 333 Mid Huai Hai Road, Shanghai 200021, China
Serco Group Pty Limited	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Holdings Limited ¹	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Inc. ³	100%	c/o Corporation Services Company, 830 Bear Tavern Rd, West Trenton, NJ 08628, United States
Serco Insurance Company Limited	100%	Maison Trinity, Trinity Square, St Peter Port Guernsey
Serco Integrated Transport Private Limited	100%	Office# 431, Level 4, Augusta Point, Sector 53 Golf Course Road, Gurgaon 122002, India
Serco International Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco International S à r.l	100%	Estera, 7 rue Robert Stümper, L-2557 Luxembourg
Serco Leasing Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Leisure Operating Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Limited ³	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Listening Company Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Luxembourg S.A.	100%	17 Boulevard Royal 17, L - 2449 Luxembourg
Serco Nederland B.V.	100%	Kapteynstraat 1, 2201 BB Noordwijk ZH, Netherlands
Serco New Zealand (Asset Management Services) Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco New Zealand Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco New Zealand Training Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco North America (Holdings), Inc.	100%	Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States
Serco North America Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Paisa Limited	50%	Surrey, Ci Tower, St. George's Square, New Malden, Surrey, KT3 4TE United Kingdom
Serco PIK Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Pension Trustee Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Projects LLC	49%	Global Business Centre 2, Second Floor, Al Hitmi Village Building, C-Ring Road, PO Box 25422 Doha, State of Qatar

Appendix: List of subsidiaries continued

Company name	Serco Group interest	Country of incorporation
Serco Regional Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Srl	100%	15, rue Lumière 01630 Saint Genis Pouilly, France
Serco SAS	100%	15, rue Lumière 01630 Saint Genis Pouilly, France
Serco Saudi Arabia LLC	100%	Mazaya Tower, 1st Floor, King Saud Road, PO Box 366877, Riyadh 11393, Kingdom of Saudi Arabia
Serco Services GmbH	100%	Lise-Meitner-Strasse 10, 64293 Darmstadt, Germany
Serco Services Inc.	100%	Suite 1000, 1818 Library Street, Reston VA 20190, United States
Serco Services Ireland Limited	100%	29 Earlsfort Terrace, Dublin 2, Ireland
Serco SpA	100%	Via Sciadonna 24/26, 00044 Frascati (Roma), Italy
Serco Defence Clothing Pty Ltd	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Switzerland SA	100%	86 bis Route de Frontenex, 1208 Geneva, Switzerland
Serco Traffic Camera Services (VIC) Pty Limited	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco-IAL Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
VIAPATH Group LLP	33%	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom

1 Serco Holdings Limited is directly owned by Serco Group plc. All other subsidiaries and associated undertakings are held indirectly via Group companies

2 Companies in liquidation as at 31 December 2017

3 Companies key to the consolidated numbers, all of which are engaged in the provision of support services

4 Companies with a non-controlling interest

Appendix: Supplementary information

Five-year record (unaudited)

	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Adjusted Revenue	3,310.3	3,529	4,252	4,753	5,140
Less: Share of revenue of joint ventures and associates	(356.7)	(481)	(737)	(798)	(856)
Revenue	2,953.6	3,048	3,515	3,955	4,284
Underlying Trading Profit*	69.8	82.1	95.9	113.2	257.4
OCP and Contract and Balance Sheet Review adjustments	(15.8)	14.2	20.9	(745.3)	–
Include benefit from non-depreciation and amortisation of assets held for sale	–	0.5	11.7	–	–
Include other one-time items	–	3.5	9.0	–	–
Trading Profit/(Loss)*	54.0	100.3	137.5	(632.1)	257.4
Amortisation and impairment of intangibles arising on acquisition	(4.4)	(5.1)	(4.9)	(23.7)	(21.4)
Operating profit/(loss) before exceptional items	49.6	95.2	132.6	(655.8)	236.0
Exceptional profit/(loss) on disposal of subsidiaries and operations	0.3	0.1	2.8	(5.4)	19.2
Other exceptional operating items	(19.9)	(70.6)	(190.3)	(656.1)	(109.7)
Operating profit/(loss)	30.0	24.7	(54.9)	(1,317.3)	145.5
Net finance costs	(11.6)	(12.6)	(31.9)	(36.7)	(37.2)
Exceptional finance costs	–	(0.4)	(32.8)	–	–
Other gains	0.7	–	–	–	–
Profit/(loss) before tax	19.1	11.7	(119.6)	(1,354.0)	108.3
Tax (charge)/credit	(19.0)	(12.8)	(33.5)	6.9	(9.9)
Profit/(loss) after tax	0.1	(1.1)	(153.1)	(1,347.1)	98.4
Recourse Net Debt	(141.1)	(109.3)	(82.2)	(642.7)	(725.1)
Net Debt	(141.1)	(109.3)	(82.2)	(642.7)	(745.4)
	Pence	Pence	Pence	Pence	Pence
Earnings/(loss) per share before exceptional items	2.24	6.12	6.55	(107.43)	32.74
Basic (loss)/earnings per share	(0.02)	(0.11)	(15.47)	(205.66)	20.12
Dividend per share	–	–	–	3.10	10.55

* Included in 2014 Trading Loss were charges totalling £745.3m arising from the Contract and Balance Sheet Review undertaken in 2014, with £718.0m charged to Adjusted Operating Profit and £27.3m charged to Management estimate of items relating to UK Government reviews

Shareholder Information

Our website

Our corporate website, www.serco.com, provides access to share price information as well as sections on managing your shareholding online, corporate governance and other investor relations information.

Managing your shares online

Shareholders can manage their holding online by registering to use our shareholder portal at www.shareview.co.uk. This free service is provided by our Registrar, Equiniti, giving quick and easy access to your shareholding, allowing you to manage all aspects of your shareholding online, with a useful FAQ section.

Electronic communications

We encourage shareholders to consider receiving their communications electronically. Choosing to receive your communications electronically means you receive information quickly and securely and allows us to communicate in a more environmentally friendly and cost-effective way. You can register for this service online using our share portal at www.shareview.co.uk.

Duplicate documents

Some shareholders find that they receive duplicate documentation due to having more than one account on the share register. If you think you fall into this group and would like to combine your accounts, please contact our Registrar, Equiniti.

Changes of address

To avoid missing important correspondence relating to your shareholding, it is important that you inform our Registrar, Equiniti, of your new address as soon as possible.

Sharegift

If you have a very small shareholding that is uneconomical to sell, you may want to consider donating it to Sharegift (Registered Charity no.10526886), a charity that specialises in the donation of small, unwanted shareholdings to good causes. You can find out more by visiting www.sharegift.org or by calling +44 (0) 207 930 3737.

Shareholder queries

Our share register is maintained by our Registrar, Equiniti.

Shareholders with queries relating to their shareholding should contact Equiniti directly using one of the methods listed opposite.

For more general queries, shareholders can look at our corporate website at www.serco.com.

American Depositary Receipts (ADRs)

Serco has established a sponsored Level I ADR programme. Serco ADRs are traded on the US over-the-counter market (SCGPY).

For queries relating to your ADR holding, please contact our ADR depositary bank, Deutsche Bank Trust Company Americas.

Shareholder profile

	Number of holdings	% of holdings	Number of shares	% of shares
1 and 1,000	3,381	50.18	1,339,704	0.12
1,001 and 5,000	2,272	33.72	5,177,479	0.47
5,001 and 10,000	445	6.60	3,148,311	0.29
10,001 and 100,000	378	5.61	10,525,823	0.96
100,001 and 500,000	120	1.78	27,384,313	2.49
500,001 and 1,000,000	47	0.70	33,860,368	3.08
1,000,001 and 10,000,000	71	1.05	223,563,817	20.35
10,000,001+	24	0.36	793,564,422	72.24
Total	6,738	100	1,098,564,237	100

239



www.serco.com

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E: generalenquiries@serco.com