Annual report and accounts 2014

Our strategy is to be a superb provider of public services, by being the best managed business in our sector. We will be a focused B2G (Business to Government) business, specialising across five pillars: Justice & Immigration, Defence, Transport, Citizen Services and Healthcare. We will deliver these services internationally from our operating units in the UK & Europe, North America, the Middle East and Australia & New Zealand.

Contents

Strategic Report

P02-75

Strategic Report

Chairman's Statement

Since the traumatic events of 2013 when overbilling in our Electronic Monitoring contracts and misreporting of data on the Prisoner Escort & Custody Services contract was identified, I have sought to stabilise Serco with the recruitment of strong new management and Non-Executive Directors; building a much improved relationship with the UK Government; and bringing clarity to our strategic direction. During the course of 2014 we undertook a Strategy Review which reassessed the Group's future prospects, including Contract and Balance Sheet Reviews and identified the right capital structure, to which the rights issue launched on 12 March 2015 for approximately £555m is central. All of these are necessary steps in putting Serco back onto an even keel and giving our new management team the firm foundation for taking the Company forward again.

With the benefit of hindsight and our Strategy Review, one can see the challenges in the Group's previous strategy and implementation. The move into private sector BPO was intended to reduce the Group's dependencies upon the UK and the public sector, and gain exposure to a market with a clear momentum of growth, whilst adding a new capability in middle and back office processing, alongside Serco's historic strength in the delivery of frontline services, allowing us to offer a wider range of services in the public sector. In the event, however, it turned out to be more difficult than we expected to build private sector BPO distribution using our public sector marketing resources, and the market for whole-agency outsourcing, which would demand integrated front-middle-and-back office processing, developed at a far slower pace than anticipated. In addition, the integration of the Group's acquisitions in this sector, particularly of Intelenet and The Listening Company, both with each other and the rest of the Group, was not well executed.

The in-depth analysis of our business model and operational design undertaken by our new management, which followed on from the independent reviews commissioned by the Board in the second half of 2013, revealed limitations in the Group's infrastructure and processes. It is now clear that these had not been developed to the degree appropriate for Serco's increasing scale, breadth, and complexity. Serco had sought to maintain a strong entrepreneurial drive to achieve and succeed through operating a devolved structure that gave significant responsibility to those closest to our customer. This flexibility and speed of decision-making was much-welcomed by our public sector customers. How our Contract Directors applied their autonomy was very much for them to determine, subject to their delivering against their revenue and profit commitments. Similarly, how Units and Divisions developed their businesses was largely for them to decide within the constraints of policies and operating procedures, with a relatively light touch of central management oversight.

Group policies and systems, in particular as regards bidding and contract management, that seemed sensible and proportionate when viewed from an oversight perspective, now appear too often to have been considered to be advisory rather than prescriptive. The creation of Group-wide information systems beyond merely financial reporting, identified as a development need during a previous review of the Board's effectiveness, was handicapped by the fragmented nature of our contracting business much of which operated on systems inherited from, and shared with, our public sector customers.

Alastair Lyons CBE
Chairman

In my statement last year I wrote of the findings of the independent review of Serco's culture, in particular, the Group having an inappropriately strong drive to achieve top and bottom line growth. That said Serco had a well-developed and successful history of broadening its business by moving into new areas of activity. Typically, Serco inherited much of the technical capability for the diverse activities covered under our contracts, such as helicopter flight simulation or North Sea ferry operations, when it took over the contract. In addition, Serco brought transformational business re-engineering, private sector leadership and people management practices, and long experience in managing outsourced public sector activities. The ability to broaden in this way is, however, dependent upon the contractual framework of risk transfer, something that has changed materially in recent years. Increasingly, Governments look to their suppliers to take on risks which the suppliers can do little to manage or mitigate: examples would be the number of people applying for asylum, or requiring healthcare. Where there is both a high level of risk transfer by the public sector customer, and entry into a new activity, there is a need for intense risk assessment and management scrutiny, identifying at an early stage if a contract is failing to perform, and taking corrective steps. This in turn requires a more interventionist and better informed management structure than Serco typically needed under earlier models of outsourcing. Previous shortcomings in both contracting process and risk assessment are now evident in the substantial onerous contract provisions that the Group has been required to make in its 2014 accounts against a limited number of material contracts, albeit the factors contributing to the severity of these provisions, many outside the Group's control, changed materially during the course of the year.

There have been extensive Board and management changes over the course of the last year. I am delighted that Rupert Soames has accepted the Board's invitation to become our new CEO. He brings considerable experience in providing mission-critical services to a wide range of customers, many in the public sector, across a broad geography. He has an enviable track record at Aggreko of successful sustained growth and profitability over an extended period, and has already made a great impact on Serco with his open and straightforward approach to issues great and small and his infectious enthusiasm. I am equally delighted to have Rupert reunited with Angus Cockburn as CFO. Angus is highly respected in the City for his candour, prudence, and clarity of thought: he is steering the Group through a demanding covenant reset and rights issue process, developing the necessary financial models to support the prospectus disclosures of cash flow and profitability. Our third Executive Director is Ed Casey. I would like to put on public record my personal gratitude to Ed for stepping into the breach as Interim Group CEO following Chris Hyman's resignation, despite the personal impact of moving across to the UK from his role as US CEO, and for the considerable leadership and inspiration he gave the business during an intensely difficult period. I am delighted that he has now taken the role of Group COO in which he is able to bring to bear his extensive operational experience of Serco's business.

Rupert has already added considerable talent to his executive leadership team. We welcome Kevin Craven and Liz Benison as CEOs of the UK Central Government and UK & Europe Local & Regional Government Divisions. Both are established executives with a strong track record in the supply of outsourced services. They join Dan Allen at Serco Americas; Mark Irwin and David Greer who lead, respectively, our AsPac and Middle East businesses following the retirement of David Campbell as CEO of what was previously our AMEAA division; and Susir Kumar who runs Serco Global Services. David Eveleigh has also joined us from BT Global Services in the new role of General Counsel and Company Secretary – may I take this opportunity to thank John Hickey, our previous Company Secretary, for his enormous commitment and contribution during a difficult period.

Three new Non-Executive Directors were appointed to the Board in 2014, adding considerably to the available range of business and Board experience at a senior level. Mike Clasper assumed the role of Senior Independent Director in September, having joined the Board in March. Rachel Lomax and Tamara Ingram also joined in March, Rachel to take the chair of the newly created Corporate Responsibility and Risk Committee, whilst Tamara has joined our Remuneration Committee. Taken together with our executive appointments, Serco has a strong Board to steer the company through its recovery over the next few years.

Personally, I will be very sad to stand down later this year once my successor has been selected, but the ultimate responsibility for what happens in any Company rests with the Chairman. The last two years have been hugely challenging for the business and greatly destructive of shareholder value, which I deeply regret. However, despite the strategic and operational mis-steps of the past few years Serco has, over the past 25 years, built powerful positions in its principal frontline services both in the UK and overseas in the US, Middle East, Australia and New Zealand. In these areas Serco has depth of know-how and a track record of successful delivery which has allowed it to take capability developed in one geography and create a relevant presence in another – the export of our justice and non-clinical healthcare experience from the UK to Australia is a case in point. Going forward, in pursuit of the strategy set out later in this report by Rupert Soames, Serco will focus on growing its business within those areas where it has sustainable competitive advantage, whilst at the same time reducing costs by simplifying our organisational design and sharing common services across the Group. All this will be developed within a control framework based on clear understanding of, and adherence to, Group best practice supported by focused, timely performance information that highlights unplanned exceptions at an early stage allowing effective management intervention.

Strategic Report

Chairman's Statement continued

As a shareholder myself, I look forward to seeing Serco realise its strategic objectives and recover lost value. Significant change is necessary in the way we do things, how we are organised and this will take time to achieve. We have also lost considerable momentum, particularly in new business generation, over the past couple of years and this will also take time to re-establish given the length of bid cycles in long-term contracting. However, we have a highly effective management team and a deeply committed workforce that cares passionately about the delivery of public services to the benefit of citizens. Above all, I would like to thank them for all that they have continued to contribute; it is because of what they have achieved that we are able to adopt a strategy that is based on maximising the potential of our areas of strength. Our competitors tend to be based on multiple sectors in a single geography or a single sector in multiple geographies. Serco has breadth across both sector and geography allowing it to achieve strength of presence across a number of Business to Government markets at the same time. We will in future focus on being a superb supplier of public services across five pillars: Justice & Immigration, Defence, Transport, Citizen Services and Healthcare; and in four geographies: UK & Europe, North America, the Middle East, and Australia & New Zealand. This is Serco's competitive differentiation and represents a strong base for future growth.

Alastair Lyons CBE
Chairman
12 March 2015

Strategic Report

Our Business Model

What we do, how we do it and where

Serco serves governments and other bodies who serve the public or protect their nation's interests.

Since we were founded more than 50 years ago, we have delivered services through people, supported by processes, management and technology. Our customers know what outcome or service they want to deliver to their service users, and we find new and more effective ways to achieve it for them. Over the years we have delivered innovative solutions to some of the most complex challenges of the day, bringing our experience, innovation and scale to deliver the financial, service and policy outcomes our customers want. In partnership with our customers, we make a difference to the lives of millions of people around the world, and help nations to protect their interests.

Our customers have limited resources. All governments are under intense pressure to do more, and better, with less. Delivering services to meet the high expectations citizens have of public services is very demanding. People and communities have rapidly changing needs and expect the services they use to make a positive and tangible difference to their lives. To overcome these challenges, our customers want partners who can improve the quality and efficiency of their services and help them keep their promises to their citizens.

Serco people constantly look for ways to improve the services we deliver. We can transfer our skills, insights and ideas from one sector or region to another, so we can anticipate and meet new challenges for customers. We have deep experience in the capabilities we offer and in the countries we operate in, and this is the heart of what makes us different.

A key part of our value proposition is that we provide a bridge between the drive, energy and innovation of the private sector, and the very specific requirements of the public sector. Providing services to the public, and being funded by taxpayers, is different, and in many ways more demanding, than providing services to the private sector or consumers. Influences such as politics, transparency and accountability to multiple stakeholders are seen only dimly in the private sector, but writ large in the public sector, and need skilful 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 gain the trust of our customers. As a consequence, we are granted contracts to provide services of the utmost sensitivity, from supporting strategic nuclear weapons to caring for asylum seekers and young offenders.

During 2014 we simplified our divisional structure, removing a layer of supervisory management which sat between Group and our AMEAA Division. For the balance of 2014, Serco operated through six Divisions, five of which (UK Central Government, UK & Europe Local & Regional Government, Americas, Asia Pacific and the Middle East) provide a broad range of frontline public service operations to customers in various geographic regions and one (being the Global Services Division) provides Business Process Outsourcing (BPO) services globally. More information on our Divisions their performance in the year can be found in the Divisional Review on pages 31 to 44.

Following our Strategy Review, described in more detail below, we will in future focus on five key pillars of public service: Justice & Immigration, Defence, Transport, Citizen Services and Healthcare, and deliver these services internationally from our operating units in the UK & Europe, North America, the Middle East and Australia & New Zealand. In each of these areas we identify a pipeline of long-term contract opportunities that are anticipated to be procured by customers. It is our intention to bid for and win opportunities in this pipeline; commit to a long-term contract with the customer, including specified pricing, service levels and scope of delivery; deliver on these contracted commitments at the contracted price; and on contract expiry, either win a rebid or manage a contract exit.

Strategic Report

Our Strategy

Following the arrival of Rupert Soames as our new Chief Executive in May 2014, we launched a root-and-branch Strategy Review, which also encompassed a comprehensive examination of our contracts and balance sheet. The objective of this review was to give us a firm foundation upon which we could build a stronger company to deliver value to our stakeholders: to our customers, by providing excellent, reliable and innovative services; to our shareholders, by providing sustainable and growing returns on the capital they entrust to our care; to our lenders, by providing them with a solid and secure credit; and to our colleagues, by giving them interesting and rewarding careers.

The Strategy Review is now complete. The strategy is set out in detail in this section, but like all good strategies, it can be simply expressed. Our strategy is to be a superb provider of public services, by being the best managed business in our sector. We will be a focused B2G (Business to Government) business, specialising across five pillars: Defence, Justice & Immigration, Transport, Citizen Services and Healthcare. We will deliver these services internationally from our operating units in the UK & Europe, North America, the Middle East and Australia & New Zealand.

From left:
Rupert Soames, OBE
Chief Executive

Angus Cockburn
Chief Financial Officer

The historical context

From 2000 to 2010, Serco saw strong growth through a combination of organic growth in existing markets, expansion into new countries, and contributory acquisitions. During this period Serco delivered outstanding performance, with revenues and trading profit growing strongly. Governments were keen to benefit from involving the private sector in the provision of services, and many areas of activity were contracted out for the first time. As Serco and others were able to reduce costs and improve services, contract margins grew and revenues increased rapidly.

Towards the end of the decade, however, conditions became more difficult. Margins came under pressure as 'first generation' contracts were retendered and governments, having gained experience from early contracts, became more sophisticated purchasers. At the same time, the competitive landscape became more intense, as companies from outside the public service sector were attracted by the rapid growth and strong margins, and existing operators expanded into new segments. Overlaid upon this came the consequences of the financial crisis in 2008 which led to an intense focus on public expenditure deficits. In the UK, the election in 2010 of a new Government determined to cut spending to reduce the fiscal deficit, combined with US budgetary constraints leading to a series of continuing resolutions and reductions in military expenditure, resulted in a sharp reduction in the rate of growth of the public sector outsourcing market.

Faced by these challenges, in 2010 Serco devised a strategy to reduce its dependence on frontline services and the public sector by building, largely through acquisition, a private sector Business Processing Outsourcing business. The thinking was that a private sector business could bring skills and additional services to the public sector business, and the core Serco business could add distribution, brand and heft to provide enhanced value to the private sector business. At the same time Serco sought to combat a slowing public sector market by bidding for new work, and entered new sectors such as clinical healthcare in the UK and providing housing for asylum seekers. Finally, Serco sought to gain efficiencies and reduce costs by investing in an enterprise-wide SAP ERP system and building a shared services infrastructure covering IT, human resources and finance.

Whilst this strategy was a logical reaction to challenging conditions, in practice it proved extremely difficult to implement because the synergies between the private and public sector businesses were not as expected; the acquisitions that drove entry into the BPO market were not well integrated; some of the contracts in new markets proved to be more costly and more difficult to execute than was anticipated; and the implementation of a shared services infrastructure proved problematic. At the same time, some of Serco's most profitable contracts were lost on rebid (e.g. Federal Retirement Thrift Investment Board in the US), were taken back in-house (e.g. Walsall Education in the UK) or saw sharp reductions in volumes or margins (e.g. Australian Immigration Services and the Atomic Weapons Establishment in the UK). In addition, some of the contracts we had won began to lose money; how many contracts, and how much money they were losing and likely to lose in the future only became truly apparent in the second half of 2014. Finally, in 2013, Serco suffered immense reputational damage when it was found by the UK Government to have over-charged on a major contract. A £64.3m settlement was paid to the customer, a large and profitable contract was taken away, and for a period of time, the Group was effectively unable to win material new work from the UK Government. The consequences of these factors are most obviously reflected in the financial performance and share-price of the Group. Trading Profit fell from a high of £310.7m in 2012 to £113.2m, before the impact of the Contract and Balance Sheet Reviews in 2014. The market capitalisation of the business over the same period fell from over £3bn to less than £1bn.

Faced with these challenges, the new management team commenced a Strategy Review in May 2014 to analyse the current market and competitive situation, develop a strategy that would offer the greatest opportunity for value creation for shareholders, customers and employees, and identify how best to implement the strategy.

Strategic Report

Our Strategy continued

Findings of the Strategy Review

The Strategy Review had three distinct phases. First: make sure we properly understood the causes and effects of the challenges of the last five years. Second: to explore the strategic options for the Group. Finally, having selected a strategy, plan the implementation.

The causes of our troubles have been set out in the historical context. The effects are most starkly reflected in both the financial performance and the charges we have had to take on onerous contract provisions, asset impairments and other charges which are described in more detail in the table on page 50. In short, in 2014 we have taken provisions and charges of £1.3bn, of which £447.1m relates to onerous contracts, and £504.6m to the impairment of goodwill and intangibles and the balance of £347.3m for other charges and impairment of assets.

In terms of strategic options, only two were worthy of detailed examination. First, we could continue with the existing strategy of operating both in the private and public sector; or we could focus on one and exit the other. This was a difficult decision, because our private sector operation is a high-quality business, with excellent prospects. However, it represented a very small proportion of our economic profits, and the hard fact was that Serco was not making a good job of owning it; our public sector customers have proved extremely resistant to moving middle or back office functions outside their jurisdictions, and we had failed to add value to the private sector business using our public sector distribution and brand. It became clear that the disciplines required for international success in the private and public sector BPO markets are different, and to build a Group which could have the scale to be good at both would require significant investment. Therefore we decided to focus investment and effort on our core market, where we had a strong and differentiated position. Once we have addressed the issues in our core market, and earned the confidence of our stakeholders, we believe that we would have more options in three to five years' time than we have in 2014.

Happily, the Strategy Review also identified that whilst the public service market presents a number of challenges, it also has many attractions. Most particularly, we see the market for the provision of public services by private companies as being underpinned by structural growth. There are only two things we need to believe for this hypothesis to be correct; 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, we believe that governments will continue to face huge pressures to deliver more and better public services, for less, and that these pressures will lead them to focus relentlessly on value for money and the quality of service provision. We have named these pressures 'the Four Forces' and they comprise:

- The growing costs of healthcare and the costs of supporting ageing populations and infrastructure
- 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

Whilst there has been great focus on 'austerity' as a factor affecting public finances in the short-term, we believe that these Four Forces will continue to bear on public policy for many years to come, and drive growth in private sector provision of public services in our sectors at a projected sector aggregate which is currently believed to be 5-7%. Other factors that make the public sector marketplace attractive to us are that it is unlikely to be disrupted by technology or other exogenous factors; absent catastrophe, 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.

People will ask: how large is the market? Beyond saying that it is huge, truthfully, we don't really know, as it is fiendishly hard to define. Does the support of a mainframe computer supplied by IBM but operated by the government fall within our definition of the market? What about services provided by government-owned agencies operating on an arms-length basis? Within Defence, do we count supply and support of missile systems, or just the types of services we supply (even if we could get a number for either)? And how do we disentangle wildly different definitions of expenditure used by the various governments with whom we deal? We could at considerable expense, pay consultants to try to come up with an answer, but it would be no more than a wild guess, and not even a useful one. Certainly not one that passes the 'so what?' test; if one group of consultants said the answer was £30 trillion, and another said it was £40 trillion, would it change our mind? No. When it comes to guessing, we would rather do it for ourselves for free.

Furthermore, if global market share was a determinant or measure of success, we might be more exercised by the question; but it is not, and with revenues from government of over £3bn, it would be so small against the total global market as to be not worth measuring. Within some segments – for example prisons in the UK – we can be more precise, but then we get into issues of commercial sensitivity. We are not inclined to share with competitors how much we are being paid for narrowly defined sectors, from which they might be able to extrapolate contract pricing.

So we ask stakeholders to accept the fact that the markets in which we intend to focus are huge, our market share is generally small, although in some geographies and sectors large, and we have plenty of headroom to grow.

Core to our strategy is the belief that having a diversified portfolio of exposures to different sectors and jurisdictions is an advantage. In a world where political priorities of changing governments can switch resources from defence to immigration control to healthcare and back again, being diversified by segment and jurisdiction should reduce risk and volatility and enable us to share best practice and is therefore valuable. Many of our closest competitors are specialists in either a particular sector, or within a geography. Although focused on public services, we feel we can deliver better risk-adjusted returns and lower volatility in the long-term if we have the capability to operate across more than one sector within the market, and in more than one jurisdiction.

But management of risk is only one reason we like a strategy of operating across a number of jurisdictions and sectors. We believe that governments across the world face similar challenges at many levels. At a detailed operational level, providing cleaning and catering services in a hospital is very similar in Western Australia and in Arkansas; likewise escorting prisoners to court. At a higher level, having expertise in staff rostering and time management is globally applicable across sectors, as is project and case management. Yet higher, building deep capability in continuous improvement is globally applicable. Finally, will the fact that we have deep expertise in running urban transport in one territory give us credibility in another? Will the fact that the Governments in the US and the UK trust us with some of their most secret and sensitive projects help us when bidding for defence projects in the Middle East? Will our proven track record in reducing recidivism amongst offenders in the UK and Australia be of interest to authorities in other countries? We believe the answer to all these questions is 'yes'.

Which brings us to the question: which sectors, in which jurisdictions? One of Serco's strengths – and weaknesses – is the vast number of different areas it provides services. During our Strategy Review we counted 38 discrete markets, so some focus is clearly required, and a pretty wide net has to be used in defining the services we provide. One example will suffice: in Sandwell, near Birmingham, we provide a very excellent dog warden service, picking up and caring for waifs and strays. 180 miles from there, we are intimately involved in the operation of the UK's Ballistic Missile Early Warning Station at RAF Fylingdales. Such diversity and experience gives us a foundation upon which to judge where we are able to add value, and succeed competitively.

Strategic Report

Our Strategy continued

Our core pillars

We intend to focus our business in the public sector into five pillars: Defence, Justice & Immigration, Transport, Citizen Services and Healthcare. We will exit our interests in the private sector BPO and the UK Leisure and Environmental Services markets which will significantly simplify our business. In 2014, our revenues in each of these pillars were:

Sector	Revenues 2014 (including Joint Ventures), £m	Jurisdictions	Key services
Justice and Immigration	702	UK, Australia, New Zealand	• Custodial Services • Immigration Detention and Services • Detainee transport and monitoring
Defence	1,321	N America, UK, Middle East, Australia	• Base and operational support • Engineering, management and information services • Maritime services
Transport	845	UK, US, Middle East	• Rail and Ferries • Road Traffic Management • Air Traffic Control
Citizen Services	899	UK, US, Europe, Australia, New Zealand	• Citizen contact and case management • Middle and back office services; IT services • Employment and skills services
Healthcare	256	UK, Australia, Middle East	• Non-clinical support services • Clinical support • Patient administration and contact
Other	730		• Private Sector BPO • Environmental Services/Leisure • Private sector FM • Great Southern Rail
Total	**4,753**		

Implementing the strategy

Our ambition is to be a superb provider of public services. The question is 'how'?

Serco is not a technology business; we use technology, but as an enabling tool, not a product. We combine people, processes and technology to deliver excellent services. Since the last two of these depend entirely on the first one, 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 a bit motherhood-and-apple-pie, but we believe that it is a worthy and value-creating objective, and one that we can use to inspire our management teams. 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. £1.3bn of provisions and charges say that Serco cannot currently claim to be the best-managed business in the sector, and other companies have dealt with the challenges in the market better than we have.

So we can define our ambition as wanting to be the best-managed business in our sector from a position where we can clearly do much better; everywhere we look we see opportunities for improving the way we do things. We can improve the way we manage contracts and risk; we can equip people with accurate and timely information; we can measure performance better; we can improve the efficiency of our internal processes; we can reduce costs; we can re-build our business development capability; we can re-establish our reputation for developing innovative solutions to public service challenges. None of this comes easy or quickly, and in our current circumstances we need to steer a tricky course between the urgent need to reduce our overheads in line with reduced revenues in the short-term and investing in systems and processes that will produce sustainable benefits in the long-term. We also need to retain the 'baby' of our strong culture of contract managers taking personal responsibility for their contracts, whilst chucking out the 'bathwater' of our lack of visibility, accountability and effective risk management.

At the heart of our plan to implement our strategy is to focus on building our capability in the techniques of continuous improvement. The advantage of these techniques is that they empower people to improve their operations in the way that they know best: it is not about grand gestures, or large projects, but relies on thousands of little projects, conceived, planned and executed at local level, all of which can deliver incremental improvement. The cumulative effect of all these small improvements over time can be huge improvements in productivity and service. But this is not all. Implementation means we are also improving our management information, shifting to a focus on risk-adjusted returns on capital, improving our visibility of performance, strengthening our controls and governance and becoming more efficient through delayering and making better use of our scale in procurement and the use of shared services.

The tangible evidence of our success or otherwise will be a return to industry rates of growth and margins. According to the Directors' current best estimates of the market the segments to be focused on are likely to grow at an aggregate of 5-7% and industry margins across Serco's mix of business are likely to be in the range of 5-6%. If this turns out to be correct, and markets turn out as expected, we believe that after the initial years of restructuring and transformation, it should be possible to increase growth rates towards the average of the Group's peers.

Strategic Report

How we Performed in 2014

Year ended 31 December	2014	2013
Revenue (note 1)	£3,955m	£4,284m
Trading (Loss)/Profit (note 2)	(£632m)	£257m
Operating (Loss)/Profit Before Exceptional Items	(£656m)	£236m
Operating (Loss)/Profit	(£1,317m)	£146m
EPS Before Exceptional Items (basic)	(135.0p)	32.7p
EPS (basic)	(258.4p)	20.1p
Dividend Per Share	3.10p	10.55p
Free Cash Flow	£62m	£63m
Net Debt (including that for assets and liabilities held for sale)	£682m	£745m

Note 1: Revenue is as defined under IFRS. Adjustments are no longer made for Serco's share of revenue from its joint ventures.

Note 2: Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items. Adjustments are no longer made to exclude Serco's share of joint venture tax and interest, management estimation of charges related to UK Government reviews or transaction-related costs. A reconciliation to former non-GAAP measures is included in the Finance Review.

- Revenue and profitability in line with revised expectations as set out on 10 November 2014; guidance for 2015 maintained.
- Overall financial result reflects £1.3bn of onerous contract provisions, asset impairments and other charges, broadly in line with the November estimate; Trading Loss of £632m includes £745m of such charges; Operating loss of £1,317m includes £661m of exceptional items, driven by impairment of goodwill and other balance sheet charges together totalling £541m.
- As outlined in November, a proposed equity rights issue of approximately £555m, fully underwritten, is being launched today, with details provided in a separate announcement and the accompanying Prospectus.
- Agreements reached with lending banks and US private placement noteholders, subject to successful completion of the rights issue announced today, to refinance existing facilities including the reduction of gross indebtedness by up to £450m.
- Strategy Review complete: Serco's future to be as an international Business to Government (B2G) business, specialising in public service provision.
- Corporate Renewal Programme established and a substantially new management team put in place.

Rupert Soames, Serco Group Chief Executive Officer, said: "2014 has been an extremely difficult year for Serco, and the magnitude of the provisions, impairments and other charges reflects the scale of the challenges we have had to face. However, there is a real sense that, having confessed our sins and in taking the punishment, we are now ready to start on the path to recovery. We have all we need: a good plan, strong management to execute it, and, following the successful completion of our proposed rights issue and refinancing, a balance sheet that is an appropriate foundation on which to implement our new strategy.

We are convinced that our strategy will deliver over time value to our shareholders, customers and colleagues alike. We will focus on providing public services to government and other bodies across five core sectors – Justice & Immigration, Defence, Transport, Citizen Services and Healthcare – and do so across some of the largest public services markets in the world. By concentrating on these markets, we are playing to our strengths.

Asking shareholders for financial support, and lenders to adjust terms on their facilities, is not a position any management would want to be in. But we are determined to repay the confidence and support shown to us, to the benefit of all.

Strategic Report

Principal Risks and Uncertainties

In our business, we face many risks and uncertainties which we mitigate and manage through our Board-approved risk management processes. The Group Risk Register identifies the principal risks facing the business as a whole, including those that are managed directly at the Group level through our Executive Committee and reported to the plc Board.

During 2014, we commenced a three-year programme to refresh our overall risk management approach to better support the development and ongoing performance of the global business. In 2014 we enhanced our policies, processes and systems and gave more clarity on roles and responsibilities, governance and reporting. In 2015 we will continue training our business leaders and employees, improve risk management capacity and capability in our global business, and improve visibility of risk profiles focusing on management information and decision-making. In 2016, we will evaluate our progress and ensure that our risk management programme is fully embedded at all levels of the business to the contract level and within all Group functions.

In 2014, we also undertook a review of the risks and uncertainties affecting our business which resulted in changes to the key risks on the Group Risk Register. Summarised below are the key risks and uncertainties that face us: our operations, people, revenue, profit and cash flow.

Contract non-compliance and contract performance

Our success depends on our ability to write contracts which balance risk and reward and meet the contractual requirements into which we have entered with our customers, which could be through direct delivery of services, through the use of sub-contractors, or through Joint Venture consortium partners. We are subject to risks associated with bidding for and entering into contracts (most of which are multi-year and/or fixed price contracts), including correctly assessing and agreeing pricing terms that provide for a level of return on the contract appropriate to the risks involved, accurately anticipating the costs of strict performance conditions, employee requirements and other obligations, correctly evaluating contractual and operational risks, and the risks of potential early termination or change of scope of contracts by customers. Failure to bid and negotiate performance criteria and contract provisions that can be operationally delivered at the price estimated can result in losses. Unclear, ambiguous, misread, misinterpreted contract obligations and expectations of contract performance can result in perceived or actual contract non-compliance and/or poor performance. The same is true if we, or our sub-contractors or consortium partners do not have the right expertise, tools and resources adequately to manage and monitor compliance with contract obligations and expectations. These potential failures could result in the cancellation of a contract, claims for loss, or compensation arrangements under the contract being triggered, as well as reputational damage leading to a decrease in business being undertaken with one or several customers, and an adverse effect on our financial condition, or operating or financial results and on our ability to win new business.

We are party to a number of contracts that are multi-year, fixed price, carry strict performance conditions and/or contain volumetric or other risks relating to original bid assumptions that have proven incorrect and we expect to result in losses, as a result of which we have determined the contracts to be onerous. In the second half of 2014 there were several contracts where operational issues and/or discussions with our customers resulted in us substantially revising upwards our estimates of the costs to complete our obligations under such contracts or lowering our revenue expectations. A risk based independent review of our principal contracts to identify loss-making contracts against a specific scope revealed that we have a number of contracts that have, or are expected to result in, or could result in material loss, which we have determined to be onerous. The costs to complete these contracts outweigh the financial benefit, and they are, therefore loss-making resulting in lower than expected returns and economic damage for which provisions have been made in the accounts, and there is a risk that the losses damage our reputation. The scope of contract reviews was based on a structured interview process with the relevant business and divisional teams addressing contractual features, operational and financial performance and outlook, each contract being categorised as high, medium or low risk based on the level of risk, uncertainty and judgement existing in each contract.

High risk contracts underwent a full scope review including a full financial review of the contract, a review of the accounting model including challenging and stress testing the assumptions as well as a contract balance sheet review. Those contracts deemed to be medium risk were subject to a review of specific contract risks as well as a focus on the financial impact of the key contractual clauses and a review of the contract balance sheet. Where a contract was deemed low risk, no further work was undertaken. It has not been practical to complete a full legal, operational and financial review of every contract, given the scale, complexity and volume of the contracts and the cost and time that this would have taken. No assurance can be given that the onerous provisions that we have recorded will be sufficient to cover the losses ultimately incurred under the contracts for which onerous provisions have been made or that further provisions for such contracts will not be required in the future or that the costs of fulfilling other contracts to which any member of the Serco Group is a party will not exceed the actual or expected economic benefit under such contracts resulting in the need for further onerous provisions for such contracts. Inevitably, the review of contracts was carried out at a specific point in time and with the information available at that time, which may not prove to have been entirely accurate or complete. Further, the review could not cover all possible circumstances on all contracts under which losses could in the future possibly be incurred. Contracts that have not been reviewed may in future become loss-making; and losses on contracts that have been reviewed may turn out to be worse if,

Strategic Report

Principal Risks and Uncertainties continued

for example, the review was based on information which is subsequently superseded or revised in light of any further review work undertaken or circumstances under the contract change. Similarly, we may have over-estimated the provisions taken with respect to one or more of our contracts. The onerous provisions that have been made are management's best judgement at the time of the review. The onerous provisions are subject to change if additional information comes to light in the future. If additional provisions and/or increased costs need to be recognised in the future, this may result in lower returns and economic, reputational and other impacts associated with onerous contracts, which could materially adversely affect our business, financial condition, results of operations and prospects. If any of our material contracts became loss-making, and an onerous provision covering multiple years of future losses under such contract becomes necessary, such an onerous provision might have a significant impact on a single year's operating profits, as can be seen from the results for 2014.

We have undertaken a reappraisal of Group policies for bidding, contract management and a review of compliance has been undertaken as well as improving the review and governance of bids. The resulting refreshed policies clarify our expectations of contract management and provide for enhanced contract management training. Contract performance monitoring tools are being developed to assist in providing clarity on contract performance targets, contractual obligations and commitments. Stronger management accounting systems are in the process of being put in place to report monthly the status of contracts up to Group management more accurately.

Failure to win Material Bids/Rebids

We depend and will continue to depend heavily on large contracts with a relatively limited number of major government customers and other public sector bodies and agencies for a substantial proportion of our revenue, some of which expired in 2014 or are subject to contract expiration, rebidding, contract extension or renegotiation in 2015. If such customers decrease the amount of business they undertake with us for any reason, or if the relationship with such customers were impaired, or we sustain damage to our reputation, or we are subject to negative publicity, we could lose business across our customer base and face significant economic damage. Such damage could also include losing renewals and extensions of existing contracts. The realisation of the pipeline of opportunities for new bids and rebidding for existing contracts can involve a lengthy and costly bidding process. Bid and rebid success rates determine how much of the pipeline of opportunities is realised and turned into profitable business and how much existing business is retained. Contracts with national and local governments and public sector bodies and agencies or major commercial customers may contain unfavourable or onerous provisions. Furthermore, as a supplier to public sector bodies and agencies and government regulated customers, we are subject to procurement rules and regulations and procurement delays that may increase our bidding, performance and compliance costs and could have an adverse impact on our business, financial condition, results of operations or prospects.

To win our share of new opportunities as well as our key rebids we must clearly understand our customers and their requirements. We must be aware of our competitors and their strengths and weaknesses.

Additionally, our customers must understand our strategy and our strengths. These elements, combined with the building of strong credible teams, are essential to us developing the compelling propositions needed to win.

Failure to realise the pipeline of opportunities, particularly having invested time and money in the bidding process, could impact our ability to deliver on the strategy developed in our 2014 Strategy Review.

The 2014 Strategy Review has directed the business focus to where we are strongest, which is a supplier of services to governments and public sector service providers. Better targeting of our pipeline of opportunities will allow us to make more effective and efficient use of our bid resources as we strengthen our bid pipeline.

We have put in place improved bid management policies, strengthened the criteria, processes and level of scrutiny for Divisional and Group level management review of all bids and rebids, especially those that are critical to our success. We have ensured stronger risk management earlier in the bid process to help identify potential onerous performance criteria and contract provisions as well as, transition and operational concerns.

We invest in appointing high calibre people for our key bids; train our bidding teams to improve competency and performance; and monitor our results through effective management reporting.

Major information security breach

We collect and retain confidential information in computer systems regarding our business dealings and our customers, service end-users and suppliers. The secure processing, maintenance and transmission of this information is critical to our operations. We must comply with restrictions on the handling of sensitive information (including personal and customer information). This is a heightened risk, particularly with respect to government contracts, due to the sensitive and confidential nature of government data.

We and our appointed third party service providers are vulnerable to a major information security breach resulting in the loss or compromise of sensitive information or wilful damage resulting in the loss of service. We provide high profile services, which adds to our attractiveness as a potential target. The threats facing sensitive information managed by the Group increased in 2014 with malicious and high profile attacks against major brands across the globe by well-known Hacktivist groups. Alongside this threat is the more insidious and low profile attack instigated by certain foreign governments and their proxies to obtain information for defence or economic advantage.

A major information security breach could have a significant negative impact on our reputation. This impact could result in the loss of new or existing business by disqualification from future work, contract termination, and heavy financial penalties causing a negative impact on our strategic objectives. Such breaches are costly to rectify and could dilute shareholder returns and result in criminal or civil action; contract and business external accreditations being withdrawn; and significant media attention scrutiny, all of which could materially adversely affect the business, financial condition, results of operations and prospects.

Continued investment in our internal Cyber Security programme, known as 'Think Privacy', has allowed us to mitigate our vulnerability to the accidental loss of sensitive corporate or customer data. To provide a proactive cyber defence and risk reduction capability for the Group, our Cyber Defence Programme incorporates a Global Security Operations Centre, the investment for which was approved in 2014, Cyber Essentials training and delivery of supporting security infrastructure.

SFO investigation

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 our Group's Electronic Monitoring Contract. We are cooperating fully with the Serious Fraud Office's investigation which is still in the early stages and it is not possible to predict the outcome, however, in the event that the Serious Fraud Office decides to prosecute, the range of possible adverse outcomes is any one or a combination of the following: (i) that the Serious Fraud Office prosecutes the individuals involved; (ii) that the Serious Fraud Office prosecutes the Serco Group entities involved; or (iii) that the Serious Fraud Office and the relevant Serco Group entities enter into a deferred prosecution agreement. If the Serious Fraud Office decides to prosecute the individuals involved then it is possible that contracting authorities will take the view that we should be subject to discretionary debarment from future contracts with UK Government entities. If the Serious Fraud Office decides to prosecute the entities involved, potential outcomes are that (a) the Serco Group entities involved defend the action successfully, or (b) the Serco Group entities involved are convicted, resulting in financial penalties and mandatory debarment from pre-qualifying for future contracts with UK Government entities. Under the 'self-cleansing' provisions of the Public Contract Regulations 2015, any such Serco entity could provide evidence to the relevant contracting authority to demonstrate its reliability as public contractor with the UK Government despite the conviction. If such contracting authority considers such evidence to be sufficient, we would not be excluded from a contract bid or rebid.

If any Serco Group entity enters into a deferred prosecution agreement with the Serious Fraud Office, potential outcomes could include significant financial penalties and discretionary debarment from pre-qualifying for future contracts with UK Government entities. Such debarment would be at the discretion of a contracting authority to which the relevant Serco Group entity submits a pre-qualification questionnaire for any given bid or rebid.

Any discretionary debarment could be removed if we were able, under the 'self-cleansing' provisions of the Public Contract Regulations 2015, to provide sufficient evidence to a contracting authority to demonstrate its reliability as a public contractor with the UK Government.

It is possible that further actions beyond those being implemented under the Corporate Renewal Programme may need to be taken by us to remove any mandatory or discretionary debarment, or that such debarment will not be removed for a significant period of time.

If the Group faces any criminal convictions, debarment consequences or enters into a deferred prosecution agreement, 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 its reputation which would, in turn, materially adversely affect its business, financial condition, results of 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 allow the Ministry of Justice to re-open the £64.3m settlement agreed in respect of certain issues arising under the Electronic Monitoring Contract. In such circumstances, the UK Government may seek additional payments from Serco.

Upon any such conviction or possibly following entry into a deferred prosecution agreement, the Group would be subject to enhanced scrutiny with respect to its other contracts with the UK Government, including potential designation as a 'High Risk' supplier by the Cabinet Office, which could result in the UK Government reducing the additional work given to the Group under its existing UK Government contracts and requiring the Group to undertake certain further organisational actions to remove such designation. Following such conviction, the UK Government could potentially also terminate certain contracts it has with us.

We will continue to cooperate with the Serious Fraud Office's investigation.

Strategic Report

Principal Risks and Uncertainties continued

Political and economic risk

The sustainability of our existing and future business with governments is dependent not just on normal stable government but also on a favourable policy climate to private sector provision of public services. In addition, as a supplier to governments, our business model depends on the development and maintenance of trusted relationships with politicians and officials in government. Outsourcing of governmental activities and public services is inherently controversial in many markets and geographies. Our government customers are also affected by financial, regulatory, political constraints or policy changes.

A substantial part of our business is, therefore, susceptible to adverse changes in the global economy, fiscal and monetary policy, political stability, political leadership, budget priorities, the perception and attitude of governments and the wider public to outsourcing, and policy and economic conditions. Any of these could result in decisions not to, or no longer to, outsource services, delays in placing work, cancellation, abandonment or significant reduction in scope, pressure on pricing or margins, withdrawal of projects, early termination of contracts, lower contract spend than anticipated or the adoption of less favourable contracting models. Such factors could have a significant negative impact on the number, size, scope, type, timing and duration of contracts and orders, in particular those relating to the provision of public services, maintaining and improving public infrastructure, immigration, health, the criminal justice system, defence, and the attitude to outsourcing of services and activities to the private sector, particularly in the UK, Europe, Australia, the Middle East and the US.

We operate in politically and socially sensitive sectors and our activities are therefore subject to high degree of political and social scrutiny. Failure to satisfy the requirements or targets set by government clients, or to meet the expectations of the public, could have an adverse effect on our reputation, business and operations. In addition, adverse publicity in these sectors either generally or experienced by other service providers could have an adverse impact on the public perception of us.

Political and economic risks also impact the amount of new business available for us to bid in our chosen markets. Challenging economic conditions and shrinking government expenditure, rising public debt, and high rates of unemployment could result in a lack of new investment by certain governments, increased competition and new competitors, and an increasingly price-driven environment. Other factors that can contribute to fewer bid prospects are changes in procurement requirements or eligibility to bid criteria, failure to comply with qualification to bid criteria, delays to procurement and award or increased promotion of new entrants to the market as a consequence of public sector procurement competitive policies.

The 2014 Strategy Review aims to ensure our portfolio and geographic diversity to spread the risk as changes to political policies follow different cycles in different regions. We are primarily focused on developed markets with strong and established legal systems providing protection from changes in contract terms. Dedicated teams in each region monitor the political landscape and government activities and report on government policy changes and the political environment in which we operate. Our presence across four regions allows us to move from lower growth economies to higher growth economies and focus on areas where political polices are more aligned with our core services. The business strategy is managed through Divisional Boards that closely monitor and reflect changes in government policy and budgets in their delivery of the strategy.

Rights Issue

If the proposed Rights Issue does not proceed and we are unable to obtain further waivers of our financial covenants under our financing agreements, and we are unable to avoid a breach of our financial covenants or cross-defaults through the successful implementation of one or more funding alternatives including proposed disposals, shareholders are at risk of losing all or a substantial amount of their investment in the Group and the Group is at risk of not being able to continue as a going concern.

We have agreed with the lenders and the noteholders to make certain amendments to the terms of our existing finance agreements, which will become effective once we receive the net proceeds of the Rights Issue and use the net proceeds of the Rights Issue to pay down a portion of the amounts outstanding under existing financings agreements. In the event that the Rights Issue does not proceed, however, we will be unable to pay down amounts outstanding under these financing arrangements. Furthermore, if the Rights Issue does not proceed, the amendments will not become effective as they are conditional upon us receiving the net proceeds of the Rights Issue and the payment by us of £225m under the US Note Purchase Agreements to the noteholders and confirmation by us that we will pay down £225m (or, if less, the amount then drawn) under the Facility Agreement to the lenders from such proceeds. In these circumstances, although we still expect to be able to meet the financial covenant tests under our existing finance agreements on 31 May 2015 unless further waivers or amendments are granted, we expect that we would breach our financial covenant tests and cross default thereafter.

Following any such breach the lenders or noteholders would be entitled to demand the accelerated repayment in full of any amounts outstanding, including any interest due and the payment of a 'make-whole amount' payable to noteholders, and we do not expect that we would have the funds available to repay such amounts at that time unless we are able to implement funding alternatives such as proposed disposals. In such circumstances, in the absence of being able to successfully agree or implement any such alternatives, we would be unable to continue as a going concern.

As a result, if the Rights Issue does not proceed and the amended finance agreements do not become effective, we would first seek to negotiate further waivers of our financial covenants in order to avoid any such breach of financial covenants and cross-default. We may be unable to obtain such waivers either at all or without significant cost to us and the lenders and noteholders would potentially demand to have significant involvement in our business and operations which could adversely affect implementation of our new strategy or result in us changing our strategy. Any such waivers would likely subject us to additional fees or impose more onerous obligations on us. Without the proceeds of the Rights Issue, any covenant waivers under, or any other amendments of, the existing finance agreements would only be a short-term solution that would not fundamentally address our balance sheet and capitalisation issues.

Failure to Act With Integrity

Integrity generates trust which is central to maintaining our reputation as a business. A number of factors can influence this including: how we manage our brand; compliance with legal requirements on ethical issues; and how we and those who work for us behave. Failure to manage these effectively presents a risk that might negatively impact our reputation, and from there impact our ability to grow our business. This could significantly impact the economic value of our business, increase the risk of regulatory intervention and our ability to attract and retain talent.

2014 has seen this risk remaining at an elevated level. There continue to be high levels of media scrutiny of our operations with incidents generating adverse publicity which could impact on the perception of the Group held by customers, subcontractors and suppliers. The critical area of risk for us is where operational weakness or failure intersects with a highly charged political environment.

Also given the nature of our work and the countries we work within, we are at risk of being accused of ethical breaches including relating to bribery and corruption, human rights issues or unethical behaviour by either our people or third parties not directly under our control – subcontractors, consortium partners, consultants and/or agents. These accusations would challenge the integrity of our business and could have an adverse impact on our reputation and brand.

To mitigate this risk we have developed clear policies on ethical issues including anti-bribery and corruption, protection of human rights, respect for competition law, avoidance of money laundering, conflicts of interest and employment of ex-government officials. Alongside this we have refreshed our code of conduct (www.serco.com/codeofconduct) and appointed a senior Ethics Officer at the Group level and ethics leads in each Division. We have strengthened procedures on due diligence of third parties and ongoing monitoring of those relationships. We have spent time training our leaders and managers to better understand business ethics and how their behaviour impacts the ethical culture of the business and rolled out training on our Code of Conduct and key compliance areas to all staff. Through our policies, processes and ongoing training we aim to make it clear that Serco does not engage in and will not tolerate unethical behaviour and how our people can avoid such risk.

Significant tactical programmes centred on effective reactive responses to operational issues and a proactive process of brand rebuilding is underway to preserve our reputation. We have controls and processes in place to react to emerging issues based on policy, clear guidelines, and internal networks.

People

People are at the core of our business at all levels of our organisation. Underpinning our success is the ability to attract and retain the right people in leadership roles – particularly in Executive Management, Contract Management and Bid Management. The Group is dependent on its ability to attract, train and retain its senior managers and highly skilled employees. Employee engagement is fundamental to our success; engaged employees deliver better service to our customers, are more productive, and want to stay with us. Failure to attract, motivate and engage employees can create a decline in morale and an increase in labour turnover, which may adversely affect our ability to win new and retain existing customers owing to a lack of appropriate skills and a reduction in customer satisfaction. In turn this could impact integrity, brand and reputation, and could have a material adverse impact on our financial condition and results of operations.

Strategic Report

Principal Risks and Uncertainties continued

A renewed framework for talent management is under development to identify the development needs of individuals and to identify successor candidates for senior roles. We continue to implement new strategies to improve employee engagement including employment engagement awareness for managers and employees, full cascade of our employee survey (Viewpoint) results and actions, and regular checks and communication with managers relating to actions arising from Viewpoint.

Delivery of the Group's strategy

The Group's strategy focuses us on our core competencies, built up over the last thirty years, as an expert provider of services to governments and other bodies who serve the public or protect their nation's interests. Our focus on being a Public Services Provider operating in a number of countries requires us embark on a programme of change, which will result in our becoming smaller and more focused in order to resume profitable growth.

Failure to deliver our strategy may arise from failure to execute the strategy; having the wrong strategy; or the impact of outside factors. The Group's failure to deliver the new strategy, or the successful delivery of the new strategy not achieving its intended results, could have a material adverse effect on our business, results of operations, financial condition and prospects. Factors contributing to this risk including a failure to implement cultural change successfully; insufficient development of or maintenance of our core competencies; a lack of speed of change; unrealistic or unclear expectations or a failure of employee buy-in, commitment or accountability; an inability to achieve the intended cost savings targets; a failure to develop a sufficient pipeline of new work or contracts; a failure to effectively win a fair share of new contract bids; a failure to effect the intended disposals or to make disposals on unfavourable terms; and the possibility that exiting the private sector may provide us with insufficient opportunities.

Our decentralised organisational structure contains an element of operational risk, as the Group delegates considerable operational autonomy and responsibility to our Divisions, and within the Divisions to line managers. The Group is at risk of regional or local managers not complying with the policies; of accounting irregularities, accounting misstatements or breaches or local legislation; there is also the risk that the Group will not be successful in monitoring contract performance, ensuring compliance to policy, updating controls or ensuring efficient and reliable IT systems. Any of these could individually or collectively have a material adverse effect on our business, results of operations or financial condition.

We have revised our investment approval processes to approve only those investments that support our new strategy, and in particular to ensure that major bids are properly assessed, managed and supported. Rigorous Divisional and Business Unit performance reviews now enable us to monitor progress against our new strategy goals. Our ongoing review of capability and skills development in key areas such as business development, transition and operations will ensure we develop and maintain our core competencies, and the active transfer of knowledge and best practice in our pillars will grow expertise still further. The delivery of the Corporate Renewal Programme with the accompanying revision of the Group's management systems to enhance controls and compliance, self-assessment tools for contract managers and employee training on our policies, and enhanced communication of our strategy begins our cultural change journey and the achievement of employee buy-in.

Failure of financial and commercial controls

Strong financial and commercial controls are critical to the Group's ultimate success and underpin customer, supplier and shareholder trust and confidence in our organisation.

During 2014 the Group has issued a number of profit warnings and recognised substantial impairments in the carrying value of goodwill and other intangible assets, together with other adverse financial adjustments to the 2014 results all of which threatens this confidence.

A major finance transformation programme has commenced looking at the finance function end to end, from the contract to Division, from the shared service centre to head office, and in so doing will map the processes to understand and mitigate the key risks. Given the nature of this initiative, there will be a heightened risk of financial control issues as we change the processes and improve efficiency to reduce the overall cost of the function and at the same time improve its effectiveness.

A key deliverable of the finance transformation programme is to enhance our existing financial controls environment. The programme's Steering Board will oversee and approve all proposed changes prior to implementation and progress will be subject to close monitoring.

Strategic Report

Key Performance Indicators

In 2014 we reviewed the Key Performance Indicators (KPIs) we use to monitor our performance to ensure we have a balanced set of metrics that gives appropriate emphasis to both financial and non-financial aspects of our performance. These are detailed below and now include customer satisfaction and people engagement. Alongside this we are rolling out a contract performance monitoring process with contracts reporting monthly against contractual obligations which are reviewed by Divisional Executive Management Teams and the Group Executive Management.

Financial Key Performance Indicators

1. Trading Earnings per Share (EPS)

Definition

Trading Profit/(Loss) is defined as 'operating profit/(loss)' excluding 'other expenses – amortisation and impairment of intangibles arising on acquisition' and excluding exceptional items. Exceptional items consist of 'exceptional (loss)/profit on disposal of subsidiaries and operations' and 'other exceptional operating items'.

Trading profit after tax is defined as 'Profit/(loss) for the year' excluding 'other expenses – amortisation and impairment of intangibles arising on acquisition' and excluding 'exceptional items' and excluding the tax effect of these exclusions. Exceptional items consist of 'exceptional (loss)/profit on disposal of subsidiaries and operations' and 'other exceptional operating items'.

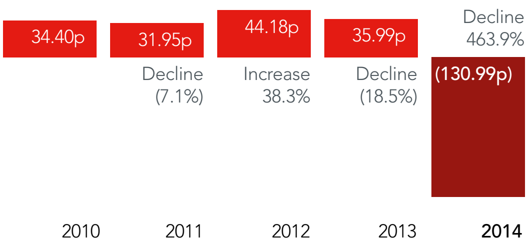
Trading EPS is calculated by dividing Trading profit after tax less 'non-controlling interests', by the weighted average number of ordinary shares outstanding during the period. The weighted average number of ordinary shares during the period is calculated in accordance with IFRS.

Relevance to strategy

Trading EPS reflects the combined ability to grow revenue and trading profit margin, together with the strength of funding and overall financial position.

Performance

Trading EPS (pence per share)



Strategic Report

Key Performance Indicators continued

2. Trading cash flow (£m) and trading cash flow conversion rate

Definition

Trading cash flow is defined as 'net cash inflow from operating activities' excluding exceptional items, as shown on the face of the Group's Consolidated Cash Flow Statement, excluding 'tax paid' plus 'dividends received from joint ventures' plus 'proceeds from disposal of property plant and equipment' plus 'proceeds from disposal of intangible assets' less 'purchase of other intangible assets' less 'purchase of property, plant and equipment'.

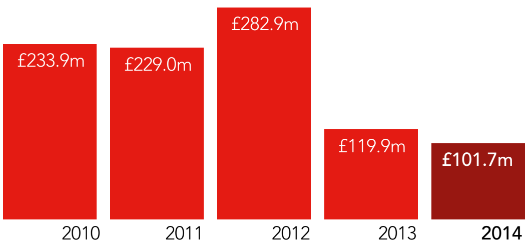
The trading cash conversion is calculated as trading profit/(loss) divided by trading cash flow and is expressed as percentage.

Relevance to strategy

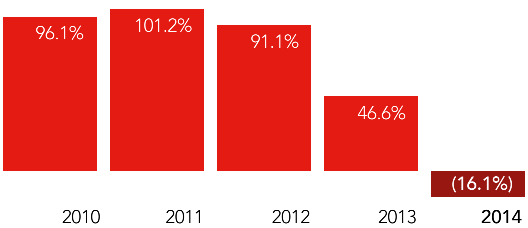
Trading cash flow reflects our ability to generate funds to invest in our future growth and strategic development. The trading cash flow conversion rate reflects the efficiency of the business in converting profits into cash.

Performance

Trading Cash Flow (£m)



Trading Cash Flow conversion rate



3. Return on invested capital (ROIC) %

Definition

ROIC is calculated as trading profit for the period divided by invested capital. Invested capital represents the assets and liabilities considered to be deployed in delivering the trading performance of the business. Invested capital is defined in terms of balances extracted from the balance sheet at the end date of the reporting period. The balance sheet items used are operating assets, being gross assets less trade and other payables (current and non-current) and excluding provisions, pension, derivatives, financing, tax and cash balances. Invested capital includes assets and liabilities classified as held for sale.

Invested capital assets are: goodwill and other intangible assets; property, plant and equipment; interests in joint ventures; 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.

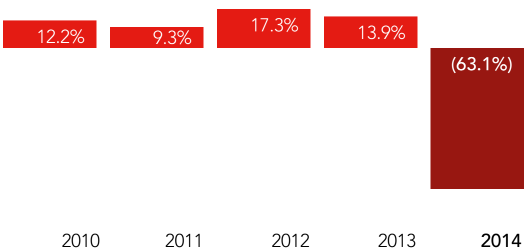
Invested capital is calculated using the closing balance sheet related to the period; for 2015 it will be calculated as a two-point average of the opening and closing balance sheets for the period.

Relevance to strategy

ROIC measures how efficiently the Group uses its capital in terms of the return it generates from its assets.

Performance

ROIC %



Non-financial Key Performance Indicators

4. Customer Insight

Definition

Each year we have reached out to customers across the Group to identify how they feel about the services we provide. In 2014 we measured Customer Satisfaction, asking how satisfied customers are with their overall experience of Serco; Customer Experience, how satisfied customers are with various aspects of their experience; and Customer Advocacy, how likely customers would be to recommend Serco to a colleague or associate. The Net Promoter Score approach to measuring customer satisfaction is most useful in businesses which have large numbers of transactions with individual customers, which is not true in Serco's case. In the coming year we will explore different ways of measuring customer satisfaction.

Relevance to strategy

Such measures act as an early warning system to identify operational issues, support our contract teams in building relationships with our customers, and help us address concerns leading to improved service levels and higher likelihood of contract retention.

Performance

Our latest survey shows that across those measured, 76% of our customers are satisfied with their overall experience of Serco with a Net Promoter Score of 4.7%. This compares with a similar survey undertaken in 2013 where overall satisfaction was 77% and the Net Promoter Score was 1.9%.

5. Employee Engagement

Definition

We partner with Aon Hewitt to run 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 (say, stay and strive) when we survey.

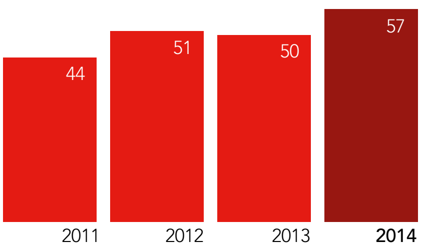
Relevance to strategy

We have completed extensive business linkage analysis across our Divisions, including internationally, to show that high levels of employee engagement lead to higher customer satisfaction and lower levels of staff turnover and absenteeism. Therefore, to achieve our strategic aims, we need highly engaged employees to deliver outstanding customer service.

Performance

During 2014's Viewpoint survey, our global engagement score is 57%, up 7% from 2013. This is 1% ahead of the global average from our external providers Aon Hewitt and 3% ahead of their Services industry average. All divisions increased their engagement scores since 2013 and we were pleased that our three key engagement drivers increased from 2013 as well (for example 'Connection to Serco' is up 5% from 2013). The Viewpoint results were cascaded to the organisation in late 2014 and we have a global plan of activities to sustain and drive employee engagement in Serco led by our Executive Committee through all Divisions. This aims to embed engagement into business as usual and into 'the way we work' in Serco.

Serco Employee Engagement



Strategic Report

Key Performance Indicators continued

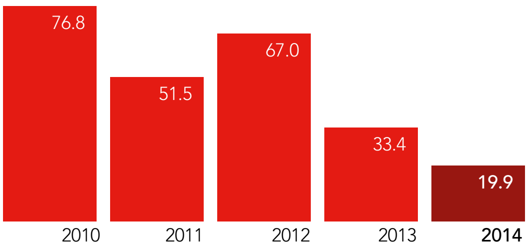
6. Major reportable incident rate (per 100,000 employees)

Definition
Major injuries are classed as fatalities, fractures, amputations, dislocations, loss of sight, chemical and hot metal burns, electrical burns, unconsciousness caused by asphyxia or exposure to a harmful substance, and acute illness resulting from substance inhalation or ingestion. The rate measures our success in providing a safe and secure working environment (excluding joint ventures).

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

Performance
The number of major reportable incidents fell by 42% to 19 in 2014, resulting in a rate of 19.9 per 100,000 employees. This can be broken down with rates for 'frontline' (higher risk) operations at 37.3 and our 'back office' operations at 4. These are ahead of our target of a rate of below 40.

Major Reportable Incident Rate (per 100,000 employees)



7. Carbon emissions headcount intensity (tonnes CO_2e per FTE)

Definition
We report our greenhouse gas emissions as tonnes of CO_2e per full time equivalent (FTE) employee. This normalises our emissions to the size of our business. We adopt ISO 14064-1 2012 to ensure we meet greenhouse gas reporting requirements and provide a fair and transparent picture of our greenhouse gas emissions.

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

Performance
Our front line operations have an emissions intensity of 6.86 tonnes CO_2e per FTE whilst our back office operations reported significantly less at 1.03 tonnes CO_2e per FTE. Combined our normalised emissions are 3.80 tonnes CO_2e per FTE which is a 6% improvement on 2013 (4.04).

Strategic Report

CEO Statement

The financial results for 2014 were in line with management's revised expectations. Even so, this meant that Serco experienced its first revenue decline in 25 years as a listed company, and profitability reduced significantly. The challenges have been numerous: we have had to increase costs to improve service delivery on some already poorly-performing contracts; other contracts with higher-than-average margins saw reduced volumes or were lost on re-bid; and we have won less new work. We have also had to take into account large impairments and onerous contract provisions established to cover future years of losses on certain contracts, and as a consequence the overall reported result for the year is a very large loss. Whilst taking these charges is bitter medicine, it is right that we face our challenges now, so that we can establish a really solid foundation on which to build Serco's future.

Establishing that foundation requires us to reduce the Group's indebtedness: a strong balance sheet with a prudent level of financial gearing is an absolute necessity if we are to retain customers' confidence and be able to execute a strategy that will allow Serco to deliver attractive levels of growth and returns in the future. To that end, we have launched today a fully underwritten equity rights issue to raise approximately £555m, the net proceeds of which will be used primarily to reduce the Group's indebtedness.

Over the last nine months we have, as promised, developed a new strategy, which is to focus on the public sector market and be a leading public service provider.

Specifically, we intend to focus on five 'pillars', or market sectors: Justice & Immigration, Defence, Transport, Citizen Services and Healthcare; and across four geographies: UK & Europe, North America, Middle East and Australia & New Zealand. The strategy builds upon Serco's long track record and expertise in the transformation and management of complex public services, and of supporting critical and sensitive activities central to nations' interests. We believe our chosen markets have compelling long-term structural growth drivers and that Serco can play a central role in helping governments respond to the challenge of improving the quality and reducing the cost of public services, whilst earning for our shareholders sustainable and attractive risk-adjusted returns.

The establishment of the Corporate Renewal Programme in 2014 and the strengthening of processes and of the management team are important first steps on our journey. There remains much to do and the many improvements still necessary will take time – not least rebuilding our pipeline of bid opportunities and making our own internal operations more efficient and effective.

Given the challenges that remain, we are cautious in our outlook for 2015, but appropriately so, as we continue to work hard on the next stage of our journey.

Serco is embarking on a programme of change to restore its health. We will get somewhat smaller and more focused on businesses we are really good at, where we can deliver outstanding service and where our skills, experience and international reach can differentiate us. While it will be a tough two or three years of transition, this is necessary to become the successful, profitable and growing company that Serco rightly aspires to be.

Rupert Soames, OBE
Chief Executive

Strategic Report

CEO Statement continued

Summary of financial performance

Revenue for 2014 was £3,955m.

This excludes Serco's share of revenue from its joint ventures (£798m); the non-GAAP measure of Adjusted Revenue, used in previous years, would have been £4,753m. At constant currency and adjusting for disposals and acquisitions, the organic revenue decline was 2.5%.

The Trading Loss for the year was £632m. This included some £745m of charges for onerous contract provisions, asset impairments and other charges (the non-GAAP measure of Adjusted Operating Profit, used in previous years, would have excluded £24m of costs from the calculation of profit). The principal drivers of the underlying decline in profitability included: changes in contract volumes (e.g. Australian Immigration Services); contracts that we have lost (e.g. Electronic Monitoring); new contracts at lower margins (e.g. support to the US Affordable Care Act); fewer new contracts won; contract re-pricing (e.g. AWE and Northern Rail); and increased costs on contracts to address operational under-performance (e.g. COMPASS and PECS). Within the £745m of charges, onerous contract provisions and contract-related asset impairments totalling some £558m reflect the scale of anticipated potential future losses in the light of recent operational developments and their deteriorating financial performance; the charge taken in 2014 represents anticipated future losses for 2015 through to 2024, with the five largest loss-making contracts representing approximately three-quarters of the total onerous contract provisions taken.

The Group also incurred a £661m net exceptional charge in 2014. Impairment of goodwill represented £466m of this, driven by the reduced carrying value of the Global Services private sector BPO division. Other exceptional impairments and provisions, together with costs associated with the various reviews and restructuring charges, totalled £196m.

The total of onerous contract provisions, asset impairments and other charges was £1.3bn, being the combination of those charged within the Trading Loss for the year and those that were exceptional items. This was broadly in line with the November estimate of £1.5bn. This earlier estimate included the estimated provision for settlement relating to the DLR pension deficit funding dispute and the estimated impairment and related charges for the Great Southern Rail business; these charges, totalling £73m, have been recognised as separate exceptional items and are therefore not part of the £1.3bn. Goodwill and other intangible asset impairments is around £0.2bn lower than the original estimate, whereas onerous contract provisions are approximately £0.1bn higher.

The equity placing conducted in May 2014 increased the weighted average number of shares for EPS purposes, and the Group's effective tax rate increased reflecting the geographic mix of taxable profits. After these effects, EPS before exceptional items was a loss of 135.0p per share and statutory EPS including the impact of exceptional items was a loss of 258.4p.

Free cash flow was £62m (2013: £63m), with the impact of the reduced level of underlying profitability largely offset by less adverse working capital flows than the prior year. Net debt, including that for assets and liabilities held for sale, was £682m at the end of the year (2013: £745m), with the reduction supported by the May 2014 equity placing.

The Revenue and Trading Profit performance are further described in the Divisional Reviews. Reconciliations to the statutory income statement and detailed analysis of earnings, cash flow, financing and related matters are described further in the Finance Review.

Contract awards, pipeline, order book and revenue visibility

The Group signed contracts valued at £3.1bn in 2014 (£3.6bn including the Group's share of joint venture contract awards) compared to £3.5bn in 2013 (also £3.5bn including joint ventures). This includes notable new awards such as the Caledonian Sleeper rail franchise, as well as the retention of a number of important existing operations such as Australian Immigration Services and an expanded second year for our contract to provide processing support services for the US Affordable Care Act. The value of new awards has however been lower than previously experienced – of our pipeline of around 40 major opportunities at the start of 2014, 19 have been lost whilst 5 have been won. Together with other movements in the pipeline, there are now around 30 opportunities we are focused on, with the result that, over the next two years, the estimated total value of new larger bid opportunities is £5bn, down from £12bn a year earlier.

The Group's order book at 31 December 2014 stood at £12.6bn (£15.8bn including the Group's share of joint venture contracts), down from £13.6bn a year earlier (£17.1bn including joint ventures). This provides revenue visibility of over 80% for 2015, based on our outlook as set out below. Whilst there are limited near-term new bid opportunities to benefit 2015 significantly, the level of future rebid risk is also reduced. With a thoroughly reviewed strategy to take the Group forward, rebuilding the pipeline is a major focus of the new management teams across the Divisions.

Outlook for 2015 and the opportunity in subsequent years

On 10 November 2014, we provided an update on the Strategy Review, including the initial findings of the Contract and Balance Sheet Reviews, and an early view of the outlook. In that statement we said that for 2015, before the impact of any disposals, we believed Adjusted Revenue could be around £4bn, that there could be a further decline in the Group's margin to around 2.5% and that Adjusted Operating Profit could be around £100m. Furthermore, we said that, depending on decisions around disposals, Adjusted Revenue could reach a nadir of £3.0-3.5bn in 2016, and margins could be as low as 2-3%. We also estimated that the provisions, impairments and other balance sheet charges would total around £1.5bn.

At the time we cautioned that whilst we had made good progress, the reviews were ongoing, and that the information set out at that time would be subject to further work through to the completion of our year end audit in March 2015. This work has now been completed and, I am glad to say that our initial estimates of the total impact of the Contract and Balance Sheet Reviews have proved largely correct, that trading for 2014 has been in line with our November statements, and that we are maintaining our guidance for 2015, albeit with a change in definition to the key forecasting measures. However, given the significance of the uncertainties further out, in particular the timing of any disposals and the time it will take to rebuild the pipeline and implement the strategic initiatives we are setting out, the Board considers the comments previously made around 2016 are no longer appropriate and the Group is no longer providing formal guidance for 2016 and beyond.

Historically, the key metrics used in forecasts were non-GAAP measures of Adjusted Revenue (adjusted to include Serco's share of joint venture revenue) and Adjusted Operating Profit (adjusted to exclude Serco's share of joint venture interest and tax as well as removing transaction-related costs and other material costs estimated by management that were considered to have been impacted by the UK Government reviews that followed the issues on the EM and PECS contracts). We believe that in the future the Group should report its results (and provide its future guidance) on metrics that are more closely aligned to statutory measures. Accordingly, our outlook for 2015 is now expressed in terms of Revenue and Trading Profit. The revenue measure is consistent with the IFRS definition, and therefore excludes Serco's share of joint venture revenue. Trading Profit, which is otherwise consistent with the IFRS definition of operating profit, adjusts only to exclude amortisation and impairment of intangibles arising on acquisition, as well as exceptional items. Trading Profit is therefore lower than the previously defined Adjusted Operating Profit measure due to the inclusion of Serco's share of joint venture interest and tax charges. We believe that reporting and forecasting using metrics that are consistent with IFRS will be simpler and more transparent, and therefore more helpful to investors.

The Group's current expectations for 2015 are revenue of approximately £3.5bn, Trading Profit of around £90m and EBITDA (as defined for covenant purposes) of approximately £160m. The expectations are unchanged from those set out in November, with the only difference being the change in definition of these measures. The principal drivers of the underlying pressure on 2015 Revenue and Trading Profit versus 2014 remain those previously described, namely the impact of net attrition from lost contracts and assumptions for reduced volumes on operations such as Australian Immigration Services. These expectations do not include any adjustment for potential disposals that may be completed over the course of 2015.

Looking further out, the Group is no longer providing formal guidance for 2016 and beyond. Performance is likely, at least in the initial stages, to remain challenging given the impact still to come through from known attrition such as our Northern Rail contract ending in 2016, and in particular due to the time required to rebuild the pipeline and implement the various initiatives to further stabilise and then transform the Group's performance. Future performance will also depend on the outcome of the programme of planned disposals.

According to the Directors' current best estimates of market growth rates, the sectors to be focused on are likely to grow at an average rate of 5-7% a year, and industry margins across Serco's mix of business are likely to be in the range of 5-6%. If this turns out to be correct, and markets develop as expected, Serco believes that after the initial years of restructuring and transformation, progress will be made towards bringing performance in line with the average of the Group's peers.

Funding strategy, proposed raising of equity and dividend policy

The Strategy Review has assessed the appropriate funding strategy for the Group. Net debt (including that for assets and liabilities held for sale) was £682m at 31 December 2014, but averaged £783m over the course of 2014. For 2015, a net cash outflow of around £150-200m is anticipated, before the effect of the proposed rights issue and any proceeds from business disposals; this reflects in particular: the projected cash outflow on onerous contracts, the updated estimate of which is £139m and is described more fully in the Finance Review; an impact from year-end net debt levels becoming more aligned with average net debt levels; and exceptional costs in 2015 which will include refinancing fees of approximately £30m, and further restructuring programmes that will be developed as part of implementing the Strategy Review.

The Board has concluded that it needs to reduce the Group's indebtedness and that the appropriate leverage for the business over the medium-term is in the region of 1-2x average net debt to EBITDA. In 2015, we anticipate that EBITDA for leverage covenant purposes will be approximately £160m, or about £70m higher than Trading Profit, before any adjustment for potential disposals that may be completed over the course of 2015.

Our future strategy, which we outline below and have explained further in the Prospectus, must be properly funded, and the Group put on a firm foundation which will allow it to grow and flourish. It has also become increasingly clear that if we are to retain customers' confidence a firm foundation is an absolute necessity. To achieve this, the business will need a sustainable balance sheet with a prudent level of financial gearing appropriate for the level of operational gearing given the mix of businesses we have. To this end, the Board is today launching a fully underwritten rights issue to raise gross proceeds of approximately £555m. Further detail on the rights issue can be found in the separate announcement and the associated Prospectus also being published on 12 March 2015.

Based on 2015 forecasts, the net proceeds of the rights issue are expected to reduce leverage to around 2x. Leverage would be expected to reduce further to around the bottom end of the target range following

Strategic Report

CEO Statement continued

the planned disposal of businesses that are no longer core to strategy. The disposal proceeds are uncertain in both timing and amount, but in combination with the proposed rights issue proceeds will enable us to reach what the Board consider an appropriate level of financial gearing. Furthermore, progress is being made to institute improved day-to-day working capital controls and cash forecasting in order to promote sustainable cash generation and to focus on appropriate levels of return on capital.

As part of the funding strategy, we have reached agreement with our lending banks and US private placement noteholders to refinance our facilities. The agreements include an extension of the Revolving Credit Facility from 2017 to 2019, and more flexible financial covenants. The amendments will only become effective upon the receipt of the proceeds of the rights issue. Full details can be found in the Capital and Indebtedness section of the Prospectus.

As part of the actions being taken to reduce the Group's indebtedness, the Board is not recommending the payment of a final dividend for the 2014 financial year. Dividends paid in the year totalled £53m or 10.55p per share, representing the final dividend for 2013 of 7.45p that was paid to shareholders on 14 May 2014, together with the interim 2014 dividend of 3.10p that was paid to shareholders on 17 October 2014.

The Board is committed to resuming dividend payments and a progressive dividend policy when it is prudent to do so. The Directors' decision as to when to declare a dividend and the amount to be paid will take into account the Group's underlying earnings, cash flows and financial leverage, the requirement to maintain an appropriate level of dividend cover and the market outlook at the time. It is not anticipated that the Board will recommend any dividend in respect of the 2015 financial year.

Proposed disposals

As announced on 10 November 2014, we intend to dispose of a number of businesses that are not core to our future strategy as summarised below, and where the resulting proceeds will contribute to reducing net debt. These businesses include the Environmental Services and Leisure businesses in the UK, the Great Southern Rail business in Australia, and the majority of our private sector BPO business. In aggregate, these businesses contributed around £560m of revenue in 2014. If any of these disposals complete in 2015, it is expected that the Group's 2015 revenue and profits (as compared with the forecasts in our outlook commentary, above) will be reduced and that this reduction may be material depending on the timing of the disposals, with the expectation being that the later in 2015 such a disposal takes place, the less the reduction will be. Further, the effect of any disposal on the Group's 2015 profits will be dependent on agreement around what cost structures transfer to a buyer, as will the resulting proceeds from any transaction. There are ongoing sale processes in respect of each business, we are encouraged with progress made to date and would anticipate transactions, if they are agreed with buyers, to complete later this year.

Corporate Renewal Programme and strengthened management team

During 2014, extensive work was undertaken as part of the Corporate Renewal Programme agreed with Government to address the issues raised in the EM/PECS investigations.

The Corporate Renewal Programme focused on improving Serco's systems, processes and management information. We have substantially rewritten our system of management control, in particular as it relates to bid development and approval and contract management; developed an approach to management information and review that focuses equally on operational as well as financial performance; and materially strengthened our processes of management assurance, risk assessment, and internal audit, as well as our Board governance. We have reduced spans of management control, establishing two UK divisions – one for UK Central Government and one for UK & Europe Local & Regional Government – where there was one before, and reducing layers, by having the management of the Asia Pacific and Middle East regions report directly to the Group CEO rather than through an intervening supervisory layer.

These programme elements and the many others we have previously described are set out in full in the Prospectus. In January 2014, the Cabinet Office issued a statement that, following scrutiny by officials and a detailed review by the Government's independently appointed Oversight Group, the scope of our Corporate Renewal Programme was accepted and that the changes Serco had already made and our commitment to go further over the coming months were positive steps that the Government welcomed. In October 2014, the Corporate Renewal Programme was reported on by the UK Government's appointed consultants confirming that Serco had identified and understood the causes of previous issues and, through the Corporate Renewal Programme, has put in place cultural and governance structures designed to address those issues and sustain ongoing customer confidence.

There has also been a significant change in the leadership of the Group and the UK divisional management, and I am very pleased to say that we have succeeded in making some really strong appointments. I am naturally delighted that Angus Cockburn, with whom I worked for 11 years at Aggreko, joined Serco as Chief Financial Officer in October 2014. He was instrumental in the success of Aggreko, is a highly experienced CFO, and he and I have complementary skills. We have also made good progress strengthening our UK management team, with the appointment of Kevin Craven, previously CEO of Balfour Beatty Services, to run the Central Government division, and Liz Benison, previously VP and General Manager of Computer Science Corporation's UK business, to run the Local and Regional Government Division; both of them started in September 2014. David Eveleigh, previously General Counsel of BT Global Services, joined as General Counsel and Company Secretary in November 2014. I would also like to pay tribute to the dedication of Bob McGuiness and Andrew White, who stepped into the breach to run the UK Divisions whilst we were looking for new people; and of course I am grateful to Andrew Jenner who guided the finance function under circumstances which were far from easy.

Your Chairman, Alastair Lyons, informed the Board in November of his intention to step down once a new Chairman has been appointed. Whilst I respect Alastair's decision, I was saddened by it, and I want to put on record the fact that he has done an outstanding job stewarding the Company through the travails of the last two years. Alastair was instrumental in stabilising Serco with new management and Non-Executive Directors, a much improved relationship with the UK Government, and clarity as to our strategic direction. Nobody could have worked harder or done more to get us to the point where we can now concentrate on building a solid future for Serco.

Strategy Review summary

In April 2014, Serco announced that we would be carrying out a comprehensive review of our strategy. The key objectives of the Strategy Review were threefold:

- Firstly, to analyse the current situation, in terms of the state of the markets, competitive positioning, opportunities and threats faced by Serco, and to identify a set of strategic options open to Serco, alongside the Contract and Balance Sheet Reviews.
- Secondly, to develop a strategy that offers the greatest opportunity for value creation, balancing risk and reward, playing to the strengths of Serco, aiming for a more simple strategy underpinned by markets that exhibit structural growth.
- Finally, to identify how to create a firm foundation from which a business can be built to deliver the strategy and therefore value to shareholders, customers and staff.

With regards to the first objective, the Strategy Review made clear that the public sector market had become a tougher place to operate, that Serco was not adding enough value to the private sector BPO business, and that Serco had some specific operational challenges that needed resolution. The public sector market has seen slower growth over recent years as budgets have been cut, and at the same time customers have become more sophisticated in procurement, risk transfer and contract management. In the private sector BPO market, new contracts tended to be more capital intensive than those Serco was used to from public sector contracts; customers are more brand wary and so were more cautious following the publicity surrounding the investigations into the Electronic Monitoring and Prisoner Escort and Custody Services contracts; and the complexity of multiple service lines across multiple sectors and geographies demanded management time without contributing significantly to Serco's core public service capabilities. Finally, the review made clear some weaknesses in the operating model, namely that financial performance was undermined by loss-making contracts and a weakened balance sheet, that the pipeline had suffered and a low win rate had affected growth, and that risk assessment mechanisms needed to be strengthened. Furthermore, Serco's devolved nature resulted in poor generation of scale benefits and underlying information and technology infrastructure was weak.

Against the second objective, the Strategy Review proposed that the Board focus the Group on where its key skills and competitive advantages lie. In other words, to exit the private sector through the sale of the majority of Serco's private sector operations, to focus on the public sector market and be a leading public service provider. Specifically to focus on five pillars of: Justice & Immigration, Defence, Transport, Citizen Services and Healthcare; and across four geographies: UK & Europe, North America, Middle East and Australia & New Zealand.

The move into private sector BPO was intended to reduce the Group's dependencies upon the UK and the public sector, and gain exposure to a market which offered higher rates of growth, whilst adding a new capability in middle and back office processing alongside Serco's historic strength in the delivery of frontline services. This failed, however, to reflect adequately the difficulty of building distribution off a base of limited presence in the private sector BPO market, and the anticipated move to whole agency public sector outsourcing in the UK has not developed at the expected pace. Furthermore, the integration of the Group's acquisitions in this sector, principally Intelenet and The Listening Company, both with each other and the rest of the Group, was not well done.

While examining our markets, we concluded that, whilst the public service market presents a number of challenges, it also has many attractions: public services tend to be of a critical nature and therefore unlikely to be disrupted by the economic cycle or disappear altogether; they are unlikely to be disrupted by technology or other exogenous factors; and a low level of private sector penetration allows plenty of headroom for market growth – all underpinned by structural drivers that will continue to promote the growth of the market over the long term.

Serco has, over the past 25 years, built powerful positions in its principal frontline services both in the UK and in North America, Asia Pacific, and the Middle East. In these areas Serco has depth of know-how and a track-record of successful delivery, which allows it to take capabilities developed in one geography and create a relevant presence in another – the export of the Group's justice and non-clinical healthcare support experience from the UK to Australia being examples. In the future, Serco will focus on growing its business within those areas where it has sustainable competitive advantage, whilst at the same time reducing costs by simplifying its organisational design and sharing common services across the Group. All this will be developed within a control framework based on clear understanding of, and adherence to, the Group's best practice. This will be supported by timely performance information that highlights unplanned exceptions at an early stage, allowing effective management intervention.

We are, therefore, able to adopt a strategy that is based on maximising the potential of Serco's areas of strength. Our competitors tend to be based on multiple sectors in a single geography or a single sector in multiple geographies. Serco has breadth across both sector and geography allowing it to achieve presence and diversification across a number of Business-to-Government ('B2G') markets at the same time. This is Serco's competitive differentiation and represents a strong base for future growth.

Strategic Report

CEO statement continued

Furthermore, we believe that nearly all governments are going to be faced by inexorable pressure on four fronts: the growing costs of healthcare and the costs of supporting ageing populations; the need to reduce public debt and expenditure deficits; rising expectations of service quality amongst public service users; and the unwillingness of voters and corporate taxpayers to countenance tax increases (we call these the 'Four Forces'). To reconcile these forces, governments need to continuously improve the quality and efficiency of service delivery. We believe that public sector monopolies are, by their nature, less well-equipped to manage continuous innovation and improvement in service delivery than the private sector, and a model in which government sets strategy, defines services so they are contestable, and then effectively competes, procures and oversees service delivery, is the best route to delivering improving quality and reducing the cost of public services. Such a strategy relies on vibrant and competitive markets of private sector suppliers to deliver public services.

Our new strategy builds on the strengths of Serco. Serco already has leading positions with recognised expertise across a number of important segments in some of the largest public services markets in the world with a unique portfolio of service offerings across Justice & Immigration, Defence, Transport, Citizen Services and Healthcare. Serco is one of the few companies that can offer a wide range of services in each of the UK, US, Australia & New Zealand and the Middle East, which are markets in which governments frequently engage private companies in the provision of public services. The combination of an international footprint with a portfolio of sectors, across federal, state and local government customers provides a healthy level of diversification without excessive complexity. Such a portfolio protects the business against sudden changes from elections in any particular geography, against changes in policy or attitude to competition, and allows Serco to balance the ebb and flow of demand across the business. Furthermore, the strategy builds upon strong relationships already held, requires a public sector ethos in delivery that is already evident, and leverages Serco's current expertise in the transformation and management of complex frontline services to the public. Finally, a simpler strategy, combined with a large order book and the resilience of longer term contracts, provide Serco with the time and clarity to improve the way the business works.

For these reasons, we believe that the future of Serco lies in being a leading provider of public services; where our customers are governments or others operating in the public sector; and where Serco benefits from scale, expertise and diversification by operating internationally across five segments.

The third objective of the Strategy Review was to identify how to create a firm foundation from which a business can be built to deliver the strategy and therefore value to shareholders, customers and staff. To achieve this foundation, our implementation plan aims to fix our challenges and so become the best managed company in the sector. We will achieve this by building a solid platform from which to grow; reducing our costs; and repositioning for growth.

Specifically, we will build a solid platform through three areas of focus. We will strengthen our balance sheet through the rights issue, improved working capital management and the disposals programme; this will result in financial position with the flexibility to implement the strategy and ensure stakeholder confidence is maintained. We will actively mitigate our loss making contracts through operational management and commercial negotiation, with plans now in place across underperforming contracts to improve profitability and cash flow performance whilst meeting all our contractual service obligations. We will also improve our management information through more frequent, balanced and detailed reporting, in order to improve our visibility of performance and strengthen our controls and governance. We will also be focusing on risk-adjusted returns on capital as a way of judging our contracts.

We will reduce our costs through continuing to delayer, rolling out continuous improvement initiatives in our contract base, and making better use of our scale in procurement and the use of shared services; all led by dedicated leadership with external support. Such actions are targeted to drive £20m of gross cost savings within our 2015 cost base, and begin the longer term journey towards recovering our margins to those more in line with our peers.

Finally, we will reposition the business for growth, enabled by a clear and focused market strategy. We will focus our business development spend on our chosen pillars; invest in the development of markets and opportunities; strengthen our bid risk management through tightened procedures and more thorough commercial reviews; and build strong cross-business networks to share capability and best practice. In this way we expect, over time, to grow our pipeline, improve our win rates, reduce the number of loss making contracts and produce a better return for the risks we take on.

More information on Serco, including the background to and further detail on the Strategy Review, are set out in the Prospectus.

Rupert Soames OBE
Serco Group Chief Executive Officer

Strategic Report

Divisional Reviews

This section is presented according to the management structure and internal reporting that Serco has put in place for 2015 as a result of actions from the Corporate Renewal Programme and the Strategy Review.

The UK Central Government division is now a separate unit which brings together Serco's work for the UK Central Government; it also brings together all transport operations, including those for devolved authorities that were previously included in the UK and Europe Local and Regional Government Division. The UK and Europe Local and Regional Government Division now incorporates public sector BPO operations previously included in the Global Services Division, together with Citizen Services previously included in the Central Government Division; all public sector BPO operations are therefore now brought together in this Division. The former AMEAA region is now reported as two separate Divisions – 'AsPac' (the Asia Pacific region, consisting principally of Serco's operations in Australia & New Zealand) and the Middle East. Americas is unchanged as a distinct regional Division. The Global Services Division now consists of BPO operations only in the private sector.

Aligned to statutory reporting, Serco's share of revenue from its joint ventures is no longer included in divisional revenue, while Serco's share of joint ventures' interest and tax costs is included in divisional Trading Profit. The Group has also simplified its reporting by ending the sharing of Income Statement reporting of certain contracts between two segments. This shared reporting of contracts occurred predominantly between the AsPac and UK segments (including, for example, Australian immigration services), with these contracts now being solely reported within the segment that delivers the contract to the end customer. Going forward, eliminating the shared Income Statement reporting of such contracts will increase the transparency and clarity of our segmental performance reporting. The prior year comparative segmental information has been restated to reflect these changes and a full reconciliation of divisional results is available within the accompanying results presentation on www.serco.com/investors. Further segmental information on this basis is included at note 5 to the consolidated financial statements, while segmental information on the previous structure, as reported to the Board during 2014, is included at note 42.

Year ended 31 December	**2014 Revenue £m**	2013 Revenue £m	**2014 Trading (Loss/Profit) £m**	2013 Trading (Loss/Profit) £m
UK Central Government	**962**	1,074	**(242.8)**	114.6
UK and Europe Local and Regional Government	**960**	963	**(90.4)**	17.8
Americas	**708**	765	**16.5**	65.1
AsPac	**706**	871	**(201.6)**	78.2
Middle East	**260**	268	**(0.2)**	24.5
Global Services	**359**	343	**(23.4)**	7.8
	3,955	4,284	**(541.9)**	308.0
Corporate costs	**n/a**	n/a	**(90.2)**	(50.6)
Revenue and Trading (Loss)/Profit	**3,955**	**4,284**	**(632.1)**	**257.4**
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			(745.3)	

UK Central Government

The UK Central Government Division includes our frontline services in Defence, Home Affairs (encompassing justice-related operations, immigration and border security) and transport (including contracts for the Department for Transport as well as those for devolved authorities).

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Loss	2013: Trading Profit
Revenue and Trading (Loss)/Profit	**962**	1,074	**(242.8)**	114.6
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			(300.8)	

Divisional revenue on a constant currency and reported currency basis declined by 11%. Excluding the impact of disposals, the organic decline was 8%. Drivers of the reduction included the loss of the Electronic Monitoring (EM) contract, the re-role of Ashfield prison and the end of the Colnbrook Immigration Removal Centre (IRC) contract. There was also an impact from volume-related reductions at our strategic partnership with the Defence Science and Technology Laboratory (Dstl) and certain other defence-related projects. There was partial offset to these reductions from additional project revenue from the expansion of Thameside prison and from additional service users on the COMPASS UK asylum seeker support contracts.

Divisional Trading Profit, before the impact of onerous contract provisions, asset impairments and other charges, reduced much more significantly than revenue. Around £7m of the decline is a result of the prior year including a profit contribution from the UK Transport Maintenance & Technology business up to its disposal on 27 November 2013. The EM, Ashfield and Colnbrook IRC contracts had a greater impact on profitability than the respective revenue decline, reflecting their above average margins. Whilst revenue increased on COMPASS due to additional service users, this only served to increase the significant losses sustained on the contract given Serco is incurring a loss on each service user, and given that limited scale efficiency is currently being achieved to reduce this loss per service user. On the Prisoner Escort & Custody Services (PECS) contract, the loss was excluded from the previous definition of Adjusted Operating Profit as it was included within management estimates related to the UK Government reviews. The loss on PECS, now within Trading Profit, increased as we continued to apply additional resources to improve the operational performance.

The contract re-pricing on AWE that began only part-way through 2013 and the interim franchise agreement on Northern Rail from April 2014 did not reduce revenue as our share of joint venture revenue is now excluded, but these re-pricings significantly reduced Trading Profit. Lower profits also reflected increased costs from operating this new division separately as part of the Corporate Renewal Programme, and from a lower recovery of bid investment costs on major bids that were unsuccessful such as those for the Defence Infrastructure Organisation (DIO), the Nuclear Decommissioning Authority, the TransPennine rail franchise and the Docklands Light Railway (DLR) rebid.

The substantial charges in 2014 for provisions, impairments and other review items reflects principally a number of significantly loss-making contracts for UK Central Government that require onerous contract provisions, together with other related impairments and charges. COMPASS has charges of £115m, reflecting the latest volume assumptions in a rapidly changing environment and the latest view of our estimated costs over the remaining five years of the contract. The Royal Navy fleet support contract (FPMS) has charges of £66m, reflecting updated vessel utilisation and maintenance cost assumptions through to 2022. The PECS and HMP Ashfield contracts have charges of £27m and £19m respectively.

The value of signed contracts totalled approximately £1.4bn in 2014. This excludes Serco's £520m share of the interim franchise for Northern Rail as this is operated as a joint venture. Serco's selection by Transport Scotland to manage the new franchise for the Caledonian Sleeper services was the Group's largest contract award in the year, with total revenue to Serco over the 15-year contract estimated at approximately £800m and therefore representing over half of the total award value for the Division. Other awards included the successful rebid of Yarl's Wood Immigration Removal Centre valued at approximately £70m, and various defence support work extended or expanded with a cumulative award value of over £100m. The awards also included the short-term extensions to the DLR and National Physical Laboratory (NPL) contracts, both of which have now ended.

In the near term, there are no major contracts that require extending or rebidding. However, the DLR, NPL and Colnbrook IRC contracts, together with all other known attrition from contract losses, accounted for 20% of 2014 divisional revenue.

Although there are limited major new bid opportunities to be decided over the next year, beyond that sees several opportunities including potential outsourcing of the Defence Fire & Risk Management Organisation. Following the significant disruption to our customer relationships with UK Central Government in 2013 and the subsequent Corporate Renewal process that has been put place over the course of 2014, rebuilding the pipeline is now a major focus. The Strategy Review is placing clear emphasis on those markets where Serco has significant skills and capabilities which for this Division includes each of Justice & Immigration, Defence and Transport in the UK, and the revised divisional structure and new management team are in place to take this business forward successfully.

Strategic Report

Divisional Reviews continued

UK and Europe Local and Regional Government

The UK and Europe Local and Regional Government Division includes our frontline services in the devolved public service delivery markets of Health, Direct Services (principally environmental and leisure services for local authorities) and Infrastructure Services (such as facilities management), together with Citizen Services which includes welfare support operations, BPO services for local authorities and various support operations for European Agencies.

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Loss	2013: Trading Profit
Revenue and Trading (Loss)/Profit	**960**	963	**(90.4)**	17.8
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			**(93.8)**	

Divisional revenue on a constant currency and a reported currency basis was broadly flat in 2014. Excluding the impact of disposals, organic growth was 3%. Growth was supported by new European Agency contracts with the European Commission and European Space Agency, together with an expansion of certain local authority BPO operations; there was offset to this from volume-related reductions on the National Citizen Service and Work Programme contracts.

Divisional Trading Profit, before the impact of onerous contract provisions, asset impairments and other charges, reduced much more significantly than revenue. There were increased costs including the effect of operating this new Division separately, together with the effect of some challenging contracts such as the National Citizen Service, and a lower level of typically higher margin public sector BPO project work and consulting.

Contracts operated by the UK and Europe Local and Regional Government division that are loss-making include Suffolk Community Healthcare, where an exceptional onerous contract provision and related asset impairments of £16m has been driven by a greater loss rate due to unanticipated increases in volume, for which there is no additional revenue, along with having to use greater numbers of agency staff to deliver improved performance; the contract is due to end in September 2015. The charge to Trading Profit for provisions, impairments and other review items of £93.8m includes those for other loss-making contracts, the largest of which is for the Hertfordshire Country Council BPO services contract.

The value of signed contracts totalled approximately £400m in 2014. Contracts for public sector BPO operations accounted for towards half of this. These were predominately for UK local authorities and included a new contract to provide a range of business process and contact centre services for Lincolnshire County Council valued at over £70m, and various extensions to our ICT services for Glasgow City Council, Peterborough City Council and the London Borough of Enfield valued in aggregate at a further £70m. In Direct Services, Havering has been added as a fifth London borough where we provide environmental services with a total contract value of around £40m, whilst an extension and expanded services at Milton Keynes is valued at £58m. In our leisure services business, we were awarded a new contract valued at approximately £50m to manage and operate the Wet 'n' Wild waterpark in North Shields, Tyne and Wear. An extension with expanded scope was secured to continue providing IT support to the European Parliament valued at €60m, whilst a new contract for additional IT support to the European Space Agency was also awarded with a value to Serco of approximately €36m.

Looking ahead, there are European Agencies IT support contracts coming up for rebid in the short term that accounted in aggregate for 4% of 2014 divisional revenue, whilst the Work Programme which is also coming up for rebid accounted for 1% of 2014 divisional revenue. The Suffolk Community Healthcare contract due to end in September 2015 accounted for 6% of 2014 divisional revenue. Attrition from known losses, predominantly Westminster City Council BPO support and a private sector facilities management contract for an aviation industry customer, accounted in aggregate for 4% of 2014 divisional revenue.

There are limited major new bid opportunities to be decided in the next 12 months. With new management in place and a revised divisional structure, rebuilding the pipeline is a clear focus. Opportunities already being developed include: further non-clinical support services for NHS trusts; local authority strategic partnerships for BPO support covering Finance, HR, ICT and citizen contact; and expanded services for European Agencies.

Divisional Reviews continued

Americas

Our Americas division provides professional, technology and management services focused on Defence, Transport, and Citizen Services (principally process outsourcing for government agencies). 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 selected US state and municipal governments.

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Profit	2013: Trading Profit
Revenue and Trading Profit	**708**	765	**16.5**	65.1
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			**(26.7)**	

Divisional revenue on a constant currency basis reduced by 1% in 2014, though the weakening of the US dollar extended the decline on a reported currency basis to 7%. Both the US Affordable Care Act (ACA) eligibility support services contract and the Virginia Department of Transport traffic management services contract began in the second half of 2013, so there was a full-year benefit of these major new operations in 2014. This largely offset other contract attrition including that relating to certain US intelligence agency IT contracts, C4ISR work on Naval Electronic Surveillance Systems and Atlantic Aviation Engineering, and various areas of support to the US Federal Retirement Thrift Investment Board (FRTIB) and the Department of Veteran Affairs.

Divisional Trading Profit, before the impact of onerous contract provisions, asset impairments and other charges, reduced more than revenue. New contracts such as processing support work for the US ACA were at lower margins than the contracts where work has ended. Our contract supporting the Department of State's National Visa Center and Kentucky Consular Center (NVC/KCC) was only extended for part of the 2014 year and was at lower margins, as was our rebid to continue providing Driver Examination Services for the Ontario Ministry of Transportation in Canada.

The impact of provisions, impairments and other review items was relatively limited for the Americas Division, in part reflecting the different contracting model which tends to be shorter term and less exposed to issues around fixed price bidding.

The value of signed contracts totalled over £650m in 2014. The largest were the expanded first option year of the US ACA valued at over US$200m, a five-year rebid for the Department of Defense providing program management and related support valued at over US$140m, and an extension to our contract providing career transition services for US soldiers. There was also good progress in securing IDIQ contract vehicles that enable Serco to compete for task orders across various areas of defence support work; this shorter term but still relatively regular work typically accounts for approximately one quarter of revenue for the Americas Division.

Looking ahead, the two largest rebids due during 2015 are our contracts for US Department of Homeland Security benefits records management services and for air traffic control services for the Federal Aviation Administration; these accounted for 5% and 3% respectively of 2014 divisional revenue. The short-term outlook for the Federal Government services market appears more stable in terms of agreement around government budgets and funding. In the longer term, the market, including defence services, remains attractive in size and growth potential. New bid opportunities include further development in non-defence areas, such as processing support for the Department of State and Department of Homeland Security, and various state transport operations and maintenance contracts. We are also looking at opportunities in non-clinical healthcare support and, longer term, the potential for our involvement in parts of the Justice & Immigration market.

Strategic Report

Divisional Reviews continued

AsPac

Operations in the Asia Pacific division include Justice, Immigration, Defence, Healthcare and Transport services. With Serco's operations in Australia being the largest element of the Division.

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Loss	2013: Trading Profit
Revenue and Trading (Loss)/Profit	**706**	871	**(201.6)**	78.2
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			**(237.1)**	

Divisional revenue on a constant currency basis declined by 9%, though significant currency weakening against Sterling, particularly the Australian Dollar, extended the decline on a reported currency basis to 19%. The Division's single largest contract which provides Immigration Services in Australia saw revenues reduce by 35% to approximately £300m; this reflected fewer people in our care following the significant changes to government policies addressing the issue of people arriving by boat without a valid visa. Other contract starts and ramp-ups provided good growth, including the Fiona Stanley Hospital in Perth moving to the operational stage, a short-term contract providing private sector aviation support services in the Australian natural resources industry; and new transport management services in Asia such as those for the Hong Kong Tsing Sha Control Area.

Divisional Trading Profit, before the impact of onerous contract provisions, asset impairments and other charges, reduced much more significantly than revenue. In Australian Immigration Services there was a greater impact on profitability from the volume reductions together with changes to the mix of services provided and the types of centres remaining in operation. The loss of the Australian regional defence garrison support services contracts, operated in partnership with Sodexo, has not reduced revenue as it was a joint venture operation, but reduced profits. The Trading Profit for 2013 included a profit still being recognised on the Armidale Class Patrol Boats (ACPB) contract which was not repeated in 2014. Overheads also increased in the Division, reflecting in particular increased bid costs on a number of unsuccessful large tenders including a new-build prison and two rail operations in Australia.

There was a significant impact from provisions, impairments and other review items in the AsPac division, with the vast majority of this driven by the ACPB contract for Defence Materiel Organisation on behalf of the Royal Australian Navy. Detailed engineering reports have revealed major issues with the class of vessel, including those related to design, manufacture, usage and maintenance practice, all of which have conspired to require maintenance expenditure far in excess of that envisaged at the time the vessels first began service in 2005. Until the second half of 2014, it was believed that these issues could be fixed as part of a one-off maintenance cycle. However, updated engineering assessments indicate far greater costs over the remaining life of the vessels and therefore for our operation of the contract through to 2022. An onerous contract provision of £136m, together with a further £60m of related impairments and other balance sheet adjustments, has therefore been required.

The value of signed contracts totalled over £200m in 2014, however this was dominated by continuation of two existing operations rather than new bids. An extension to Serco's Traffic Camera Services contract in Australia is valued at approximately £50m. By far the largest award was successfully rebidding the provision of onshore immigration detention services in Australia. Whilst the five-year contract has a much larger potential value, since it is volume related, Serco will initially only reflect in its order book an estimate of approximately £125m of revenue anticipated in relation to the first year of the contract.

Looking ahead, the estimate of lower immigration detention volumes is expected to reduce further the revenue for the AsPac division in 2015. There will also be a greater reduction in profitability than revenue following the rebid. After securing this important contract however, there are no other significant contracts that require extending or rebidding in 2015, though there will be attrition impact from the loss of the garrison support contracts and the end of the short-term private sector aviation support services contract in the Australian natural resources industry. Whilst progress on new bids was weak in 2014, significant market opportunities remain in the region. These include further opportunities in Justice & Immigration, defence support and transport operations where Serco has strong presence in each of these local markets. Serco is also looking to develop opportunities in Citizen Services and build upon its skills in non-clinical healthcare.

Strategic Report

Divisional Reviews continued

Middle East

Operations in the Middle East Division include Transport, Defence, Healthcare and other Direct Services such as facilities management.

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Loss	2013: Trading Profit
Revenue and Trading (Loss)/Profit	**260**	268	**(0.2)**	24.5
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			**(19.3)**	

Divisional revenue on a constant currency basis increased by 3%, though the weakening of local currencies against Sterling resulted in a reported currency decline of 3%. Growth was led by expanded transport operations including those in Dubai, new health services in Abu Dhabi and defence training services in Qatar.

Divisional Trading Profit, before the impact of onerous contract provisions, asset impairments and other charges, reduced more than revenue. The greater impact on profitability reflected lower margins on the Dubai Metro contract that was extended in late 2013, the end of air traffic control operations in Kurdistan, together with delays in awards and lower overall success rates on new bids.

The impact of provisions, impairments and other review items was limited for the Middle East Division compared to the other divisions, and mainly reflects receivable and other impairments rather than any significant onerous contracts.

The value of signed contracts during 2014 totalled approximately £135m. This included the successful rebids of air navigation services in Bahrain and Sharjah, and of our public facilities management contract for the Abu Dhabi Municipality, the next phase of the new military college in Qatar and new contracts won for further healthcare support services in Abu Dhabi and Saudi Arabia.

Looking ahead, rebids to secure in 2015 include Sowwah Square facilities management, Baghdad air navigation services, Palm Jumeirah Monorail operations and logistics and base support services provided to the Australian Defence Force (ADF) in the region; these accounted in aggregate for 22% of 2014 divisional revenue. Whilst new bid win rates have been lower in 2014, there remains a vibrant public service outsourcing market in the region and Serco has strong references to continue expanding. Major opportunities include light rail across the region and other transport operations, as well as further non-clinical healthcare and defence training support.

Divisional Reviews continued

Global Services

Following the transfer of public sector BPO operations to our other divisions, the Global Services Division now consists of Serco's private sector BPO business, predominantly for customers in the UK, India and North America. The operations consist of middle and back office skills and capabilities across customer contact, transaction and financial processing, and related consulting and technology services. As previously described, Serco intends to dispose of the majority of the private sector BPO business.

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Loss	2013: Trading Profit
Revenue and Trading (Loss)/Profit	**359**	343	**(23.4)**	7.8
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			**(30.3)**	

Divisional revenue on a constant currency basis increased by 11%, though the weakening of local currencies against Sterling resulted in a reported currency growth of 5%. Growth was led by new customers or expanded services in India and the Middle East, the latter of which included the benefit of a small infill acquisition of a regional provider of BPO services; organic growth was 9%. Revenue in the UK declined, reflecting in particular the end of the additional work for the transformation phase of the major Shop Direct contract as well as exits from certain loss-making contracts.

Divisional Trading Profit, before the impact of onerous contract provisions, asset impairments and other charges, reduced much more significantly than revenue. Cost reduction activity announced last year has delivered savings in 2014, but these were offset by profit decreases on certain contracts moving from transformation to full operational phase and an increase in costs associated with internal systems. The exit of low margin or loss-making work has also had the impact of a number of delivery centres in the UK and India becoming under utilised in the short term.

The impact of provisions, impairments and other review items reflects a number of onerous contract provisions required on loss-making contracts, all of which are relatively small. In addition to the £30.3m charged to Trading Profit, there is an exceptional £39.2m impairment of Global Services assets transferred to held for sale; within this the largest contract-related charge is for £8.7m for Shop Direct.

The value of signed contracts during 2014 totalled approximately £250m. The largest, with a value of approximately £140m over 10 years was a new contract for multi-channel customer contact services for a major UK retailer. Other similar contracts have been awarded in the United States, Qatar and Australia, reflecting continued regional development of private sector BPO operations.

Looking ahead, there is no significant attrition anticipated from the ending of any individual contracts and there are also no significant contracts that require extending or rebidding during 2015. As always, existing customers are always seeking to reduce costs, however our efficiency plans include a number of specific operational improvement initiatives in several major contracts and delivery centres to improve profitability. Currently there are a limited number of major new bid opportunities to be decided, although the pipeline in this business tends to be generated over a shorter time period than those for our frontline public service operations. Reinvigorating business development efforts is a key focus of management to recover the division from the consequential impact of challenges elsewhere in Serco, particularly some residual brand issues in the UK market.

Divisional Reviews continued

Corporate costs

Corporate costs relate to typical central function costs of running the Group including executive, governance and support functions. 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, and these include the costs of the Corporate Renewal Programme.

There was a £37.3m charge to Trading Profit relating to the impairment of various intangible assets held at Group level, property dilapidation provisions and balance sheet timing adjustments in recognition of employee-related costs.

Year ended 31 December £m	2014 Revenue	2013 Revenue	2014: Trading Loss	2013: Trading Loss
Revenue and Trading (Loss)	**n/a**	n/a	**(90.2)**	(50.6)
Of which, onerous contract provisions, asset impairments and other review items charged in 2014			**(37.3)**	

Strategic Report

Finance Review

Changes to non-statutory measures

Our financial statement disclosure has been simplified, increasing the transparency of how we report and making it easier for the reader of our Annual Report and Accounts to interpret the financial information. The format and style of this Finance Review has therefore changed with the use of newly defined non-statutory numbers and more explanation of what lies behind the numbers. The Finance Review is longer than usual as a result, but there is a lot to talk about and our objective is to give our shareholders as clear an understanding as we can about what has happened from a financial perspective in 2014.

The simplification in the use of supplemental non-statutory measures used by the Board to assess the performance of the business has involved moving to measures that are more closely aligned with IFRS and which are clearly and easily reconciled to the numbers in the statutory financial statements. A reconciliation to the former adjusted measures is provided below to provide comparability from the old measures to these new ones.

With respect to revenue, the former Adjusted Revenue measure included Serco's share of the revenue of joint ventures. We now exclude revenue from joint ventures in line with the statutory definition.

In terms of profit, our new measure of Trading Profit more closely aligns to the statutory number meaning fewer reconciling items. Trading Profit is defined as Operating Profit before (i) amortisation and impairment costs of intangibles arising on acquisitions, and (ii) exceptional items. A significant change from the former Adjusted Operating Profit measure has been to present joint venture results on a statutory accounting basis which includes the share of joint venture results after tax and interest instead of proportionally consolidating joint venture Adjusted Operating Profit. In addition, Trading Profit is now stated after transaction-related costs and no longer excludes any 'Management Estimates'. For example, during financial year 2013, management excluded from Adjusted Operating Profit the estimated impact of the charges related to UK Government reviews on the business. From this set of Accounts onwards, no 'Management Estimates' will be included in the Trading Profit measure unless they are classified as exceptional items in the statutory consolidated Income Statement.

Trading 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 and is stated after capital expenditure on tangible and intangible purchases less proceeds of tangible and intangible disposals, adding dividends we receive from joint ventures and adjusting to remove tax payments or receipts. Free Cash Flow is Trading Cash Flow after adjusting to add interest received, deduct interest paid, deduct tax payments, and add tax received. Free Cash Flow and Trading Cash Flow, consistent with Trading Profit, exclude exceptional items which are considered to be non-recurring in nature and outside the normal operations of the Group. Consistent with Trading Profit these measures also no longer exclude transaction-related costs and 'Management Estimate' items.

A new measure of pre-tax return on invested capital (ROIC) has been introduced in 2014 to measure how efficiently the Group uses its capital in terms of the return it generates from its assets. Pre-tax ROIC is calculated as Trading Profit 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. Of the total

Angus Cockburn
Group Chief Financial Officer

Strategic Report

Finance Review continued

assets on the balance sheet, Invested Capital assets are: goodwill and other intangible assets; property, plant and equipment; interests in joint ventures; trade and other receivables; inventories; and assets classified as held for sale. All other assets are excluded from Invested Capital, being: retirement benefit assets; tax assets; derivative financial instruments; and cash and cash equivalents. Of the total liabilities on the balance sheet, Invested Capital liabilities are trade and other payables and liabilities classified as held for sale. All other liabilities are excluded from Invested Capital being: retirement benefit obligations; tax liabilities; provisions; obligations under finance leases; derivative financial instruments; and loans. The calculation of ROIC is shown in a table presented later in this review.

Overview of financial performance

Serco faced an unprecedented set of challenges in 2014, and as a consequence our financial performance in 2014 was very poor. Some of these challenges arose in 2014 as a direct result of the issues we encountered in our relationship with the UK Government in 2013 and other key customers, and there is little doubt that these difficulties had a substantial impact in 2014 on our ability to win new business and to satisfactorily resolve contractual issues; others were due to some valuable contracts being lost or taken back in house; while on certain other contracts the cost of providing services rose – in some cases dramatically.

- The business encountered critical operational difficulties during the year on some large contracts (for example COMPASS and ACPB) with a consequent and unexpected increase in costs to levels far above those seen in 2013.
- Contracts which in 2013 had contributed significant amounts of profit were lost (e.g. Electronic Monitoring), had reduced margins on re-bid (e.g. Northern Rail) or saw sharply lower profitability as a consequence of reduced volumes (e.g. Australian Immigration).
- There has been a significant change in senior management, in particular in the Group leadership and the UK business, together with a restructuring of the latter into two new Divisions.
- The business was operating for a number of months in a strategic vacuum as the new management team were actively developing a new strategic direction for the Group.

These challenges had a significant adverse impact on the trading performance of the business.

As part of the Strategy Review, Contract and Balance Sheet Reviews were undertaken ahead of year-end based on management accounts as at 30 September 2014. This was then updated to reflect the position as at 31 December 2014. Onerous contract provisions and impairments had a material impact on the trading result for the year and include the impact of the new strategic direction of the Group and management's best estimate as to the likely outcome on key multi-year contracts.

The Trading Loss for the year was £632.1m (2013: Trading Profit £257.4m) including charges of £745.3m from onerous contract provisions, asset impairments and other provisions. In addition, exceptional losses of £661.5m included £466.0m of non-cash charges from the impairment of goodwill.

Consolidated Income Statement

For the year ended 31 December

	2014 £m	2013 (Restated[1]) £m
Revenue	**3,955.0**	4,284.2
Trading (loss)/profit	**(632.1)**	257.4
Other expenses – amortisation and impairment of intangibles arising on acquisition	**(23.7)**	(21.4)
Operating (loss)/profit before exceptional items	**(655.8)**	236.0
Exceptional (loss)/profit on disposal of subsidiaries and operations	**(5.4)**	19.2
Other exceptional operating items	**(656.1)**	(109.7)
Exceptional operating items	**(661.5)**	(90.5)
Operating (loss)/profit	**(1,317.3)**	145.5
Investment revenue	**6.2**	5.2
Finance costs	**(42.9)**	(42.4)
(Loss)/profit before tax	**(1,354.0)**	108.3
Tax on (loss)/profit before exceptional items	**(11.1)**	(38.7)
Tax on exceptional items	**18.0**	28.8
Tax credit (charge)	**6.9**	(9.9)
(Loss)/profit for the year	**(1,347.1)**	98.4
Trading margin	**(16.0%)**	6.0%
Trading (loss)/earnings per share	**(131.0p)**	36.0p
(Loss)/earnings per share before exceptional items	**(135.0p)**	32.7p
(Loss)/earnings per share	**(258.4p)**	20.1p
Dividends per share	**3.10p**	10.55p

1 Restated to reflect prior period adjustments as set out in Note 4 to the Consolidated Financial Statements.

Revenue

Revenue declined by 7.7% in the year to £3,955.0m (2013: £4,284.2m) which is a 3.5% decline at constant currency. This included the impact of lower volumes on the Australian Immigration services contract and net contract attrition elsewhere, particularly in the UK Central Government and Americas divisions. Organic revenue (which excludes currency effects, acquisition and disposals) was negative 2.5%. This was less than the constant currency decline of 3.5% largely due to the adjustment, when calculating organic revenue growth, to remove the effect of the prior year revenue relating to the UK Transport Maintenance business which was disposed of in November 2013.

Trading loss

The Trading Loss for 2014 of £632.1m (2013: Trading Profit of £257.4m) reflected the poor trading performance, including the recognition of future contract losses, asset impairments and other charges. The most significant losses were incurred in Central Government with a £242.8m Trading Loss (2013: Trading Profit £114.6m) and in AsPac where there was a £201.6m Trading Loss (2013: Trading Profit £78.2m). Both of these segments losses reflected the outcome of the Contract and Balance Sheet Reviews which included significant onerous contract provisions.

Reconciliation to former non-statutory measures

In order to provide comparability the tables presented show reconciliations to the former non-statutory measures of Adjusted Revenue, Adjusted Operating Profit and Free Cash Flow from the new performance measures of Revenue, Trading Profit, Free Cash Flow and Trading Cash Flow.

For the year ended 31 December	2014 £m	2013 (Restated) £m
Revenue	**3,955.0**	4,284.2
Add: share of joint venture revenues	**798.3**	855.8
Adjusted Revenue	**4,753.3**	5,140.0
Trading (loss)/profit[1]	**(632.1)**	257.4
Transaction related costs	**0.9**	3.5
Share of joint venture tax and interest	**7.9**	11.8
Management estimation of charges related to UK Government reviews[1]	**42.9**	21.0
Adjusted Operating (loss)/profit[1]	**(580.4)**	293.7

1 Included in the 2014 Trading Loss of £632.1m were charges totalling £745.3m related to the onerous contract provisions, asset impairments and other provisions in 2014. With respect to the charge of £745.3m there was £718.0m charged to Adjusted Operating Profit and £27.3m was charged to the management estimation of charges related to UK Government reviews.

Trading Cash Flow and Free Cash Flow: Year ended 31 December	2014 £m	2013 £m
Trading Cash Flow	**101.7**	119.9
Add: Tax received/(paid)	**0.1**	(18.8)
Add: Interest received	**2.7**	2.6
Less: Interest paid	**(42.3)**	(40.8)
Free Cash Flow	**62.2**	62.9
Add: Transaction cash costs	**0.3**	2.8
Add: Management estimate cash items	**16.9**	9.2
Add: Directly reimbursed capital expenditure	**–**	9.9
Free Cash Flow (as previously defined)	**79.4**	84.8

Strategic Report

Finance Review continued

Reportable Segments

This section is presented according to the management structure and internal reporting that Serco has put in place for 2015 as a result of actions from the Corporate Renewal Programme and the Strategy Review. The UK Central Government Division is now a separate unit which brings together Serco's work for the UK Central Government; it also brings together all transport operations, including those for devolved authorities that were previously included in the UK & Europe Local & Regional Government Division. The UK & Europe Local & Regional Government Division now incorporates public sector BPO operations previously included in the Global Services Division, together with Citizen Services previously included in the Central Government Division; all public sector BPO operations are therefore now brought together in this Division. The AMEAA region is now reported as two separate divisions – 'AsPac' (the Asia Pacific region, consisting principally of Serco's operations in Australia & New Zealand) and the Middle East. Americas remains as a distinct regional Division. The Global Services Division now consists of BPO operations only in the private sector.

Aligned to statutory reporting, Serco's share of revenue from its joint ventures is no longer included in divisional revenue, while Serco's share of joint ventures' interest and tax costs is included in divisional Trading Profit. The Group has also simplified its reporting by ending the sharing of Income Statement reporting of certain contracts between two segments. This shared reporting of contracts occurred predominantly between the AsPac and UK segments, with these contracts now being solely reported within the segment that delivers the contract to the end customer. Going forward, eliminating the shared Income Statement reporting of such contracts will increase the transparency and clarity of our segmental performance reporting. The prior year comparative segmental information has been restated to reflect these changes. Further segmental information is included at note 5 to the accounts, while segmental information on the previous structure, as reported to the Board during 2014, is included at note 42.

2014	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Revenue	**961.4**	**959.8**	**708.1**	**706.0**	**260.4**	**359.3**	**–**	**3,955.0**
Change	(10.5%)	(0.3%)	(7.4%)	(18.9%)	(2.8%)	4.6%	–	(7.7%)
Change at constant currency	(10.5%)	0.4%	(1.5%)	(8.7%)	3.3%	10.8%	–	(3.5%)
Trading (loss)/profit[1]	**(242.8)**	**(90.4)**	**16.5**	**(201.6)**	**(0.2)**	**(23.4)**	**(90.2)**	**(632.1)**
Amortisation of intangibles arising on acquisition	(0.1)	(1.7)	(2.3)	(2.2)	–	(5.1)	–	(11.4)
Impact of onerous contract provisions, asset impairments and other charges on impairment of intangibles arising on acquisition	–	(5.5)	–	(6.4)	–	(0.4)	–	(12.3)
Operating (loss)/profit before exceptional items	**(242.9)**	**(97.6)**	**14.2**	**(210.2)**	**(0.2)**	**(28.9)**	**(90.2)**	**(655.8)**
1 Included in the 2014 Trading Loss were the following charges from onerous contract provisions, asset impairments and other charges:	(300.8)	(93.8)	(26.7)	(237.1)	(19.3)	(30.3)	(37.3)	(745.3)

2013 (restated)	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Revenue	1,074.6	963.0	764.6	870.6	267.9	343.5	–	4,284.2
Trading profit/(loss)	114.6	17.8	65.1	78.2	24.5	7.8	(50.6)	257.4
Amortisation of intangibles arising on acquisition	(0.4)	(1.7)	(11.3)	(2.4)	–	(5.6)	–	(21.4)
Operating profit/(loss) before exceptional items	114.2	16.1	53.8	75.8	24.5	2.2	(50.6)	236.0

Strategy Review and Funding

The Strategy Review determined that Serco's future focus will be as an international Business to Government (B2G) business with core sectors of: Justice and Immigration, Defence, Transport, Citizen Services and Healthcare. The Review has identified the need for the Group to have a sustainable balance sheet for the future with a level of financial gearing appropriate for the Group's business mix. Significant operational issues experienced during the year resulted in a marked deterioration in business performance, and has led to the need to reduce the Group's debt levels. The Group intends to reduce debt by way of the proposed equity rights issue and the disposal of businesses identified as non-core to the future strategy. A strong Balance Sheet will restore customer confidence in Serco and give the business a platform from which to implement the new strategy.

The proposed new equity to be raised through the rights issue is fully underwritten and a prospectus will be issued to shareholders on 12 March 2015. The rights issue, which is subject to shareholder approval, is scheduled to complete in late April 2015 when gross funds of approximately £555m (approximately £528m after costs) are expected to be received.

Planned non-core disposals include the majority of the Global Services private sector BPO business, the Environmental and Leisure businesses in the UK and the Great Southern Rail business in Australia. These businesses are disclosed as assets held for sale in the balance sheet.

In the fourth quarter of 2014 it became clear that the reduced trading outlook and impact of the onerous contract provisions, asset impairments and other charges could result in the Group failing its debt covenant obligations for 2014 and 2015. The Group announced on 10 November 2014 that it would be seeking discussions with its lenders, to ensure Serco remained compliant with the terms of its debt covenants. Agreement was reached in December 2014 to allow the Group to defer its December 2014 financial covenant test until 31 May 2015 on the condition that the proposed Rights Issue is completed prior to this date. In addition, a number of changes were made to the way in which the covenant test will be calculated to exclude the financial impact of the Contract and Balance Sheet Reviews whilst including the impact of the Rights Issue on net debt. A further agreement has now been reached with lenders, conditional on the Rights Issue proceeding as planned and on up to £450m of the proceeds being used to repay gross debt.

Contract and Balance Sheet Reviews

A part of the Strategy Review involved conducting a review ahead of the year-end of major contracts and the Balance Sheet (the Contract and Balance Sheet Reviews), based on management accounts at 30 September 2014. There was a particular focus on the carrying value of assets and of contracts that were experiencing operational challenges. In our July 2014 update statement and at the time of our Half Year Results in August 2014, the Group reported that the results of the Contract and Balance Sheet Reviews could have an impact on our profits for the year.

The Contract and Balance Sheet Reviews was undertaken in the second half of 2014, assisted by the accountancy firm, Ernst & Young LLP (EY), and involved Serco's divisional finance teams and contract managers. The scope of the work covered all our contracts and balance sheets around the world. The Contract Reviews were based on a structured interview process with the relevant business and divisional teams assessing contractual features, operational and financial performance and outlook. The contracts were categorised as high, medium or low risk, based on the level of risk, uncertainty and judgement existing in each contract. High risk contracts underwent a full scope review including a full financial review of the contract, a review of the accounting model including challenging and stress testing the assumptions as well as a contract balance sheet review. Those contracts deemed to be medium risk were subject to a review of specific contract risks as well as a focus on the financial impact of the key contractual clauses and a review of the contract balance sheet. Where a contract was deemed low risk, no further work was undertaken. Full scope reviews were carried out on 19 contracts and specific scope reviews on 114 contracts. In terms of the Balance Sheet reviews, these assessed the recoverability of all assets including goodwill, property, plant, and equipment, intangibles and receivables, as well as a review of potential unrecorded liabilities. These reviews also encompassed balance sheet items pertaining to financial instruments and tax.

The onerous contract provisions, asset impairments and other provisions made were based on the findings from the risk based review of the Group's contracts, together with a number of financial, commercial and legal reviews of the medium and high risk contracts and the business unit balance sheets. There is a high level of uncertainty and judgement involved in assessing the assumptions underlying these charges, with a potentially broad range of outcomes including projecting contract and business performance for many years in to the future. However, we believe that we have taken the best estimate of the likely outcome based on the information currently available.

The 10 November 2014 trading update explained that the progress of the Contract and Balance Sheet Reviews brought management to a point where it was able to provide an initial estimate of the impairments, write-downs and onerous contract provisions that were likely to be required at the 2014 year end. These were estimated to total around £1.5bn, approximately half of which related to the impairment of goodwill and intangibles. The assessment of the carrying value of goodwill and intangible assets reflected the likely outcome of the Strategy Review and the resulting planned disposal of non-core businesses. The onerous contract provisions reflected the re-assessment of the scale of potential future losses on the larger loss-making contracts in the light of the latest operational developments and the worse than expected financial performance in the year.

Strategic Report

Finance Review continued

Charge to Operating Profit from onerous contract provisions, asset impairments and other provisions

The overall impact of the items identified in the Contract and Balance Sheet Reviews was £1.3bn. The guidance that we gave in November projected a number of around £1.5bn but it should be noted that £73m which was in the original projection related to the DLR pension settlement and asset impairment charges associated with Great Southern Rail that are included as stand-alone exceptional items. Taking these items into account, the overall number is broadly in line with what we indicated in November when the Review was still in progress. However, as we completed the Review so the make-up of the number has evolved and is different from the November update principally as there is a lower level of impairment of goodwill and intangibles, largely due to updated information on the structure and expected proceeds from assets held for sale and an increase to onerous contract charges following higher charges on individually material contracts. The table below shows the outcome from the charges identified in the Strategy Review and the Contract and Balance Sheet Reviews.

	Year ended 31 December 2014		
	Onerous contract losses and related impairments £m	Other impairments and charges £m	Total £m
Items charged to Trading Loss:			
Onerous contract provision for future year contract losses	(433.4)	–	(433.4)
Intangible fixed asset impairments and write-downs	(8.7)	(17.6)	(26.3)
Property, plant and equipment impairments	(19.1)	(3.0)	(22.1)
Impairment of receivables and other assets	(86.9)	(61.9)	(148.8)
Other provisions and accruals	(9.4)	(105.3)	(114.7)
Total items charged to Trading Loss	(557.5)	(187.8)	(745.3)
Impairment of intangibles arising on acquisition	(6.3)	(6.0)	(12.3)
Total items charged to operating loss before exceptional items	(563.8)	(193.8)	(757.6)
Exceptional items:			
UK frontline clinical health provision for future year contract losses	(13.7)	–	(13.7)
UK frontline clinical health other charges	(2.4)	–	(2.4)
Other provision for legal claims	–	(20.1)	(20.1)
Impairment of Global services assets transferred to held for sale	–	(39.2)	(39.2)
Impairment of goodwill	–	(466.0)	(466.0)
Total items charged to exceptional items relating to Review	(16.1)	(525.3)	(541.4)
Total charge to operating loss	(579.9)	(719.1)	(1,299.0)

The charges to operating loss set out above were assessed to determine whether they related to circumstances existing at 31 December 2013, and, if so, whether any amounts should be recognised as prior period adjustments. Serco has a number of contracts that are multi-year, fixed price and/or carry strict performance conditions, and, as a result, determining the future financial performance is complex and includes many assumptions, estimates and accounting judgements. Accordingly, one of the key areas of focus during the Contract and Balance Sheet Reviews was to determine the reasons underlying significant changes made to future estimated financial and operational performance, i.e. the 'trigger points' for such changes. This focus was to ensure that there was adequate information to assess whether the accounting entries arising resulted from an error or a change in accounting estimate, for the purpose of determining whether the write-off should be reflected in the 2014 period or prior periods. The Contract and Balance Sheet reviews concluded that the onerous contract provisions arose from unexpected events and operational challenges occurring in the course of 2014, and therefore represented necessary revisions to the accounting estimates used previously, rather than errors arising from prior years.

Management have recognised a prior year adjustment to reflect the restatement of financial instruments giving rise to a net charge of £5.6m against prior year reported profits, which included a net credit to the 2013 Income statement of £3.0m. These amounts had previously been taken directly to reserves, and as a consequence there was no adjustment required to restate the net assets or cash flows of the Group as at 31 December 2013 or the prior year. The adjustment arose from the fact that the appropriate documentation required to support hedge accounting treatment was not fully in place for two hedges, which is more fully explained in Note 4 to the accounts. The Group concluded that all other charges are changes in estimates rather than errors. The events that occurred in 2014 and the detailed Review, performed in conjunction with Ernst & Young LLP, led us to conclude that all other charges are changes in estimate in nature.

Onerous contract provisions and related impairments

Included in the charge to Trading Loss were £557.5m of charges related to onerous contracts. The largest element of this charge was £433.4m related to the recognition of future year projected cumulative trading losses on contracts up to the contractual end date including attributable overheads and, where the impact of the time value of money was significant, discounting. Attributable overheads, such as IT and finance costs, are included in the provision and relate to the allocation of shared costs that can be linked to the contract activity performed. The costs are allocated on the basis of the key cost drivers, except where this is impracticable, where contract revenue is used as the basis. The balance of the charge to Trading Loss relating to onerous contracts was £124.1m and comprised impairment of contract balances which were predominantly non-cash in nature.

The £433.4m provision for future contractual losses charged to Trading Profit and held on the balance sheet at 31 December 2014 is based on projections of the future losses on approximately 50 contracts, with losses extending up to ten years to 2024 on the longest contract. These contracts, including UK frontline clinical healthcare, made a cumulative loss in 2014, before the impact of onerous contract provisions arising from the review, of approximately £95m. Significant judgement is required in determining the appropriate level of onerous contract provision, reflecting the extended time periods involved and a number of future variable items of which some, but not all are within management's control. Based on information currently available we believe that our estimate of the most likely outcome is, in aggregate, appropriate. Going forward, our contracts with onerous contract provisions will be assessed at least every six months (and more frequently if required due to changes in circumstances or performance). Given the nature of the contracts, it is possible that the actual financial performance may well be different from our current projections and as a result, our onerous contract provision, particularly in regard to individual contracts, might fluctuate year to year. This is a judgemental area but we will maintain a consistent approach to assessing forecast contract outcomes and will provide clear disclosure in our reporting in future periods of the utilisation and other changes to the onerous contract provisions.

Given the scale of these onerous contract provisions, asset impairments and other charges, and the consequent impact on future cash flow, the background to the five contracts with the largest financial impact is explained in more detail below. These account for approximately three quarters of the total onerous contract provisions charged to Trading Loss. The remaining contracts with charges related to onerous contract provisions cover a number of different sectors and geographies, but none has expected future cumulative trading losses greater than £15m.

	Year ended 31 December 2014		
	Onerous contract losses for future year contract losses £m	Related impairments and charges £m	Total charge Operating profit £m
Items charged to Trading Loss:			
ACPB	(135.6)	(60.0)	(195.6)
COMPASS	(112.3)	(3.0)	(115.3)
FPMS	(50.2)	(15.4)	(65.6)
PECS	(14.1)	(12.8)	(26.9)
Ashfield	(15.3)	(3.5)	(18.8)
Five largest	(327.5)	(94.7)	(422.2)
Other	(105.9)	(29.4)	(135.3)
Total items charged to Trading Loss	(433.4)	(124.1)	(557.5)
ACPB – Impairment of intangibles arising on acquisition	–	(6.3)	(6.3)
Total onerous contracts charged to operating loss before exceptional items	(433.4)	(130.4)	(563.8)
UK frontline clinical health exceptional provisions	(13.7)	(2.4)	(16.1)
Total onerous contract charges to operating loss	(447.1)	(132.8)	(579.9)

Strategic Report

Finance Review continued

Armidale Class Patrol Boats (ACPB) contract. Total impairments and provisions: £201.9m

The single largest onerous contract provision for future year losses relates to our contract to operate and maintain a fleet of patrol boats for the Royal Australian Navy. This contract was entered into in December 2003 with an initial design and build phase, after which the fleet became operational in 2007. The boats were originally designed for general patrol duties. Serco's key obligation is to have the fleet available for operations for a fixed number of days a year.

In 2009 Australia was faced by a rapid and unforeseen increase in illegal arrivals by sea. The Armidale Class patrol boats were heavily used for detection and interception, and transporting immigrants to places of safety. Consequently, the patrol boats began to operate at a greatly increased operational tempo, and spent much more time in areas where sea conditions are hostile and extremely stressful on vessels. Neither the customer, nor Serco anticipated such a change in use of the patrol boats. As a consequence, the vessels have been operated in a manner beyond that originally anticipated and for which they were specified, which has resulted in increased repair and maintenance costs, longer periods in port, and consequent penalties being imposed by the customer for vessel non-availability. The contract has a further eight years to run, expiring in 2022. The Group is currently in negotiations with the Australian Defence Materiel Organisation with a view to agreeing the implementation of a remedial programme and improving the terms of the contract.

In the years to 31 December 2013, the contract was modestly profitable. As repair costs increased in 2012 and 2013, anticipated margins were reduced, but until the second half of 2014 it appeared likely that the revenues would exceed costs over the remaining life of the contract, and therefore there was no need to recognise an onerous contract provision. It was also believed that the customer would accept a proportion of the excess repair costs, particularly those related to corrosion, as an independent report, commissioned by the customer, had confirmed that the customer was partially responsible for the damage. However, in 2014 a number of events occurred that materially changed this judgement:

- In the first quarter of 2014, structural cracks were found in one of the patrol boats. Over the following months, inspections were carried out on the fleet as they came in from patrol, and it became clear that most of the boats had suffered similar damage, the remediation of which would require major work. As a result of this and increasing costs of repair and maintenance, in November 2014 we commissioned a specialist vessel engineering consultancy to produce a detailed projection of likely costs over the life of the contract both of repairing the structural damage, and maintaining the fleet through to the end of the contract. This report was recently finalised.
- As the amount of time spent on repairs increased, our ability to maintain fleet availability in accordance with the contract decreased, and this caused hardening attitudes between us and our customer. In 2013 and through the first half of 2014 we expected that a reasonable commercial settlement based on an equitable division of excess costs would be possible. By the time of our contract review, it was becoming clear that this would not be easily or quickly achieved. Furthermore, the costs of penalties payable to the customer for failure to meet availability targets increased.
- These problems were compounded by a major fire on one of the fourteen patrol boats whilst it was under repair in August 2014. This boat was rendered inoperable, increasing further the risk of missing the fleet availability targets and consequent additional penalties.

As a result of these contractual developments, a charge totalling £201.9m has been expensed in the year with a provision of £135.6m related to anticipated future losses over the remaining eight years of the contract. There were also £66.3m relating to impairments of contract balances and other charges, including the impairment of receivables of £52.2m arising from spend that was previously expected to be recoverable from the customer and £6.3m of impairment of intangibles arising on acquisition. Our estimate of future losses is based on our recent internal engineering assessment as well as the external expert review and reflects the scale of the remediation required and the operational availability challenge, exacerbated by the loss of one of the vessels.

Given the fact that the systemic extent of cracking and corrosion and remediation cost was not apparent until the second half of 2014, compounded by the deterioration in the customer relationship during the year and the loss of one vessel through fire in August 2014, we have concluded that this is a change in accounting estimate in 2014, and not a prior period error. The above amount is considered to be the most appropriate charge to reflect the best estimate of future losses along with other write offs and impairments. However, Serco remains in ongoing discussion with the customer and is pursuing all avenues to mitigate losses.

Commercial and Operational Managers Procuring Asylum Support Services (COMPASS) contract. Total impairments and provisions: £115.3m

The second largest onerous contract provision for future year losses relates to our COMPASS contract with the UK Home Office, which is for the provision of accommodation, transportation and subsistence payments for asylum seekers whilst their claims are being processed. Claim processing can take from a few months to several years.

This contract commenced in 2012 and provides services in two of the six administrative regions of the contract in the UK; the North West, comprising fourteen Local Authority areas; and Scotland & Northern Ireland. The contract runs to December 2017, with a further extension of up to two years at the option of the customer.

The contract was originally bid at a low margin and despite losses in the two years to 31 December 2013 there were expectations that it would become profitable within the contract period given anticipated volumes of asylum seekers, and on the assumption that the costs of running the contract could be reduced over time. Accordingly, no onerous contract provision was recognised at the 2013 year end. At 30 June 2014 an onerous contract provision of £6m was recognised, which was based on the then-current assumptions regarding asylum seeker numbers, the duration of accommodation and support services required, and forecasts of costs to deliver the contract.

The contractual performance and outlook have seen significant adverse changes since June 2014. In particular a number of events have occurred which have led to a significant increase in the level of contract loss we now expect to incur:

- There has been a significant increase in the volume of asylum seekers in our care during the course of 2014. At 31 December 2013 we had 10,024 in our care, whereas by December 2014 we were looking after 12,448 – a year-on-year increase of 24%, with an accelerating growth rate in the second half of the year. Growth in the number of asylum seekers is driven by three factors: the number of new asylum seekers arriving in the UK; the rate at which the Immigration Authorities process claims; and the proportion of asylum seekers allocated to each contractual region by the Immigration Authorities. We have no control over these factors, and all moved to our disadvantage during 2014.
- Despite the fact that the profile of our costs does not decrease in proportion to volume, the contract includes a price reduction provision at certain volumes of asylum seekers in our care, which was triggered in October 2014 by the volume growth.
- Availability and cost of housing: when finding housing for asylum seekers, we have to work closely with Local Authorities to gain permissions to house asylum seekers in their areas. Local Authorities have a statutory responsibility to provide and fund healthcare and education services for asylum seekers in their areas from existing budgets. Accordingly, gaining Local Authority agreement to allow asylum seekers to be housed in their areas can be challenging and takes time. If we have large numbers of additional asylum seekers we find ourselves having to provide accommodation for large numbers of asylum seekers in hotels rather than houses, which is much more expensive.
- Volatility in the number of service users has also become a major issue; as the system has come under strain from increasing numbers, so the numbers the Home Office instructs us to take can change rapidly from week to week, whereas procurement of properties takes a much longer timescale. On occasions, we have been instructed by the Home Office to take large numbers of service users with only a few days' notice and this inevitably causes increased costs and operational strain on the system. Similarly, if there is a sudden drop off in numbers of asylum seekers this can lead to a surplus in unoccupied rented housing, which also creates additional costs.
- Given recent volume growth we have reassessed our forecast volume assumptions. Based on historic numbers and trend analysis, we have assumed an average growth rate of 1.46% per month in the North West and 1.49% in Scotland and Northern Ireland. This produces forecasts of significantly higher numbers of asylum seekers towards the end of the contract, and as a result the projected losses are far larger than were previously anticipated.

As a result of these factors, a provision of £112.3m has been recognised to cover anticipated losses over the remaining five years of the contract (including the two extension years), and there have been asset impairments and other charges of £3.0m. This represents our current best estimate of the likely outcome, although the losses on the contract are closely linked to volume of asylum seekers, which is not in Serco's control and the range of potential outcomes is wide, given that there is no contractual cap on the total number of service users that could be assigned to Serco.

As the triggers for these charges have been the recent significant changes in volumes and the consequent activation of the volume price reduction, we have concluded that the charge is a change in accounting estimate in 2014, and not a prior period error.

Future Provision of Marine Services (FPMS) contract. Total impairments and provisions: £65.6m

The FPMS contract, which has a 15-year duration, provides marine support services to the UK Ministry of Defence (MOD) dockyard ports of Portsmouth, Plymouth and Faslane as well as support to military exercises and training and to the Raasay Ranges. Serco has been delivering services to the MOD under the FPMS contract since its inception in 2007 and operational performance against key performance indicators has remained consistently strong.

The contract has specific tasks that we are required to deliver in return for a fixed fee. Additionally, variable revenues are recognised for extra tasking (as instructed by the MOD and other third parties), and from time to time through the chartering of vessels to third parties.

The contract was profitable in the early years. However, a reduction in fixed fee revenue resulted in losses in 2011 and 2012. In 2013 the contract returned to profit as the Group secured a large number of extra tasking requests and third party charters, with the reduced fixed fee revenue also being offset to some extent by a cost reduction programme. During 2014, the contract again lost money as there were few opportunities for third party chartering revenue and additional tasking requests also ran at a lower level than previous years.

It has become clear that there is significant uncertainty about our future ability to generate third party chartering revenue. In addition, recent cost reduction measures put in place by the customer are likely to limit the volume of variable revenue opportunities in terms of extra task orders. Furthermore, a review of the contract during the second half of 2014, based on latest cost estimates, considered the on-going cost base to deliver the contract. This review covered the required resourcing, repairs and maintenance spend and sub-contractor agreements and concluded that, despite efforts in recent years to reduce the cost base, Serco is likely to lose money on the fixed fee element of the contract.

As a result of these factors a charge totalling £65.6m has been taken, comprising a provision of £50.2m to cover anticipated future losses over the remaining eight years of the contract and £15.4m of asset impairments and other charges. As the triggers for this adjustment were the significant and unexpected reduction of variable revenues from chartering and

Strategic Report

Finance Review continued

task orders in the year, which could not have been foreseen, together with the findings from the contract review, we have concluded that this is a change in accounting estimate in 2014, and not a prior year error.

Prisoner Escort and Custody Services (PECS) contract. Total impairments and provisions: £26.9m

This is a contract with the Ministry of Justice (MOJ) for the provision of prisoner transportation between courts and prisons and for the management of prisoner welfare when at court. The seven-year contract was awarded in 2011, with three one year extension options at the customer's discretion.

In 2013 Serco identified mis-reporting of its Designated Ready and Available for Court Time (DRACT) performance measure, and in late 2013 an outline agreement was reached with the MOJ that Serco could retain the contract in return for making service improvements, at Serco's cost, and forgoing any future profit. During the course of 2014 Serco and the MOJ worked together to determine the detail of this agreement and the consequent level of investment required by Serco. Discussions were at an early stage at June 2014 and are now concluded. This has allowed us finally to determine the transformation activities necessary, and as a result in the second half of 2014 we took the decision to extend our transformation programme into 2015, at an additional estimated cost of £6m. The crystallisation of these obligations has also allowed us to refine our assessment of the future level of resources which will be necessary within the contract to sustain our service at the agreed levels for the remainder of the contract term. This resulted in a significant increase in expected future costs.

The total onerous contract provision at 31 December 2014 is £14.1m, to cover future anticipated losses over the remaining three years and eight months of the contract, with asset impairments and other charges of £12.8m. The principal factors driving our estimate are the extent and speed of our ability to reduce the level of staff overtime and the requirement for short-term agency resource through planned operational improvements.

This adjustment is a direct result of the discussions concluded in the second half of 2014, and consequently the adjustment is considered to be a change in accounting estimate in 2014, and not a prior period error.

Ashfield prison. Total impairments and provisions: £18.8m

The HMP Ashfield PFI contract commenced in 1999 and runs through to 2024. In 2013 the operational role of Ashfield was changed from a Young Offender Institution to an adult male sex offenders' prison resulting in a changed cost base. Such changes are normal in the life of a 25-year contract, and there is an established process for agreeing resultant price changes. However, since the change of operational role of the prison the MOJ has imposed on us a level of pricing which we dispute, and which would result in substantial losses over the remaining life of the contract. We remain in negotiation with the MOJ but progress has been slow and agreement has not yet been reached. Should we continue to be unable to reach a resolution with the MOJ, we will have to invoke contractual remedies, including the dispute resolution mechanism under the terms of the contract. Since the outcome of any such process is uncertain, we judge we need to take an onerous contract provision of £15.3m to cover anticipated future losses, as well as impairing certain other assets totalling £3.5m, making an aggregate charge against the contract of £18.8m.

As the adjustment is the result of the failure to resolve pricing in 2014, the adjustment is considered to be a change in accounting estimate in 2014, and not a prior period error.

Other onerous contract provisions charged to trading loss

Total other onerous contact provisions charged to Trading Loss for future year losses of £105.9m, related to contracts which each had cumulative future year trading losses of up to £15m. These contracts were individually reviewed as part of the Contract and Balance Sheet Reviews by EY and management and arise from one or more of the following factors in the second half of 2014: a change to the strategic direction of the business, a reassessment of the likely outcome of disputed items, and adverse operational results arising from external factors leading to a reassessment of the future profitability. These factors led to these contracts becoming onerous and provisions being recognised at the lower of the net costs to fulfil contracts and, where applicable, the costs to end contracts early. In each case, it was concluded that as the triggering events arose in 2014, these provisions were changes in estimates.

Onerous contract provisions projected utilisation

Projecting the future utilisation of the onerous contract provision is not easy given the inherent uncertainties of predicting future contract performance, particularly when the performance on a number of key contracts depends on future service demand and volume which are factors we do not control. It is hard to forecast, for example, the number of asylum seekers entering the United Kingdom. However, given the fact that projected utilisation correlates with the estimated cash impact of these future contract losses, we have estimated the projected phasing below. The projected utilisation reflects, where the impact was significant, discounting of the future contract losses and this has reduced the total provision on the balance sheet by £21m. Clearly, we will in future years review our contract performance regularly and update our estimate of onerous contract provisions and associated projected future utilisation.

	2015 £m	2016 £m	2017 onwards £m	**Total £m**
Projected provision utilisation[1]	139	83	225	**447**

1 Including exceptional items for UK frontline clinical Health and provisions included in held for sale liabilities.

The projected provision utilisation represents our current understanding of the contracts' future financial outturn. Depending on various factors, as outlined below, the extent of actual losses and cash flows is likely to vary from these estimates over the coming years.

These projections may need to be revised or could prove to be incorrect due to various internal and external factors, such as, (i) contract trading performance, (ii) the extent of actual losses, (iii) any renegotiations of contract terms, (iv) insurance or other claims made or disputes or litigations with customers or suppliers, (v) the impact of macro-economic, social and political factors on the Group, such as economic recessions, changes to government policies and budgets and (vi) changes to volume, such as, significant increases or decreases in the number of asylum seekers under the Group's existing relevant contracts, (vii) changes to demand, such as, significant increases or decreases in the use of outsourcing services by the Group's government customers, or (viii) changes to costs, such as, increases in the cost of labour or materials employed by the Group.

Other impairments and charges to trading loss

Included in management's best estimate of outcomes from the accelerated review as announced in November 2014 were £187.8m of charges to Trading Loss. A significant portion relates to £105.3m of provisions and accruals for contracts, property, employee and legal related exposures. An estimated future cash impact of these items is expected to be £72.5m and these are all in relation to contracts that remain profitable, or for areas covering a range of contract or Group activity. These charges have arisen as a result of new information being made available in light of the changing risk profile of the Group and changing direction of the business which has led to a hardening of positions taken by customers and other parties where we have potential liabilities. The impact of the changes in certain customer positions as a result of these triggering events in the year has also led to a non-cash impairment of receivable balances of £61.9m.

There are also non-cash impairments of intangible and tangible assets of £20.6m, relating primarily to corporate assets abandoned as a result of the strategy review. The business has developed various IT systems and processes which we no longer consider to be necessary to the future direction of the business, nor, therefore, is it appropriate to continue to hold these assets.

Impairment of intangibles arising on acquisition

As a result of the Strategy Review there are areas of the business where acquisitions were made but where we will no longer be pursuing opportunities, resulting in the abandonment of certain intangible assets, resulting in impairments totalling £12.3m, some of which related to contracts with future losses. As these are directly linked to the Strategy Review concluded in the year, they represent changes in management's best estimate.

Exceptional Items

Exceptional items are non-recurring items of financial performance that are outside normal operations and material to the results of the Group either by virtue of size or nature. After taking into consideration the reminder issued by the Financial Reporting Council in December 2013, regarding the treatment of exceptional items, we believe that 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.

	Year ended 31 December 2014 Total £m	Year ended 31 December 2013 Total £m
Costs associated with UK Government review	**(9.2)**	(11.6)
Settlement amount relating to UK Government reviews	**–**	(66.3)
UK frontline clinical health contract provisions	**(16.1)**	(17.6)
Restructuring costs	**(32.7)**	(14.9)
Provision for settlement relating to DLR pension deficit funding dispute	**(35.6)**	–
Other provision for legal claims	**(20.1)**	–
Impairment and related charges of Australian rail business	**(37.2)**	(9.6)
Impairment of Global Services business transferred to assets held for sale	**(39.2)**	–
Impairment of goodwill	**(466.0)**	–
Deferred consideration adjustment relating to prior year acquisition	**–**	10.3
Total other exceptional items	**(656.1)**	(109.7)
(Loss)/profit on disposal of businesses	**(5.4)**	19.2
Total exceptional items	**(661.5)**	(90.5)

Strategic Report

Finance Review continued

Costs associated with UK Government reviews

During the year there were exceptional costs totalling £9.2m (2013: £11.6m) associated with the UK Government reviews and the programme of corporate renewal. This reflected external costs incurred and included external adviser costs related to these reviews and the Corporate Renewal Programme.

UK Frontline clinical health contract provisions

During 2014, there were additional exceptional provisions of £16.1m (2013: £17.6m), including an onerous contract provision of £13.7m to cover the anticipated future year loss from the unexpected increase in patient volumes in 2014 on the Suffolk Community Health contract. The provisions relate to the re-evaluation of the forecast losses of the UK clinical health operations, against which an exceptional onerous contract provision of £17.6m was made in the prior year and reflect the Group's withdrawal from the front-line UK clinical health market, with the future focus of the Group on Healthcare being on the provision of non-frontline health services. This re-evaluation reflected reviews showing there are additional costs of delivering improved service levels and meeting performance obligations through to the end of the contracts. The Cornwall out-of-hours contract is being exited early in May 2015 and Braintree Clinical Services was disposed of in March 2014. The third loss-making contract, Suffolk Community Health, is being run through to the end of the contract term in September 2015.

Restructuring costs

As a result of analysis of the cost structures in the businesses and initial actions from the Strategy Review, an exceptional restructuring charge of £32.7m was taken in the year reflecting £19.8m in relation to headcount reductions, £6.9m in relation to property-related exit costs and related asset impairments and £6.0m of adviser costs associated with the Strategy Review and the Contract and Balance Sheet Reviews. These have been treated as exceptional costs as they have arisen directly as a result of restructuring in response to the impact of the UK Government reviews and the Strategy Review.

Provision for settlement relating to DLR Pension deficit funding dispute

In November 2014 the Group agreed to settle a dispute with the Trustees of the Docklands Light Railway (DLR) Pension Scheme over the extent of its liability to fund the deficit on the scheme. This had previously been included as a contingent liability in 2013 based on legal advice taken at the time. The settlement has resulted in a total exceptional charge inclusive of costs of £35.6m, consisting of the full and final settlement amount of £33.0m and costs of £2.6m. The settlement is to be paid over four equal annual instalments from January 2015 to January 2018 covering all past and any future DLR associated pension liabilities.

Other provision for legal claims

An exceptional provision of £20.1m has been recognised for legal claims made against Serco for commercial disputes. This provision is based on legal advice received by the Company.

Impairment and related charges of Australian rail business

In 2014 the Group put the business up for sale and this is expected to complete in the first half of 2015. An impairment review was performed on the Australian rail business, Great Southern Rail, resulting in a charge totalling £37.2m (2013: £9.6m). This consisted of an impairment of £23.1m to reduce the carrying value of its net assets to the estimated recoverable amount and a charge of £14.1m in relation to the break costs of leases relating to the business.

Impairment relating to Global Services Business transferred to assets held for sale

As part of the Strategic Review certain assets have been designated as non-core and are disclosed in the balance sheet as held for sale. Consequently a calculation of the fair value of the Global Services businesses has been performed and resulted in an impairment of the carrying value of assets of £39.2m. This relates to an impairment of the UK part of the Global Services business.

Impairment of goodwill

As goodwill is not amortised, it is tested for impairment annually or if there are indications that it might 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 and key risks. These forecasts include an appropriate level of new business wins and an assumption that the final year forecast continues on into perpetuity at a CGU specific terminal growth rate that does not exceed the forecast GDP growth for the relevant market of the business.

The output of the Strategic Review identified a non-cash exceptional impairment of goodwill of £466.0m in relation to the reduction in the carrying value of net assets to the estimated recoverable amounts in the CGUs of the Group. The impairments arise as a result of two key issues. Firstly, forecasts of cash flows have been significantly impacted by the Strategy Review undertaken during the year, and secondly, the discount rates applied in the impairment calculations have increased to reflect the changing level of risk associated with the business and the fall in the Group's market capitalisation. The impairments arose in the following cash generating units.

Exceptional impairment of goodwill by cash-generating Unit	Year ended 31 December 2014 Total £m
UK Local & Regional Government: Local Services	(57.6)
UK Local & Regional Government: UK Health	(22.9)
Americas	(100.7)
Global Services	(284.8)
Total exceptional goodwill impairment charge	(466.0)

Loss on disposal of businesses

The net loss on disposal of businesses of £5.4m relates to the following specific disposals.

On 19 June 2014 the Group disposed of its debt collection business, Collectica Limited, which after disposal related costs, resulted in a loss on disposal of £3.5m. On 30 September 2014, the Group disposed of its Sky Germany business resulting in a loss on disposal of £3.1m. In the year there was also a £0.1m loss on disposal arising from the sale of Ascot College in 2013. These losses were offset by a gain of £0.5m on the disposal of the Braintree Community Hospital business on 10 March 2014 and a gain of £5.4m recognised in the period in relation to the disposal of the nuclear assurance technical consulting services business that had been sold in 2012, following the release of provisions which have become time expired. In the year, a loan receivable in respect of a prior year disposal in the prior year was impaired by £4.6m.

Net finance expense

Net finance costs of £36.7m were £0.5m lower than 2013. This reflected reduced bank loan interest charges incurred in the year as a result of lower average net debt, and slightly higher investment revenue, which were partly offset by a £2.2m increase in facility fees associated with revisions to the terms of lending agreements.

Taxation

Our tax strategy is to manage all taxes to ensure that we pay the appropriate amount in the countries in which we operate, while both respecting applicable tax legislation and utilising appropriate legislative reliefs. Our strategy is aligned with the Group's business strategy and endorsed by the Board. Responsibility for tax strategy and risk management sits with the Chief Financial Officer. Day-to-day delivery of the strategy is executed by a global team of professionals who are aligned with our businesses and who work closely with local tax authorities and local advisors.

Taxes received

We received net tax of £0.1m in the year with income taxes paid of £25.9m during the period, principally in our ASPAC (£10.1m), Americas (£5.9m) and Global Services India (£4.2m) divisions. We also received UK tax refunds of £26.0m arising from carrying back tax losses to earlier periods and from surrendering some of our tax losses to our UK joint ventures.

As at 31 December 2014, the Group has gross estimated UK tax assets of £723m (£145m net), which are potentially available to offset against future UK taxable profits. These comprise mainly UK tax losses available for carry-forward and deferred tax depreciation. Of these tax assets, £589m arise in Serco Limited, the Group's principal UK trading entity; the remaining £134m arise in other UK group companies. Of the net £145m of tax assets, only £10.5m is recognised on the balance sheet on the basis of forecast utilisation against future taxable profits, with £134.5m being a contingent asset not recognised on the balance sheet.

Strategic Report

Finance Review continued

Tax charge

In 2014 we recognised a tax charge of £11.1m on a pre-tax and pre-exceptional loss of £692.5m. The £11.1m charge includes a £34m deferred tax credit associated with ASPAC onerous contract provisions offset by a write-off of UK deferred tax assets and additional provisions against prior year uncertain tax positions. There is no tax credit arising on the pre-tax and pre-exceptional loss principally because no deferred tax credit is being recognised on UK tax losses arising from the Contract and Balance Sheet Reviews due to insufficient forecast taxable profits.

In 2014 we also recognised a £18.0m credit on exceptional losses of £661.5m. The credit represents the net impact of AsPac deferred tax arising on the impairment of our Australian rail business and deferred tax credits on provisions relating to other legal claims. There is only a limited tax credit associated with these exceptional costs principally because no deferred tax credit is being recognised in respect of goodwill impairment and no deferred tax credit is being recognise on UK tax losses arising.

The tax charge arising on Trading Profit before the impact of the Contract and Balance Sheet Reviews in 2014 is approximately 30%. This is higher than the 25% guidance we gave at Half Year due to a new tax election in respect of UK research & development made by our National Physical Laboratory subsidiary during the second half, the benefit of which is appropriately shown in operating costs rather than income taxes. The rate is also impacted by the change in reporting measure from Adjusted Operating Profit to Trading Profit, resulting in the exclusion of tax benefits airing in our joint ventures.

Our tax charge in future years will be materially impacted by our accounting for UK deferred taxes. To the extent that future UK tax losses are not recognised, our effective tax rate will be higher as we will not be recognising the associated tax benefit arising on the losses. To the extent that our existing UK tax losses are subsequently recognised or utilised, our effective tax rate will bring in the associated tax benefit and will reduce accordingly.

Joint ventures – Serco's share of results

Year ended 31 December	2014 £m	2013 £m
Revenue	**798.3**	855.8
Operating profit	**37.9**	58.9
Net finance cost	**(0.3)**	(0.4)
Income tax expense	**(7.6)**	(11.4)
Profit after tax	**30.0**	47.1
Dividends received from joint venture	**34.8**	51.5

The most significant joint ventures are the UK's Atomic Weapons Establishment (AWE) and Northern Rail. Serco manages AWE in a consortium with Lockheed Martin and Jacobs Engineering Group in a 25 year contract to 2025. In 2014 Serco's share of revenue was £329.8m (2013: £341.2m) and profit after tax was £16.9m (2013: £22.3m). Northern Rail is a 50% joint venture with Abellio to operate the rail franchise that runs until February 2016. In 2014 Serco's share of revenue was £288.7m (2013: £325.2m) and profit after tax was £6.5m (2013: £12.4m). The prior year contract re-pricing on AWE and that agreed as part of the Northern Rail interim franchise drove the profit reductions.

(Loss)/earnings per Share (EPS)

The loss per share 258.4p (2013: earning per share 20.1p). Loss per share excluding exceptional items of 135.0p (2013: earnings per share 32.7p). Measures of basic EPS are calculated on a weighted average share base of 521.5m (2013: 489.0m), the increase reflecting the 49.9m of new shares issued following the share placing completed on 7 May 2014.

Dividend

As part of actions being taken to reduce the Group's indebtedness, the Board is not recommending the payment of a final dividend for the 2014 financial year. Dividends paid in the year totalled £53.1m or 10.55p per share (2013: £51.5m or 10.55p per share) representing the final dividend for 2013 of 7.45p per share that was paid to shareholders on 14 May 2014 and the interim 2014 dividend of 3.10p per share that was paid to shareholders on 17 October 2014.

The Board is committed to resuming dividend payments and adopting a progressive dividend policy when it is prudent to do so. The Directors' decision as to when to declare a dividend and the amount to be paid will take into account the Group's underlying earnings, cash flows and balance sheet leverage, the requirement to maintain an appropriate level of dividend cover and the market outlook at the time. It is not anticipated that the Board will recommend any dividend in respect of the 2015 financial year.

Cash Flow reconciled to net debt

The table below shows the operating loss and Free Cash Flow reconciled to movements in net debt. Free Cash Flow is the cash flow from subsidiaries and dividends received from joint ventures and is stated before exceptional items which are considered non-recurring in nature. Free Cash Flow for 2014 was £62.2m compared to £62.9m in 2013. This reflected a £154.4m year-on-year improvement in working capital, reduced tax payments of £18.9m and lower purchases of tangible and intangibles assets of £23.3m, offset by a £181.1m reduction in the Operating cash inflow (before movements in working capital, exceptional items and tax) and reduced dividends from joint ventures of £16.7m. The impact of the Contract and Balance Sheet Reviews was mostly non-cash in nature in 2014, relating principally to provision movements and other impairments.

Cash Flow: Year ended 31 December	2014 £m	2013 (Restated) £m
Operating (loss)/profit	(1,317.3)	145.5
Less: exceptional items	661.5	90.5
Operating (loss)/profit before exceptional items	(655.8)	236.0
Less: profit from joint ventures	(30.0)	(47.1)
Non-cash movements	772.2	78.6
Operating cash inflow before movements in working capital, exceptional items and tax	86.4	267.5
Working capital movements	17.0	(137.4)
Tax received/(paid)	0.1	(18.8)
Cash flow from operating activities before exceptional items	103.5	111.3
Dividends from joint ventures	34.8	51.5
Interest received	2.7	2.6
Interest paid	(42.3)	(40.8)
Proceeds from disposal of tangible and intangible assets	6.9	5.0
Purchase of intangible assets	(20.0)	(27.8)
Purchase of tangible assets	(23.4)	(38.9)
Free Cash Flow	62.2	62.9
Acquisition of subsidiaries net of cash acquired	(6.5)	(18.6)
Proceeds from disposal of subsidiaries and operations	1.9	40.6
Costs of equity rights issue	(4.1)	–
Proceeds from share placement	156.3	–
Purchase of own shares net of share option proceeds	2.3	(14.9)
Acquisition of other investments	(3.5)	–
Increase in security deposits	–	(0.2)
Capitalisation of loan costs	4.6	–
Amortisation of capitalised loan costs	(1.0)	–
Impairment of loan receivable	(4.6)	–
Non-recourse loan advances	(6.8)	(5.3)
New and acquired finance leases	(13.7)	(23.0)
Exceptional items	(40.4)	(103.4)
Dividends paid	(53.1)	(51.5)
Non-controlling dividends paid	–	(0.6)
Foreign exchange (loss)/gain on net debt	(30.4)	0.6
Movement in net debt including assets and liabilities held for sale	63.2	(113.4)
Assets held for sale movement in net debt	39.5	–
Net debt at 1 January	(745.4)	(632.0)
Net debt at 31 December	(642.7)	(745.4)

Strategic Report

Finance Review continued

The table below provides an analysis of Trading Cash Flow and provides the equivalent pre-interest and pre-tax cash flows equivalent to Trading Profit. This is derived from the cash flow from operating activities excluding tax items and is shown after net capital expenditure and after dividends received from joint ventures. The percentage conversion of Trading Profit into Trading Cash Flow is also provided in this table and this is 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.

Trading Cash Flow: Year ended 31 December	2014 £m	2013 £m
Cash flow from operating activities before exceptional items	**103.5**	111.3
Less: Tax (received)/paid	**(0.1)**	18.8
Dividends from joint ventures	**34.8**	51.5
Proceeds from disposal of tangible and intangible assets	**6.9**	5.0
Purchase of intangible assets	**(20.0)**	(27.8)
Purchase of tangible assets	**(23.4)**	(38.9)
Trading Cash Flow	**101.7**	119.9
Trading (Loss)/profit	**(632.1)**	257.4
Trading Profit cash conversion	**n/a**	46.6%

Cash flow from operating activities, before exceptional items, was £103.5m and this was £7.8m lower than the prior year, with the cash impact of the reduction in profit in large part offset by the improvement in working capital and movements in non-cash items. Trading Cash Flow which is shown before the impact of exceptional items, tax and interest was £101.7m and this was down £18.2m on the prior year reflecting the £7.8m lower operating cash flow and the £16.7m reduction in dividends from joint ventures, being partly offset by reduced capital expenditure on tangible and intangible assets.

The Trading profit conversion into Trading Cash flow was 46.6% in 2013. There was a Trading Loss in 2014 and consequently the cash conversion rate is not reported above, however excluding the charges noted above from onerous contract provisions, asset impairments and other charges totalling £745.3m the conversion rate into Trading Cash Flow would have been 89.8%.

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 operation 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 reviewed annually. Financial instruments are only executed for hedging purposes: speculation is not permitted. A monthly report is provided to senior management and treasury operations are subject to periodic internal review.

Liquidity and funding

As at 31 December 2014, the Group had available committed funding of £1,314.8m, comprising a £730.0m revolving credit facility with a syndicate of banks and £584.8m of private placement notes. The principal financial covenants attaching to these facilities are that the ratio of net debt to EBITDA should not exceed 3.5x and the ratio of EBITDA to interest expense should be greater than 3.0x. In December 2014 the Group negotiated amendments to these covenants for the 31 December 2014 covenant test broadly to exclude the effect of the Contract and Balance Sheet Reviews from the definition of EBITDA, to delay the delivery of the 31 December 2014 covenant test until 31 May 2015 and assuming the rights issue is completed, to apply the proceeds of the proposed rights issue to reduce net debt. In addition to the above debt facilities the Group had a receivables financing facility of £60.0m.

Interest rate risk

Given the profile of the Group's business, we have a preference for fixed rate debt. Our treasury policies require 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 2014, 95% (2013: 87%) of the Group's net debt was at fixed rates.

Foreign exchange risk

The Group is subject to currency exposure on the translation to GBP 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 GBP and USD.

The Group manages its currency flows to minimise foreign exchange risk arising on transactions denominated in foreign currencies and uses forward contracts if appropriate to hedge net currency flows. As part of the Contract and Balance Sheet Reviews we have reviewed current hedge designations and associated documentation.

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 limiting the aggregate amounts and their duration based on external credit ratings of the relevant counterparty.

Debt covenants

The above facilities are unsecured and have financial and non-financial covenants and obligations typical of these arrangements. The principal financial covenants (as defined) require leverage not to exceed 3.5 times EBITDA and EBITDA to cover interest at least 3.0 times. In December 2014, agreement was reached for the Group to defer its December 2014 covenant test until 31 May 2015, along with certain other amendments to ensure that the Group remained in compliance. In March 2015 further amendments were agreed, conditional on the receipt of Rights Issue proceeds and pay-down of up to £450m of gross debt, and prospectively these two financial covenants remain unchanged.

The covenant definition of Consolidated Total Net Borrowings represents Group recourse net debt at the balance sheet date adjusted to exclude encumbered cash, loan receivable amounts, and also adjusted to reflect the impact of currency hedges associated with recourse loans. The covenant definition of EBITDA is the operating profit of the business before exceptional items, and after deducting profits from joint ventures and after adding back depreciation, intangible amortisation, share-based payment charges and dividends received from joint ventures. The covenant test for 31 December 2014 has been deferred until 31 May 2015 and is therefore not shown below. When this is calculated at that time, the covenant definitions will have been amended so that EBITDA also excludes the impact of charges arising from the Contract and Balance Sheet Reviews and Consolidated Total Net Borrowings is calculated after the net proceeds from the equity rights issue. The covenant test for the year ended 31 December 2013 is shown below.

	At 31 December 2013 £m
Operating profit before exceptional items[1]	234.3
Less: Joint venture post-tax profits	(47.1)
Add: Dividends from joint ventures	51.5
Amortisation of Intangible assets	46.1
Depreciation	47.7
Share-based payment	2.9
Other adjustments	(4.1)
EBITDA per covenant	331.3
Net finance costs	37.2
Other adjustments	0.5
Net finance costs per covenant	37.7
Recourse net debt	725.1
Encumbered cash and other items	21.7
Consolidated Total Net Borrowings (CTNB)	746.8
Covenant CTNB/EBITDA (not to exceed 3.5x)	2.25x
Covenant EBITDA/Net finance costs (at least 3.0x)	8.79x

1 Operating profit is shown before the impact of the restatement disclosed in note 4.

Strategic Report

Finance Review continued

Balance sheet summary

The balance sheet at 31 December 2014 is summarised below showing the impact of the assets and liabilities held for sale adjustment on line items. This shows net liabilities of £66.2m at 31 December 2014 compared to net assets of £1,095.9m a year earlier. The principal driver of this decline has been the £1,299.0m of charges against operating profit identified in respect of onerous contract provisions, asset impairments and other charges, in part offset by the £156.3m increase in net assets from the share placement which completed on 7 May 2014 and involved cash receipts from the issue of 49.9m new shares.

	At 31 December 2014 Including assets held for sale £m	At 31 December 2014 Adjustment for assets held for sale £m	At 31 December 2014 as reported £m	At 31 December 2013 (restated) £m
Non-current assets				
Goodwill	820.6	(279.1)	541.5	1,270.8
Other intangible assets	123.8	(5.0)	118.8	185.7
Property, plant and equipment	132.9	(94.5)	38.4	176.8
Other non-current assets	73.5	(26.8)	46.7	86.4
Deferred tax assets	48.4	(11.0)	37.4	57.9
Retirement benefit assets	143.9	–	143.9	64.2
	1,343.1	(416.4)	926.7	1,841.8
Current assets				
Inventories	33.9	(2.7)	31.2	49.4
Trade and other current assets	623.7	(119.0)	504.7	773.1
Current tax	20.7	(4.2)	16.5	19.5
Cash and cash equivalents	202.5	(22.4)	180.1	125.1
	880.8	(148.3)	732.5	967.1
Assets classified as held for sale	–	564.7	564.7	–
Total current assets	880.8	416.4	1,297.2	967.1
Total assets	2,223.9	–	2,223.9	2,808.9
Current liabilities				
Trade and other current liabilities	(695.7)	96.1	(599.6)	(664.3)
Current tax liabilities	(34.4)	21.8	(12.6)	(10.4)
Provisions	(223.8)	18.1	(205.7)	(26.2)
Obligations under finance leases	(18.5)	8.9	(9.6)	(14.9)
Loans	(48.4)	4.5	(43.9)	(52.2)
	(1,020.8)	149.4	(871.4)	(768.0)
Assets classified as held for sale	–	(219.9)	(219.9)	–
Total current liabilities	(1,020.8)	(70.5)	(1,091.3)	(768.0)
Non-current liabilities				
Other non-current liabilities	(37.3)	7.6	(29.7)	(55.2)
Deferred tax liabilities	(11.7)	2.5	(9.2)	(34.4)
Provisions	(384.1)	11.9	(372.2)	(34.9)
Obligations under finance leases	(45.1)	28.2	(16.9)	(53.1)
Loans	(773.7)	20.3	(753.4)	(756.1)
Retirement benefit obligations	(17.4)	–	(17.4)	(11.3)
	(1,269.3)	70.5	(1,198.8)	(945.0)
Total liabilities	(2,290.1)	–	(2,290.1)	(1,713.0)
Net (liabilities)/assets	(66.2)	–	(66.2)	1,095.9

Net Debt	At 31 December 2014 as reported £m	At 31 December 2014 Assets and liabilities held for sale adjustment £m	At 31 December 2014 including assets and liabilities held for sale £m	At 31 December 2013 £m
Cash and cash equivalents	180.1	22.4	202.5	125.1
Loans receivable	1.0	–	1.0	5.8
Other Loans	(797.3)	(0.8)	(798.1)	(788.0)
Obligations under finance leases	(26.5)	(37.1)	(63.6)	(68.0)
Recourse net debt	(642.7)	(15.5)	(658.2)	(725.1)
Non-recourse debt	–	(24.0)	(24.0)	(20.3)
Net debt	(642.7)	(39.5)	(682.2)	(745.4)

At 31 December 2014 net debt including debt items from assets and liabilities held for sale was £682.2m, a reduction of £63.2m on the prior year closing level. Average monthly net debt for the year was £782.9m (2013: £844.6m). The Group has a committed £730.0m (2013: £730.0m) five year multi-currency revolving credit facility (RCF) that matures in March 2017. As at 31 December 2014 £185.0m (2013: £175.0m) had been drawn down. In addition there are US private placement notes (Notes) totalling £584.8m (2013: £574.7m) with scheduled repayments between 2015 and 2024.

Pensions

At 31 December 2014, the net retirement benefit asset included in the balance sheet arising from our defined benefit pension scheme obligations was £101.1m (31 December 2013: net asset of £42.7m). The pension scheme asset base is £1.5bn (2013: £1.4bn).

Defined Benefit Pension Schemes	At 31 December 2014 £m	At 31 December 2013 £m
Group schemes – non-contract specific	130.5	58.4
Contract specific schemes (including franchise adjustment)	(4.0)	(5.5)
Net retirement benefit asset	**126.5**	52.9
Retirement benefit assets	143.9	64.2
Retirement benefit obligations	(17.4)	(11.3)
Intangible assets arising from rights to operate franchises and contracts	–	1.0
Deferred tax liabilities	(25.4)	(11.2)
Net retirement benefit asset (after tax)	**101.1**	42.7
Key assumptions:		
Discount rate	3.60%	4.60%
Inflation rate of increase in pensions in payment	2.0% CPI and 3.0% RPI	2.5% CPI and 3.3% RPI
Life expectancy (years)		
Current pensioners at 65 – male	87.5	87.5
Current pensioners at 65 – female	90.0	89.9
Future pensioners at 65 – male	89.3	89.2
Future pensioners at 65 – female	92.0	91.9

The Group provides a number of occupational defined benefit and defined contribution schemes for its employees. The Group's principal defined benefit pension scheme is the Serco Pension and Life Assurance Scheme (SPLAS) and this had a surplus of £143.9m (2013: surplus £64.2m) calculated under IAS19 rules and is shown in the non-contract specific section of the above table. The increase in the surplus was driven principally by an increase in the value of Liability Driven Investments (LDI) assets in the year, coupled with a reduction in the inflation rate assumed when compared to last year. This more than offset the increase in the value of liabilities because of the effect of the 1.0% reduction in the AA corporate bond discount rate compared to the prior year.

Of the total net retirement benefit asset of £130.5m that related to non-contract specific schemes there was a surplus of £143.9m (2013: surplus £64.2m) in SPLAS; a deficit of £13.1m (2013: deficit £5.5m) in the Serco Section of the Railways Pension Scheme and a deficit of £0.3m (2013: deficit £0.3m) in a small German pension scheme.

The last formal actuarial valuation of SPLAS was undertaken as at 5 April 2012 and showed a deficit of £24m. The estimated actuarial deficit at 31 December 2014 was approximately £5m (2013: deficit £13m). The principal difference between the actuarial valuation and the IAS19 valuation relates to the use of a lower discount rate applied to measure the scheme liabilities for the actuarial basis. The main investments of this scheme are LDI that seek to reduce volatility by matching the liabilities of the scheme for changes in interest and inflation rates through a combination of gilts and corporate bonds with inflation and interest swap overlays.

The Group also had two contract-specific schemes. The £4.0m contract specific deficit related to the Serco Public Services Ltd Essex Pension Fund (2013: deficit £2.5m). In addition to this, the NPL contract and its associated defined benefit pension scheme ceased to be part of the Serco Group on 1 January 2015. As at 31 December 2014, there was a nil deficit on the NPL contract after the franchise adjustment (2013: deficit £0.9m) with the Group consolidated balance sheet including the scheme's fair value of scheme assets of £104.6m, present value of scheme liabilities of £127.5m and a balancing franchise adjustment of £22.9m.

On 7 December 2014, the DLR contract and its associated defined benefit pension scheme ceased to be part of the Serco Group. As a result, Serco's responsibilities as the participating employer in the DLR pension scheme ended. This has removed from the Group's balance sheet the DLR pension scheme, which resulted in a reduction in the fair value of scheme assets of £130.5m, present value of scheme liabilities of £161.7m and the franchise adjustment of £31.2m.

Strategic Report

Finance Review continued

Assets held for sale

As part of the Strategic Review certain assets and liabilities have been designated as non-core and are held for sale. As at 31 December 2014 the following businesses have been disclosed as held for sale: National Physical Laboratory, Great Southern Rail, the UK environmental and leisure businesses, the offshore BPO business and the majority of the UK private BPO business.

Order book

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

The order book at 31 December 2014 was £12.6bn, a decrease of £1.0bn from the 31 December 2013 level of £13.6bn. This followed £3.1bn of signed contracts in 2014 (2013: £3.5bn) which did not fully replenish the £4.0bn revenue recognised in the year, with an additional £0.1bn adverse impact from foreign exchange. Signed contracts in the year included Caledonian Sleepers and Yarl's Wood rebid in Central Government, Centers for Medicare and Medicaid Services CMS expansion and Department of Defense providing program management and related support rebid in Americas, Department of Immigration and Border Protection rebid in AsPac and Lincolnshire County Council in Local & Regional Government.

ROIC

Invested Capital is calculated as explained earlier using the closing balance sheet related to the period; for 2015 it will be calculated as a two-point average of the opening and closing balance sheets for the period. For 2014 a single point has been used as there has been a significant reduction in net assets reflecting the losses in the year. For 2014, the return from Trading Profit before the impact of the Contract and Balance Sheet Reviews items was 11.3% (2013: 13.9%). The composition of Invested Capital and calculation of ROIC is summarised in the table below.

Invested capital and ROIC %

	At 31 December 2014 £m	At 31 December 2013 £m
Non-current assets		
Goodwill	**541.5**	1,270.8
Other intangible assets	**118.8**	185.7
Property, plant and equipment	**38.4**	176.8
Interest in joint ventures	**1.6**	8.1
Trade and other receivables	**38.1**	78.3
	738.4	1,719.7
Current assets		
Inventory	**31.2**	49.4
Trade and other receivables	**498.8**	764.4
Assets classified as held for sale	**564.7**	–
	1,094.7	813.8
Total invested capital assets	**1,833.1**	2,533.5
Current liabilities		
Trade and other payables	**(581.9)**	(644.1)
Assets classified as held for sale	**(219.9)**	–
Non-current liabilities		
Trade and other payables	**(29.7)**	(34.1)
Total invested capital liabilities	**(831.5)**	(678.2)
Invested capital	**1,001.6**	1,855.3
Trading (loss)/profit	**(632.1)**	257.4
ROIC %	**n/a**	13.9%

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2014, the Directors have considered the principles of the Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009'; namely assessing the applicability of the going concern basis, the review period and disclosures.

The Group's current principal debt facilities at the year-end comprised a £730m revolving credit facility, and £584.8m of US private placements notes. As at 31 December 2014, the Group had £1,314.8m of committed credit facilities and headroom of £545.0m. Additionally the Group had a receivables financing facility of £60.0m. The Group's stated intention is to reduce the Group's indebtedness to a more prudent level of financial gearing, and anticipates achieving this through the proceeds from the rights issue expected to be received in late April 2015 and the disposal of non-core businesses.

In December 2014, agreement was reached for the Group to defer its December 2014 covenant test until 31 May 2015. When the covenant is calculated in May 2015, EBITDA will exclude the impact of charges arising from the Contract and Balance Sheet Reviews and Consolidated Net Borrowings will include the net proceeds from the equity rights issue, provided the proceeds are received by 30 June 2015.

Assessment of going concern

The Directors have undertaken a rigorous assessment of going concern and liquidity taking into account financial forecasts, the anticipated receipt of proceeds from the rights issue, proposed debt refinancing, and disposals of non-core businesses. 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 the proposed terms of the debt covenants under the amended and restated credit facility, our ability to generate cash from trading activities, and the estimated gross proceeds of approximately £555m due in April 2015 from the proposed fully underwritten rights issue that is subject to shareholder approval. Additionally there has been consideration of the potential reduction in debt levels from planned disposals of non-core businesses in 2015.

Review period

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future, which is interpreted as the period to December 2016. The Directors have also reviewed the principal risks we face taking account of those identified from the outcome of the Contract and Balance Sheet Reviews.

Risks relating to Rights Issue

The Directors have considered in their assessment of going concern, the prospects of the rights issue proceeding, and the net proceeds of the rights issue being received by the Group, together with the risks attached to the rights issue not taking place. The directors highlight that the prospectus to raise approximately £555m before costs, was sent to shareholders at the same time as the accounts were signed.

The Underwriters' agreement to underwrite the entire rights issues is conditional, amongst other things, on the Company's shareholders passing an ordinary resolution granting the Directors the authority to issue the rights issue shares at the general meeting scheduled to take place on 30 March 2015. The Underwriters will also have termination rights in respect of, for example, breach by the Group of representations, warranties, and undertakings under the Underwriting Agreement. The Underwriting Agreement will become unconditional following admission of the rights issue shares to trading on the London Stock Exchange, which is expected to be on the day following the general meeting (31 March 2015). The Group may still be liable for any losses suffered from breaches of representations, warranties, and undertakings under the Underwriting Agreement.

Strategic Report

Finance Review continued

Risks relating to refinancing

The Group has entered into agreements with its lenders and noteholders to refinance its current debt facilities, which are conditional on the rights issue proceeding, the Group receiving the net proceeds of the rights issue and the Group repaying up to £450m of its debt facilities. Should the rights issue not proceed, the existing debt facilities will remain in place, subject to meeting ongoing financial debt covenant tests. The Group expects to be able to meet its financial covenant tests under the existing debt facilities on 31 May 2015 in respect of the year ending 31 December 2014. However, unless further waivers or amendments are granted by the lenders, it is anticipated that the Group would breach its financial covenant tests in respect of the 12-months ending 30 June 2015 under the revolving credit facility and the receivables financing agreement when they are tested 90 days after 30 June 2015, which would trigger a cross-default under the US private placement notes. Following any such breach of financial covenants or cross-default, the lenders or noteholders (as applicable) would be entitled to demand the accelerated repayment in full of any amounts outstanding under the relevant existing debt facilities, including any interest due and the payment of a 'make-whole amount' paid to noteholders under the US private placement notes. In this event, the Group does not anticipate that it would have the funds available to repay such amounts at that time, and would need to take alternative steps in order to be able to continue as a going concern, such as seeking:

- to negotiate further waivers of its financial covenants under the existing financing agreements with the lenders and noteholders;
- to establish alternative long-term committed debt facilities with wider covenants to replace the existing financing agreements;
- to derive other forms of funding, such as through a new equity restructuring with private capital investors or a conversion by the Group's lenders of existing debt into equity; and/or
- to make disposals of further assets not already considered for disposal, subject to necessary approvals from lenders and note holders.

Assessment

Despite the challenges and uncertainties which remain in our business, we are making good progress in implementing the plan of actions coming out of the Strategy Review including refocusing the Group as an international B2G business, and in rebuilding trust and confidence with the UK Government. Serco's more focused core will increasingly benefit from the transferability of skills and knowledge from one public service market or geography to another. The portfolio also offers a degree of risk diversification and allows adaptation to the requirements of changing Governments at different times.

As stated above the Group is embarking on a rights issue in order to substantially reduce its debt, and give it a firm financial foundation for its future. However, whilst the rights issue is fully underwritten, it is scheduled to complete within 6 weeks after the date of signing these accounts, and is dependent, inter alia, upon shareholders approving the proposed fundraising. The Directors expect the fundraising to be successfully completed by 24 April 2015, The shareholder approval is expected to be received on 30 March 2015, but at the time of signing these accounts there remains a material uncertainty related to events or conditions that may cast a significant doubt on Serco's ability to continue as a going concern and, therefore that it may be unable to realise its assets and discharge its liabilities in the normal course of business. The Directors believe that the fundraising is likely to be successfully completed by 24 April 2015, and they therefore 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.

Strategic Report

Corporate Responsibility

For Serco to be successful and sustainable, we have to work in the right way. This means living up to our responsibilities to our customers, the public, our employees, partners, suppliers, communities and the environment.

Being a responsible business means ensuring that we:

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

By acting responsibly, we will enhance our financial performance and create sustainable value for our shareholders. Corporate responsibility (CR) is therefore embedded within all aspects of the Serco Management System (SMS) so that it is built into the way we operate. The SMS defines the rules that govern the way we behave, operate and deliver our strategy. It encompasses a set of Group-wide policies and standards, covering subjects ranging from business conduct and ethics, health, safety and the environment (HSE), people to procurement and supply chain. During 2014, we completed a comprehensive review and republished the SMS along with an extended and fully refreshed Code of Conduct.

The way we manage our responsibilities and our performance in the year are summarised below.

Managing corporate responsibility

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

The Board has ultimate responsibility for our Group business strategy which encompasses our approach to CR. One of our Non-Executive Directors is the Board sponsor for CR and chairs the Corporate Responsibility and Risk Committee (CRRC). More information on the CRRC can be found in the Corporate Governance Report on page 78.

This Board Committee has oversight of our approach to CR and its governance, ethics, risk management, security and health, safety and environment matters. This committee met four times during 2014 receiving at each meeting formal progress reports on the elements making up our CR framework.

The Group Chief Executive Officer is a member of the CRRC and is responsible for promoting the Group's approach to CR and its effective implementation across the Group. This is agreed with the Executive Committee which oversees its implementation.

Each CR element has a designated Group lead responsible for engaging with Divisional leads to develop an appropriate strategy, objectives, and performance indicators and monitor and report on performance. Each Divisional Executive Management Team under the direction of the Divisional Chief Executive then develops specific plans to address the elements within the CR framework relevant to their business operations and strategy.

Strategic Report

Corporate Responsibility continued

Ensuring ethical standards

At the heart of being a responsible business is a commitment to doing the right thing. To support this commitment in 2014 we further strengthened ethical governance across the business with the appointment of Ethics Leads. Reporting to the relevant Divisional Executive Management team they are responsible for the development and implementation of the Division's ethics and compliance programme in line with Group strategy and assessed risks. Working collaboratively with colleagues on the Divisional Executive Management team they support the business in identifying and resolving ethical challenges, risks and potential conflicts. They are also responsible for managing our whistle-blowing 'Speak Up' process and investigating and resolving issues raised.

Our Speak Up process is supported by an online whistle-blowing case management system provided by a third party independent provider. This was fully implemented across the Group in 2014. These processes along with our Speak Up policies and standards were reviewed as part of the SMS refresh in 2014 with changes made to strengthen them. This was supported by specific training of those involved in the investigation of Speak Up issues.

Awareness of Speak Up was raised with the relaunch of our Code of Conduct (www.serco.com/codeofconduct). The results of our employee engagement survey 'Viewpoint' showed that 80% felt that they had received the information they needed to understand Serco's Code of Conduct with 73% feeling they can report unethical conduct without fear (above the Aon benchmark average of 69%).

Of the Speak Up cases closed in 2014 all were reviewed with 95% investigated. Those that were not investigated either had insufficient information from an anonymous caller or were addressed directly by management. 56% of the cases resulted in some corrective action being taken; 15% resulted in disciplinary action; and a further 9% resulted in one or more employees being dismissed. 70% of the cases were closed within three months of the issue being raised.

A focus during 2014 has been on ethics training with over 800 leaders attending a face to face workshop 'Business Ethics in a Challenging World'. This was followed by a workshop for managers 'Values Based Leadership' which was attended by over 3,500 managers.

Online training was made available to support the rollout of the refreshed Code of Conduct with an introduction from Rupert Soames, Group Chief Executive Officer highlighting its importance to him and his commitment to it. This is mandatory training for all employees that will be repeated annually

People

We are trusted to deliver essential and life-enhancing services that our communities depend on. Delivering great service starts with our colleagues. We depend on their skills and commitment to deliver the services our customers expect. They contribute directly to our reputation and ability to grow.

We recognise the privileged role we are given, and that we must enable our people to deliver great service. We must also make it easy to manage our workforce with standard, simple and intuitive systems and processes:

- We want our leaders to be fit for the future, agile and adaptable and clear on the behaviours and results expected of them.
- We want our colleagues to be highly engaged and passionate about service. We want them to share our values and a sense of personal responsibility for delivering great customer outcomes, and achieve them time after time.
- We want our workforce and people management practices to have an unrivalled reputation for effectiveness and efficiency.

Leadership model

An objective for 2014 was to roll out our new leadership model. This was launched at the beginning of 2014 when work began to integrate it into our leadership hiring, profiling and performance review processes. The revisions to leadership hiring were used to good effect throughout the year with a number of significant senior leadership hires successfully completed, bringing high quality, well-reputed talent into the organisation and strengthening our leadership capability. The arrival during the year of Rupert Soames as Group Chief Executive Officer presented an opportunity for his shaping of the leadership model which was completed and incorporated in Q4.

Alongside this, a new annual performance review process was launched (the Performance & Development Review) which integrates with the Leadership Model and is designed to support a balanced range of performance targets through 'Customer', 'Operational Excellence', 'People & Culture' and 'Financial' objectives.

During 2015 we intend to continue to build leadership capability through our talent management strategy, focusing on resourcing, development and career progression, underpinned by our new leadership model.

Employee engagement

We have continued to build on best practices in engagement through 2014. A comparative analysis study, 'Engagement links to business performance', established robust and replicable positive correlations between employee engagement at Serco and staff turnover, sickness absence and lost time incident rates. Recognising its importance employee engagement was added into Leadership Performance and Development and Divisional Performance Review processes as a key performance indicator.

We measure engagement through an annual 'Viewpoint' survey. Our survey questionnaire was restructured and expanded in 2014 to improve our ability to interpret and respond to the results, while analysis of global team sizes enabled us to update the minimum team size for engagement scores from ten to seven, providing greater granularity of results and greater precision in action planning. The 2014 Viewpoint Survey successfully launched and completed in Q3 achieved a strong participation rate (81% for all employees globally, 98% for leaders). Our current global engagement strengths are: diversity and inclusion, line management, customer focus and performance management.

During 2015 we will continue to focus on improving engagement, with particular emphasis on our priority engagement drivers: recognition, acting on employee feedback, connection to Serco, and use of employee knowledge, skills and abilities.

Developing systems and processes

Through 2014 we continued work to identify and analyse opportunities for enhancement of our HR system's (MyHR) functionality and enhancements with additional services. Milestones for 2014 included the implementation of new learning and recruitment solutions.

At the beginning of 2014 it was recognised that the implementation of a new Learning Management System (LMS) would be fundamental to delivering the numerous compliance and behavioural training requirements outlined in the Corporate Renewal Programme. The new LMS was successfully implemented for the UK in Q3, going live to a growing number of pilot audiences. A comprehensive training curriculum to achieve global training objectives for Corporate Renewal is being delivered from the LMS platform.

A pilot for a new global recruitment solution went live successfully at Fiona Stanley Hospital in Australia in Q2. The implementation includes a new recruitment website (http://fshcareers.com.au) to attract candidates and drive them to live vacancies, robust candidate tracking, talent pooling to create a searchable database of prospective candidates, and an extensive reporting and analytical capability. Through the remainder of 2014, over 10,000 applications were processed through the system. To put this single site pilot in context, globally Serco connected with in excess of 700,000 prospective candidates in 2014 through our recruitment processes (includes estimated contact through all channels, eg mass volume campaigns and recruitment events, on top of c.585,000 actual recorded applications).

These two implementations represent the first steps on our journey to globally consistent learning and recruitment solutions that will greatly improve our capabilities in those areas. Both integrate to our existing HR systems driving further value. Plans to extend both solutions across the UK, the Asia Pacific region and other geographies are now in development.

Work was also completed in 2014 to review our people policies and standards as part of a broader refresh of the SMS. Having relaunched these the focus in 2015 will be to ensure our people standards for Employee Wellbeing and the Employee Lifecycle are embedded with specific focus on resourcing, developing, managing and rewarding our people.

Diversity

Serco is an inherently diverse business. We value difference and work to create an inclusive and fair environment for all. We treat people fairly and equally, accept and embrace diversity and, as far as is reasonably possible, reflect the local communities in which we work.

Serco ensures equality, diversity, inclusion, and anti-discriminatory practice in the workplace and community, offers fair treatment in every aspect of working life and fosters a positive climate of employee relations where all employees are treated with respect and dignity. We adopt equality-proofed polices and processes to promote equality in the workforce and monitor its diversity (where allowed to do so by law). According to our 2014 engagement survey, 78% of employees believe that Serco values diversity. This is up 7% from 2013. By comparison, externally the global average is 71%. Diversity and inclusion is one of our areas of strength in engagement.

At 31 December 2014, the numbers of men and women employed by Serco were as follows:

	Number		Percentage	
	Male	Female	Male	Female
Directors	7	3	70%	30%
Senior Managers	70	12	85%	15%
Employees[1]	73,553	41,489	64%	36%

1 At 31 December 2014, we had 118,621 employees, of which we had gender information on 115,042. (Source: Serco global HR systems, figures provided on a total headcount basis includes joint ventures.)

Strategic Report

Corporate Responsibility continued

Human rights

We recognise the importance of protecting human rights. We respect the United Nations Declaration of Human Rights and its Guiding Principles on Business and Human Rights, as well as the national laws of the jurisdictions in which we operate.

We have policies in place aimed not only at protecting human rights but also providing employees with an opportunity to raise any concerns they may have in relation to such rights, in order for appropriate action to be taken if necessary.

Our Business Conduct and Ethics policy and Group standard requires us to respect the human rights and dignity of individuals, and not to take part in, or benefit from, any activity that breaks any law relating to human rights. This policy applies to all jurisdictions in which we operate to help ensure that, as a company, we do not adversely impact human rights. Ethical and human rights considerations are reviewed as part of risk management. If a significant ethical or human rights issue is raised it is reviewed by the Divisional Executive Management Team and appropriate action agreed. In instances where a significant ethical issue arises, it is raised to the Executive Committee for a final decision.

Human rights risks are assessed and appropriate due diligence is undertaken when we are considering new markets, geographies and establishing working relationships with joint venture partners or other third parties. In forming a decision, we have a 'decision tree' which enables us to highlight any potential human rights issues associated with the contracts we are thinking of bidding.

The Investment Committee determines Serco's position in relation to new geographic markets, or opportunities and activities. Where those activities have been identified as presenting an ethical dilemma which either has implications across the Group or represent a significant reputational risk to the Group, then such activities will be considered by the CRRC on behalf of the Board.

We recognise we can be a force for good and will consider operating in countries where there are known human rights issues, provided we would not knowingly be connected to any abuses either directly by our employees or through associated third parties. Furthermore, in areas where we have an influence and believe this influence can be used to improve others' respect for human rights, we have the option to do so.

Our approach to due diligence of new opportunities as well as the selection of third parties we work with is currently being reviewed, updated and enhanced and will be re-issued along with supporting training in 2015.

The refresh of our Code of Conduct in 2014 included a specific update on human rights and now includes specific guidance on the topic. In support of its relaunch we are training all staff which includes our commitment to the protection of human rights.

Marketplace

Customers

Developing and improving long-term relationships with our customers is central to our business. Furthermore, one conclusion from the reviews that supported the development of our Corporate Renewal Programme was that we needed to improve our oversight of the delivery of our contractual obligations to our customers. We have learned that being clear and transparent with our customers is fundamental to maintaining trusting relationships. While day-to-day responsibility for meeting our customers' needs lies with our contract directors, we have sought to increase the frequency and transparency of our customer engagement and invested in more formal oversight of delivery of our contractual commitments. This will help to ensure we identify and respond promptly to operational performance issues and to our customer concerns. This commitment is embedded in a new Operations Group Standard which forms part of our refreshed SMS. We have also placed customer satisfaction at the core of our management reporting and incentive structures, so we are fully focused on ensuring our customers receive the high-quality services they deserve from us.

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

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

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

Suppliers

Effective procurement helps us to achieve our vision and deliver high-quality service to customers. We aim to be professional in all our dealings with suppliers and to establish mutually beneficial relationships. We have a Procurement and Supply Chain function, which is responsible for putting this approach into practice and for Group procurement policy and standards. These documents have been reviewed, updated and re-published in 2014 as part of the refreshed SMS. As a result we have strengthened guidance on due diligence of third parties to ensure they meet our policy standards and Code of Conduct, including for example our zero tolerance to bribery and corruption.

In line with the relaunch of our Code of Conduct we also reviewed and republished our Supplier Code of Conduct. This sets out the principles and standards we expect from those we work with, to ensure we operate not just legally, but ethically and fairly.

Joint venture partners

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

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

Strategic partners

We often deliver services as part of a consortium, either as prime contractor or as a subcontractor. This allows us to bring together companies with the skills to meet the precise requirements of a bid. This includes working with voluntary sector organisations that often lack the scale and experience to access major government programmes. Responsibility for relationships with our strategic partners lies with the relevant contract and Divisional management.

Community

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

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

In 2014 we set an objective to recognise exceptional contributions made by our people to the communities in which they live and work. The Serco Pulse Awards recognise people at every level and from every part of the company whose behaviours are making a difference, and providing role models that help shape our businesses in the future. By recognising these individuals and teams we are rewarding the right behaviours that demonstrate Serco's values. During 2014 we reviewed and revised the award categories to introduce a specific Community Award. This award recognises people who have, through Serco, given an exceptional and sustained level of commitment to the communities we serve. Sixteen divisional pulse community awards have been recognised of which five will receive a Global Pulse Community Award. These reflect just a few examples of the many initiatives that contracts undertake to engage with the communities in which they work.

Serco Foundation

We also committed to promote and support the Serco Foundation. The Serco Foundation was established in December 2012 to work with charities and NGOs within the regions where Serco operates, to capitalise on the passion of our people to do good and to make donations that will significantly benefit the campaigns of the charities it chooses to work with. It will also seek to work with large scale Foundations and NGOs to help them consider how to improve the delivery outcomes they seek to achieve.

In 2013, linked to the celebration of 25 years of Serco, our staff around the world carried out a wide range of fund-raising activities, which continued into 2014 and raised just over £500,000 for the nine regional charities which had been selected by our employees, all linked by our chosen initiative of supporting 'Every Child Everywhere'. These charities were:

- In the Americas – St Jude Children's Research Hospital, Ronald McDonald House Charities and Military Child Education Coalition.
- In India – Swiss Emmaus Leprosy Relief work.
- In the Middle East – Al Noor.
- In Asia Pacific – Canteen, KidsCan and Po Leung Kuk (Society for the Protection of Women and Children).
- In the UK – WhizzKidz.

Concurrently during 2014, the Serco Foundation has been exploring a strategic relationship with a global charity to enable them to have access to the experience and capabilities within Serco that might help them to maximise their impact on the lives of children around the world. We are planning to run a pilot scheme with them, funded by the Serco Foundation during 2015 to prove the concept.

Community investment

We monitor our involvement with the communities we serve by recording our community investment through donations of money, assets and time and have typically aimed to invest 1% of adjusted pre-tax profits into the wider society. Whilst in 2014 we are reporting a significant loss in the year compared to profits previously, we have continued to support the communities we operate in. As a result we invested £1,464k into society in 2014. This is made up of:

- Cash Donations £475k
- Employee volunteering £296k
- Gifts in kind £332k
- Management time £361k

Strategic Report

Corporate Responsibility continued

Health and safety

Our aspiration is zero harm. Nothing is so urgent or important that we cannot do it safely. A strong HSE performance ensures the safety of our people and protects our reputation. Wherever they work and whatever their role, our people must adhere to stringent health and safety procedures. These procedures are embedded in the SMS and are the minimum standards that apply. During 2014 these policies, standards and supporting Group operating procedures were reviewed, revised and re-published as part of the refresh of the SMS.

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

We monitor and have objectives around a number of performance indicators including lost time incidents; major reportable incidents and physical assaults.

Lost time incidents

In 2014 we saw an 18% reduction in numbers of Lost Time Incidents (LTI) compared to 2013 resulting in a 9.4% improvement in the lost time incident rate. At 457 our LTI rate (per 100,000 employees) has exceeded target (462) for the year by 1%. When the higher risk elements of our business ('frontline') are considered our LTI rate of 925 has seen a 10.8% improvement against 2013 and is 2.6% ahead of target (950). This reflects ongoing continuous improvements which have seen a 29% improvement in our LTI rate over the last five years. This is in the context of an increasing risk profile in some operations (eg from within our custodial business). For 2015 our objective is a further 3% reduction in the LTI rate to 444 for our combined frontline and back office operations.

Slips/trips/falls and manual handling continue to be the highest contributors to LTIs. Where this risk exists a variety of risk reduction initiatives are being implemented including staff awareness and training. Our approach is risk based in regard to safety critical areas where we have driven a number of initiatives including: improved governance arrangements; development of consistent process and toolsets; and significant improvements in the monitoring and reporting of safety performance.

Major reportable incidents

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.

The number of major reportable incidents fell by 42% to 19 in 2014, resulting in a rate of 19.9 per 100,000 employees. This can be broken down with rates for 'frontline' (higher risk) operations at 37.3 and our 'back office' operations at 4. These are ahead of our target of 40. For 2015 our objective is to sustain a major reportable incident rate under 30.

Physical assaults

No employee should be subjected to either physical or verbal abuse. We have clear policies to support all our employees and recognise the risks that some employees face.

This performance indicator has been an area of specific management focus in the UK Divisions and ASPAC where we have significant risk of assaults mainly through our immigration and custodial businesses. Many initiatives, working groups to spread best practice and training have helped to manage this risk area. For example the issue of 'legal highs' which has affected the UK custodial business has impacted by fuelling assault situations, however we have led an industry-wide working group to look at ways of addressing this.

In ASPAC, reducing the potential for assaults is managed through controls such as intelligence reports and surveillance, and training of our personnel in de-escalation and situational response strategies. In addition, Justice and Corrections in New Zealand launched a violence reduction strategy and a multi-disciplinary safer custody committee to assist in reducing the potential for assaults.

Having said this, with an evolving risk profile we have seen an increase in 2014 in the physical assault rate per 100,000 employees of 15% (554) against our rate in 2013 (481). This falls short of our target (460) by 20%. When just 'frontline' performance is considered our rate in 2014 at 1,155 is 12% higher than in 2013 (1,035) and misses our target of 988 by 17%. This reflects an erratic performance over the last five years which is reflective of the changing risk profile. We will continue to build on current initiatives and engage with others in the industry with the objective of reducing our physical assault rate by 3% in 2015 to 537.

Environment

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

Although Serco's activities are typically managed at a local level, we are united in our strategy of measuring our impact and reducing our environmental footprint. This supports a range of initiatives in our operations around the world. A small number of examples of initiatives included:

- In Americas, consulting and guidance were provided to industrial contracts on a wide range of environmental issues, with examples including hazardous waste disposal, wastewater treatment, ozone depleting substances, industrial hygiene topics and others.
- In Australia, at Acacia Prison we engaged in a partnership into a hydroponic nursery and seedling production. Creating training, employment opportunities in a sustainable business model. Also across their immigration centres they introduced biodegradable plates to eliminate 1000s of plastic plates being manufactured and waste to landfill.
- In the Middle East, our aviation business is looking at continuous descent approach and climb departure to reduce fuel and CO_2e emissions.
- In India, 70% of operations are now certified to ISO14001.
- In the UK, we are implementing a Combined Heat and Power solution at Tenterden Leisure Centre and introducing an LED lighting upgrade of external lighting and plant controls at Lilleshall National Sports Centre.

Where environmental initiatives have been identified specific indicators relevant to the project are agreed so that delivery and where possible impact can be assessed. This is monitored within the relevant Division and managed locally to ensure appropriate ownership and sustainability of projects. In 2015, the introduction in the UK of the Energy Saving Opportunity Scheme (ESOS) regulations will require Serco to present to the Executive Committee costed energy reduction initiatives for a representative section of the business.

Across more than two thirds of our business, we are working on our customers' premises and are therefore not in direct control of the environment in which we operate. That is why collaborative working with our customers on environmental issues is important. Serco recognises its responsibility to ensure that any adverse impact on the environment is reduced, or where possible, eliminated by applying the most appropriate management systems at contract level – whether designed by our customers or by us.

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

In 2014, Serco again responded to the Carbon Disclosure Project FTSE 350 (CDP) request for information achieving an improved score of 97% (16th equal and 2nd in our business sector), compared to 92% (18th equal in the FTSE 350 report) in 2013, retaining us in the Carbon Disclosure Leadership Index.

Strategic Report

Greenhouse Gas Emissions

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

Reporting year

Our reporting year for greenhouse gas emissions is one quarter behind our financial year, namely 1 October 2013 to 30th September 2014. We established this reporting period last year to ensure that the emissions information we obtain from supplier invoices is complete and we set last year as the baseline.

Global greenhouse gas emissions data

For the period 1 October 2013 to 30 September 2014 our total carbon dioxide equivalent (CO_2e) was 368,012 tonnes. A breakdown of this by emission type is provided in Figure 1. This reflects an 8% reduction compared to last year's emissions which were 398.519. This results from the impact of weather, a warmer winter in 2013/14; changes in contributing contracts; and the impact of initiatives taken. Figures 2 and 3 draw comparisons between years by type (scope 1 and 2) and by Division.

Reporting boundary and responsibility

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

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

In 2014 we achieved an overall materiality level of just under 5% and our objective is to maintain this for future reporting.

We do not have responsibility for any emission sources that are beyond our operational control, for example, business travel other than by our own transport, and therefore do not report them here. Scope 3 emissions can be found in our annual Carbon Disclosure Project FTSE 350 submission.

Methodology

Serco quantifies and reports to ISO 14064-1 2012. We have used the Department for Environment, Food and Rural Affairs (DEFRA) 2014 conversion factors within our reporting methodology. We have also opted to use operational control as the consolidation approach, due to the nature of our business, with employees who are often on customer sites where no operational control is possible. As this approach is inconsistent with the financial statements, we have described the classification of reporting boundaries in detail in our Basis of Reporting 2014 document, which is available on our website, www.serco.com.

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

The sum of all estimated emissions is below x5% of our global emissions, so we consider the potential error to be immaterial.

Scope of reported emissions

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

Division	Country
ASPAC	Australia & New Zealand
Middle East	Bahrain Hong Kong India UAE
Americas	USA Canada
Global Services	Australia India Ireland UK
Central Government Local and Regional Government	UK Ireland

The emissions that have not been included in this year's report relate to refrigerant gases from air conditioning and refrigeration outside the UK. After analysis, we believe these emissions are immaterial.

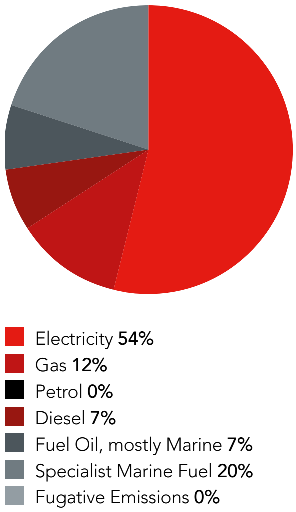
For countries where we have very limited operations, such as Dominican Republic and Virgin Islands where we have fewer than ten employees we have undertaken a materiality assessment and consider that the related emissions are not material and are therefore excluded.

Intensity ratio

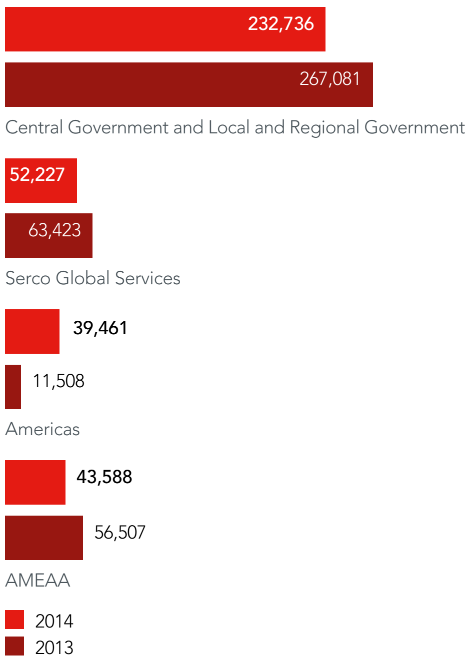
To express our annual reported emissions in relation to the scale of our activities, we have used full time equivalents (FTE) as our intensity ratio. This is the most relevant indication of the constantly changing nature of our business and provides the best comparative measure over time.

Our frontline operations have an emissions intensity of 6.86 tonnes CO_2e per FTE whilst our back office operations reported significantly less at 1.03 tonnes CO_2e per FTE. Combined our normalised emissions are 3.80 tonnes CO_2e per FTE which is a 6% improvement on 2013 (4.04).

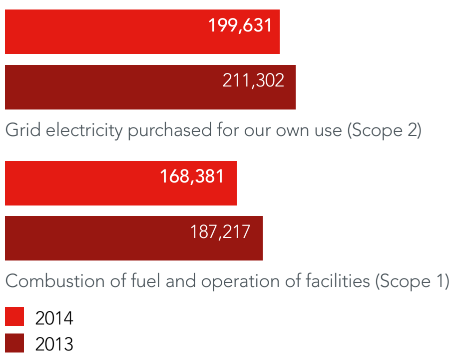
% breakdown 2014 by emission type



Summary of emissions by Corporate Divisions (tonnes CO_2e) 2014 v 2013



Global Scope 1 and 2 emissions in tonnes 2014 v 2013



Directors' Report

P76-131

Directors' Report

Corporate Governance Report

Chairman's governance overview

Dear shareholder,

As Chairman of the Board, I am pleased to present the Company's Statement of corporate governance on behalf of the Board.

This report sets out the Company's governance policies and practices and includes details of how the Company applies the principles of the UK Corporate Governance Code. At Serco, we are committed to achieving high standards of corporate governance, integrity and business ethics in all of our activities. Serco's framework of governance ensures the best interests of all our stakeholders – our customers, our employees, our shareholders, and the societies and communities of which we are a part – are uppermost in all our minds as we go about our business, and that where these interests are not directly aligned, we make decisions on the basis of what is right: this is an essential part of our public service ethos.

Last year I reported that in 2013 we found ourselves challenged at the heart of the way in which we do business. A number of individuals were found to be acting outside our values as epitomised by our Governing Principles and our framework of governance had not identified sufficiently clearly the root causes that had allowed this to happen. This challenged the trust in which we are held by our customers, our employees, and society at large. During 2014, the Company implemented a comprehensive Programme of Corporate Renewal to deliver stronger, more effective governance, organisational change and operational resilience across the Group going forward. The Corporate Renewal programme was wide-ranging and included a relaunch of the Company's management system (the Serco Management System: SMS), the introduction of new contract reporting and bidding procedures including a review of delegation thresholds, the simplification of internal board structures to enhance transparency and accountability, the introduction of a risk operating model and new SMS compliance arrangements, and a comprehensive global staff and management training programme covering a variety of mandatory modules which support the above.

In the following pages, we illustrate how our governance arrangements work in practice focusing on the key elements of the Board's role: leadership, effectiveness, accountability and engaging with shareholders.

Changes to the Board composition

During the year, there have been a significant number of changes to the Board. Rupert Soames was appointed as Group Chief Executive Officer, Ed Casey was appointed Group Chief Operating Officer in May following a period as Acting Group Chief Executive Officer subsequent to Chris Hyman's resignation and Angus Cockburn as Group Chief Financial Officer. Three new Non-Executive Directors were appointed to the Board in 2014, adding considerably to the available range of senior business and Board experience. Mike Clasper assumed the role of Senior Independent Director in September, having joined the Board in March. Rachel Lomax and Tamara Ingram also joined in March, Rachel to take the chair of the newly created Corporate Responsibility and Risk Committee, whilst Tamara has joined our Remuneration Committee. Taken together with our executive appointments, Serco has a strong Board to steer the Company through its recovery over the next few years.

In 2015, I shall stand down as Chairman once my successor has been selected. The process for finding my successor is set out on page 98 of this report.

Leadership and effectiveness

An independent external evaluation of the Board, its Committees and individual Directors was carried out in early 2015. The results of the review have been discussed by the Board and the output will be provided to the incoming Chairman to provide an initial independent perspective on the Board and how it functions. The Board recognises the importance of continual and constructive evaluation of its performance, and will continue to conduct annual performance reviews internally with external input at least every three years.'

Alastair Lyons CBE
Chairman

Compliance statement

Throughout the financial year ended 31 December 2014, Serco Group plc complied fully with all relevant provisions of the UK Corporate Governance Code (the Code) with the exception of membership of the Audit Committee as explained in the Audit Committee Report on page 92. The Code can be found on the Financial Reporting Council's website at frc.org.uk.

Leadership

Our governance framework

Gender diversity	
Male	7
Female	3

Board tenure		
1	< One year	5
2	Between one and three years	2
3	> Three years	3

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

The work that the Company has undertaken in relation to the Corporate Renewal programme has further developed our governance processes both at a Board level and throughout the Group in particular through an enhancement of the Serco Management System.

The role of the Board

The Board is responsible to shareholders for creating and delivering sustainable shareholder value through the management of the Group's businesses. The Board determines the strategic objectives and policies of the Group to deliver such long-term value, providing overall strategic direction within a framework of risk appetite and controls. The Board's aim is to ensure that management strikes an appropriate balance between promoting long-term growth and delivering short-term objectives.

The Board is responsible for demonstrating ethical leadership and promoting the Company's values, culture and behaviours and for acting in a way that promotes the success of the Company for the benefit of the shareholders as a whole.

The Board is also responsible for ensuring that management maintains systems of internal control that provide assurance of effective and efficient operations, internal financial controls and compliance with law and regulations. In addition, the Board is responsible for ensuring that management maintains an effective risk management and oversight process at the highest level across the Group. In carrying out these responsibilities, the Board must have regard to what is appropriate for the Group's business and reputation, the materiality of the financial and other risks inherent in the business and the relative costs and benefits of implementing specific controls. The Board is also responsible for deciding other matters of such importance as to be of significance to the Group as a whole because of their strategic, financial or reputational implications or consequences.

Specific key decisions and matters have been reserved for approval by the Board. These include decisions on the Group's strategy, approval of risk appetite, capital and liquidity matters, major acquisitions, mergers or disposals, Board membership, financial results and governance issues, including the corporate governance framework.

Directors' Report

Corporate Governance Report continued

Leadership

Meet the Board

Alastair Lyons CBE (61)

Role:
Chairman

Appointment:
Alastair was appointed a Non-Executive Director of Serco Group plc in March 2010, becoming Chairman at the conclusion of the Company's AGM in May 2010. As announced on 17 November 2014, Alastair will step down once a new Chairman has been appointed.

Responsibilities:
Alastair is responsible for the effective operation of the Board and oversight of corporate governance. He is Chair of the Nomination and Board Oversight Committees and a member of the Remuneration and Corporate Responsibility and Risk Committees.

Experience:
In his executive career Alastair was Group Finance Director and subsequently Chief Executive of the National & Provincial Building Society. When the society was acquired in 1996 by Abbey National he joined the Abbey National main Board as Managing Director of its Insurance Division. In 1997 he became Chief Executive of the pension's specialist NPI where he led its demutualisation and acquisition by AMP, subsequent to which he joined NatWest in 1999 as Director of Corporate Projects. A chartered accountant with an MA in economics from Trinity College Cambridge, Alastair has been a Non-Executive Director of, successively, the Department for Work & Pensions and the Department for Transport. He was awarded the CBE in 2001 for his services to social security.

External appointments:
Since 2000 Alastair has been Chairman of Admiral Group plc, the direct motor insurer, and in 2008 he was appointed Deputy Chairman of Bovis Homes Group PLC, one of the UK's leading quoted house-builders. In February 2011 he was appointed Chairman of the Towergate Insurance Group.

Rupert Soames, OBE (55)

Role:
Group Chief Executive Officer

Appointment:
Rupert joined Serco as Group Chief Executive Officer on 1 May 2014.

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

Experience:
Prior to joining Serco, Rupert served for 11 years as the Chief Executive of Aggreko plc, the FTSE-100 temporary power business. During his tenure at Aggreko, the market capitalisation of the business increased from £450m to over £5bn. Prior to Aggreko, he was with the software company Misys plc for five years, latterly as Chief Executive of its Banking and Securities Division. He spent the first 16 years of his career at GEC plc; in the last four years of his service at GEC he was responsible for the UK, African and Asian operations of Avery-Berkel. He studied Politics, Philosophy & Economics at Oxford University and was President of the Oxford Union.

External appointments:
Rupert is Senior Independent Director of Electrocomponents plc and a member of its remuneration, nomination and audit committees.

Angus Cockburn (51)

Role:
Group Chief Financial Officer

Appointment:
Angus joined Serco on 27 October 2014 as Group Chief Financial Officer.

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

Experience:
Angus joined Serco from Aggreko plc, the FTSE-100 temporary power business, where he served 14 years as Chief Financial Officer and latterly, Interim Chief Executive. Angus brings corporate finance and accounting experience, gained across a variety of sectors whilst working for highly competitive global companies. During his tenure at Aggreko he drove through a programme of continuous improvement within the finance function.

Prior to Aggreko, Angus spent three years as Managing Director of Pringle of Scotland, a Division of Dawson International Plc; five years at PepsiCo Inc. in a number of senior finance positions, including Regional Finance Director for Central Europe; and several years at KPMG working in the UK and USA. Angus is an Honorary Professor at the University of Edinburgh.

External appointments:
Angus is an experienced Non-Executive Director and is currently serving on the Board of GKN plc where he is a member of the audit, remuneration and nomination committees.

Edward J Casey, Jr (56)

Role:
Group Chief Operating Officer

Appointment:
Ed was appointed Group Chief Operating Officer in May 2014 after serving as Acting Group Chief Executive Officer following his appointment to the Board in October 2013.

Responsibilities:
Ed is responsible for the day-to-day operations of the Group, ensuring that the business is efficient and effective and that proper service to customers is conducted.

He is a member of the Board Oversight Committee.

Experience:
Ed has been with the company since 2005. Previously, Ed was Chief Executive Officer of Serco's Americas Division. He is also a member of the Executive Committee. Under Ed's leadership, the Americas business tripled in size and successfully integrated two acquisitions: RCI in 2006 and SI International in 2008.

Prior to Serco, Ed worked for nine years in the energy business, including President and Chief Executive Officer of NP Energy Inc., an energy marketing business he founded and later sold; President and Chief Operating Officer of Tenneco Energy until it was sold for $4bn; and as Group President and Chief Financial Officer for LG&E Energy Corp. Previously, Ed worked over ten years in investment banking and private equity, including with The Blackstone Group and Fremont Group LLC

External appointments:
None

Mike Clasper, CBE (61)

Role:
Non-Executive Director

Appointment:
Mike joined Serco as a Non-Executive Director in March 2014 and was appointed Senior Independent Director in September 2014.

Responsibilities:
Mike is Senior Independent Director and a member of the Corporate Responsibility & Risk, Audit and Nomination Committees.

Experience:
Mike was previously the Group Chief Executive of BAA plc from 2003 to 2006 and Chairman of HMRC from 2008 to 2012. Mike was previously the Senior Independent Director at ITV PLC from which he stepped down on 31 December 2013 after eight years on the ITV Board. Mike has an MA in Engineering from St John's College, Cambridge. In 1995 he was granted the title CBE, and received an Honorary Doctorate from Sunderland University.

External appointments:
Mike is currently Chairman of Coats Group plc and Which? Limited. Mike has also been appointed President of the Chartered Management Institute (CMI) from October 2014.

Ralph D Crosby, Jr (67)

Role:
Non-Executive Director

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

Responsibilities:
Ralph is a member of the Board Oversight Committee.

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

External appointments:
Ralph is a Non-Executive Director of American Electric Power Co Inc. in the United States and Airbus Group, N.V. in the Netherlands.

Tamara Ingram (54)

Role:
Non-Executive Director

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

Responsibilities:
Tamara is a member of the Corporate Responsibility & Risk and Remuneration Committees.

Experience:
Tamara is Executive Vice President at WPP, where she is Managing Director at Grey Group and CEO, Team P&G. In 2013 Tamara stepped down after completing nine years as a Non-Executive Director of The Sage Group plc. Previously, Tamara chaired the Board of Visit London (formerly the London Tourist Board) from 2001 – 2011.

External appointments:
Tamara is currently a Trustee of Save the Children (UK).

Rachel Lomax (69)

Role:
Non-Executive Director

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

Responsibilities:
Rachel is the Chair of the Corporate Responsibility & Risk Committee and a member of the Audit Committee.

Experience:
From 2003 to 2008 Rachel was Deputy Governor (Monetary Policy) of the Bank of England and was previously Permanent Secretary at the Department for Transport, the Department for Work and Pensions (formerly the Department of Social Security) and the Welsh Office.

External appointments:
Rachel is a Non-Executive Director of HSBC Holdings plc, Heathrow Airport Holdings Limited, and a member of the supervisory board of Arcus European Infrastructure Fund.

Rachel is a trustee/board member of Imperial College London, the Institute of Fiscal Studies (of which she is also President), Ditchley Park, Breugel and City UK.

Angie Risley (56)

Role:
Non-Executive Director

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

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

Experience:
Previously, Angie was Group HR Director at Lloyds Banking Group and prior to that she was Executive Director of Whitbread plc until May 2007, having joined the Whitbread Group in 1989. She has also been a member of the Low Pay Commission, and a Non-Executive Director of Biffa plc and Arriva plc.

External appointments:
Angie is currently the Group Human Resources Director of J Sainsbury plc, and a member of the Sainsbury's Operating Board.

Malcolm Wyman (68)

Role:
Non-Executive Director

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

Responsibilities:
Malcolm is Chairman of the Audit Committee, he is also a member of the Remuneration, Nomination and Board Oversight Committees.

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

External appointments:
Malcolm is a Non-Executive Director and Audit Committee Chairman of Imperial Tobacco Group plc and Senior Independent Director and Audit Committee Chairman of Nedbank Group Limited in South Africa.

Directors' Report

Corporate Governance Report continued
Leadership

Roles on the Board

Chairman

- Leads the Board and ensures that it is effective in all aspects of its role.
- Takes a leading role in determining the structure and composition of the Board, and its capabilities.
- Manages the business of the Board, ensuring that it facilitates the Board to fulfil its role and function and, in doing so, ensuring that:
  - the Directors receive timely, accurate, concise and clear information.
  - the Board invests sufficient time on each matter for effective consideration and decision-making, in keeping with the relative importance of each matter and especially for complex or strategically important issues.
- Provides appropriate counsel and support to the Group Chief Executive whilst respecting executive responsibility.
- Takes a leading role in the development and succession needs of the Board, and the effective performance of each Director, including:
  - promoting the effective contribution of the Non-Executive Directors.
  - ensuring that new Directors receive an effective induction.

Group Chief Executive Officer

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

Group Chief Financial Officer

- Provides leadership in the continuous evaluation of short and long-term strategic financial objectives.
- Provides accurate and timely financial information and analysis to ensure performance trends are clear and decision-making is based on rigorous financial analysis.
- Directs and oversees all aspects of the Finance and Accounting functions of the Group including the recruitment and development of the team; responsible for Tax, Treasury and Investor Relations
- Evaluates and advises the Board on the impact of long range planning, introduction of new programs/strategies and accounting standards.
- Provides the Executive Committee with advice on the financial implications of business activities.
- Manages processes for financial forecasting, budgets and consolidation reporting.
- Ensures that effective internal controls are in place and ensures compliance with appropriate accounting regulations for financial and tax reporting.

Chief Operating Officer

- Leads the day to day implementation of the Group's strategic and operational plans.
- Directs the following Group functions: Corporate Strategy, Mergers & Acquisitions, Information Technology, Communications & Government Relations, Corporate Shared Services, and Compliance & Risk Management.
- Provides oversight of the day-to-day operations of the business. Alongside the Group Chief Financial Officer leads the monthly Divisional Performance Reviews.
- Supports the Group Chief Executive Officer in strategic planning and developing and executing implementation plans, including plans to drive growth through the development of global capabilities and to achieve operational improvements and cost savings by better utilising corporate shared services and lean principles.
- Chairs the Group Investment Committee review and approval of investment decisions, including acquisitions and disposals, bid approvals and parent company support mechanisms.
- Accountable for delivery of the Corporate Renewal Programme, including responsibility for the Serco Management System, the accurate reporting of operational performance indicators and the adoption of robust compliance and risk management processes.
- Working with the Group Chief Information Officer, ensures that the information systems are appropriate to support the operational performance of the Group and the delivery of the strategic plan, and are robust in terms of data and information security.
- Has oversight over insurance and pensions matters.

Roles on the Board

Senior Independent Director

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

Non-Executive Directors

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

Company Secretary

- Responsible for advising the Board on all corporate governance matters.
- Assists the Chairman in ensuring that all Board procedures are followed and that there are good information flows, together with facilitating induction programmes for newly appointed Directors.

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

Conflicts of interest

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

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

Directors' Report

Corporate Governance Report continued

Leadership

How the Board operates

The Board and its committees

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

Many key Board responsibilities are referred to four standing Board Committees: the Audit, Nomination, Remuneration and Corporate Responsibility & Risk Committees. This structure allows particularly detailed or complex matters to be given special scrutiny and oversight. The Board has a fifth committee, the Approvals and Allotments Committee. This Committee comprises the Executive Directors and the Company Secretary and meets on an ad hoc basis to approve proposals that have more operational significance but do not merit full Board consideration.

There is a sixth Committee, the Board Oversight Committee, which was formed in 2013 to oversee the Corporate Renewal Programme. The Board Oversight Committee will remain in place to monitor the further embedding of the policies and procedures that have been put in place as part of the Corporate Renewal Programme.

Except where decisions are specifically delegated, each Committee reports and submits recommendations back to the Board for its review and, where necessary, decision. Each Committee operates within clearly defined terms of reference, which are reviewed annually by the respective Committees and, if necessary approved by the Board, to ensure they remain appropriate and reflect any changes in good practice and governance. The Terms of Reference are all available online at www.serco.com.

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

The Board and the four standing Committees meet with sufficient frequency to fulfil their respective responsibilities, using structured but flexible agendas to ensure that regular matters are addressed properly, while allowing time to discuss significant new issues. More information on the work and performance of the Board can be found in the following pages. Separate reports describing the activities of the Audit, Board Oversight, Corporate Responsibility & Risk, Nomination, and Remuneration Committees are presented on pages 92 to 125.

Conduct of meetings

Board meetings are scheduled eight times a year. The Company uses an electronic portal to ensure that papers are provided in a timely manner. Board meetings are held over one, two or three days and are structured to allow open discussion of the strategy and trading and financial performance of the Group. To facilitate a proper understanding of the Group's businesses, Board and Committee meetings are held at varying locations and the opportunity is used to combine the formal business of the Board with site visits and Divisional presentations and discussions. Additional Board meetings are held as required.

Board decisions are usually taken by consensus. Exceptionally, if a decision is to be taken by vote, the Chairman has a second or casting vote.

Reserved matters

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

- the Group strategy;
- annual financial and operating plans;
- major contract bid decisions, capital expenditure, acquisitions or divestments;
- annual and half-year financial results and satisfying itself as to the integrity of financial information;
- the Company's dividend policy;
- ensuring there are adequate succession plans for the Board and senior management;
- appointing and removing Directors, the Company Secretary and committee members;
- setting and reviewing risk management and treasury policies;
- setting levels of operational delegated authorities;
- agreeing the Group's culture, values, and ethical compass;
- reviewing the Group's overall governance arrangements;
- reviewing the effectiveness of the Group's system of internal control and risk management processes.

Other specific responsibilities are delegated to Board Committees which operate within clearly defined terms of reference. Details of the responsibilities delegated to the Committees are given on pages 92 and 100. Each Committee has an appropriate balance of skills, experience, independence and knowledge of the Group.

Effectiveness

The work of the Board

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

At its meetings during the year, the Board discharged its responsibilities and, in particular, reviewed the following areas. In addition the Board gave specific focus to the Programme of Corporate Renewal, the Contract and Balance Sheet Reviews and the proposed rights issue scheduled for April 2015:

Strategy and transformation	The Group and Divisional corporate strategies, transformation plans, portfolio management and the Group's health and safety strategy.
Funding and capital	Review of the Group's capital and funding structure to support the new strategy, Treasury policy.
Investor relations	Investor feedback and analyst meetings following the release of the full year 2013 and half year 2014 results.
Business performance	The operational performance of each of the Divisional businesses, and periodic updates presented by the Divisional Management Teams.
Governance	Work undertaken with regard to the Corporate Renewal Programme referred to above and in particular forming the Corporate Responsibility and Risk Committee of the Board and the recruitment of new Executive Directors and three Non-Executive Directors.
Financial and risk management	The Group's business plans, presentations on the Group risk register and significant areas of risk.
Diversity, talent and succession	Presentation from Group Human Resources and Talent Directors on talent management and development across the Group.

Board effectiveness

Balance

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

Induction, training and ongoing development

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

- an overview of the Group's businesses, risks, governance arrangements and relations with investors;
- structured meetings with a range of relevant senior managers from across the Group;
- meetings with key advisors and shareholders as appropriate to the Director's role; and
- site visits to gain first-hand insight into operational contracts with major customers.

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

As part of its annual evaluation process, the Board considers the training needs of the Directors and the Company Secretary. Development needs fall within the remit of the Chairman, who reviews and agrees these with each individual. All Board members are encouraged to attend relevant external training courses at the Company's expense. More information on Board evaluation can be found on page 86. Induction programmes including site visits and meetings with senior executives of, and advisors to, the Group for Rupert Soames, Mike Clasper, Tamara Ingram and Rachel Lomax were successfully completed and a programme for Angus Cockburn who joined the Board on 27 October 2014, is under way. All Directors continue to undertake programmes of contract visits and meetings with senior executives.

Board independence

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

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

Directors' Report

Corporate Governance Report continued

Effectiveness

The Board considered the Chairman to be independent on his appointment in 2010. The Nomination Committee keeps the Board's diversity, balance and independence under review, the details of which can be found on page 85.

The terms and conditions of the appointment of the Directors are summarised in the Directors' Remuneration Report on page 111 and are available on request from the Company Secretary.

Re-election of Directors

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

Notwithstanding the above, in accordance with provisions contained within the UK Corporate Governance Code, all Directors retired and stood for re-election at the 2014 AGM and will do so, on an annual basis, at each AGM. Their names are set out in the Notice of Annual General Meeting.

Time commitment and external Directorships

As part of the Board evaluation process, the available time commitment of each Director is considered. The Board considers that the Executive Directors can gain valuable experience and knowledge through appropriate and limited non-executive appointments in other listed companies or independent sector organisations. The Board is careful to ensure that any such appointments do not present any material conflicts of interest to Serco, or compromise the effective management of the Group, and these are approved in advance of any appointments being taken up. Details of the fees received by Executive Directors for external appointments can be found in the Directors' Remuneration Report on page 103.

Board attendance

The frequency and content of Board meetings are reviewed by the Board annually. During the year there were seven scheduled Board meetings and five additional meetings, five scheduled Remuneration Committee meetings and seven additional meetings; three scheduled Audit Committee meetings and two additional meetings and three scheduled Nomination Committee meetings and one additional meeting.

The attendance of the individual Directors at Board and Committee meetings of which they were members during 2014 was as follows:

	Board	Audit	Remuneration	Nomination	Corporate Responsibility	Board Oversight
Number held	12	5	12	4	4	7
Alastair Lyons	12	n/a	11	2	4	6
Edward J. Casey, Jnr	12	n/a	n/a	2(2)	4	7
Angie Risley	12	1(1)	12	4	n/a	n/a
Ralph D. Crosby Jr.	11	n/a	n/a	n/a	n/a	4
Malcolm Wyman	12	5	12	4	n/a	6
Rupert Soames	9(9)	n/a	n/a	3(3)	2(2)	n/a
Angus Cockburn	4(4)	n/a	n/a	n/a	n/a	n/a
Mike Clasper	8(9)	4(4)	n/a	3(3)	3(3)	n/a
Rachel Lomax	9(9)	4(4)	n/a	n/a	3(3)	n/a
Tamara Ingram	9(9)	n/a	4(8)	n/a	2(3)	n/a

Notes:

1. The table excludes attendances of Directors who attended committee meetings by invitation only.
2. Where a number is given in brackets against a Director's attendance, this is the number of meetings which took place during their tenure.
3. There were two Nomination Committee meetings in the year which Alastair Lyons did not attend as the Committee was discussing the recruitment of the replacement Chairman.

Performance evaluation

A formal independent effectiveness review of the Board, its Committees and individual Directors was carried out in early 2015 in respect of the year ended 31 December 2014 and was facilitated externally by CTMC&A Limited, an independent company with no connections to the Board. CTMC&A Limited has previously facilitated an effectiveness review of the Board. The results have been discussed by the Board. The output will also be provided to the incoming Chairman to provide an initial independent perspective on the Board and how it functions.

Given Alastair Lyons' intention to step down once a new Chairman has been appointed, no review of the Chairman has been carried out since February 2014.

Accountability

Managing business risks and internal control

The events of 2013 identified the need for the company to reassess its framework of management and control, strengthening the three lines of defence provided by management assurance, risk management, and internal control, and revisiting the entirety of the Serco Management System (SMS) that represents the codification of the Group's control structure. Much of this reassessment was undertaken as part of the reviews undertaken to establish the Corporate Renewal Programme agreed as appropriate with the UK Government in January 2014 and subsequently entered into implementation across the Group's trading activities, accompanied by the appropriate leadership and training. The revision of the SMS focused in particular on the processes and controls appropriate to contract bidding and contract management taking on board the learning from the Contract & Balance Sheet Reviews carried out in 2014. As part of the redefinition of the system of management control, particular emphasis has been placed on establishing appropriate performance review structures with relevant clear and timely management information to enable effective management oversight of the Group's decentralised organisation structure.

Serco has a system of internal control, including financial, operational and compliance controls and risk management, designed to safeguard shareholders' investments, our assets and our reputation. The Board has overall responsibility for our internal control system and for reviewing its effectiveness, and has delegated to management the implementation of policies on risk and control.

Risk management is fundamental to how we manage the business; it informs decision-making and aligns to the organisation's strategic objectives. The actions identified, and in the course of being implemented as a result of the Corporate Renewal Programme, are designed to further develop and strengthen our structure of internal control and risk management having regard to the breadth and depth of the Group's activities. All parts of the business have appropriate crisis management plans that meet defined policy standards.

During the year, the Board has conducted a review of the effectiveness of the Company's risk management and internal controls systems, which excluded a review of internal controls at joint ventures.

Whilst Divisional Boards review the risks they face on a quarterly basis, the Executive Committee also reviews them quarterly to provide governance and oversight of risk across the Group. The Corporate Responsibility & Risk Committee of the Board receives a quarterly report on the Executive Committee's assessment of the principal risks facing the Group and the action being taken by management to mitigate risks that are outside of the Group's risk appetite.

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

Such systems and processes, however, can only be designed to mitigate, rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against misstatement or loss. The Board confirms that this process has been in place for the year under review and up to the date of approval of the 2014 Annual Report and Accounts.

Our approach to risk within the Serco Management System

Significant work was completed in 2014 to review, revise and better align the policies and standards that make up the Serco Management System with business operations and core management processes around our business lifecycle. Inherent within this is our approach to risk management and management assurance.

The review highlighted the need for greater clarity around the processes we expect to be in place and their associated controls that demonstrate compliance and ensure risks are being managed. This included better definition of the gate processes which are our principal controls at different stages through our business lifecycle and ensure effective management oversight and management of risks.

As a result of this work we have defined within the Group Standards that support each of our policy areas the processes and associated controls that must be in place along with clear definition of those responsible for ensuring compliance. It is these controls that manage or mitigate risks faced by the business.

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

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

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

Directors' Report

Corporate Governance Report continued

Accountability

Risk identification

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

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

Risk assessment

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

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

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

Risk planning and control

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

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

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

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

Risk monitoring

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

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

Managing and mitigating risk

The objective of our risk management process is to provide a governance overview of our operational risk profile. Operational risk can never be eliminated; risks are necessary to achieve targeted benefits (risk management informs decisions). However, while risk is necessary, we seek to minimise the probability and impact of threats through the consistent implementation of the SMS, ensuring that appropriate infrastructure, controls, systems, staff and processes are in place.

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

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

Group risk function

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

Internal audit

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

During 2014, there was a change in administrative reporting lines of the Group Head of Internal Audit from the Group Chief Executive Officer to the Group Chief Financial Officer. The administrative reporting line of the Group Head of Internal Audit has been reviewed in the light of the implementation of changes arising from the Corporate Renewal Programme and it is now considered that the Group Chief Financial Officer is a more appropriate reporting line. Functionally, the Group Head of Internal Audit reports to the Chair of the Audit Committee and is responsible for delivery of the internal audit programme, ensuring that it is risk-based and aligned with the overall strategy of the Group. The Group Head of Internal Audit also makes regular reports to the Corporate Responsibility and Risk Committee. Internal audit is delivered using a mix of co-sourced and in-house resources. Each Division reviews the results of relevant internal audits four times a year. The findings of the overall internal audit programme are reported directly to the Board's Audit Committee. The effectiveness and resourcing of our internal audit capability has been specifically reviewed as part of our Corporate Renewal Programme.

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

Directors' Report

Corporate Governance Report continued

Accountability

Financial reporting process

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

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

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

Management assurance

Management assurance is part of the business assurance process. Each Division is required to carry out a programme of management assurance to provide comfort that the Division is managing its risks effectively and in compliance with the SMS. The results of the programme are reviewed by the Divisional Executive Management Teams. A compliance sign-off statement is received from each Divisional CEO and reviewed by the Audit Committee to confirm that known risks are being managed, Group internal controls are being implemented and that there are no known control failures that present an unmitigated material risk to the division or the Group.

As part of the 2014 redefinition of the Serco Management System we have introduced a specific Group Standard on compliance to ensure a consistent approach across the Group in regard to management assurance. In 2014 we developed a self-assessment tool to enable contracts to assess their compliance with the SMS and plan actions to close any gaps. This will be rolled out in 2015.

Business conduct

Serco Group operates within a management system that defines the policies, standards and processes to be applied wherever we operate. Integral to this is our policy on Business Conduct and Ethics that applies to all business Divisions, operating Companies and business units throughout the world. This policy outlines the Group's position on a wide range of ethical and legal issues including conflicts of interest, financial inducements, human rights and legal and regulatory compliance. It applies to Directors and to all employees regardless of their position or location. Recognising that ethical dilemmas may arise in a growing company, the Group has an ethics consultation process that is to be followed to determine the Group's position on particular issues. As the leadership of the Company, the Executive Committee will make judgements about what it considers acceptable with reference, where appropriate, to the Corporate Responsibility and Risk Committee.

We have established the Corporate Responsibility and Risk Committee of the Board which provides oversight of our approach to Corporate Responsibility and its governance, ethics, risk management, security and health, safety and environment matters. In 2014 we further strengthened ethical governance across the business with the appointment of Ethics Leads responsible for the development and implementation of the Division's ethics and compliance programme in line with Group strategy and assessed risks. We have also updated and reissued our Code of Conduct (www.serco.com/codeofconduct); launched an intranet based gifts and hospitality register and updated our Say No Toolkit (serco.saynotoolkit.net); and fully implemented across the Group an online case management system, provided by a third party independent provider, to support our whistle-blowing 'Speak Up' process.

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

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

Going concern

The Directors have acknowledged the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' and 'An update for Directors of Listed Companies: Responding to increased country and currency risk in financial reports', published by the Financial Reporting Council in October 2009 and January 2012 respectively. This is discussed in the Finance Review starting on page 45.

Engaging with shareholders

How we engage with shareholders

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

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

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

Investor meetings

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

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

Annual General Meetings (AGMs)

The AGM provides an opportunity to communicate with all shareholders, especially our private shareholders. Individual shareholders have the opportunity to question the Chairman and, through him, the Chairs of the various Board Committees and other Directors. The Notice of Meeting sets out the resolutions being proposed at the AGM to be held on 6 May 2015. It is the Company's policy at present for all resolutions to be voted at a general meeting by way of a poll. A poll reflects the number of voting rights exercisable by each member and is considered by the Board to be a more democratic method of voting. Shareholders are advised of the total number of votes lodged for each resolution, in the categories 'for' and 'against' together with the number of 'votes withheld'. This information is also posted on the Group's website www.serco.com.

Formal consultations

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

Direct communications initiated by shareholders and representative bodies

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

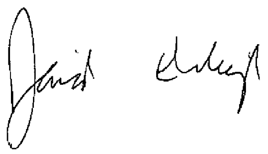
External advisors

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

Corporate website

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

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



David Eveleigh
Secretary
12 March 2015

Directors' Report

Audit Committee Report

Chairman's overview

The Audit Committee's primary roles are to support the Board in monitoring and reviewing the integrity of the Company's financial information, ensure that the internal controls are robust and operating properly, and to make recommendations to the Board in relation to the re-appointment of the Company's external auditor.

During the financial year, the Group undertook a Strategic Review (as more fully set out in the Strategic Report on pages 29 to 30) which encompassed, inter alia, detailed reviews of the Group's contracts and balance sheet in order to provide it with a stable financial foundation for future growth. The Group also renegotiated the terms of its existing loan financing agreements and put in place arrangements to carry out a rights issue in the first quarter of 2015. The Contract and Balance Sheet Reviews' outcomes include significant provisions being made for onerous contracts, significant impairments for goodwill, other intangible assets and tangible assets, and other related provisions and charges being made, all as described in the Financial Review on pages 45 to 66. The Review has required significant judgements to be made by management, and the key judgements and how these issues were addressed by the Audit Committee, are included in this report.

The principal responsibilities of the Audit Committee are:

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

A copy of the Committee's full Terms of Reference is available online at www.serco.com.

Membership and meetings

The Audit Committee consists of Non-Executive Directors only with all members being independent Non-Executive Directors.

The Committee currently comprises Malcolm Wyman, who chairs the Committee, Mike Clasper and Rachel Lomax. All members of the Committee are considered to meet the Code's requirement of having recent and relevant financial experience. The UK Corporate Governance Code sets out that the Committee should have at least three members throughout the year. Until Mike Clasper and Rachel Lomax were appointed to the Committee in March 2014, the Committee had two members and was therefore not in compliance with the UK Corporate Governance Code. In order to maintain effective communications, the Audit Committee invites the Chairman, Group Chief Executive Officer, Group Chief Operating Officer, the Group Chief Financial Officer and the Group Financial Controller to all meetings as well as the Head of Internal Audit, KPMG LLP (the Group's co-sourced internal audit provider), the Senior Statutory Auditor, for Deloitte LLP, and other members of the management team as required. The Chairman of the Audit Committee reported to the Board on how the Committee had discharged its responsibilities.

The Committee met five times during the 2014 financial year, along with three times in 2015 up until the publication of the 2014 results announcement. Of these meetings, four were called specifically to consider matters and announcements relating to the Strategic Review, the Contract and Balance Sheet Reviews and the rights issue, whist these matters were also on the agenda of certain of the meetings held within our normal reporting cycle.

The Committee's Terms of Reference provide that it will meet at least four times per annum at key times within the reporting cycle.

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

Significant issues considered by the Committee

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

- Monitoring the integrity of the financial statements of the Company, including the Corporate Governance Report and statement of Directors' Responsibilities, for inclusion in the 2013 Annual Report and Accounts and also in respect of those for the 2014 Annual Report and Accounts, the 2014 Half Year Report and Auditors' Report thereon and the Interim Management Statements issued during the year.
- The Contract and Balance Sheet Reviews and outcomes, and the disclosures pertaining thereto in various announcements and reporting to shareholders.
- Accounting issues, judgements and information to support the statements including but not limited to going concern, revenue recognition, onerous contract provisions, impairments and exceptional items.
- The annual audit plan of the external auditors and the 2014 external audit fees.
- Pre-approving any fees in respect of non-audit services provided by the external auditors and ensuring that the provision of non-audit services did not impair the external auditors' independence or objectivity.
- Evaluation and independence of the Audit Committee and its members.
- The continuing independence of the external auditors and the effectiveness of the external audit process.
- The implementation of the 2014 internal audit programme and approval of the proposed 2015 programme.
- Reviewing the internal control environment processes and systems.
- The Committee's work plan for the year ahead and a review of its achievements against the Committee's Terms of Reference.

Significant issues and key judgements

Contract and balance sheet reviews

Nature of issue

The most significant issue considered by the Audit Committee in 2014 related to the output from the Contract and Balance Sheet Reviews performed during the fourth quarter. This review was undertaken as part of the Strategy Review that was carried out by the Group in 2014. Full details of the outcome of the Contract and Balance Sheet Reviews are given in the Finance Review on page 49. Given the scale and significance of the resultant impairments and onerous contract and other provisions, the Audit Committee spent a considerable amount of time discussing and challenging management on the significant estimates, assumptions and judgements made by management during the course of the review, and also on the content and outcomes of this review.

Action taken	Outcomes
• Among the elements considered by the Audit Committee was the scope of the review. The Audit Committee supported the engagement of Ernst & Young LLP to provide financial reporting and accounting advice in connection with the Contract and Balance Sheet Reviews, and also challenged the scope of the review to ensure that it was appropriately rigorous. The Audit Committee also considered various principal contract reviews that were being undertaken as part of the Corporate Renewal Programme to ensure that any issues arising from this work were taken into account and included in the Contract and Balance Sheet Reviews.	• The Audit Committee formed the opinion that the initial structured interview and financial review process for segmenting all contracts by risk was appropriate and thorough, and considered, through detailed discussion with Ernst & Young LLP, that the work programme for each category of risk was appropriate.
• The Audit Committee met regularly to review progress and challenge management on the process and results of the Contract and Balance Sheet Reviews. In all, three additional meetings were held prior to the publication of the 2014 Annual Report and Accounts. These meetings reviewed in detail the results of the review and the key accounting papers to assess whether there was any evidence of bias in management's assessment of accounting treatment and determination of the levels of provisioning, and particularly long length and/or complex contracts with inherent uncertain outcomes.	• The Audit Committee considered levels of provisioning including the potential range of outcomes on key contracts and satisfied itself that the overall provisions were appropriately positioned taking account of the range of possible outcomes on long term and complex contracts.
• As part of the Audit Committee's detailed review and challenge, the Committee also focused on whether there was evidence that impairments and provisions should have been identified in a prior year (based on information available, or which should have been available at the time), and might therefore be categorised as errors. To support this work the Committee engaged Ernst & Young LLP to establish whether there was evidence of error or not. The Audit Committee discussed these issues with the External Auditor.	• The Audit Committee concluded that prior period errors that have been identified are immaterial other than in relation to a Treasury adjustment relating to a hedge that is in place and correctly documented in India but for which the original documentary evidence could not be located to confirm the hedge applied at Group level since inception. As a result of this documentation issue, a prior year adjustment was identified to reflect the restatement of financial instruments, giving rise to a net charge of £5.6m against prior year reported profits, which included a net credit to the 2013 income statement of £3.0m. These amounts had previously been taken directly to reserves, and as a consequence there was no adjustment required to restate the net assets of the Group as at 31 December 2013 or prior years. (Further details are included in the Finance Review on pages 45 to 66).
• The Audit Committee reviewed the treatment of items considered as being exceptional and therefore requiring separate disclosure to assist the reader in understanding the results of the Group. Management prepared documentation to support the Financial Statements which was reviewed and challenged by the Audit Committee in light of the guidance issued by the Financial Reporting Council in December 2013, and discussed with the External Auditor.	• The Committee concluded on which items were exceptional, and that they have been reported as such.
• The Audit Committee also considered the appropriateness of the accounting policies and instructed both Ernst & Young LLP and management to carry out a detailed review of policies, and discussed the policies with the External Auditor.	• The Committee concluded that the accounting policies were appropriate.

Directors' Report

Audit Committee Report continued

Tax and deferred tax reporting

Nature of issue

The Group is exposed to various claims raised by tax authorities in the normal course of business, generally in territories outside of the UK. Any such claim is assessed with regards to the local tax laws and makes provisions based on the best estimate of the likely outcome when an unfavourable outcome is considered probable.

The Group recognises deferred tax assets in respect of temporary differences in relation to fixed assets and carried forward losses. These losses largely arose as a result of the settlement with the UK Government in 2013 and trading losses from onerous contracts in both the UK and Australia. At 31 December 2014 total deferred tax assets were £38.6m (2013: £57.9m). Recognising such assets requires an assessment of their likely utilisation recovery, which includes an assessment of the taxable profits expected to be made in each of the relevant jurisdictions.

Action taken	Outcomes
• The Committee has reviewed the summary documentation prepared by management supporting the provisions made and that relating to significant claims not provided for.	• The documentation has been challenged and the Audit Committee is satisfied that the conclusions reached are appropriate. In particular, the Committee agrees with the conclusion reached by management regarding the claim by the Indian Authority for Advance Rulings disclosed in note 32 to the financial statements.
• Consideration has been made as to whether it is appropriate to recognise the full value of the deferred tax asset at the year end and whether the recovery of the associated tax losses can be foreseen. Management have presented the relevant documentation needed to scrutinise the conclusions reached, including forecast information.	• The Committee is satisfied that it is appropriate to recognise the deferred tax assets in the Group's balance sheet. • Contingent deferred tax assets of £180m exist off balance sheet. • Recognised deferred tax assets of £37.4m have been recognised in the balance sheet.

Goodwill and other intangible asset impairment

Nature of issue

The Group has made several acquisitions over the years and has invested in a number of systems and products to benefit future periods, which resulted in carrying values for goodwill of £1,270.8m and other intangible assets of £176.8m. As a result of the Annual Impairment Review, both goodwill and other intangible balances were impaired and the balances remaining at the 2014 financial year end were £820.6m (see notes 20 and 41 to the financial statements,) and £123.8m (see notes 21 and 41 to the financial statements) respectively. Details of the Group's goodwill and intangible assets is provided in notes 20 and 21 to the financial statements, and details of the judgements applied can be found in note 3 to the financial statements. Core to the assessment of the value of the goodwill and other intangible assets is management's estimate of the future cash flows associated with them, which is dependent on circumstances both within and outside of their control, and discount rates that are adjusted to reflect risks specific to individual assets.

Action taken	Outcomes
• The methodology and results of the impairment tests were presented to the Audit Committee by management 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 strategy and forecasts.	• The Committee is satisfied that the assumptions underlying the impairments made in the year are appropriate and that the assessment of the remaining balances is appropriate.
• The disclosures made in the financial statements have been reviewed to ensure that they provide the appropriate level of information to the users of the accounts.	• The Audit Committee have concluded that the disclosures provided in the financial statements are transparent and in compliance with financial reporting requirements.

Going concern

Nature of issue

Consideration of the going concern risk is a fundamental responsibility of the Board of Directors and the Audit Committee has given this matter its full attention. The going concern assertion has a significant impact on the financial statements in terms of both the valuation of assets and liabilities held and the presentation of assets and liabilities as non-current. The Audit Committee has taken due consideration of the guidance issued by the Financial Reporting Council 'Going Concern and Liquidity Risk – guidance for Directors of UK Companies 2009'. Further details of the Directors' assessment of going concern is provided in 65.

Action taken	Outcomes
• The Committee has challenged the going concern assessment prepared by management and reviewed the work performed to support the working capital statement in the Group's Rights Issue prospectus. These issues were discussed with the External Auditor.	• The Committee considers the going concern review to have been rigorous and is satisfied that the conclusion reached is appropriate. The Committee has considered the opinion given by Deloitte LLP in their audit report and it agrees that there is uncertainty due to the dependency of the Rights Issue on shareholder approval. The Committee considers that, on the basis that this can be expected to occur, the assessment of going concern is appropriate.
• Consideration was given by the Audit Committee to the period of review, which is expected to be a period of at least 12 months from the date of approval of the relevant financial statements.	• As the going concern review has been prepared for 24 months to December 2016, the Audit Committee has concluded that the period covered by the review is appropriate.
• The Audit Committee has reviewed the going concern disclosures made in the Annual Report and Accounts to ensure that they are balanced, proportionate, clear and give a true and fair view.	• The Committee is satisfied that page 144 of the Annual Report and Accounts includes detailed disclosures regarding going concern, and in particular disclosure of the conditionality on the Rights Issue and agreements regarding loan financing.

Restructuring costs

Nature of issue

2014 has been a period of unprecedented change for the Group, as a result of the change in executive management and the subsequent Strategy Review. This has had a significant impact on the future direction and focus of the business and includes a Group-wide restructuring programme which will continue through 2015. Management has concluded that these restructuring costs are exceptional in size and nature, and as they are directly linked to the Strategy Review, they are one-off in nature. This conclusion, and determining whether all obligations for future costs have been appropriately provided for at the year-end, requires judgement to be applied. The total charge in 2014 was £32.7m (2013: £14.9m).

Action taken	Outcomes
• Management were challenged regarding the non-recurring nature of the expense to ensure that business as usual costs were not included in this expense. For exceptional provisions documentation prepared by management supporting the treatment was discussed and reviewed.	• The Audit Committee has concluded that it continues to be appropriate to treat these restructuring costs as exceptional and that all obligations have been correctly provided for.

Directors' Report

Audit Committee Report continued

Defined benefit pension schemes

Nature of issue

The Group is responsible for paying contributions into a number of defined benefit pension schemes directly linked to contracts in addition to the main company scheme, Serco Pension and Life Assurance Scheme (SPLAS), and several other small non-contract specific schemes. SPLAS has a significant pension asset at the end of the year of £143.9m (2013: £64.2m) and the other schemes have a combined pension liability of £17.4m (2013: £11.3m). The value of the individual schemes fluctuates due to changes in underlying assumptions, which include the forecast bond yield rates and the forecast inflation rate.

During the year a settlement was reached with the Trustees of the Docklands Light Railway Pension Scheme, a contract specific scheme where a dispute had arisen prior to the end of our obligation period. A total of £35.6m will be paid including legal costs of £2.6m. £33m will be paid in four equal annual instalments from January 2015 to January 2018.

Further details of the pension arrangements can be found in note 34 to the Group's financial statements.

Action taken	Outcomes
• The Committee considered both the process management undertook 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.	• The Committee concluded that the process followed was appropriate and the resulting calculation appropriately balanced.
• The Audit Committee has considered whether the Group is exposed to any additional payments similar to the settlement reached with the Trustees of the Docklands Light Railway Pension Scheme through review of management's risk assessment and after taking advice from both external advisors.	• The Committee agrees with management's assessment that there are no material exposures to potential settlements with Trustees of the schemes into which contributions are paid.

Contingent liabilities

Nature of issue

As with any business, the Group is exposed to a number of potential legal claims and exposures. Where these claims have been assessed as being likely to result in a payment being made to settle an obligation, these amounts have been provided for. No material charges were incurred in 2014. In circumstances where management have assessed that there is a more than remote chance of payment, but less than likely (considered to be in the range of 5% to 50% likelihood), disclosure is made in the notes to the financial statements (see note 32).

Action taken	Outcomes
• The Audit Committee has reviewed the documentation provided to it by the Group's General Counsel. All material matters have been discussed in detail and the assessments made and processes followed have been challenged.	• The Committee is satisfied that management's assessment is complete and the assessment of likelihood for material matters is appropriate.
• The Committee has reviewed the disclosures in the financial statements.	• The Committee agrees that appropriate level of disclosure is made, considering the likelihood of outcomes and the level of commercial sensitivity involved.

Internal audit

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

Effectiveness of internal audit

During the year, the Audit Committee reviewed the effectiveness of the internal audit process. A questionnaire was sent to members of the Committee and to senior finance stakeholders across the Group. Areas covered by the questionnaire included an assessment of the position of the internal audit function in the Company, the internal audit team, and its processes.

The replies to the questionnaire provided good input to support the Audit Committee's assessment of the effectiveness of the internal audit function. Responses were generally positive, and recognised that the department was still in the early stages of a strategic restructuring, and continues to develop.

External auditors

The Audit Committee has responsibility for making a recommendation on the appointment, re-appointment and removal of external auditors. Deloitte LLP was re-appointed as auditor of the Group at the Annual General Meeting held in May 2014. During the year, the Committee received and reviewed audit plans and reports from the external auditor. The external auditors also met privately with the Audit Committee without any member of management or the Executive Directors being present, and meets with the Chairman of the Audit Committee in between Audit Committee meetings.

Non-audit services

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

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

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

Where such services are considered to be recurring in nature, approval of the Committee may be sought for the full financial year at the beginning of that year. Approval for other permitted non-audit services has to be sought on an ad hoc basis: where no Audit Committee meeting is scheduled within an appropriate time frame, approval is to be sought from the Chairman of the Committee (or his nominated alternate). The Committee may establish fee thresholds for pre-approved services and similar approvals are required for work awarded to accounting firms other than Company's auditor, where fees are expected to exceed pre-approved limits. The Group Company Secretary is nominated by the Audit Committee as the point of review and approval for the engagement of non-audit services. The Committee is targeting a cap on fees permitted for non-audit services of 70% of average audit fees over a three year period (non-audit services required by law or regulation do not count against the cap).

The Group has complied with the policy throughout the year. Where appropriate, non-audit services have been provided by companies other than Deloitte LLP to safeguard auditor objectivity and independence. The fees paid to Deloitte LLP for audit, audit-related and non-audit services for 2014 can be found in Note 12 to the Consolidated Financial Statements. The principal areas of engagement of Deloitte LLP for audit-related and non-audit services were commissioned in full compliance with the above policy. The services principally related to taxation advice, IT advisory work and due diligence and other corporate finance advisory services.

Effectiveness of external auditors

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

Audit tendering

The Audit Committee has noted the Competition & Markets Authority's final Order on mandatory tendering and audit committee responsibilities for FTSE 350 companies (the 'Order') as well as the BIS and FRC consultations on options for UK implementation of the EU Audit Directive (the 'Consultation').

The Order applies to financial years beginning on or after 1 January 2015 and is therefore not applicable to the year under review. The Committee notes however that the Order requires mandatory tendering every ten years in line with EU Regulation. As a result of Deloitte LLP being the Company's auditor for in excess of 20 years, for the Company, the transitional arrangements require that there must be a competitive tender process in respect of the external auditor appointment made on or after 17 June 2020.

The Committee also notes the headlines of the Consultation and will keep informed of developments in relation to it. The independence, objectivity and effectiveness of the external auditors have been examined by the Committee and discussions were held regarding their terms of engagement and remuneration. The Senior Statutory Auditor is Richard Knights, who was appointed to the role in respect of the audit for the year ended 31 December 2010. In line with best practice, Richard will be replaced by Jack Kelly in respect of the audit for the year ending 31 December 2015. There are no contractual obligations that restrict the Company's current choice of external auditor. Following an assessment of the independence, objectivity and effectiveness of Deloitte LLP, the Committee recommended to the Board that Deloitte LLP be proposed for reappointment at the forthcoming 2015 Annual General Meeting. This recommendation has been accepted by the Board and will be proposed to shareholders.

Malcolm Wyman
Chair of the Audit Committee
12 March 2015

Directors' Report

Nomination Committee Report

Annual statement by the Chairman of the Nomination Committee

The Nomination Committee has an important role to play in supporting the Board on the following matters:

- Reviewing the size, structure and composition of the Board.
- Recommending membership of Board Committees.
- Undertaking succession planning for the Chairman, Group Chief Executive Officer and other Directors.
- Searching for candidates for the Board, and recommending Directors for appointment.
- Determining the independence of Directors.
- Assessing whether Directors are able to commit enough time to discharge their responsibilities.
- Reviewing induction and training needs of Directors.
- 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.

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

Membership and meetings

The Nomination Committee consists of the Alastair Lyons who chairs the Committee, Mike Clasper, the Senior Independent Director, Angie Risley, Malcolm Wyman and Rupert Soames, the Group Chief Executive Officer. The majority of members are independent Non-Executive Directors.

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

Process for Board appointments

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

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

Principal activities during the year

At its meetings during the year, the Committee discharged its responsibilities as outlined above.

During the year, the Committee considered the recruitment into the role of Group Chief Financial Officer following Andrew Jenner's resignation from the Board. The appointment of Angus Cockburn took effect at the end of October 2014.

In addition, the Company announced on 17 November 2014 that Alastair Lyons had informed the Board of his intention to step down once a new Chairman has been appointed. Mike Clasper, as Senior Independent Director, chairs meetings of the Nomination Committee when they deal with the search for a new Chairman. At the date of this report, the search process is ongoing.

To support the search process for a new Group Chief Financial Officer and Chairman, the Nomination Committee engaged the Zygos Partnership, an independent external executive search consultancy. The Board has previously used Zygos Partnership and the Board confirms the Zygos Partnership is not connected with the Company in any way.

Diversity

The Board strongly supports the principle of diversity and recognises the benefits that diversity can have across all areas of the Group believing this adds to Serco's continued success and advantage. The Board will always seek to appoint on merit against objective criteria, including diversity. When considering the optimum composition of the Board, the benefits of diversity of the Board are appropriately reviewed and balanced where possible, including in terms of differences of skills, industry experience, approach, gender, race, age, nationality, background and other contributions that individuals may bring. The Committee continues to focus on encouraging diversity of thought and experience, recognising that having Directors with diverse skill sets, capabilities and experience gained from different geographic and cultural backgrounds enhances the Board. In addition to Board diversity, the Company believes in promoting diversity at all levels of the organisation. As highlighted earlier in the Corporate Governance Report, the Board has an increased focus on the balance of women in senior executive positions in the organisation, in order to provide opportunities for talented women to become Directors, both Executive and Non-Executive. At present 15% of our senior managers are female and the Board will be seeking to increase this over time.

Alastair Lyons CBE
Chair of the Nomination Committee
12 March 2015

Directors' Report

Corporate Responsibility and Risk Committee Report

Annual statement by the Chairman of the Corporate Responsibility and Risk Committee

The Corporate Responsibility and Risk Committee was originally established as the Corporate Responsibility Committee, which the Board committed to establish under the Corporate Renewal Programme and which is responsible for overseeing the Company's approach to health and safety, its contribution to the communities in which its people live and work; its impact on the environment in which the Company operates; oversight over the effectiveness of the Company's risk management framework including the principal risk facing the Company and the action being taken by management to mitigate risks that are outside the Company's risk appetite. The Corporate Responsibility Committee then became the Corporate Responsibility and Risk Committee to reflect the Committee's full remit.

The Corporate Responsibility and Risk Committee has an important role to play in supporting the Board on the following matters:

- Assisting the Board in providing independent oversight and guidance as to the impact of the Company's Corporate Responsibility related strategy, policies, and practices relating to how the Company conducts its business and its reputation. The Group's Corporate Responsibility framework encompasses our people; health and safety; our interaction with communities; the environment; our marketplace, which covers our relationships with our customers, suppliers and other parties; and our commitment to ethics and business conduct.
- Approving and overseeing the effectiveness of implementation of such strategies, policies and processes
- Monitoring performance against agreed KPIs and targets including the review of relevant elements of employee engagement surveys
- Agreeing the ethical compass and culture of the organisation and the structure and mechanics of its ethical leadership and support
- Reviewing the Company's Code of Conduct
- Ensuring the appropriate progression of issues raised through the Company's 'Speak Up' (whistle-blowing) process and procedures, in particular that root cause analysis is undertaken and acted upon
- Reviewing the Company's stewardship of health and safety
- Reviewing the Company's impact on the environment and the communities in which it operates
- Reviewing the extent to which policies and practices support the fostering of a culture of transparency and openness in dealings with customers, suppliers and other parties
- Overseeing the effectiveness of the Company's risk management framework including the assessment of the principal risks facing the Company and the action being taken by management to mitigate risks that are outside the Company's risk appetite.

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

Membership and meetings

The Corporate Responsibility and Risk Committee is chaired by Rachel Lomax, the other members are Mike Clasper, Tamara Ingram, Alastair Lyons and Rupert Soames.

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

Principal activities during the year

At its meetings during the year, the Committee:

- Discharged its responsibilities as outlined above.
- Reviewed the Company's ethical compass and in particular how to embed the appropriate supporting culture into the Group.
- Reviewed the Group's corporate responsibility framework and how the Group monitors performance and benchmarks with other companies.
- Reviewed the progress on embedding the new risk framework in the Group.
- Reviewed in detail key risks including cyber security and the risk of failure of significant customer programmes.

The Committee received at each of its meetings reports from the business in regard to ethics and 'Speak Up', health safety and environment, security and risk. These included an overview of performance against agreed KPIs and targets as well as initiatives being taken and issues for consideration by the Committee. This included a review of greenhouse gas emissions which are detailed in the Strategic Report (see page 74).

Rachel Lomax
Chair of the Corporate Responsibility and Risk Committee
12 March 2015

Directors' Report

Board Oversight Committee

Annual statement by the Chairman of the Board Oversight Committee

The Board Oversight Committee was established as an ad-hoc Committee of the Board to oversee the process of implementing the Corporate Renewal Programme during the period of its activities. The Board Oversight Committee will remain in place to monitor the further embedding of the policies and procedures that have been put in place as part of the Corporate Renewal Programme.

The key components of the Programme were as follows:

- Revising Serco's Code of Conduct, Values Statement and Governing Principles, supported by extensive training and formalised induction processes and appropriate performance management.
- Comprehensively reassessing and reissuing the Serco Management System, being the Company's framework of management control, to include more prescriptive guidance on required operational processes and procedures and training this into management across the organisation.
- Strengthening contract level governance, including improved contract bid processes to ensure appropriate levels of risk assessment, senior management scrutiny and technical and operational input.
- Enhancing transparency, with robust reporting of operational and financial contract KPIs to both executive management and, in summary, to the Board and its committees.
- Achieving greater engagement of public sector customers at contract and Government departmental level.
- Creating a separate division for our UK Central Government work to achieve both focus on and openness with the UK Government as a collective customer.
- Strengthening risk management compliance and internal audit processes and capabilities.
- Appointing three additional Board Non-Executive Directors.
- Creating the Corporate Responsibility and Risk Committee of the Board to formalise the process of guidance and decision-making on ethical issues.
- Establishing Ethics Officers in each division, accompanied by the redesign of our whistle-blowing process to the highest international standards.
- Measuring the progress of attitudinal change throughout the organisation with ongoing independent culture and ethics reviews.

Membership and meetings

The Board Oversight Committee is chaired by Alastair Lyons and the other members are Ed Casey, Ralph Crosby and Malcolm Wyman. In addition, Lord Gold was appointed as an independent third-party member of the Board Oversight Committee. The majority of members are independent Non-Executive Directors. The Committee met seven times during 2014.

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

Principal activities during the year

The Board Oversight Committee oversaw the implementation of the Corporate Renewal Programme during the year. In October 2014, the Corporate Renewal Programme was reported on by the UK Government's appointed consultants confirming that Serco had identified and understood the causes of previous issues and, through the Corporate Renewal Programme, had put in place cultural and governance structures designed to address those issues and sustain ongoing customer confidence.

The Board Oversight Committee continues to assess and reinforce the Company's ethical compass and assesses the commitment of the Company's leadership throughout the business to 'do what is right' by dealing with customers fairly. It will continue as a committee into part of 2015 to support the embedding of the Corporate Renewal Programme within the Company.

Alastair Lyons CBE
Chair of the Board Oversight Committee
12 March 2015

Directors' Report

Remuneration Report

Dear Shareholder

On behalf of your Board, I am pleased to present our Directors' Remuneration Report for the year ended 31 December 2014.

The Remuneration Committee continues to recognise the clear link between pay and performance and provides information on this in the Report by way disclosures on our reward structure and on our remuneration decisions in line with the recommendations of the UK Corporate Governance Code and the requirements of the UKLA Listing Rules. This Report also complies with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (Regulations).

We have structured the Report into two sections:

1. Directors' Remuneration Policy setting out all elements of our Company's remuneration policy and the key factors that were taken into account in setting that policy. This policy was subject to a binding shareholder vote at last year's General Meeting and will be resubmitted to shareholders for a vote at least every third year.

2. Annual Report on Remuneration setting out payments and awards made to our Directors and an explanation of the link between Company performance and remuneration for the financial year covered by the accounts. This report on remuneration, together with this letter is subject to an advisory shareholder vote at the Annual General Meeting on 6 May.

2014 Overview

As reported in the Strategic Review (pages 2 to 75), we have sought to stabilise Serco with strong new management and additional Non-Executive Directors; a much improved relationship with the UK Government; and clarity as to our strategic direction. Recognising the need for strong and effective leadership, I am delighted with the appointments of Rupert Soames as our new CEO and Angus Cockburn as CFO, and that Ed Casey has taken the role of COO, to which he is able to bring to bear his extensive operational experience of Serco's business. Following their appointments this new leadership team launched a root and branch Strategy Review and a Contract and Balance Sheet Reviews, encompassing a reassessment of the Group's future prospects and the creation of an appropriate capital structure: these are all necessary steps to give our new management team a firm foundation on which to take the Company forward again.

Remuneration outcomes in respect of 2014

2014 Share Awards

The Committee consulted with major shareholders and the voting guidance services in March on the appropriate targets to apply to our long-term incentives for 2014 awards. The targets we intended to use for the 2014 share awards were then summarised in the 2013 Annual Report and Accounts and the 2014 Notice of Meeting.

However, (in advance of making the 2014 share awards), many factors came to a head at the time of our Q1 IMS and provided significantly greater visibility as to the prospects for 2014. We were also very mindful of our key objective to incentivise appropriately our new leadership team to restore Serco's profitability and shareholder value. In light of these factors the Committee reviewed the appropriateness of the targets that we intended to use for the 2014 share awards and concluded that our original targets were no longer realistically attainable and that to grant such an award would be de-motivating rather than achieve our objective of incentivising our leadership.

Given these exceptional circumstances we actively engaged with shareholders in late May and early June and as a result made two overriding changes to the performance conditions for the share awards granted in 2014. First, we extended the performance period for our share price and EPS targets. Recognising that our prospects for 2014 were significantly reduced we concluded that it would take us longer to achieve the targeted financial performance we had set out, albeit that we still wished to incentivise management to achieve the same level of performance.

Second, we adjusted the targets which are expressed on a per share basis to reflect the impact of the placing in May. The placing provided the extra capital needed to support planned earnings with a more appropriate balance sheet structure. Whilst the Committee has sought to maintain, wherever possible, our long-term aspirations for the profitability and the market capitalisation of Serco we have reduced those targets expressed on a per share basis (EPS and share price) to reflect the fact that we now have c10% more shares in issue.

The performance measures for the 2014 share awards are described in more detail in the Implementation Report on pages 120 to 121. These awards are subject to malus, clawback and a holding period.

Leadership changes

I provided details of the terms on which Rupert Soames was appointed as our new CEO in my letter accompanying last year's Directors Remuneration Report. Ed Casey's base salary and bonus opportunity remained unchanged following his appointment to Group COO, full details of his package being detailed in the 'At a glance' table on page 103.

During 2014 Andrew Jenner resigned as Group Chief Financial Officer and Angus Cockburn was appointed. He joined the Company on 27 October 2014 on a base salary of £500,000, with a first review date of 1 April 2015, and will receive a pension supplement of 30% of salary. His incentives are in line with the remuneration policy approved at our 2014 AGM. In order to compensate him for awards he had forgone at Aggreko as a result of joining Serco, Angus also received an initial one-off long-term incentive award of 135% of salary under the PSP and an award of shares vesting over the period to 16 April 2017. The performance conditions for the one-off PSP award were relative TSR, Share Price and strategic objectives. Any Aggreko awards that had performance conditions attached were replaced with Serco awards with performance conditions. Angus will also receive a payment of £111,068 to compensate him for the pro-rated (three months) of bonus that he would have received from Aggreko in respect of the final three months of 2014 had he not left to join Serco.

Directors' Report

Remuneration Report continued

As communicated at the time, and as described elsewhere in this Report, Andrew Jenner only received his contractual entitlement of 12 months payment in lieu of notice, paid on a phased basis and subject to mitigation. He was allowed to retain the 2012 Performance Share Plan (PSP) and Deferred Bonus Plan (DBP) awards that were due to vest within his notice period. However, as the threshold performance conditions for these awards were not met, they lapsed entirely and no payment was made. He has also voluntarily waived any entitlement to bonus in respect of 2014.

2014 Bonus Awards

Our new leadership team have made an outstanding contribution to putting Serco on the path to recovery, putting in place cultural and governance structures under the Corporate Renewal Programme and bringing the Strategy Review and Contract and Balance Sheet Reviews to clear conclusions with the appropriate consequent restructuring of the Group's debt and equity, and demonstrating strong leadership in a time of great instability. They have effected significant change in the executive leadership of the Group and made great progress in restoring the Group's relationship with the UK Government. Given what has been achieved the Committee determined to award a commensurate bonus to Rupert Soames. Rupert has, however, decided that, given the position the Company finds itself in, it would be in the best interests of the Company if he were to waive payment of his annual bonus, and no bonus will, therefore, be paid to him in respect of 2014. Ed Casey's performance has also been judged very strong against all objectives. The Chairman has put on public record his personal gratitude to Ed for stepping into the breach as Interim Group CEO following Chris Hyman's resignation, despite the personal impact of moving across to the UK from his role as US CEO, and for the considerable leadership and inspiration he gave to the business during an intensely difficult period. Based on Ed's achievement against his objectives both during the period he was in the role of Interim Group CEO and subsequently as COO, and the unwavering personal commitment he has shown, a bonus award of 71.2% of maximum (106.9% of salary) has been determined for him in respect of 2014 performance.

Vesting Awards

As a consequence of our financial performance falling short of where we wanted it to be, the long-term incentive awards made under the PSP and DBP in 2012, and due to vest in 2015 based on 2014 results, will lapse. We were below median against our peer group on a relative Total Shareholder Return basis and EPS growth fell short of the threshold of 5.5% pa compound.

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

Remuneration for 2015

As agreed on appointment, Rupert Soames' salary is not due for review until April 2016 so the Committee only reviewed the salaries of Ed Casey and Angus Cockburn, taking into account the competitiveness of their remuneration against the UK market and the current economic climate. The Committee also has had regard to the overall pay decisions for employees across the Group as a whole. With effect from 1 April 2015, the salary for Angus Cockburn and Ed Casey will remain unchanged at £500,000 and US$1,061,690 respectively.

We are not making any changes to our Remuneration Policy this year. However, operating within our existing policy, the Committee are consulting with major shareholders on possible minor changes to the performance measures applied under our incentive plans in order to align Serco's incentive plans with the Group's Strategy Review. Consultation will continue following the publication of the Prospectus related to our Rights Issue.

Shareholder engagement

I and the Committee believe it is important to continue to maintain effective channels of communication with our shareholders. The Committee takes the views of shareholders very seriously and these views have been influential in shaping our policy and practice. We welcome shareholder feedback on any aspect of executive remuneration.

The voting outcome at the 8 May 2014 General Meeting in respect of the Annual Report on Remuneration and the Director's Remuneration Policy for the year ending 31 December 2013 reflected very strong shareholder support for the Company's remuneration policy with 99.61% and 98.08% vote in favour respectively.

Summary

2014 has been hugely challenging for the business. I believe that the Remuneration Committee has rigorously made the necessary decisions to ensure that reward is clearly linked to performance and shareholder interests and that no payment is made for failure. We will continue to engage with shareholders to ensure that our new leadership team are rewarded appropriately to incentivise them to recover lost value for shareholders through realising Serco's strategic objectives.

Angie Risley,
Chair of Remuneration Committee
12 March 2015

At a glance: implementation of remuneration policy for 2015 and key decisions for 2014

The table below summarises how key elements of the remuneration policy will be implemented in 2015 and key decisions taken by the Remuneration Committee in relation to base pay and incentives for Executive Directors in respect of 2014 year end.

Element	CEO (Rupert Soames)	CFO (Angus Cockburn)	COO (Ed Casey)
Base salary from 1 April 2015	£850,000	£500,000	$1,061,690
Pension	30% of salary	30% of salary	30% of salary including cost of participation in US 401K plan
Annual bonus	Max 150% of salary On-target 75% of salary	Max 130% of salary On-target 65% of salary	Max 150% of salary On-target 75% of salary
Annual bonus measures	• 70% financial targets including Revenue, Trading Profit, Free Cash Flow • 30% non-financial targets.		
Deferred Bonus Plan (DBP)	Maximum of 50% of earned bonus can be deferred to purchase investment shares, each individual investment share purchased will be matched (on a gross investment basis) by a maximum of two 'matching' shares.		
DBP measures	EPS is the sole measure to determine the vesting of matching shares measured over three years.		
Performance Share Plan (PSP)	Maximum 200% of salary	Maximum 175% of salary	Maximum 175% of salary
PSP measures	• Operating within our existing policy, the Committee are consulting with shareholders on possible changes to the measures in order to align Serco's incentive plans with the Group's Strategy Review.		
Holding requirement	**Vested shares from the PSP to be held for two years post vesting (after payment of tax)**		
Shareholding requirement	200% of salary	150% of salary	150% of salary
Malus and clawback	• Clawback provisions will apply to the annual bonus plan • Malus provisions will apply to PSP and DBP awards during the three year performance period prior to vesting • Clawback provisions will apply during the two year post-vesting holding period to shares arising from PSP awards • Clawback provisions will apply to matching shares awarded under the DBP.		
Changes for 2015	• Weighting of financial targets in the annual bonus increased from 50% to 70% • Trading Profit replaced AOP as a measure in the annual bonus • Claw-back provision introduced into the annual bonus • Post-vesting claw-back introduced for Matching Shares in the DBP • The relative TSR comparator group for the 2015 awards will be changed to the FTSE 250 Index (excluding investment trusts).		
Year-end decisions made			
Executive Directors			
1 April 2015 salary review	No change	No change	No change
2014 Bonus outcome:			
Currency value	Decided to waive bonus payment	£111,068	$1,134,681
% of salary	N/A	19.50%	106.9%
% of maximum	N/A	15.00%	71.2%
2012 LTIP vesting	N/A	N/A	Nil
2012 DBP vesting	N/A	N/A	N/A
Non-Executive Directors			
Senior Independent Director Fee effective 1 September 2014			£25,000

Directors' Report

Remuneration Report continued

Directors' remuneration policy

The following report details the remuneration policy and the decisions on remuneration of the Directors of the Group for the year ended 31 December 2014. This report has been drafted in compliance with the disclosure requirements of the UK Corporate Governance Code and the requirements of the UKLA Listing Rules. This Report also complies with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (Regulations).

The remuneration policy report was approved by shareholders at the 2014 AGM and will apply until Shareholders next consider and vote on the Policy.

The Directors' remuneration policy is displayed on the Company's website, in the investor area.

Remuneration policy

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

- Support Serco's long-term future growth, strategy and values;
- Align the financial interests of executives and shareholders;
- Provide market competitive reward opportunities for performance in line with expectations and deliver significant financial rewards for sustained out-performance;
- Enable Serco to recruit and retain the best executives with the required skills and experience in all our chosen markets;
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

Future policy table

The remuneration package for Executive Directors consists of base salary, annual bonus, long-term share-based incentives, pension and other benefits. The Company's policy is to ensure that a significant proportion of the package is related to performance.

The following table sets out each element of reward and how it supports the Company's short- and long-term strategic objectives. Whilst the table is focused on Executive Directors, the table set out on page 108 provides further information of how pay policies are set for the broader employee population.

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Base salary To help recruit and retain executives of the necessary calibre to execute Serco's strategic objectives and to recognise an individual's experience, responsibility and performance. To ensure base salaries are competitive in the market in which the individual is employed.	Pay levels are designed to be competitive and fair and reflect the skills and performance of individuals. Salaries are benchmarked from time to time against salaries for the Company's relevant peer group, with the market positioning dependent on the scale of challenges intrinsic to the individual's role and individual's ability, experience and role. In some circumstances there may be phased movement to that positioning. Salaries are reviewed annually and any changes are effective from 1 April in the financial year.	Over the policy period, base salaries for Executive Directors will be set at an appropriate level within the peer group and will normally increase at no more than the greater of inflation and salary increases made to the general workforce in the jurisdiction the Executive Director is based in. Higher increases may be made in exceptional circumstances, for example when there is a change in role or responsibility.	None
Benefits To provide a competitive level of benefits.	Serco pays the cost of providing the benefits on a monthly basis or as required for one-off events such as receiving financial advice. These include but are not limited to car allowances, private medical insurance, permanent healthcare insurance, life cover, annual allowance for independent financial advice, and voluntary health checks every two years. Relocation benefits will be provided in a manner that reflects individual circumstances and Serco's relocation benefits policy. For example, relocation benefits could include temporary accommodation for the Executive and dependents and tax equalisation. Benefits are reviewed annually against market practice and are designed to be competitive.	The maximum opportunity for benefits is defined by the nature of the benefits and the cost of providing them. As the cost of providing such benefits varies based on market rates and other factors, there is no formal maximum monetary value.	None
Annual bonus Incentivise Executives to achieve specific, predetermined goals during a one-year period. Reward ongoing stewardship and contribution to core values.	Bonus result is determined by the Committee after the year end, based on performance against objectives and targets. Annual bonuses are paid after the end of the financial year end to which they relate. There is an optional deferral of up to 50% of the total earned bonus into Serco shares. On change of control the Remuneration Committee may pay bonuses on a pro-rata basis measured on performance up to the date of change of control.	Maximum bonus opportunity: 150% of salary for CEO 130% of salary for CFO 150% of salary for COO On-target bonus: 75% of salary for CEO 65% of salary for CFO 75% of salary for COO Threshold bonus is 20% of maximum bonus opportunity.	Bonus is earned on the basis of achievement of a mix of financial and non-financial objectives of which at least 50% are financial. Financial measures are based on the Company's Key Performance Indicators (KPIs) and the non-financial measures are based on key strategic objectives. Performance is measured over the financial year. The Committee has discretion to vary the weighting of performance metrics over the life of this remuneration policy. Also the Committee has discretion in exceptional circumstances to vary performance measures part-way through a performance year if there is a significant event (such as a major transaction or transition in role) which causes the Committee to believe the original performance conditions are no longer appropriate.

Directors' Report

Remuneration Report continued

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Deferred Bonus Plan (DBP) This plan is to incentivise executives to achieve superior returns for shareholders and to align executives to shareholder interests	Executive Directors can elect to defer, for three financial years, up to 50% of their annual bonus by purchasing investment shares. Each individual investment share purchased will be matched (on a gross investment basis) by up to a maximum of two 'matching' shares. Dividends are reinvested and distributed only in respect of shares that vest at the end of the performance period. The Committee, at its discretion may attach a post-vesting holding period for awards. In circumstances such as fraud, misconduct and/or misstatement by a participant, the Company will be entitled to withhold before the vesting date the value of any shares to be released or the payment of cash equivalents under the DBP. On a change of control awards vest pro-rata for time and performance up to the date of change of control unless the Committee decides otherwise. As provided in the plan rules approved by shareholders, the Committee has discretion to adjust awards in the event of, for example, corporate restructuring or capital events.	For maximum performance, each investment share is matched by two matching shares. For threshold performance each investment share is matched by half a matching share.	Earnings Per Share (EPS) is the sole measure to determine the vesting of matching shares. The performance condition is measured over three years. In exceptional circumstances the Committee retains discretion to change performance measures and targets and the weightings attached to performance measures part-way through the performance period if there is a significant event (for example a major transaction) which causes the Committee to believe the original measures, weightings or targets are no longer appropriate The Committee has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group.
Performance Share Plan (PSP) To drive achievement of longer term objectives, increase shareholder value aligned closely to creating shareholders' interests.	Awards of nominal cost options/ conditional shares made annually. Dividends are reinvested and distributed only in respect of shares that vest at the end of the performance period. The Committee, at its discretion may attach a post-vesting holding period for awards. In circumstances such as fraud, misconduct and/or misstatement by a participant, the Company will be entitled to withhold before the end of the holding period the value of any shares to be released or the payment of cash equivalents under the PSP. On a change of control awards vest pro-rata for time and performance up to the date of change of control unless the Committee decides otherwise. As provided in the plan rules approved by shareholders, the Committee has discretion to adjust awards in the event of, for example, corporate restructuring or capital events.	Face value on grant of 200% of base salary for the CEO and 175% for the CFO and COO. 25% of the award vests for threshold performance.	Vesting is dependent on at least two performance conditions chosen from: • EPS • Relative TSR • Share Price or absolute TSR The measures are independent, and are measured over three years. The weighting of each is determined prior to award. The Remuneration Committee has discretion to adopt other measures following consultation with major shareholders. In exceptional circumstances the Committee retains discretion to change performance measures and targets and the weightings attached to performance measures part-way through the performance period if there is a significant event (such as a major transaction) which causes the Committee to believe the original measures, weightings or targets are no longer appropriate. The Committee has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group.

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Pension To provide funding for retirement.	Executive Directors may participate in tax-approved pension plans operated by the Company. A cash allowance is available for those not participating in a pension scheme or whose participation exceeds one or more tax allowances.	Rupert Soames and Angus Cockburn receive a cash allowance in lieu of pension equal to 30% of base salary. Ed Casey participates in the US 401k pension and receives a cash allowance in lieu of pension equal to 30% of base salary less the cost of participation in the US 401k plan.	None
Shareholding requirement To support long-term commitment to the Company and the alignment of employee interests with those of shareholders.	Unvested performance shares or options are not taken into account. Share price is measured at end of each financial year. Executives are required to retain in shares 50% of the net value of any performance shares vesting or options exercised until they satisfy the shareholding requirement.	CEO – 200% of salary CFO – 150% of salary COO – 150% of salary The Committee has the discretion to increase the shareholding requirements of the Executive Directors.	None

Notes to the policy table:

Performance measures and targets

The table below sets out a rationale for the performance conditions chosen for annual bonus, Deferred Bonus Plan and Performance Share Plans and how targets were set.

Element	Performance measures and rationale	How targets are set
Annual bonus	• Financial and non-financial performance measures. • The Committee selected the financial measures based on the Company's Key Performance Indicators (KPIs) and the non-financial measures were individually set and based on key strategic goals.	• The performance targets are determined annually by the Committee taking into account analyst consensus and the Company's forecasts.
Deferred Bonus Plan	• EPS is the sole measure to determine the vesting of matching shares. • The Committee selected EPS as it is a key performance indicator both for the Company and its major shareholders. • The Committee believes EPS can be directly influenced by Executive decision-making while also reflecting shareholder value.	• EPS targets are set in reference to analyst forecasts, Company business plans, and levels of EPS required to support our share price goals. • Share price targets will be set to reflect what the Committee determines as stretching, taking into account the recent fall in share price and historic share price levels, but also what is realistic and consistent with achievable levels of financial performance. • The Committee consults with a selection of the largest shareholders and the voting guidance services when determining targets for the Company's LTI arrangements.
Performance Share Plan	• EPS, Relative TSR and Share Price or absolute TSR • As set out above EPS is an important measure of shareholder value which can also be influenced by Executive decision-making • Relative TSR reflects our performance relative to other companies in which investors could choose to invest • The rationale for the share price measure is explicitly to recognise the recent falls in share price and to ensure that the full award is not delivered unless shareholders benefit from a significant recovery in value over the next three years. • Operating within our existing policy, the Committee are consulting with shareholders on possible changes to the measures in order to align Serco's incentive plans with the Group's Strategy Review.	

Directors' Report

Remuneration Report continued

Remuneration policy for other employees

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

Element	Difference in remuneration policy for other employees
Base salary	• The same principles and considerations that are applied to Executive Directors are, as far as possible, applied to all employees.
Benefits	• Serco also has provisions for market aligned benefits for all employees.
Pension	• The Group operates a number of defined benefit schemes and defined contribution schemes. Individuals who have exceeded certain tax allowances may be offered cash allowances in lieu of pension benefits.
Annual bonus	• Approximately 500 members of the Global Leadership Team are eligible for a bonus award under The Leadership Team Bonus Scheme.
Deferred Bonus Plan (DBP)	• Members of the Executive Committee are invited to participate in the DBP on the same terms as the Executive Directors.
Performance Share Plan (PSP)	• The PSP is awarded to approximately 500 employees in the Global Leadership Team.
Sharesave	• An all-employee scheme. Options are normally granted at a discount of 10% to the market value and have no performance conditions. The Executive Directors do not participate in Sharesave.

Considerations of conditions elsewhere in the Group

Although the Committee does not consult directly with employees on the Directors' Remuneration Policy, the Committee does consider the general base salary increase, remuneration arrangements and employment conditions for the broader employee population when determining the remuneration policy for the Executive Directors.

Illustrations of application of the remuneration policy

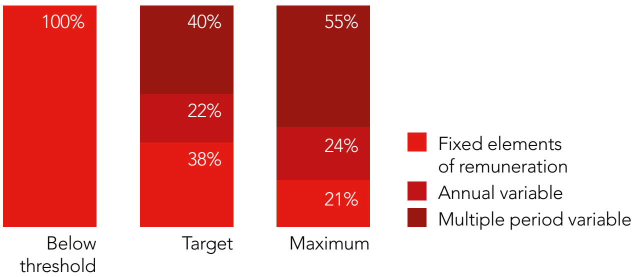
The charts illustrate the composition and value of the different elements of remuneration that the Executive Director's will receive for below threshold, target and maximum corporate performance.

The graphs show an estimate of the remuneration that could be received by Executive Directors under the policy set out in this Report. Each of the bars is broken down to show how the total under each scenario is made up of fixed elements of remuneration, the annual bonus and share based incentives.

The charts indicate that a significant proportion of both target and maximum pay is performance-related. For 'target' performance – variable pay accounts for nearly two thirds of total pay for the CEO, and over half for the CFO and the COO.

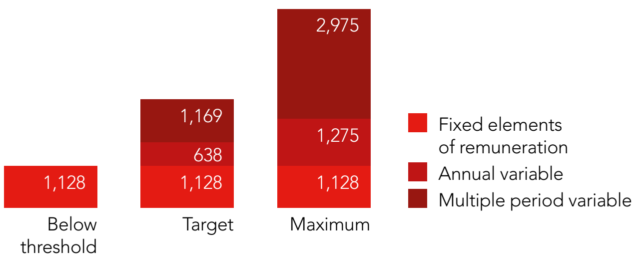
CEO

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



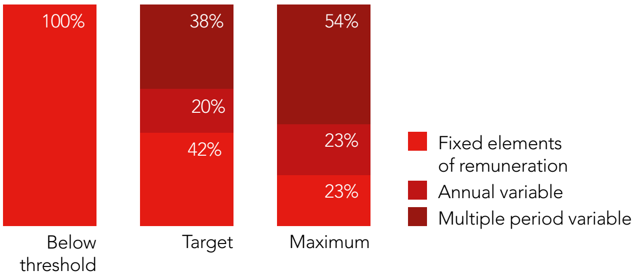
CEO

Potential value of CEO's 2015 remuneration package £000



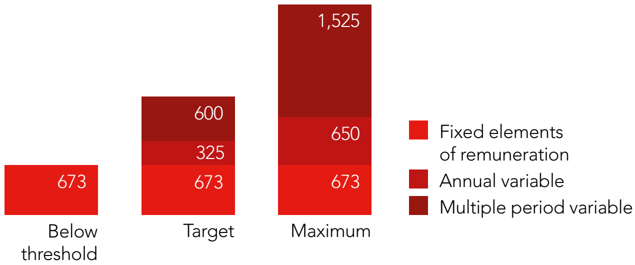
CFO

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



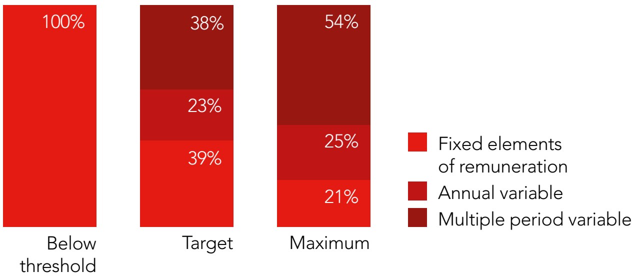
CFO

Potential value of CFO's 2015 remuneration package £000



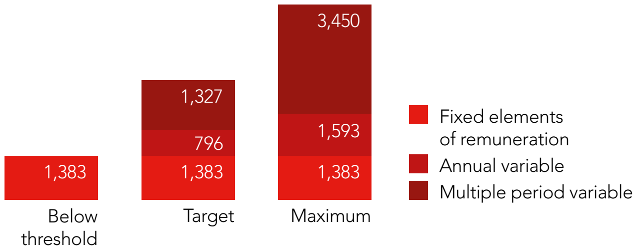
COO

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



COO

Potential value of COO's 2015 remuneration package USD$000



Notes: The scenarios in the above graphs are defined as follows:

	Below Threshold	Target performance	Maximum performance
Fixed elements of remuneration	Base salary as at 1 April 2015 Estimated value of benefits provided under the remuneration policy Cash allowance in lieu of pension 30% of salary for CEO and CFO Cash allowance in lieu of pension 30% of salary for COO less the cost of participation in the US 401k plan Ed Casey's fixed elements of pay are converted into GBP with an exchange rate of GBP1 = USD1.6453		
Annual bonus (payout as a % of salary)	0%	75% CEO 65% CFO 75% COO	150% CEO 130% CFO 150% COO
Deferred Bonus Plan	Nil	1:1 Matching Shares[1]	2 Matching Shares[1]
Performance Share Plan (as a % of face value)	Nil	50%[1]	100%[1]

1 The LTI values reflect target and maximum vesting of the proposed 2015 award. Share price movement or dividend equivalent has not been incorporated into the above figures.

Directors' Report

Remuneration Report continued

Approach to recruitment remuneration

Serco operates in diverse markets and geographies and many of its competitors for talent are outside the UK. In the event of hiring a new Executive Director, the Committee will typically align the remuneration package with the above remuneration policy, which provides for a maximum total incentive under bonus, PSP and DBP combined of 500% of salary in any one year (assuming maximum bonus, maximum investment in the DBP and maximum achievement of all performance conditions). This is the maximum level of incentives excluding buy-outs that will apply to new recruits. Different performance conditions may apply for new recruits from those set out in the policy, depending on the particular circumstances at the time (which could, for example, include the appointment of an interim Executive Director).

In determining appropriate base salary on hiring a new Executive Director, the Committee will take into account all factors it considers relevant including their experience and calibre, current total remuneration, levels of remuneration for companies in the Committee's chosen peer group, and the remuneration required to attract the best candidate for Serco. The Committee will seek to ensure that the arrangement is in the best interests of the Company and its shareholders without paying more than is necessary. New promotions or recruitments to the Board may on occasion have their salaries set below the targeted policy level while they become established in their role. In such cases, salary increases may be higher than inflation or the general UK workforce increase until the targeted market positioning is achieved.

Where it is necessary to compensate a candidate for entitlements and/or unvested long-term incentive awards from an existing employer that are forfeited, the Committee will seek to match the quantum, structure and timeframe of the award with that of the awards forfeited. In determining the form and quantum of replacement awards, the Committee will consider whether existing awards are still subject to performance requirements and the extent to which those are likely to be met, with the aim of providing an opportunity of broadly equivalent value. The principle will be to seek to replace awards that remain significantly at risk for performance at the candidate's current employer with awards subject to performance at Serco and to seek to make any other replacement awards in the form of Serco shares, subject to appropriate vesting or holding requirements. Any compensation for awards forfeited is not taken into account in determining the maximum incentive award level.

The recruitment policy also includes the additional provision of benefits in kind, pensions and other allowances, such as relocation, education and tax equalisation in line with Serco policies as may be required in order to achieve a successful recruitment. The policy for recruitment also includes benefits that are either not significant in value or are required by legislation. It is anticipated that any new Executive Director would be offered a pension allowance equal to 30% of base salary in lieu of pension.

Where a new Executive Director is an internal promotion, the Committee reserves discretion to allow the new Executive Director to continue to benefit from existing awards granted, or benefit entitlements (such as pension) prior to appointment to the Board.

The policy on the recruitment of new Non-Executive Directors is to apply the same remuneration elements as for the existing Non-Executive Directors. It is not intended that day rates or benefits in kind be offered, although in exceptional circumstances such remuneration may be required in currently unforeseen circumstances.

The Committee will include in future Annual Reports details of the implementation of the Policy in respect of any such recruitment to the Board.

Element of remuneration	Maximum percentage of salary
Maximum variable pay: normally comprising: • Annual bonus • Long-term incentives	500% 150% 350%
Pension allowance	30% cash allowance in lieu of pension

Note: Maximum percentage of salary for annual bonus and long-term incentives excludes compensation for awards forfeited.

Service contracts and loss of office payments

The policy for service contracts for new Directors is shown in the table below. Ed Casey has a service contract which has aspects that differ from policy as highlighted underneath the table. The Committee may under this policy at any time, with the agreement of a Director, alter aspects of their existing contracts so that they are in line with the policy for new Directors. Copies of the Directors' service contracts and letters of appointment are available for inspection at the Company's registered office. The date of appointment for each Director is shown in the table below.

Provision	Detailed terms
Notice period	• 12 months notice from the Company • 12 months notice from the Director
Termination payment	• Payment in lieu of notice comprising: ◦ Base salary ◦ Pension allowance ◦ Selected benefits • All of the above would be paid in instalments in accordance with the Director's contractual payment schedule, subject to an obligation on the part of the Director to mitigate his loss such that payments will either reduce or cease completely, in the event that the Director gains new employment/remuneration. In the event of a compromise or severance agreement, the Committee may make payments it considers reasonable in settlement of potential legal claims. It may include in such payments reasonable reimbursement of professional fees incurred by the Director in connection with such agreements and reasonable payments in respect of restrictive undertakings. • The Remuneration Committee may agree that if a Director steps down from the Board then for a transitional period notice (including payment in lieu of notice) would continue to be based on the equivalent of up to 12 months' notice based on their rate of salary and benefits while a Director, payable in instalments and subject to mitigation. • The reimbursement of repatriation costs or fees for professional or outplacement advice may also be included in the termination package, as deemed reasonable by the Committee, as may the continuation of benefits for a limited period.
Treatment of annual bonus on termination under plan rules	• No payment unless employed on date of payment of bonus except for 'good leavers': defined as death, disability, redundancy and other circumstances at the Committee's discretion. • 'Good leavers' are entitled to a bonus pro-rated to the period of service during the year, subject to the outcome of the performance metrics and paid at the usual time. • The Committee has discretion to reduce the entitlement of a 'good leaver' in line with performance and the circumstances of the termination.
Treatment of unvested performance shares or options and unvested matching deferred share awards on termination under plan rules	• All awards lapse except for 'good leavers': ill-health, injury or disability, death, redundancy, retirement, change of control (as defined in the plan rules) and other circumstances at the Committee's discretion (to the extent that they allow 'good leaver' treatment for particular awards). • For 'good leavers' vesting is pro-rated on a time basis and is dependent on the achieved performance over the performance period. • The Committee has the discretion to vary the level of vesting to reflect the individual performance, and may, depending on the circumstances of the departure allow some awards to vest while lapsing others.
Change of control	• Where the Director leaves the Company following a change of control, whether or not he is dismissed or he elects to leave on notice, he will be entitled to receive a payment equivalent to up to one year's remuneration.
Exercise of discretion	• Intended only to be used to prevent an outcome that is not consistent with performance. The Committee's determination will take into account the particular circumstances of the Executive Director's departure and the recent performance of the Company.
NEDs	• Appointed for initial three-year term • Appointment may be terminated on three months' written notice. • All NEDs are subject to annual re-election. • No compensation or other benefits are payable on early termination.

Notes:

Operating within our existing policy in respect of Ed Casey, the Committee have increased the notice period to 12 months from the Company to align with the other Directors, and four months from the Director to more closely align with US employment practice.

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 claw back provisions would continue to apply in the event that such discretion were exercised.

Service contracts outline the components of remuneration paid to the individual but do not prescribe how remuneration levels may be adjusted from year to year.

Directors' Report

Remuneration Report continued

The Chairman and Non-Executive Directors' fees

In accordance with the Company's policy, the fees of the Chairman and the Non-Executive Directors, which are determined by the Board, are set at a level which is designed to attract individuals with the necessary experience and ability to make a substantial contribution to the Group's affairs.

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
To attract Non-Executive Directors with the necessary experience and ability to make a substantial contribution to the Group's affairs.	The fees of the Chairman are determined and approved by the Remuneration Committee (excluding Chairman) and fees of the Non-Executive Directors, are determined and approved by the Board as a whole. The Chairman receives a base fee. The following fees are paid to Non-Executive Directors in addition to their base fee: • SID fee • Committee Chairmanship fee • Committee membership fee Fees are reviewed on an annual basis against a relevant peer group and taking into consideration market practice. An allowance is payable to Directors for attendance at meetings outside their country of residence where such meetings involve inter-continental travel. In addition, reasonable travel and business related expenses are paid. 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 requirement.	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. 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. Current fee levels are shown in the section on implementation of policy.	Non-Executive Director fees are not performance-related.

Dates of Director's Service Contracts/Letters of Appointment

Director	Date of appointment to the Board
Rupert Soames	8 May 2014
Angus Cockburn	27 October 2014
Ed Casey	24 October 2013
Alastair Lyons	16 March 2010
Angie Risley	1 April 2011
Ralph D. Crosby Jnr	30 June 2011
Malcolm Wyman	1 January 2013
Mike Clasper	3 March 2014
Tamara Ingram	3 March 2014
Rachel Lomax	3 March 2014

Notes:

All Directors are put forward annually for re-election at the AGM.

Andrew Jenner was appointed to the Board on 3 May 2002 and ceased to be a Director on 30 September 2014.

Annual Report on remuneration

Statement of Implementation of Remuneration Policy for year ended 31 December 2014

The remuneration policy for the year ended 31 December 2014 was consistent with the policy on which shareholders will vote at the 2015 AGM apart from the following that are being implemented for 2015:

- The relative TSR comparator group for the 2014 awards was the FTSE 51-130 (excluding investment trusts). For 2015 awards the comparator group will be changed to the FTSE 250 Index (excluding investment trusts).

Single Figure – Directors remuneration (audited information)

Executive Director's single figure

The following table shows a single total figure of remuneration in respect of qualifying services for the – financial year for each Executive Director, together with comparative figures for 2013. Details of NED's fees are set out in the next section.

		Rupert Soames		Angus Cockburn		Ed Casey		Andrew Jenner	
		2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
Salary and fees	£	**566,667**	N/A	**83,333**	N/A	**733,604**	121,113	**360,450**	452,750
Taxable benefits[1]	£	**10,988**	N/A	**103,031**	N/A	**9,960**	2,634	**52,255**	72,553
Bonus[2]	£	**–**	N/A	**–**	N/A	**689,650**	134,701	**–**	–
LTI[3]	£	N/A	N/A	N/A	N/A	**–**	–	**–**	–
Pension[4]	£	**170,000**	N/A	**27,016**	N/A	**171,850**	36,334	**114,239**	149,408
Other[5]		**–**	N/A	**111,068**	N/A	**–**	–	**–**	–
Total	£	**747,655**	N/A	**324,448**	N/A	**1,605,064**	294,782	**526,944**	674,711

Notes:

1. The value of the 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 and private medical assessments. In 2014 Angus Cockburn received a one-off reimbursement of £100,000 for relocation costs.
2. The bonuses shown include performance bonuses earned in the period under review, but not paid until the following financial year. The Committee were due to pay a bonus of £908,438 to Rupert Soames, but he has decided to waive payment of his 2014 bonus and therefore the bonus figure in the table is nil. Andrew Jenner has voluntarily waived any entitlement to bonus in respect of 2014.
3. The value of shares vested in the year is based on an average market value over the last quarter of the financial year. The 2012 PSP and DBP awards vested at zero.
4. The pension amount includes payments made in lieu of pension, calculated as a percentage of base salary, from which the Executive Directors make their own pension arrangements and which do not include the value of accrued pension under the DB scheme.
5. The amount shown is to compensate Angus for the pro-rated bonus that he would have received from Aggreko in respect of the final three months of 2014 had he not left to join Serco.
6. Rupert Soames' remuneration relates to the period 8 May to 31 December 2014.
7. Angus Cockburn's remuneration relates to the period 27 October to 31 December 2014.
8. Ed Casey's remuneration is paid in US Dollars, for the purpose of the 2014 single figure £1 = USD 1.6453. For the purpose of 2013 his remuneration relates to the period of 25 October to 31 December 2013 and £1 = USD 1.609.
9. Andrew Jenner's remuneration is prorated to 30 September 2014.

The annual base salaries of the Executive Directors for the year ended 31 December 2014 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	$1,061,690	1 April 2014	1.5%
Andrew Jenner	£463,855	1 April 2014	1.5%

Variable pay outcomes (audited information)

Performance-related annual bonus

For 2014, the Executive Director bonus was on achieving a mix of financial and non-financial objectives which were weighted 50:50. The financial measures were based on Revenue (20%), Free Cash Flow (40%) and Adjusted Operating Profit (40%) and the non-financial measures were individually set and based on key strategic goals.

Andrew Jenner has voluntarily waived any entitlement to bonus in respect of 2014.

The Remuneration Committee reviewed the achievements against the targets for the year and proposed annual incentive payments for Rupert Soames and Ed Casey. The table below shows the achievement against the financial and non-financial measures. Although the Remuneration Committee considers that the Group Chief Executive, Rupert Soames, has significantly outperformed the targets he was set for 2014 and had intended to award a bonus on the basis of performance for the year, Rupert Soames has decided that, given the position the Company finds itself in, it would be in the best interests of the Company if he were to waive payment of his annual bonus for 2014. Given this, no bonus will be paid to him in respect of 2014. However, it remains the Board's intention over the course of the recovery period to reward the Group Chief Executive fairly and appropriately for achieving the targets that will contribute to Serco's recovery.

Directors' Report

Remuneration Report continued

The Chairman has put on public record his personal gratitude to Ed for stepping into the breach as Interim Group CEO following Chris Hyman's resignation, despite the personal impact of moving across to the UK from his role as US CEO and for the considerable leadership and inspiration he gave to the business during an intensely difficult period. Based on Ed's achievement against his objectives both during the period he was in the role of Interim Group CEO and subsequently as COO, and the unwavering personal commitment he has shown, a bonus award of 106.9% of salary has been determined for him in respect of 2014 performance.

Financial Performance

Performance Measure	Weighting for 2014 (% maximum opportunity)	Threshold target (m)	Maximum target (m)	Actual performance (m)	Rupert Soames	Ed Casey
Revenue	10%	£4,700.0	£4,900.0	£4,948.0	100%	100%
Free Cash Flow	20%	£60.0	£95.0	£81.0	56%	56%
Adjusted Operating Profit	20%	£175.0	£210.0	£150.1	0%	0%
Non-financial	50%		See table below		100%	100%
Total bonus payable as % of maximum					71.25%	71.25%
Bonus opportunity as % of salary					150%	150%
Bonus amount achieved as % of salary					106.9%	106.9%
Bonus amount earned					£908,438	$1,134,681

Rupert Soames has decided to waive payment of his 2014 annual bonus and therefore no bonus will be paid in respect of 2014 performance.

Non-financial performance

Rupert Soames	Rupert's objectives focused on: • Rebuilding the executive team • A comprehensive Strategic Review • Implementing the Company's Corporate Renewal Plan	The Committee deemed performance to be very strong against all objectives. Examples of successes include the addition of considerable talent into the executive leadership team, the completion of a root-and-branch strategic review to analyse our strengths, weaknesses and challenges resulting in a good strategy that we can now execute and putting in place cultural and governance structures under Corporate Renewal Programme, leading from the front in terms of both behavioural and cultural leadership. Based on Rupert's achievement the Committee has awarded 200% performance of target for the non-financial element.
Ed Casey	Ed's objectives focused on: • Stabilising the business • Restructuring the UK&E division • Implementing the Company's Corporate Renewal Plan • The creation and delivery of the 2014 business plan	The Committee deemed performance to be very strong against all objectives. Examples of successes include the significant improvement in visible leadership, setting the tone for open and honest communication across the organisation, the successful restructuring of the UK&E business against an aggressive plan and the putting in place cultural and governance structures under Corporate Renewal Programme. Based on Ed's achievement the Committee has awarded 200% performance of target for the non-financial element.

Notes:

1. Rupert Soames, Group CEO has decided to waive payment of his 2014 annual bonus.
2. Ed Casey, Group COO will be paid a bonus subject to him remaining in employment until 31 March 2015.
3. Angus Cockburn will receive a payment of £111,068 to compensate him for the pro-rated bonus that he would have received from Aggreko in respect of the final three months of 2014 had he not left to join Serco.
4. All Executive Directors are entitled to participate in the Deferred Bonus Plan (the 'DBP') in 2015, up to a maximum of 50% of the bonus determined in respect of 2014 performance. Whilst Rupert Soames, Group CEO, decided to waive payment of 2014 bonus (£908,438) he retains the option to purchase a number of shares and allocate these as Investment Shares under the DBP. Under the rules of the DBP he can invest shares up to 50% of the net value of the bonus that has been determined but not paid.

Deferred Bonus Plan (DBP)

The LTI amount included in the 2014 single total figure of remuneration includes the DBP matching share award which was awarded in 2012. For matching awards which completed their performance period on 31 December 2014, achievement against the measure is shown in the table below:

Performance condition	Weighting	Threshold – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max achieved
EPS compound growth. For threshold performance each invested share is matched by half a share rising to a match of two shares at maximum performance.	100%	5.5%	10.5%	–21.44%	No shares vest
Total					0%

For awards made in 2012 onwards, EPS is the sole performance measure.

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

The awards made to the Executive Directors were as follows:

2012 DBP Matching share awards	Number of shares awarded	Number of shares vesting	Vesting date	Value of vesting £
Andrew Jenner	87,010	0	21 May 2015	0

Note:

1. Ed Casey did not participate in the DBP in 2012.

Performance Share Plan (PSP)

The LTI amount included in the 2014 single total figure of remuneration includes the PSP award which was awarded in 2012. Face value awards on grant were 175% of base salary for the CFO. For the PSP awards which completed their performance period on 31 December 2014, achievement against the measure is shown in the table below:

Performance condition	Weighting	Threshold – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max achieved
EPS growth. For threshold performance 25% of the award vests rising on a straight-line basis to 100% at maximum performance.	50%	5.5%	10.5%	–21.44%	No shares vest
Relative TSR. For median performance 25% of the award vests rising on a straight-line basis to 100% for upper quartile performance.	50%	Median	Upper Quartile	Below Median	No shares vest
Total					0%

For awards made in 2012 onwards the EPS weighting was increased from 30% to 50% and the TSR weighting was reduced from 70% to 50%.

The awards made to the Executive Directors were as follows:

2012 PSP share awards	No of shares awarded	No of shares vesting	Vesting date	Value of vesting £
Ed Casey	84,579	0	8 June 2015	0
Andrew Jenner	139,672	0	8 June 2015	0

Note:

1. Ed Casey's PSP award was made prior to him being appointed to the Board.

Directors' Report

Remuneration Report continued

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[1] £		Total £	
	2014	2013	2014	2013	2014	2013
Alastair Lyons Chairman; Chairman of Nomination Committee and Member of Remuneration Committee	**270,000**	267,500	**10,000**	10,000	**280,000**	277,500
Mike Clasper Senior Independent Director; Member of Audit and Nomination Committees	**60,833**	–	**5,000**	–	65,833	–
Ralph D Crosby Jnr	**50,000**	50,000	**30,000**	30,000	**80,000**	80,000
Tamara Ingram Member of Corporate Responsibility and Remuneration Committees	**52,500**	–	**5,000**	–	**57,500**	–
Rachel Lomax Chairman of Corporate Responsibility and Risk Committee; Member of Audit Committee	**58,333**	–	**5,000**	–	**63,333**	–
Angie Risley Chairman of Remuneration Committee; Member of Nomination Committee	**60,000**	60,000	**5,000**	–	**65,000**	60,000
Malcolm Wyman Chairman of Audit Committee; Member of Nomination and Remuneration Committees	**72,917**	64,250	**5,000**	–	**77,917**	64,250
Total	**624,583**	441,750	**65,000**	40,000	**689,583**	481,750

Notes:

1. £5,000 is payable for each occasion that requires inter-continental travel outside of the Director's country of residence.
2. Mike Clasper, Tamara Ingram and Rachel Lomax were appointed on 3 March 2014 fees shown are for the ten months served in 2014.

Annual NED Fees

Role	**Base fee 1 April 2014[1] £**	Base fee 1 April 2013 £	Percentage increase
Chairman	**270,000**	270,000	No change
Senior Independent Director	**25,000**	10,000	150%
Board fees	**50,000**	50,000	No change
Audit Committee Chairmanship	**12,500**	12,500	No change
Audit Committee Membership	**5,000**	0	New fee
Corporate Responsibility Committee Chairmanship	**15,000**	0	New fee
Corporate Responsibility Committee Membership	**8,000**	0	New fee
Remuneration Committee Chairmanship	**10,000**	10,000	No change
Remuneration Committee Membership	**5,000**	0	New fee
Travel to international meetings	**5,000**	5,000	No change

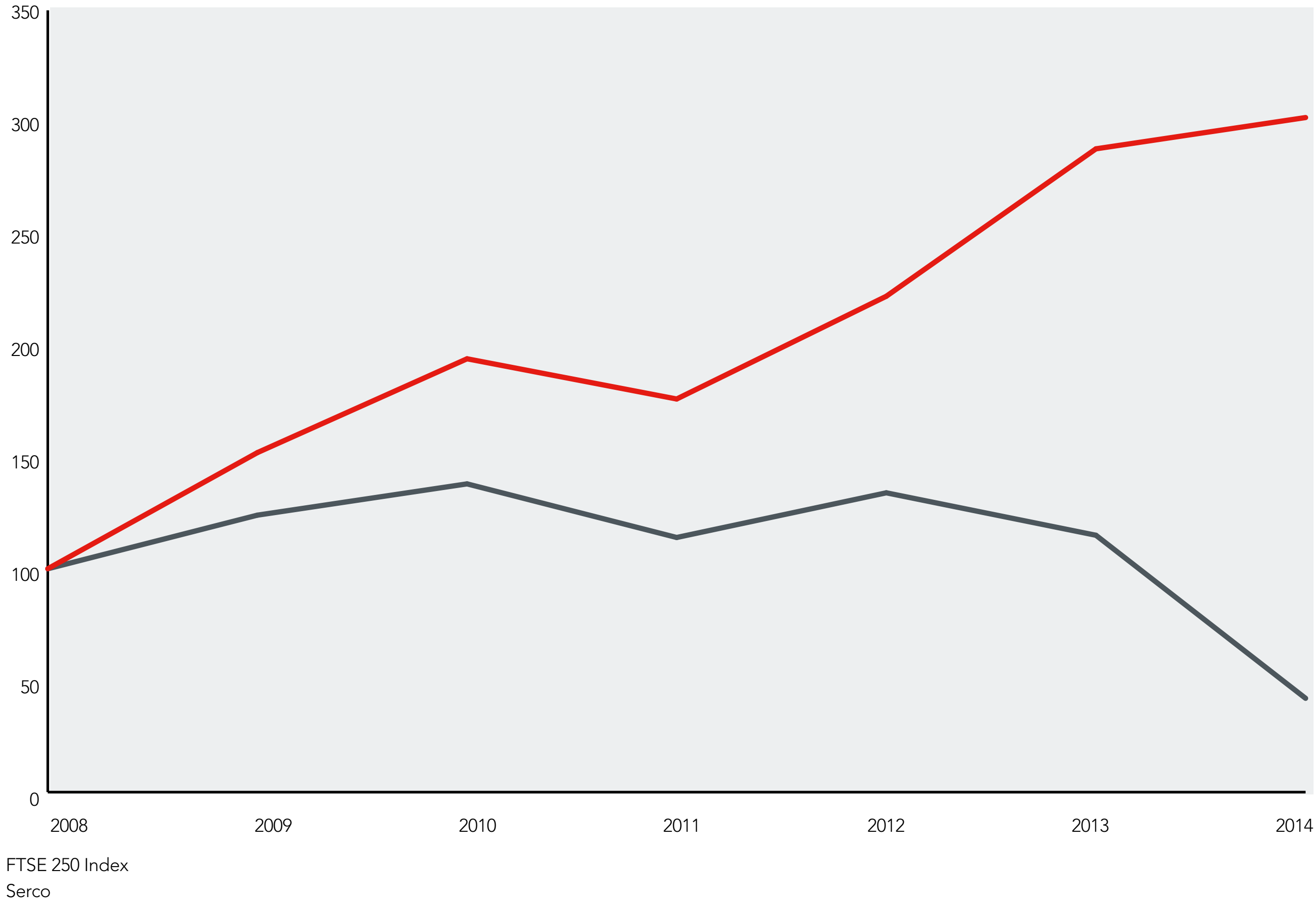
Notes:

1. The Senior Independent Director fee increased with effect 1 September 2014

Performance graph and table

This graph shows the value as at 31 December 2014, of a £100 investment in Serco on 31 December 2008 compared with £100 invested in the FTSE 250 index on the same date. It has been assumed that all dividends paid have been reinvested. The TSR level shown at 31 December each year is the average of the closing daily TSR levels for the 30-day period up to and including that date.

Serco Performance Graph



CEO's pay in last six 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%	295.42%
2010	Christopher Hyman	2,646,894	91%	168.77%
2011	Christopher Hyman	2,826,038	81%	80%
2012	Christopher Hyman	2,582,185	72%	63.60%
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

Directors' Report

Remuneration Report continued

Percentage change in CEO's remuneration

There were changes to the postholder of CEO in 2013 and 2014 and therefore a calculation of the change in CEO's remuneration between these years is not possible. Ed Casey, Acting CEO during the last three months of 2013 and the first four months of 2014 received a 1.5% salary increase as at 1 April 2014, 0% increase in annualised rate of benefits (other than one-off expatriate benefits provided in respect of Serco's requirement for him to work in the UK) and 3.7% decrease in bonus for the period served as CEO. The average percentage changes for employees in the leadership team were 2.17%, 0% and a 6.43% increase respectively.

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.

	2014 vs 2013	2014	2013
Dividend	-70.6%	3.10	10.55
Overall Expenditure on Staff Pay	-6.2%	1,643.7	1,752.5

'Dividend' and 'Overall Expenditures on Staff Pay' have the same meaning as in the preparation of the accounts of the Company.

Pensions (audited information)

Andrew Jenner is a member of the Serco Pension and Life Assurance Scheme, which is a defined benefits scheme, for pensionable service up to 31 December 2010, when he ceased pension accrual. At 31 December 2014, he had a deferred pension of £83,195 pa which is payable from age 60. No special terms apply on early retirement. No pension contributions have been paid to the Scheme by Mr Jenner during the year. As at 31 December 2014, there were no Executive Directors actively participating in or accruing additional entitlement in the Serco Pension and Life Assurance Scheme.

Payments for loss of office (audited information)

Andrew Jenner ceased to be a Director and left employment of the Company on 30 September 2014. During the five-month notice period that he worked (1 May to 30 September) he was paid £299,547.

The principle adopted by the Committee when calculating his loss of office payment was to pay contractual entitlements and to allow a retention of awards that would have vested on performance periods completed during his 12-month notice period had he served such notice. All other unvested awards were forfeited.

Andrew Jenner's compensation payment

7 months	£
Salary	270,582
Pension benefit[1]	89,292
Other benefits[2]	39,508
Total	**399,382**

1 The pension allowance is a cash allowance equal to 33% of base salary in lieu of pension contributions.

2 Private medical, permanent health insurance, life cover, financial advice, health checks and the provision of a car allowance.

Vesting of LTI awards

The awards granted to Andrew Jenner in 2012 under the DBP and the PSP would have vested on the usual vesting dates (21 May 2015 and 8 June 2015 respectively) to the extent that the relevant performance conditions have been met. These would have been reduced pro-rata to reflect the proportion of the performance period which had elapsed at the date of cessation of employment. However, the performance conditions were not met and so these awards lapsed.

Share awards	Performance achieved	Shares vested	£
2012 DBP award (87,010 shares)	Minimum vesting level not achieved	No shares vest	0
2012 PSP award (139,672 shares)	Minimum vesting level not achieved	No shares vest	0
Value of shares vesting			0

Andrew Jenner has six months from the date of ceasing employment to exercise his previously vested outstanding options under the Serco Group plc 2005 Executive Share Option Plan.

Payments to past Directors

No payments were made in the year to past Directors other than the payments made to Andrew Jenner on him ceasing to be a Director.

Directors' Report

Remuneration Report continued

Awards made in 2014

Deferred Bonus Plan (DBP) (audited information)

No awards were made in 2014 under the DBP.

Performance Share Plan (PSP) (audited information)

In 2014 the Executive Directors received awards equivalent to 200% of salary for the CEO and COO and 175% for the CFO.

The shares will normally only vest at the end of the performance period, if the Executive Directors are still in employment with Serco and the performance measures have been met. The measures are:

Performance measure	Weighting of measure	Performance target	Performance period end date
Relative TSR	1/3rd	Median (threshold) to upper quartile (maximum) when ranked against companies in the FTSE 51 to 130 (excluding investment trusts). Measured over the 30 days following announcement of the Company's 2016 results.	27 June 2017
2016 EPS	1/6th	22p (threshold) to 26p (maximum) for the Company's 2016 results.	27 June 2017
Absolute Share Price	1/3rd	450p (threshold) to 600p (maximum), measured over the 30 days following the announcement of the Company's 2017 results	27 June 2018
2018 EPS	1/6th	30p (threshold) to 35p (maximum) for the Company's 2018 results.	27 June 2019

The structure for vesting is the same for all measures 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 (i.e. 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	Scheme	Basis of award (% of salary)	Award date	Market price at award (p)[1]	Face value £	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	Performance Share Plan (nominal cost options)	200%	27 Jun 14	364.2	1,699,998	25%	466,776	See above
Ed Casey[2]	Performance Share Plan (conditional share award)	200%	27 Jun 14	364.2	1,248,605	25%	342,835	See above
Angus Cockburn	Performance Share Plan (nominal cost options)	175%	31 Oct 14	295.8	874,997	25%	295,807	See above

Notes:

1. The market price at award was the preceding day's MMQ.
2. Ed Casey's conditional share award under the Performance Share Plan was made on the basis of his role as Acting CEO and a Director and was equivalent to 200% of salary, from 2015 this will reduce to 175%.

Recruitment awards (audited information)

In compensation for performance based awards that Rupert Soames and Angus Cockburn forfeited at Aggreko as a result of joining Serco, they were granted a one-off award under the PSP of 150% of salary and 135% respectively.

The shares will normally only vest at the end of the performance period, providing they remain in employment with Serco and the performance measures have been met. The measures are:

Performance measure	Weighting of measure	Performance target	Performance period end date
Relative TSR	40%	Median (threshold) to upper quartile (maximum) when ranked against companies in the FTSE 51 to 130 (excluding investment trusts). Measured over the 30 days following announcement of the Company's 2016 results.	27 June 2017
Strategic objectives	20%	Implementing the Company's Corporate Plan; rebuilding the senior management team; improving cash conversion; and improving operating margin	27 June 2017
Absolute Share Price	40%	450p (threshold) to 600p (maximum), measured over the 30 days following the announcement of the Company's 2017 results	27 June 2018

Each element of the one-off PSP award is subject to a post-vesting holding requirement that takes the total term of the award (i.e. performance period plus holding period) to a minimum of five years. Pre-vesting malus and post-vesting clawback is also applicable to these awards.

Director	Scheme	Basis of award (% of salary)	Award date	Market price (p)[1]	Face value £	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	Performance Share Plan (nominal cost options)	150%	27 Jun 14	409.1	1,275,107	25%	311,686	See above
Angus Cockburn	Performance Share Plan (nominal cost options)	135%	31 Oct 14	295.8	674,998	25%	228,194	See above

Notes:

1. The market price used to calculate Rupert's award was the average share prices over the period from 30 January to 26 February 2014 inclusive.
2. The market price used the calculate Angus' award was the preceding days MMQ.

In compensation for non-performance based awards that Rupert and Angus forfeited they were also granted the following non-performance-related awards:

Directors	Scheme	Award date	Number of shares	Vesting date
Rupert Soames	Performance Share Plan (nominal cost options)	27 Jun 14	16,125	16 Apr 15
Rupert Soames	Performance Share Plan (nominal cost options)	27 Jun 14	23,994	6 Aug 16
Rupert Soames	Performance Share Plan (nominal cost options)	27 Jun 14	47,770	1 Apr 17
Angus Cockburn	Performance Share Plan (nominal cost options)	31 Oct 14	19,304	5 Aug 16
Angus Cockburn	Performance Share Plan (nominal cost options)	31 Oct 14	32,271	4 Mar 17
Angus Cockburn	Performance Share Plan (nominal cost options)	31 Oct 14	20,974	16 Apr 17

Remuneration Report continued

Statement of voting at the general meeting

At the last Annual General Meeting, votes on the Remuneration Report were cast as follows:

	For % Number	Against % Number	Withheld %[1] Number
2013 Annual Report on Remuneration	99.61% 367,080,126	0.39% 1,442,674	N/A 2,302,116
2013 Remuneration Policy	98.08% 358,418,242	1.92% 7,033,412	N/A 5,373,262
2012 Remuneration Report	95.82% 346,071,397	4.18% 15,084,901	N/A 5,923,160
2011 Remuneration Report	93.72% 351,474,463	6.28% 23,547,217	N/A 8,299,355

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.

The disclosure in the 2015 Remuneration Report will include details of the binding shareholder vote at the 2015 AGM on Directors' remuneration policy.

External appointments

The Board believes that the Group can benefit from its Executive Directors holding appropriate Non-Executive Directorships of companies or independent bodies. Such appointments are subject to the approval of the Board. Fees are retained by the Executive Director concerned.

During the year, Rupert Soames, Angus Cockburn and Andrew Jenner served as Non-Executive Directors of Electrocomponents plc, GKN plc and Galliford Try plc respectively. Fees payable in the year were £37,917, £13,750 and £35,067 respectively. Fees shown are pro-rated for the period that the Directors have served on the Board of Serco.

No other fee-paying external positions were held by the Executive Directors.

Directors' shareholding and share interests (audited information)

Current shareholdings are summarised in the table below. Shares are valued for these purposes at the year-end price, which was 160.7p per share at 31 December 2014.

	Share ownership requirements (% of salary)	Number of shares owned outright (including connected persons)	Vested but unexercised share options	Restricted share awards subject to performance conditions	Restricted share awards not subject to performance conditions	Share ownership requirements	Weighted average exercise price of vested options	Weighted average period to vest of restricted share awards
Rupert Soames	200%	242,000	–	778,462	87,889	No	N/A	0.02
Ed Casey	150%	62,920	–	503,175	–	No	Nil	Nil
Angus Cockburn	150%	84,600	–	524,001	72,549	No	N/A	0.02
Andrew Jenner	150%	353,326	150,354	226,682	–	No	4.47	N/A
Alastair Lyons	N/A	62,600	N/A	N/A	N/A	N/A	N/A	N/A
Mike Clasper	N/A	5,967	N/A	N/A	N/A	N/A	N/A	N/A
Ralph D Crosby Jnr	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Tamara Ingram	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Rachel Lomax	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Angie Risley	N/A	10,254	N/A	N/A	N/A	N/A	N/A	N/A
Malcolm Wyman	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Notes:

1. Ordinary shares are beneficial holdings which include the Directors' personal holdings and those of their spouses and minor children.
2. Executives are required to retain in shares 50% of the net value of any performance shares vesting or options exercised until they satisfy the shareholding requirement.
3. Rupert Soames and Angus Cockburn were recruited to the Board in 2014, they have two years from appointment to build their investment.
4. 20,737 of Andrew Jenner's shares are held in trust on his behalf under the terms of his participation in the Deferred Bonus Plan. Provided such shares remain in trust for three years and subject to certain performance conditions, he is also granted an award over matching shares equivalent to two times the gross bonus initially used for the share purchase.

Gain on exercise of share awards

	Number of options exercised	Exercise price (p)	Market value on exercise (p)	Gain on exercise of share option/ award £
Ed Casey	87,738	Nil	466.2	409,035
Andrew Jenner	133,178	217	468.5	334,943
	116,885	235	468.5	272,926
	88,495	339	468.5	114,601
	79,401	002	468.5	370,406
	50,624	Nil	468.5	237,173
Aggregate gain on exercise of shares awards				**1,739,084**

Note:

1. The awards that Ed Casey exercised during the year were granted prior to him being appointed to the Board.

Other shareholding information (audited information)

Shareholder dilution

Awards granted under the Serco Group plc share plans are met either by the issue of new shares or by shares held in trust when awards vest. The Committee monitors the number of shares issued under its various share plans and their impact on dilution limits. The relevant dilution limits established by the 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 2014, our dilution level was 6.12% against all share plans and 4.04% against discretionary share plans.

The Group has an employee share ownership trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet various obligations under the share plans.

The Trust held 11,883,973 and 10,659,290 ordinary shares at 1 January 2014 and 31 December 2014 respectively.

Rights Issue

The options and awards granted with the Serco Employee Share Schemes may be adjusted in such a way as the Remuneration Committee considers appropriate to compensate option and award holders for any effect of the Rights Issue will have on those options and awards (as permitted by the rules of the relevant Serco Employee Share Scheme). Any adjustments will not be made until after the ex-rights date and will be subject to the approval of HMRC and the Company's auditors where required. Participants in the Serco Employee Share Schemes will be contacted separately with further information on how their options and awards may be affected by the Rights Issue.

Directors' Report

Remuneration Report continued

The Remuneration Committee

The Committee determines the overall remuneration policy for senior management and the individual remuneration of the Executive Directors and the members of the Executive Committee. This includes the base salary, bonus, long-term incentives, pensions and terms of employment (including those terms on which service may be terminated). The Committee also determines the remuneration of the Chairman.

Terms of reference

The terms of reference of the Committee, a copy of which can be found on the Group's website, are reviewed annually to ensure that they remain appropriate. Details of the Directors' attendance at meetings of the Committee can be found in the Corporate Governance Report on page 84.

Members of the Committee

All members of the Committee are independent. Non-Executive Directors of the Group are initially appointed for a three-year term, and that appointment may be terminated on three months' written notice.

Remuneration Committee members and attendees (the Committee met 12 times during 2014)

Remuneration Committee members	Position	Comments
Angie Risley	Chairman of Remuneration Committee from 14 May 2012	
Alastair Lyons	Member from 10 May 2011	
Malcolm Wyman	Member from 1 January 2013	
Tamara Ingram	Member from 3 March 2014	

Remuneration Committee attendees during the year	Position	Comments
Rupert Soames	CEO	Attended by invitation
Ed Casey	COO	Attended by invitation
Andrew Jenner	CFO	Attended by invitation
Geoff Lloyd	Group HR Director	Attends as an executive responsible for advising on the remuneration policy
Tara Gonzalez	Group HR Director, Reward	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
Steve Williams	Deputy Company Secretary	Attends as the secretary to the Committee

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

Summary of the Committee's activities during the financial year

Meeting	Regular items	Ad hoc items
February	Consider salary review proposals for the Executive Directors, members of the Executive Committee and the Company Secretary; review final draft of the Remuneration Report; Confirmation of bonus payable; review of achievement of performance conditions for LTI vesting	Review of the Executive Director service agreements; approve changes to the bonus plan
March	Consider proposals for LTI performance measures	
April	Review the performance measures for the LTI awards; review bonus objectives;	Finalisation of termination package for Andrew Jenner
May	Review the share scheme performance; approve LTI awards; review bonus objectives	Approve the executive committee service agreement; approve the change to the PSP and DBP rules
June	Approve the performance measures for the LTI awards	
September	Review performance of the Executive Directors against bonus objectives	
November	Review the Committee Terms of Reference; review initial draft of the Remuneration Report	

Advisors to the Remuneration Committee

The Committee has been advised during the year by PricewaterhouseCoopers LLP (PwC). PwC were selected as advisors to the Committee through a competitive tendering process in 2012 and no conflicts of interest were identified.

PwC have provided advice throughout the year mainly around the following key executive reward areas:

- Advice on remuneration for leavers and joiners in the light of changes to the Executive Directors during 2014
- Benchmarking fees for the Chairman
- Benchmarking the total remuneration of the Executive Directors
- Support in reviewing the Directors' Remuneration Report
- Advice on the calibration of performance targets
- Responding to general and technical reward queries

A representative from PwC attends each meeting of the Remuneration Committee. Consulting services have also been provided to the Group by the advisors in relation to retirement benefits and pay data, accounting and taxation services.

Fees paid to PwC as advisors to the Committee during the year totalled £124,900, fees are charged on an hourly rate basis. PwC are members of the Remuneration Consultants' Group which oversees the voluntary code of conduct in relation to executive consulting in the UK.

The Committee reviews the objectivity and independence of the advice it receives from PwC each year. It is satisfied that PwC is providing robust and professional advice. In the course of its deliberations, the Committee considers the views of the Chief Executive on the remuneration and performance of the other members of the Executive Committee. The Committee have also received legal advice from Linklaters LLP and Clifford Chance LLP during the year.

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

David Eveleigh
Secretary
12 March 2015

Directors' Report

Annual Report and Accounts

The Directors present the Annual Report and Accounts of the Group for the year ended 31 December 2014. Comparative figures used in this report are for the year ended 31 December 2013. The Corporate Governance Report set out on pages 78 to 91 forms part of the Statutory Directors' Report.

The Chairman's Statement and the CEO Statement and Divisional Review on pages 25 to 44 report on the activities during the year, post balance sheet events, and likely future developments. The information in these reports which is required to fulfil the requirements of the Business Review is incorporated in this Directors' Report by reference.

Share capital

The issued share capital of the Company, together with the details of shares issued during the year is shown in note 35 to the Consolidated Financial Statements.

The powers of the Directors to issue or buy back shares are restricted to those approved at the Company's Annual General Meeting.

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

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. The rules governing the appointment and replacement of Directors are set out in the Company's Articles of Association. The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

Dividends

An interim dividend of 3.10p (2013: 3.10p) per ordinary share was paid on 17 October 2014. The Directors do not recommend a final dividend to be paid for 2014 (2013: 7.45p).

Interests in voting rights

As at 11 March 2015 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:

	Number of shares (millions) As at date of notification	Nature of holding	% held As at 31 December 2014
Invesco Limited	54.8	Indirect	9.98
GIC Private Limited	35.1	Direct	6.40
MSDC Management, L.P.	30.6	Indirect	5.58
Artisan Partners Limited Partnership, Artisan Investments GP LLC, Artisan Partners Holdings LP, and Artisan Partners Asset Management Inc.	27.6	Indirect	5.04
Morstan Nominees Limited	25.1	Indirect	4.58
BlackRock Inc.	25.0	Indirect	4.56
FIL Limited	24.4	Indirect	4.46
AXA S.A.	24.4	Indirect	4.44
FMR LLC	24.3	Indirect	4.42
Newton Investment Management Limited	23.6	Indirect	4.30
Ruane, Cunniff & Goldfarb Inc.	22.2	Indirect	4.05
Lancaster Investment Management LLP	22.0	SWAP	4.01
Woodford Investment Management LLP	16.7	Indirect	3.04

The Directors are unaware of any restrictions on transfer of securities in the Company or on voting rights. There are also no known agreements between holders of the Company's securities which may result in such restrictions.

Directors

The current members of the Board together with biographical details of each Director are set out on pages 80 to 81.

On 28 February 2014, the Company announced the appointment of Rupert Soames as Group Chief Executive, commencing 1 May 2014 (as revised). On 30 April 2014 the Company announced that Andrew Jenner would be standing down as Group Chief Financial Officer once a successor had been appointed, which he did on 30 September 2014. On 12 August 2014, the Company announced the appointment of Angus Cockburn as Group Chief Financial Officer with effect from the end of October 2014. Angus will stand for election at the Company's AGM on 6 May 2015. On 17 November 2014, the Company announced Alastair Lyons' intention to step down from his role of Chairman once a new Chairman has been appointed.

As in previous years, and in accordance with the UK Corporate Governance Code, all other Directors will stand for re-election at the 2015 AGM. Although the Chairman has stated his intention to step down, he is standing for re-election so that he can remain Chairman until his replacement has been appointed.

Directors' interests

With the exception of the Executive Directors' service contracts and the Non-Executive Directors' letters of appointment, there are no contracts in which any Director has an interest.

Certain change in control conditions are included in the service contracts of Directors which provide compensation or reduction of notice periods in the event of a change in control of the Company.

Details of the Directors' interests in the ordinary shares and options over the ordinary shares of the Company are set out in the Remuneration Report on pages 101 to 125.

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, a deed was executed in 2015 indemnifying each of the Directors of the Company and/or its subsidiaries 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 of the Company.

Branch offices

In certain jurisdictions, the Group will operate through a branch.

Authority for the purchase of shares

As at the date of this report authority granted at the Company's AGM in May 2014 remains in force, as set out in the Notice of Meeting that is available on the Company's website, at the date of this report.

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 of the Group company concerned, 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 them if the Company is subject to a change of control.

Material customer contracts

- 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 available two year extension options. 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 33.3% 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. In the event that there is a change of control of Serco Holdings Limited or a controlling interest in the Serco Group then the other shareholders in the AWE JV are entitled to purchase the shares and loans held by Serco Holdings Limited and any other member of the Serco Group.
- 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. In the event of a sale of Serco Inc. to a company or person that is under foreign ownership, control or influence (FOCI), the SSA may be terminated by the US Department of Defense.

Directors' Report continued

Financing facilities

- Revolving credit facility: the Company has a £730,000,000 revolving credit facility dated 28 March 2012 with the Bank of America Securities Limited, Barclays Bank PLC, Commonwealth Bank of Australia, Credit Agricole Corporate and Investment Bank, DBS Bank Limited, London Branch, 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, to be amended and restated as a £480,000,000 revolving and bonding credit facility following the successful completion of the rights issue. The facility provides funds for general corporate and working capital purposes, and following its amendment and restatement will provide bonds to support the Group's business needs. The facility agreement provides (and will continue to provide after it has been amended and restated) 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 issued notes under four US Private Placement Note Purchase Agreements (the 'USPP Agreements') dated, 20 August 2003, 9 May 2011, 20 October 2011 and 13 May 2013, respectively. The total amounts of the notes under the four USPP Agreements are £16,600,000 and $886,000,000 and their maturity is between 30 August 2015 and 14 May 2024. Under the terms of the USPP Agreement dated 20 August 2003, if a change of control of the Company is combined with a rating downgrade, the Company is required to offer to prepay the entire principal amount of the notes together with interest to the prepayment date plus a modified make-whole amount. Under the terms of the other three USPP Agreements, if a change of control of the Company occurs, regardless of whether it is combined with a rating downgrade, it is required to offer to prepay the entire principal amount of the notes together with interest to the prepayment date but without payment of any make-whole amount.

Share plans

The Company's share plans contain provisions in relation to a change of control. Outstanding options and awards may vest and become exercisable on a change of control of the Company, in accordance with the rules of the plans.

Annual General Meeting

The Annual General Meeting of the Company will be held at the offices of Clifford Chance LLP, 10 Upper Bank Street, London E14 5JJ on 6 May 2015 at 3.00pm.

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

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 183 to 189.

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. All Group wide human resources policies were reviewed and updated as part of the review of the Serco Management System with new documentation published and communicated in the final quarter of 2014.

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 respect the United Nations Declaration of Human Rights and its Guiding Principles on Business and Human Rights as well as the national laws of the jurisdictions in which we operate. These are embedded in the Company's policies and standards and considered when reviewing business opportunities.

The Group remains proud of its record of managing employee relations and continues to believe that the structure of individual and collective consultation and negotiation is best developed at a local level.

Over the years, the Group has demonstrated that working with trade unions and creating effective partnerships allows improvements to be delivered in business performance as well as in terms and conditions of employment. Where employees choose not to belong to a trade union, employee communication forums such as works councils exist to ensure involvement of staff within the business. These mechanisms ensure employee's 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 sharesave schemes, a share option scheme, and long term incentive arrangements for senior management, which effectively align their interests with those of shareholders by requiring that performance criteria are achieved prior to exercise.

Corporate Responsibility

The Group maintains a focus on corporate responsibility through a model that is applied across the business focusing on our people, safety, the environment and the communities we serve. This model forms an integral part of our Management System and is supported by defined policies in all of the areas it covers. More information on Corporate Responsibility, including Greenhouse Gas Emission reporting, can be found in the Strategic Report on pages 67 to 75.

Research & Development

Serco undertakes a limited amount of research and development, given that our primary business model is the delivery of public services through our people. Nonetheless we spent £21.5m on R&D in 2014 (note 12 to the Consolidated Financial Statements), of which over 85% was accounted for by our contract at the National Physical Laboratory. This contract, operated by Serco on behalf of the UK's Department for Business Innovation and Skills (BIS) was extended for a period of up to 12 months from 1 April 2014. NPL is a global leader in measurement science and a key international collaborator in projects that develop new measurements to make and exploit new scientific discoveries. The scientific output of NPL continues to increase, and in 2014, 256 papers were published by NPL scientists in peer-reviewed scientific journals.

Political donations

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

Financial statements

At the date of this report, as far as each Director is aware, there is no relevant audit information of which the Group's auditors are unaware. Each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

Auditors

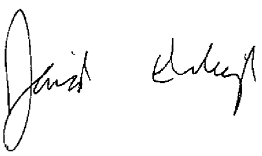
Deloitte LLP has expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Directors' Report continued

Index of Directors' Report disclosures

The information required to be disclosed in the Directors' Report can be found in this Annual Report on 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 (*).

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



David Eveleigh
Secretary
12 March 2015

Directors' Report

Directors' Responsibilities Statement

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the Parent Company financial statements in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing the Parent Company financial statements, the Directors are required to:

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

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

- Properly select and apply accounting policies.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- Provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.
- Make an assessment of the Company's ability to continue as a going concern.

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

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

Responsibility statement

We confirm that to the best of our knowledge:

1. The financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole
2. The Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
3. The annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

By order of the Board

Rupert Soames
Group Chief Executive Officer
12 March 2015

Angus Cockburn
Group Chief Financial Officer
12 March 2015

Financial Statements

P132-216

Independent Auditor's Report to the members of Serco Group PLC

Opinion on financial statements of Serco Group plc

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2014 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise of the Group Income Statement, the Group Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Changes in Equity and the related notes 1 to 57. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Emphasis of matter - Going concern

As required by the Listing Rules we have reviewed the directors' statement contained within Strategic Report in respect of the group's ability to continue as a going concern.

As described in the note 2 to the financial statements the group is in the process of re-financing its debt facilities and seeking approval to raise approximately £555m by way of a fully underwritten rights issue. The completion of the rights issue is dependent on approval from the shareholders of the Company, which at the time of issuing these financial statements has not yet been obtained. If the proposed rights issue is not approved, the group is forecast to breach the covenants in its loan facilities which, in the absence of a waiver, would result in all of the group's debt facilities becoming repayable on demand. In this event, the Group does not anticipate that it would have the funds available to repay such amounts at that time, and would need to take alternative steps in order to be able to continue as a going concern.

Whilst we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate, these conditions indicate the existence of a material uncertainty which may give rise to significant doubt over the group's ability to continue as a going concern. We describe below how the scope of our audit has responded to this risk. Our opinion is not modified in respect of this matter.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team and are the same risks identified as in the prior period other than for the inclusion of going concern and covenant compliance.

Risk

Going concern & covenant compliance

The group is in the process of re-financing its debt facilities and seeking approval to raise approximately £555m by way of a fully underwritten rights issue which as explained in the emphasis of matter paragraph above is dependent on approval from the shareholders of the Company. In the event that the group does not obtain approval for the rights issue, the group is forecast to breach its covenants by June 2015 which would then make the group's debt payable on demand unless the group is successful in obtaining a waiver for such breach.

How the scope of our audit responded to the risk

We considered the impact of group's ongoing discussions with the group's existing lenders noting the covenant deferment received for the measurements of financial covenants as at 31 December 2014;

- We assessed the group's financial forecasts and assessed linkage of the forecasts to the business model and medium-term risks;
- We assessed the historical accuracy of forecasts prepared by management and the review and challenge by management on the current forecasts;
- The group applied commercial and operational sensitivities to its forecasts, We challenged the level of sensitivities applied for reasonableness; and
- We have also considered the adequacy of the extent of disclosure around the uncertainty affecting the going concern assumption.

We include in 'Emphasis of matter – Going Concern' the conclusion of our review of the directors' statement in respect of the group's ability to continue as a going concern.

Risk

Revenue and profit recognition

Revenue and profit recognition on contracts requires judgement over complex areas including assessment of stage of completion; consideration of onerous contract terms; recognition of pre-contract costs; and billing and cash flow arrangements.

During the year, the group identified a number of contracts had become onerous. For these contracts, the group has recognised onerous contract provisions at 31 December 2014 of £476.1m to cover the excess of unavoidable costs of meeting the obligations under the contracts over the economic benefits expected to be received over the remaining term of such contracts. Such provisions arise predominantly where contractual volume and / or price risk rest with the group and forecast revenues are largely fixed.

The group is required to make operational and financial assumptions over periods that can extend up to 10 years into the future in order to estimate the onerous contract provisions. The prediction of future events contains inherent risk and a high degree of management judgement. The group is also required to assess whether the onerous contract provision is a change in estimate arising from an event in the current year or in relation to a prior year error.

Refer to notes 2 and 3 for the group's accounting policy and critical accounting judgements over revenue and profit recognition and refer to note 30 for detailed disclosures of onerous contract provisions recognised by the group as at 31 December 2014.

How the scope of our audit responded to the risk

- We carried out tests relating operating effectiveness of controls over revenue recognition, including the timing of, and the right to recognise, revenue.
- We performed tests relating to controls over internally generated data that the group relies on to recognise revenue over a sample of its contracts.
- We also reviewed forecast costs to complete and profit recognition policies on those contracts where the requirement is to recognise revenue on a percentage of completion basis.
- We developed an expectation of revenue from contracts where the contracts stipulate fixed revenue on a regular basis or by using external volume data and applying the rates per unit as per the contract to test the revenue recognised by the group.
- Where the revenue is not based on a fixed amount or fixed rates per unit, we have performed test of details by testing the underlying work order / change orders for the contracts and the actual expenses incurred to provide those services.
- We challenged specific contract forecasts and historical operational costs to assess whether contracts are deemed to be onerous and reviewed provisions for anticipated losses. This has included a review and challenge of evidence produced by third party experts in determining certain future contract costs.
- We have tested the historical accuracy of forecasting costs to complete.
- For contracts where onerous contract provisions have been recognised, we have assessed whether the provisions were a change of estimate arising from new circumstances in the year or whether they represented the correction of a prior period error.

Risk

Impairment of goodwill and intangible assets

The group has previously recognised goodwill of £1,270.8m allocated to its various cash generating units (CGUs). In the current year, the group has recognised an impairment of £466.0m of goodwill, including £339.7m in respect of businesses held for sale. Refer to note 20 for further detail on impairments and notes 2 and 3 for the group's accounting policy and critical judgements over impairment of goodwill.

The test of impairment of goodwill requires management to estimate the recoverable amounts for the CGUs to which such goodwill is allocated. Estimation of the recoverable amount requires that the group make assumptions in respect of forecast operating cash flows and discount rates.

The group has previously recognised £185.7m of intangible assets and recognised £41.7m of impairment and amortisation in the year. Refer to note 21 for further detail.

The risk for intangible assets is that there are insufficient future operational cash inflows to allow the recovery of these assets which would then result in impairment.

How the scope of our audit responded to the risk

- We have considered the results of management's strategy review and its implications on the carrying value of goodwill for related CGUs.
- Where businesses are held for sale, we have tested management's estimate of fair value less estimated costs to sell in arriving at the impairment of goodwill.
- We challenged management's assumptions within the cash flow forecasts used in the value in use calculations for CGU by reconciling the forecasts to budgets approved by the Board and by performing tests on historical forecasting accuracy. This has included a review and challenge of discount rates provided by third party experts.
- We have challenged the discount rate applied to the separate CGUs by utilising valuation experts, the prevailing group cost of capital at the year end and our understanding of the future prospects of the group.
- We have challenged management's assumptions on the recoverability of intangible assets from future cash flows together with management's assumptions in the allocation of intangible corporate assets to related CGUs.
- We have tested the consistency of forecasts used by management for the assessment of potential impairment of goodwill and intangible assets to the forecasts used for onerous contract provisions, recoverability of deferred tax assets and going concern.

Independent Auditor's Report to the members of Serco Group PLC

Risk

Presentation of exceptional items

The group has recorded £661.5m as expenditures in respect of transactions that fall outside of the normal course of trading. Refer to note 3 for the group's critical acccounting judgement on identification and note 11 for disclosure of such transactions.

In particular, the group undertook a strategy review in the year and have decided to dispose of certain non-core businesses as disclosed in note 41 to the financial statements which has resulted in impairment of the related goodwill and intangible assets of £339.7m.

Exceptional items are not defined by IFRSs as adopted by the European Union. The group is required to exercise judgement in respect of what constitutes a one-off transaction that would distort the underlying performance of the business and comparability of the results with previous years. The group has taken into account the Financial Reporting Council's ("FRC") guidance issued in December 2013 in respect of disclosures of such transactions.

How the scope of our audit responded to the risk

- We reviewed the nature of exceptional items, challenged management's judgements in this area and agreed the quantification of the items to supporting documentation.
- We assessed the other significant gains / losses incurred in the year to ensure that any other items that are exceptional in nature are appropriately disclosed.
- On the impairment of goodwill and intangible assets, we reviewed and challenged management's forecasts and underlying assumptions in determining the level of exceptional costs recorded.
- We obtained and challenged the Directors assessment in respect of inclusion of the costs related to the strategy review in one-off transactions and verified the costs to appropriate audit evidence.
- In respect of the sales of businesses in the year, we also tested the component parts of the profit on disposal calculation to source documentation including the proceeds received, the net assets disposed of and the costs associated with the disposal, including goodwill allocation to the disposed entities.

Risk

Pension commitments

The group has a net pension related asset in relation to its SPLAS scheme of £143.9m and a net pension related liability of £17.4m for other schemes as at 31 December 2014. Refer to note 34 to the financial statements for further details. The net asset value is based on actuarial assumptions used in the measurement of the group's pension commitments which involves judgement in relation to mortality, price inflation, discount rates, and rate of pension and salary increases. Judgement is also exercised in determining whether a pension surplus should be recognised as an asset, and the extent of the group's pension liability in respect of franchise and other contractual agreements.

The group's accounting policy and critical judgement disclosures in relation to recognition of pension assets and liabilities are set out in note 2 and 3.

How the scope of our audit responded to the risk

- We evaluated the appropriateness of the principal actuarial assumptions used in the calculation of the group's pension commitments, using our own actuarial experts, by making enquiries of the group's external actuary as to the key assumptions made and comparing these to our knowledge of market practice.
- As part of our work we obtained advice received by the group and used our internal actuarial specialists to challenge the advice in relation to the group's unconditional right of refund and the recoverability of pension surplus amounts.
- We challenged contract specific pension commitments recorded including those arising from franchise arrangements.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee discussed on page 92.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the group to be £20m, which is set at 3% of adjusted pre-tax loss. Pre-tax loss has been adjusted by adding back net exceptional costs of £661.5m. We have used our judgement to continue to use an income statement based measure and have selected pre-tax loss as the basis for setting materiality to reflect the impact of the current year performance of the group. The loss before tax is adjusted for the net exceptional costs as these costs are of one-off nature and do not represent the underlying performance of the business. The significant losses in the current year have resulted in the Group being in a net liability position as at 31 December 2014. Our selected materiality is less than 1% of the total assets of the Group.

In the previous year, materiality for the group was set at £12.5m which was set at 6.5% of the adjusted pre-tax profit for the year ended 31 December 2013 and was less than 1% of the total assets of the Group. The pre-tax profit was adjusted by adding back net exceptional costs of £90.5m.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.4m (2013: £0.2m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level.

Our identification of significant components is in line with the group's identification of its segments. During the year, the group split the erstwhile UK & Europe (UK&E) segment into Central Government (CG) & Local & Regional Government (LRG) segments and the Australia, Middle East Asia & Asia (AMEAA) segment into Asia Pacific (ASPAC) and Middle East (ME) segments. Therefore, in the current year, we have identified seven significant components compared to the four in the previous year which are all subject to a full scope audit. The seven components and the scope of work performed on each are described below:

Component	Component auditor used	Component materiality
(£ million)		
CG	No	4.6
LRG	No	3.9
SGS	Yes	3.9
ASPAC	Yes	3.9
ME	No	3.5
Americas	Yes	3.9
Corporates	No	3.5

The scope of work over the components set out above provided us with 100% coverage over the group's revenue and net assets.

The group audit team visited the component audit teams in Australia, America and India respectively during the current year audit. In addition to the component auditors mentioned above, we have directed the performance of audit procedures at the group's shared services centre in India and at the group's ME operations with full oversight by the group audit team.

At the parent entity level, the group audit team has tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

In addition to the components described above, the group audit team issued referral instructions to the auditors for the group's joint ventures and reviewed their audit work to seek assurance over the joint venture results included in the financial statements.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate Governance Statement

Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the company's compliance with ten provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Independent Auditor's Report to the members of Serco Group PLC

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Richard Knights (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
12 March 2015

Financial Statements

Consolidated Income Statement

For the year ended 31 December

Continuing operations	Note	2014 £m	2013 (restated)[1] £m
Revenue	10	**3,955.0**	4,284.2
Cost of sales		**(4,019.7)**	(3,788.9)
Gross (loss)/profit		**(64.7)**	495.3
Administrative expenses			
General and administrative expenses		**(597.4)**	(285.0)
Exceptional (loss)/profit on disposal of subsidiaries and operations	11	**(5.4)**	19.2
Other exceptional operating items	11	**(656.1)**	(109.7)
Other expenses – amortisation and impairment of intangibles arising on acquisition		**(23.7)**	(21.4)
Share of profits in joint ventures, net of interest and tax	7	**30.0**	47.1
Operating (loss)/profit		**(1,317.3)**	145.5
Operating (loss)/profit before exceptional items		**(655.8)**	236.0
Investment revenue	14	**6.2**	5.2
Finance costs	15	**(42.9)**	(42.4)
(Loss)/profit before tax		**(1,354.0)**	108.3
Tax on (loss)/profit before exceptional items	16	**(11.1)**	(38.7)
Tax on exceptional items	16	**18.0**	28.8
Tax credit/(charge)		**6.9**	(9.9)
(Loss)/profit for the year		**(1,347.1)**	98.4
Attributable to:			
Equity owners of the Company		**(1,347.3)**	98.4
Non-controlling interests		**0.2**	–
Earnings per share (EPS)			
Basic EPS	19	**(258.35p)**	20.12p
Diluted EPS	19	**(258.35p)**	19.66p

1 Prior year adjustments have been made to reflect the restatement of certain financial instruments. Further details are given in note 4.

Financial Statements

Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2014 £m	2013 (restated) £m
(Loss)/profit for the year		**(1,347.1)**	98.4
Other comprehensive income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial gain on defined benefit pension schemes[1]	34	**52.8**	30.3
Actuarial gain/(loss) on reimbursable rights[1]	34	**13.5**	(37.1)
Tax relating to items not reclassified[1]	16	**(12.9)**	3.0
Share of other comprehensive income in joint ventures		**1.9**	3.9
Items that may be reclassified subsequently to profit or loss:			
Net exchange gain/(loss) on translation of foreign operations[2]		**24.9**	(58.7)
Fair value loss on cash flow hedges during the year[2]		**(2.7)**	(0.9)
Tax relating to items that may be reclassified[2]	16	**–**	(0.1)
Share of other comprehensive expense in joint ventures		**(3.8)**	(1.8)
Total comprehensive (expense)/income for the year		**(1,273.4)**	37.0
Attributable to:			
Equity owners of the Company		**(1,273.7)**	37.0
Non-controlling interest		**0.3**	–

1 Recorded in retirement benefit obligations reserve in the consolidated statement of changes in equity.

2 Recorded in hedging and translation reserve in the consolidated statement of changes in equity.

Financial Statements

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 2013	10.0	326.5	0.1	900.7	(138.6)	77.7	(58.8)	10.0	1,127.6	1.3
Prior year adjustment (note 4)	–	–	–	(8.7)	–	–	–	8.7	–	–
At 1 January 2013 (restated)	10.0	326.5	0.1	892.0	(138.6)	77.7	(58.8)	18.7	1,127.6	1.3
Total comprehensive income for the year	–	–	–	100.5	(3.8)	–	–	(59.7)	37.0	–
Shares transferred to option holders on exercise of share options	–	1.3	–	–	–	(4.5)	4.3	–	1.1	–
Dividends paid	–	–	–	(51.5)	–	–	–	–	(51.5)	(0.6)
Expense in relation to share-based payments	–	–	–	–	–	2.9	–	–	2.9	–
Tax charge in relation to share-based payments	–	–	–	–	–	(5.9)	–	–	(5.9)	–
Purchase of own shares for Employee Share Ownership Trust (ESOT)	–	–	–	–	–	–	(16.0)	–	(16.0)	–
At 1 January 2014 (restated)	**10.0**	**327.8**	**0.1**	**941.0**	**(142.4)**	**70.2**	**(70.5)**	**(41.0)**	**1,095.2**	**0.7**
Total comprehensive (expense) for the year	–	–	–	(1,349.2)	53.4	–	–	22.1	(1,273.7)	0.3
Issue of share capital[1]	1.0	–	–	155.3	–	–	–	–	156.3	–
Shares transferred to option holders on exercise of share options	–	0.1	–	–	–	(3.8)	6.0	–	2.3	–
Dividends paid	–	–	–	(53.1)	–	–	–	–	(53.1)	–
Expense in relation to share-based payments	–	–	–	–	–	5.4	–	–	5.4	–
Tax charge in relation to share-based payments	–	–	–	–	–	(0.4)	–	–	(0.4)	–
Change in non-controlling interest	–	–	–	–	–	–	–	–	–	0.8
At 31 December 2014	**11.0**	**327.9**	**0.1**	**(306.0)**	**(89.0)**	**71.4**	**(64.5)**	**(18.9)**	**(68.0)**	**1.8**

1 During the year, the Group raised £156.3m via an equity placing of £49.9m shares. A cash box structure was used in such a way that merger relief was available under Companies Act 2006, section 612 and thus no share premium needed to be recorded. As the redemption of the cash box entity's preference shares was in the form of cash, the transaction is treated as qualifying consideration and the premium is therefore considered to be a realised profit.

Consolidated Balance Sheet

	Note	At 31 December 2014 £m	At 31 December 2013 (restated) £m	At 1 January 2013 (restated) £m
Non-current assets				
Goodwill	20	**541.5**	1,270.8	1,312.1
Other intangible assets	21	**118.8**	185.7	215.7
Property, plant and equipment	22	**38.4**	176.8	176.9
Interests in joint ventures	7	**1.6**	8.1	11.9
Trade and other receivables	24	**38.1**	78.3	49.2
Derivative financial instruments	33	**7.0**	–	0.1
Deferred tax assets	17	**37.4**	57.9	40.1
Retirement benefit assets	34	**143.9**	64.2	69.7
		926.7	1,841.8	1,875.7
Current assets				
Inventories	23	**31.2**	49.4	53.1
Trade and other receivables	24	**498.8**	764.4	778.1
Current tax assets		**16.5**	19.5	24.6
Cash and cash equivalents	26	**180.1**	125.1	142.8
Derivative financial instruments	33	**5.9**	8.7	2.7
		732.5	967.1	1,001.3
Assets classified as held for sale	41	**564.7**	–	–
		1,297.2	967.1	1,001.3
Total assets		**2,223.9**	2,808.9	2,877.0
Current liabilities				
Trade and other payables	27	**(581.9)**	(644.1)	(757.3)
Derivative financial instruments	33	**(17.7)**	(20.2)	(13.8)
Current tax liabilities		**(12.6)**	(10.4)	(9.6)
Provisions	30	**(205.7)**	(26.2)	(11.5)
Obligations under finance leases	28	**(9.6)**	(14.9)	(10.7)
Loans	29	**(43.9)**	(52.2)	(64.0)
		(871.4)	(768.0)	(866.9)
Liabilities directly associated with assets classified as held for sale	41	**(219.9)**	–	–
		(1,091.3)	(768.0)	(866.9)
Non-current liabilities				
Trade and other payables	27	**(29.7)**	(34.1)	(42.3)
Derivative financial instruments	33	**–**	(21.1)	(24.5)
Deferred tax liabilities	17	**(9.2)**	(34.4)	(30.4)
Provisions	30	**(372.2)**	(34.9)	(44.7)
Obligations under finance leases	28	**(16.9)**	(53.1)	(39.5)
Loans	29	**(753.4)**	(756.1)	(661.8)
Retirement benefit obligations	34	**(17.4)**	(11.3)	(38.0)
		(1,198.8)	(945.0)	(881.2)
Total liabilities		**(2,290.1)**	(1,713.0)	(1,748.1)
Net (liabilities)/assets		**(66.2)**	1,095.9	1,128.9
Equity				
Share capital	35	**11.0**	10.0	10.0
Share premium account	36	**327.9**	327.8	326.5
Capital redemption reserve		**0.1**	0.1	0.1
Retained (loss)/earnings		**(306.0)**	941.0	892.0
Retirement benefit obligations reserve		**(89.0)**	(142.4)	(138.6)
Share-based payment reserve		**71.4**	70.2	77.7
Own shares reserve		**(64.5)**	(70.5)	(58.8)
Hedging and translation reserve		**(18.9)**	(41.0)	18.7
Equity attributable to owners of the Company		**(68.0)**	1,095.2	1,127.6
Non-controlling interest		**1.8**	0.7	1.3
Total equity		**(66.2)**	1,095.9	1,128.9

The financial statements were approved by the Board of Directors on 12 March 2015 and signed on its behalf by:

Rupert Soames
Group Chief Executive Officer

Angus Cockburn
Group Chief Financial Officer

Financial Statements

Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2014 £m	2013 £m
Net cash inflow from operating activities before exceptional items		**103.5**	111.3
Exceptional items		**(40.4)**	(103.4)
Net cash inflow from operating activities	40	**63.1**	7.9
Investing activities			
Interest received		**2.7**	2.6
Increase in security deposits		**–**	(0.2)
Dividends received from joint ventures		**34.8**	51.5
Proceeds from disposal of property, plant and equipment		**5.8**	4.6
Proceeds from disposal of intangible assets		**1.1**	0.4
Proceeds on disposal of subsidiaries and operations	9	**1.9**	40.6
Acquisition of subsidiaries, net of cash acquired	8	**(6.5)**	(18.6)
Acquisition of other investments		**(3.5)**	–
Purchase of other intangible assets		**(20.0)**	(27.8)
Purchase of property, plant and equipment		**(23.4)**	(38.9)
Net cash (outflow)/inflow from investing activities		**(7.1)**	14.2
Financing activities			
Interest paid		**(42.3)**	(40.8)
Dividends paid	18	**(53.1)**	(51.5)
Non-controlling interest dividends paid		**–**	(0.6)
Repayment of loans		**(36.0)**	(77.5)
Repayment of non-recourse loans		**(3.1)**	(10.2)
New loan advances		**17.4**	176.5
Capital element of finance lease repayments		**(18.2)**	(4.9)
Purchase of own shares for Employee Share Ownership Trust (ESOT)		**–**	(16.0)
Costs of equity rights issue		**(4.1)**	–
Share placement net proceeds		**156.3**	–
Proceeds from issue of other share capital and exercise of share options		**2.3**	1.1
Net cash inflow/(outflow) from financing activities		**19.2**	(23.9)
Net increase/(decrease) in cash and cash equivalents		**75.2**	(1.8)
Cash and cash equivalents at beginning of year		**125.1**	142.8
Net exchange gain/(loss)		**2.2**	(15.9)
Cash reclassified to assets held for sale	41	**(22.4)**	–
Cash and cash equivalents at end of year	26	**180.1**	125.1

Financial Statements

Notes to the consolidated financial statements

1. General Information

Serco Group plc (the Company) is a company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY.

These consolidated financial statements (the financial statements) are presented in pounds Sterling because this is the currency of the primary economic environment in which Serco Group operates. Foreign operations are included in accordance with the policies set out in note 2.

2. Significant Accounting Policies

Basis of Accounting

These financial statements on pages 132 to 216 have been prepared in accordance with International Financial Reporting Standards (IFRSs) adopted for use in the European Union 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 for the prior year adjusted item set out in note 4.

Going Concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2014, the Directors have considered the principles of the Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009'; namely assessing the applicability of the going concern basis, the review period and disclosures.

The Group's current principal debt facilities at the year-end comprised a £730m revolving credit facility, and £584.8m of US private placements notes. As at 31 December 2014, the Group had £1,314.8m of committed credit facilities and headroom of £545.0m. Additionally the Group had a receivables financing facility of £60.0m. The Group's stated intention is to reduce the Group's indebtedness to a more prudent level of financial gearing, and anticipates achieving this through the proceeds from the rights issue expected to be received in late April 2015 and the disposal of non-core businesses.

In December 2014, agreement was reached for the Group to defer its December 2014 covenant test until 31 May 2015. When the covenant is calculated in May 2015, EBITDA will exclude the impact of charges arising from the Contract and Balance Sheet Review and Consolidated Net Borrowings will include the net proceeds from the equity rights issue, provided the proceeds are received by 30 June 2015.

Assessment of Going Concern

The Directors have undertaken a rigorous assessment of going concern and liquidity taking into account financial forecasts, the anticipated receipt of proceeds from the rights issue, proposed debt refinancing, and disposals of non-core businesses. 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 the proposed terms of the debt covenants under the amended and restated credit facility, our ability to generate cash from trading activities, and the estimated gross proceeds of approximately £555m due in April 2015 from the proposed fully underwritten rights issue that is subject to shareholder approval. Additionally there has been consideration of the potential reduction in debt levels from planned disposals of non-core businesses in 2015.

Review Period

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future, which is interpreted as the period to December 2016. The Directors have also reviewed the principal risks we face taking account of those identified from the outcome of the Contract and Balance Sheet Review.

Risks Relating to Rights Issue

The Directors have considered in their assessment of going concern, the prospects of the rights issue proceeding, and the net proceeds of the rights issue being received by the Group, together with the risks attached to the rights issue not taking place. The Directors highlight that the prospectus to raise approximately £555m before costs, was sent to shareholders at the same time as the accounts were signed.

The Underwriters' agreement to underwrite the entire rights issues is conditional, amongst other things, on the Company's shareholders passing an ordinary resolution granting the Directors the authority to issue the rights issue shares at the general meeting scheduled to take place on 30 March 2015. The Underwriters will also have termination rights in respect of, for example, breach by the Group of representations, warranties, and undertakings under the Underwriting Agreement. The Underwriting Agreement will become unconditional following admission of the rights issue shares to trading on the London Stock Exchange, which is expected to be on the day following the general meeting (31 March 2015). The Group may still be liable for any losses suffered from breaches of representations, warranties, and undertakings under the Underwriting Agreement.

2. Significant Accounting Policies (continued)

Risks Relating to Refinancing

The Group has entered into agreements with its lenders and noteholders to refinance its current debt facilities, which are conditional on the rights issue proceeding, the Group receiving the net proceeds of the rights issue and the Group repaying up to £450m of its debt facilities. Should the rights issue not proceed the existing debt facilities will remain in place, subject to meeting ongoing financial debt covenant tests.

The Group expects to be able to meet its financial covenant tests under the existing debt facilities on 31 May 2015 in respect of the year ending 31 December 2014. However, unless further waivers or amendments are granted by the lenders, it is anticipated that the Group would breach its financial covenant tests in respect of the 12 months ending 30 June 2015 under the revolving credit facility and the receivables financing agreement when they are tested 90 days after 30 June 2015, which would trigger a cross-default under the US private placement notes. Following any such breach of financial covenants or cross-default, the lenders or noteholders (as applicable) would be entitled to demand the accelerated repayment in full of any amounts outstanding under the relevant existing debt facilities, including any interest due and the payment of a 'make-whole amount' paid to noteholders under the US private placement notes. In this event, the Group does not anticipate that it would have the funds available to repay such amounts at that time, and would need to take alternative steps in order to be able to continue as a going concern, such as seeking:

- to negotiate further waivers of its financial covenants under the existing financing agreements with the lenders and noteholders;
- to establish alternative long-term committed debt facilities with wider covenants to replace the existing financing agreements;
- to derive other forms of funding, such as through a new equity restructuring with private capital investors or a conversion by the Group's lenders of existing debt into equity; and/or
- to make disposals of further assets not already considered for disposal, subject to necessary approvals from lenders and note holders.

Assessment

Despite the challenges and uncertainties which remain in our business, we are making good progress in implementing the plan of actions coming out of the Strategy Review including refocusing the Group as an international B2G business, and in rebuilding trust and confidence with the UK Government. Serco's more focused core will increasingly benefit from the transferability of skills and knowledge from one public service market or geography to another. The portfolio also offers a degree of risk diversification and allows adaptation to the requirements of changing Governments at different times.

As stated above the Group is embarking on a rights issue in order to substantially reduce its debt, and give it a firm financial foundation for its future. However, whilst the rights issue is fully underwritten, it is scheduled to complete within 6 weeks after the date of signing these accounts, and is dependent, inter alia, upon shareholders approving the proposed fundraising. The Directors expect the fundraising to be successfully completed by 24 April 2015. The shareholder approval is expected to be received on 30 March 2015, but at the time of signing these accounts there remains a material uncertainty related to events or conditions that may cast a significant doubt on Serco's ability to continue as a going concern and, therefore that it may be unable to realise its assets and discharge its liabilities in the normal course of business. The Directors believe that the fundraising is likely to be successfully completed by 24 April 2015, and they therefore 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.

Basis of Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (together, the Group) up to 31 December each year. Control is achieved 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.

Financial Statements

Notes to the consolidated financial statements continued

2. Significant Accounting Policies (continued)

Adoption of New and Revised Standards

The following changes to IFRSs became effective in the current reporting period:

Title	Type	Background	Impact on Serco
IAS 32 *Financial Instruments: Presentation*	Amendment to existing standard	IAS 32 affects the offsetting of financial assets and liabilities and was amended to clarify certain requirements on offsetting to make application more consistent.	Historically, financial assets and financial liabilities have not been offset within the Group financial statements as there has been limited ability to do so. Therefore, the impact of the amendments are not expected to have a material impact on future transactions and no adjustment is needed for the required retrospective application.
IAS 39 *Financial Instruments: Recognition and Measurement*	Amendment to existing standard	IAS 39 was amended to clarify that there is no need to discontinue hedge accounting if a hedging derivative is novated (provided certain criteria are met). In order to apply the amendments and continue hedge accounting, novation to a central counterparty must happen as a consequence of laws or regulations or the introduction of laws or regulations.	As the novation of derivatives instruments has not been performed at Serco recently, the application of the amendments did not impact on the Group financial statements when applied retrospectively. There is no expectation to novate any currently held derivatives and therefore there is no future impact anticipated as a result of this change.

New Standards and Interpretations not Applied

At the date of authorisation of these financial statements, the following changes to IFRSs have not been applied in these financial statements but could potentially have a significant impact:

Title	Type	Status	Background	Impact on Serco
IFRS 9 *Financial Instruments*	New standard	Pending EU endorsement, expected prior to the effective date of 1 January 2018	The standard replaces IAS 39 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.	IFRS 9 will impact both the measurement and disclosures of financial instruments and the total value of financial instruments at 31 December 2014 was £354.0m of assets (2013: £361.0m) and £941.3m of liabilities (2013: £1,087.5m), further detail of which can be seen in note 33. However, it is not practicable to provide a reasonable estimate of the effect of this standard until a detailed review has been completed.
IFRS 15 *Revenue*	New standard	Pending EU endorsement, expected prior to the effective date of 1 January 2017	The new standard supersedes all of the following: • IAS 11 *Construction contracts*; • IAS 18 *Revenue*; • IFRIC 13 *Customer loyalty programmes*; • IFRIC 15 *Agreements for the construction of real estate*; • IFRIC 18 *Transfers of assets from customers*; and • SIC-31 *Revenue – Barter transactions involving advertising services*. The new standard is intended to bring greater transparency and comparability to financial reporting, and was initialised as part of the US GAAP convergence project.	The new revenue standard could result in a delay of revenues and profits over those previously recognised, in particular with respect of percentage of completion accounting and where elements of revenues associated with transition activities (also referred to as 'phase-in') have been recognised in the early stages of contracts. Given the significance of the standard we are unable to provide the quantum of any such impact until a full review of our entire contract base has been completed. It is not anticipated that the standard will be adopted early, which would be permitted on endorsement by the EU.

2. Significant Accounting Policies (continued)

In addition to the items detailed above, the changes to IFRSs listed below have not been applied in these financial statements and the Directors do not expect that the adoption of these standards will have a material impact on the Group's financial statements in the period of initial application.

Title	Type	Background	Status
IFRS 12 *Disclosure of Interests in Other Entities*	Amendments	Applying the consolidation exception	Pending EU endorsement, expected prior to the effective date of 1 January 2016.
IAS 1 *Presentation of Financial Statements*	Amendment	Disclosure initiative	Pending EU endorsement, expected prior to the effective date of 1 January 2016.
Annual Improvements to IFRSs: 2010-2012 Cycle: • IFRS 2 *Share-based Payment* • IFRS 3 *Business Combinations* • IFRS 8 *Operating Segments* • IFRS 13 *Fair Value Measurement* • IAS 16 *Property, Plant and Equipment* • IAS 24 *Related Party Disclosures* • IAS 38 *Intangible Assets*	Amendments	Various matters	Endorsed 17 December 2014. Effective for annual periods beginning on or after 1 July 2014.
Annual Improvements to IFRSs: 2011-2013 Cycle: • IFRS 1 *First-time Adoption of International Financial Reporting Standards* • IFRS 3 *Business Combinations* • IFRS 13 *Fair Value Measurement* • IAS 40 *Investment Property*	Amendments	Various matters	Endorsed 18 December 2014. Effective for annual periods beginning on or after 1 July 2014.
IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*	Amendment	Clarification of acceptable methods of depreciation and amortisation.	Pending EU endorsement, expected prior to the effective date of 1 January 2016.
IAS 19 *Employee Benefits*	Amendment	Clarification of accounting for employee contributions set out in the formal terms of a defined benefit plan.	Endorsed 17 December 2014. Effective for annual periods beginning on or after 1 July 2014.
IFRS 11 *Joint Arrangements*	Amendment	Accounting for acquisitions of interests in joint operations.	Pending EU endorsement, expected prior to the effective date of 1 January 2016.

Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or 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 IFRS 2 *Share-based Payments*, leasing transactions that are within the scope of IAS 17 *Leases*, or the calculation of net realisable value under IAS 2 Inventories or value in use under IAS 36 Impairment of Assets.

Revenue Recognition

Revenue is measured as the fair value of the consideration received or receivable and represents amounts due for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Calculating the fair value of revenue typically does not require a significant level of judgement, the exceptions to this are the following areas (further detail of which is provided in note 3):

- Uncontracted variations or claims.
- Payments by results contracts.
- Long-term contracts.

Revenue is deferred when payment is received in advance of performing the related service or delivering the associated goods, and released when the relevant contractual commitment is fulfilled.

Revenue Recognition: Repeat Service-based Contracts

Revenue on repeat service-based contracts is recognised as services are provided. Where initial contract costs (phase-in costs) are paid for by the customer, revenue is recognised when the related costs are incurred.

Financial Statements

Notes to the consolidated financial statements continued

2. Significant Accounting Policies (continued)

Revenue Recognition: *Long-term Project-based Contracts*
The Group has a number of long term contracts for the provision of complex, project-based services. Where the outcome of such long term project-based contracts can be measured reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date in accordance with IAS 18 *Revenue* and IAS 11 *Construction Contracts*. This is 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.

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.

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 is awarded preferred bidder status. Bid costs incurred after this point are then capitalised within trade and other receivables. On contract award these bid costs are amortised through the income statement over the contract period by reference to the stage of completion of the contract activity at the balance sheet date. Bid costs are only capitalised to the extent that it is expected that the related contract will generate sufficient future economic benefits to at least offset the amortisation charge.

Phase in costs that are incremental and directly related to the initial set-up of contracts are capitalised within trade and other receivables and are recognised on a straight-line basis over the life of the contract, except where they are specifically reimbursed as part of the terms of the contract when they are recognised as revenue.

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 24 and further detail of the judgements can be seen in note 3.

Foreign Currencies
Transactions in currencies other than Sterling are recorded at the rates of exchange on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Gains and losses arising on retranslation are included in the net profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity through the consolidated statement of comprehensive income (SOCI).

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

Business Combinations
Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. Acquisition related costs are recognised in profit or loss as incurred.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition date fair value. Subsequent changes in fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (which is subject to a maximum of one year). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with the relevant accounting standards. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 (2008) *Business Combinations* are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

2. Significant Accounting Policies (continued)

Assets Classified as Held For Sale

Non current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is only met when the sale is highly probable, the asset or disposal group is available for immediate sale in its present condition and the Group expects the sale to be completed within one year. Amounts classified as held for sale are measured as the lower of the carrying amount and fair value less cost to sell.

Assessing whether the criteria are met requires judgement, in particular with regards to whether the subject of the assessment is in a suitable condition for sale. In addition, the calculation of the value of any goodwill to be allocated to the sale is dependent on an assessment of the likely sales proceeds and the likely structure of the transaction.

Investments in Joint Ventures

A joint venture is an arrangement whereby the owning parties have joint control and rights over the net assets of the arrangement. 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 is provided in notes 6 and 7.

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 advisors and any amount of consideration which is contingent in nature is evaluated at the end of each reporting period, based on internal forecasts. There were no material acquisitions in the current or prior year.

Other Intangible Assets

Material intangible assets are grouped into classes of similar nature and use and separately disclosed and are amortised from the date of completion.

Customer relationships can arise on the acquisition of subsidiaries and represent 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, it 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.

Financial Statements

Notes to the consolidated financial statements continued

2. Significant Accounting Policies (continued)

While customer relationship and licence assets will arise from specific transactions and can be clearly identified, both software and development type assets can include a significant level of internal costs and determining whether these are directly incremental to the creation of the specific asset requires a high level of judgement (further detail of which is provided in note 3).

Pension related intangibles represent assets arising in relation to the Group's right to manage and operate contracts where there is a defined benefit pension scheme and it is not virtually certain that contributions will be recovered from the customer but where the Group's obligation to contribute to the scheme ends when the contract ends. The intangible assets represent the Group's share of scheme net liabilities on the date that contracts commence and are amortised on a straight-line basis over the life of the contract. At the creation of such assets, a reasonable level of judgement is required in order to determine if the specific rules and obligations associated with the scheme allow the responsibility of paying down the remaining deficit at the end of a contract to be passed on to the new supplier, and legal advice is sought to mitigate this risk. As explained in note 11, during the year a settlement was made to the Trustees of the Docklands Light Railway Pension Scheme in respect of a legal claim made against us to fund the pension deficit. Whilst the payment was made to resolve the issue with the customer, the historic accounting for the pension scheme remains appropriate and the judgement applied in recognising the pension related intangible was appropriate at the time based on the legal documentation and advice provided.

Property, Plant and Equipment

Assets held for use in the rendering of services, or for administrative purposes, are stated in the balance sheet at cost, net of accumulated depreciation and any provision for impairment. Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

Depreciation is provided on a straight-line basis at rates designed to reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:	
Freehold buildings	2.5%
Short-leasehold building improvements	The higher of 10% or the rate produced by the lease term
Machinery	15%–20%
Motor vehicles	10%–50%
Furniture	10%
Office equipment	20%–33%
Leased equipment	The higher of the rate produced by the lease term or useful life

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement. 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 involve significant judgement.

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 IAS 36 *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 its carrying amount, 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 units 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.

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 adjusted for unrecognised past service costs, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds (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 outside the income statement and are presented in the SOCI.

Multi-employer Pension Schemes

Multi-employer pension schemes are classified as either a defined contribution pension scheme or a defined benefit pension scheme under the terms of the scheme.

Derivative Financial Instruments and Hedging Activities

The Group enters into a variety of derivative financial instruments to manage the exposure to interest rate, foreign exchange risk and price risk, including currency swaps, foreign exchange forward contracts, interest rate swaps and commodity future contracts. Further details of derivative financial instruments are given in note 33.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities (fair value hedges) or hedges of highly probable forecast transactions or hedges of firm commitments (cash flow hedges).

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 33.

Notes to the consolidated financial statements continued

2. Significant Accounting Policies (continued)

Fair value Hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Hedge accounting is discontinued when the Group de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

Cash Flow Hedges
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss, in the same line of the income statement as the recognised hedged item.

Hedge accounting is discontinued when the Group de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

Tax
The tax expense represents the sum of current tax expense and deferred tax expense.

Current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for accounting purposes.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which these items can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of an asset and liability in a transaction other than a business combination and, at the time of the transaction, affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be utilised.

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same tax authority where the Group intends to settle its current tax assets and liabilities on a net basis.

2. Significant Accounting Policies (continued)

Share-based Payment
The Group makes equity-settled share-based payments to certain employees and operates an HMRC approved Save As You Earn (SAYE) share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. SAYE options are treated as cancelled when employees cease to contribute to the scheme, resulting in an acceleration of the remainder of the related expense.

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of the Binomial Lattice or Monte Carlo Simulation models depending on the type of scheme, as set out in note 38. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

Inventories
Inventories are stated at the lower of cost and net realisable value and comprise service spares, parts awaiting installation and work in progress for projects undertaken for customers where payment is received on completion. Cost comprises direct materials and, where applicable, direct labour costs that have been incurred in bringing the inventories to their present location and condition.

Trade Receivables
Trade receivables are recognised initially at 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 or are blue chip private sector companies 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 the likelihood is considered to be greater than 50%.

Financial Statements

Notes to the consolidated financial statements continued

2. Significant Accounting Policies (continued)

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 linked to the activity performed within contracts 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 loss over the remaining contract period. Where a customer has an option to extend a contract and the Group is expected to make a loss during the extension period, this 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.

An inherent level of judgement covering all of the items below exists regarding whether an amount recognised in the financial statements represents an error or a change in estimate. An error exists when an amount is recognised based on information that was available when the prior period financial statements were issued and could be reasonably expected to have been obtained and taken into account when those financial statements were prepared. The only such item relates to the mistreatment of certain hedging relationships as explained in note 4.

Provisions for Onerous Contracts

Determining whether provisions are required for loss making contracts requires significant judgements to be made regarding the ability of the Company to maintain or improve operational performance. Judgements can also be made regarding the outcome of matters dependent on the behaviour of the customer in question.

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.

In recent years, additional contractual risks have been passed from customers to the Group, which has involved matters over which the Group has limited control and where there is insufficient contractual compensation for the changes. These include Service User volumes and the level of customer use of assets where we have a requirement to fund repairs and maintenance. Certain events in the current year have led to a significant crystallisation of such risks, resulting in a charge to onerous contract provisions of £476.1m. Further details can be seen in note 30. Additionally, and as a result of certain contracts becoming onerous in the period, contract specific assets including property, plant and equipment, bid costs, phase-in costs, accrued income and prepayment balances of £114.7m have been impaired.

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. The total value of assets which are covered by this assessment process (after previous impairments) is £1,379.4m (2013: £2,628.7m), which is the maximum exposure related to this judgement. We mitigate the risk associated with this judgement by putting in place processes and guidance for the finance community and internal review procedures.

3. Critical Accounting Judgements and Key Sources of Estimation Uncertainty (continued)

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.

During the year, goodwill associated with four CGUs was determined to be impaired, resulting in an exceptional charge of £466.0m. In addition, a charge of £44.6m was recognised in respect of certain intangible assets. A charge of £40.7m was recognised in respect of certain items of property, plant and equipment and £21.6m in respect of billed receivables. Further details of these impairments can be seen in notes 20, 21, 22 and 24 to the financial statements.

Capitalisation of Internally Generated Intangible Assets
When the Group creates an intangible asset where the future economic benefits are greater than the expected costs, the development costs are capitalised if they meet the other requirements of IAS 38, Intangible Assets, as set out in the accounting policies section above.

Revenue and Recognition
Calculating the fair value of revenue typically does not require a significant 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 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.
- 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.
- 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 to estimated whole-life contract costs, except where whole life contract costs exceed the contract value, in which case the excess is expensed immediately.

Separation of Income Statement Items from Underlying Results
IAS 1 requires material items to be disclosed separately in a way that enables users to assess the quality of a company's profitability. In practice, these are commonly referred to as 'exceptional' items, but this is not a concept defined by IFRS and therefore there is a level of judgement involved in determining what to include in underlying profit. We consider items which are material, non-recurring and outside of the normal operating practice of the Company to be suitable for separate presentation.

Retirement Benefit Obligations
The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates (see note 34). The value of net retirement benefit obligations at the balance sheet date is an asset of £126.5m (2013: £52.9m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in note 34.

Assets Classified as Held For Sale
The Group has classified several businesses as held for sale in the current year and where appropriate an allocation of goodwill has been made. This allocation is a best estimate based on indicative offers and these values may change as the deals are finalised. In addition, customer consent is required in some cases, which is usual and customary for the sale of businesses with outsourcing contracts. Receipt of these consents is assumed to be highly probable, but this is an area of judgement.

4. Prior Year Restatement

Two prior year adjustments have been made to reflect the restatement of certain financial instruments. These resulted in a cumulative net charge of £5.6m to prior years' reported profits, which included a net credit to the 2013 profit for the year of £3.0m. These amounts had previously been taken directly to reserves, and as a consequence there was no adjustment required to restate the net assets of the Group as at 31 December 2013 or prior years.

The first adjustment relates to derivatives held by Intelenet at the time of Serco's acquisition of that company in 2011. Under IFRS 3, in order to achieve hedge accounting at a Group level, these derivatives should have been designated at Serco Group level at that time. Because the Group designation was not made at that time, they do not qualify for hedge accounting and so the fair value movement on these instruments since 2011, together with the associated tax, has been reclassified to either retained earnings or the income statement. The second adjustment relates to net investment hedges that should have been designated in 2011. Because the designations were not made at that time, they do not qualify for hedge accounting and so the fair value movement on these instruments since 2011 has been reclassified to either retained earnings or the income statement.

Financial Statements

Notes to the consolidated financial statements continued

4. Prior Year Restatement (continued)

Impact of prior year restatement on summarised financial statements

Year ended 31 December 2013	As previously disclosed £m	Derivatives £m	Net Investment Hedges £m	Restated £m
Income statement				
Revenue	4,288.1	(3.9)	–	4,284.2
Operating profit	**143.8**	**(3.9)**	**5.6**	**145.5**
Investment revenue	5.2	–	–	5.2
Finance costs	(42.4)	–	–	(42.4)
Profit before tax	**106.6**	**(3.9)**	**5.6**	**108.3**
Tax (charge)/credit	(11.2)	1.3	–	(9.9)
Profit for the year	**95.4**	**(2.6)**	**5.6**	**98.4**
Earnings per share	**19.51p**	**(0.53p)**	**1.14p**	**20.12p**
Other comprehensive (expense)/income for the year	(58.4)	2.6	(5.6)	(61.4)
Total comprehensive income for the year	**37.0**	**–**	**–**	**37.0**
Balance sheet				
Non-current assets	1,841.8	–	–	1,841.8
Current assets	967.1	–	–	967.1
Total assets	**2,808.9**	**–**	**–**	**2,808.9**
Current liabilities	(768.0)	–	–	(768.0)
Non-current liabilities	(945.0)	–	–	(945.0)
Total liabilities	**(1,713.0)**	**–**	**–**	**(1,713.0)**
Net assets	**1,095.9**	**–**	**–**	**1,095.9**
Retained earnings	946.7	(30.9)	25.2	941.0
Hedging and translation reserve	(46.7)	30.9	(25.2)	(41.0)
Other equity accounts	195.9	–	–	195.9
Equity	**1,095.9**	**–**	**–**	**1,095.9**
Cash flow				
Net cash inflow from operating activities	7.9	–	–	7.9
Investing activities	14.2	–	–	14.2
Financing activities	(23.9)	–	–	(23.9)
Net decrease in cash and cash equivalents	**(1.8)**	**–**	**–**	**(1.8)**
Net exchange loss	(15.9)	–	–	(15.9)

Year ended 31 December 2012	As previously disclosed £m	Derivatives £m	Net Investment Hedges £m	Restated £m
Income statement				
Revenue	4,060.1	(3.3)	–	4,056.8
Operating profit	**272.2**	**(3.3)**	**18.3**	**287.2**
Investment revenue	6.4	–	–	6.4
Exceptional other gain	51.1	–	–	51.1
Finance costs	(48.6)	–	–	(48.6)
Profit before tax	**281.1**	**(3.3)**	**18.3**	**296.1**
Tax (charge)/credit	(40.1)	1.1	–	(39.0)
Profit for the year	**241.0**	**(2.2)**	**18.3**	**257.1**
Attributable to equity shareholders of the Company	240.4			256.5
Earnings per share	**48.94p**	**(0.44p)**	**3.72p**	**52.22p**
Other comprehensive (expense)/income for the year	(79.6)	2.2	(18.3)	(95.7)
Total comprehensive income for the year	**161.4**	**–**	**–**	**161.4**

4. Prior Year Restatement (continued)

At 1 January 2013	As previously disclosed £m	Derivatives £m	Net Investment Hedges £m	Restated £m
Balance sheet				
Non-current assets	1,875.7	–	–	1,875.7
Current assets	1,001.3	–	–	1,001.3
Total assets	**2,877.0**	**–**	**–**	**2,877.0**
Current liabilities	(866.9)	–	–	(866.9)
Non-current liabilities	(881.2)	–	–	(881.2)
Total liabilities	**(1,748.1)**	**–**	**–**	**(1,748.1)**
Net assets	**1,128.9**	**–**	**–**	**1,128.9**
Retained earnings	900.7	(28.3)	19.6	892.0
Hedging and translation reserve	10.0	28.3	(19.6)	18.7
Other equity accounts	218.2	–	–	218.2
Equity	**1,128.9**	**–**	**–**	**1,128.9**
Cash flow				
Net cash inflow from operating activities	220.9	–	–	220.9
Investing activities	(4.0)	–	–	(4.0)
Financing activities	(259.8)	–	–	(259.8)
Net decrease in cash and cash equivalents	(42.9)	–	–	(42.9)
Net exchange loss	(8.9)	–	–	(8.9)

At 1 January 2012	As previously disclosed £m	Derivatives £m	Net Investment Hedges £m	Restated £m
Balance sheet				
Non-current assets	1,872.1	–	–	1,872.1
Current assets	958.9	–	–	958.9
Total assets	**2,831.0**	**–**	**–**	**2,831.0**
Current liabilities	(922.7)	–	–	(922.7)
Non-current liabilities	(904.5)	–	–	(904.5)
Total liabilities	**(1,827.2)**	**–**	**–**	**(1,827.2)**
Net assets	**1,003.8**	**–**	**–**	**1,003.8**
Retained earnings	703.5	(26.1)	1.3	678.7
Hedging and translation reserve	28.6	26.1	(1.3)	53.4
Other equity accounts	271.7	–	–	271.7
Equity	**1,003.8**	**–**	**–**	**1,003.8**

5. Segmental Information

This note is presented according to the management structure and internal reporting that Serco has put in place for 2015 as a result of actions from the Corporate Renewal Programme and the Strategy Review. The former segments, as reported in 2014 to the Board, is provided in note 42. The UK Central Government division is now a separate unit which brings together Serco's work for the UK Central Government; it also brings together all Transport operations, including those for devolved authorities that were previously included in the UK and Europe Local and Regional Government division. The UK and Europe Local and Regional Government division now incorporates public sector BPO operations previously included in the Global Services division, together with Citizen Services previously included in the Central Government division; all public sector BPO operations are therefore now brought together in this division. The AMEAA region is now reported as two separate divisions – 'AsPac' (the Asia Pacific region, consisting principally of Serco's operations in Australia and New Zealand) and the Middle East. Americas remains as a distinct regional division. The Global Services division now consists of BPO operations only in the private sector.

The Group has simplified its reporting by ending the sharing of Income Statement reporting of certain contracts between two segments. This shared reporting of contracts occurred predominantly between the AsPac and UK segments, with these contracts now being solely reported within the segment that delivers the contract to the end customer.

Going forward, eliminating the shared Income Statement reporting of such contracts will increase the transparency and clarity of our segmental performance reporting. The prior year comparative segmental information has been restated to reflect these changes.

Notes to the consolidated financial statements continued

5. Segmental Information (continued)

The Group's new reportable operating segments reflecting the information reported to the Board in 2015 under IFRS 8 *Operating Segments* are:

Reportable segments	Operating segments
UK Central Government	Frontline services for sectors including Defence, Justice & Immigration and Transport delivered to UK Government;
UK and Europe Local and Regional Government	Services for sectors including Health, Local Government Direct Services, Citizen Services and BPO services delivered to UK & European public sector customers;
Americas	Professional, technology and management 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	Frontline services for sectors including Defence, Justice and Immigration, Transport, Healthcare and Citizen Services in the Asia Pacific region including Australia, New Zealand and Hong Kong;
Middle East	Frontline services for sectors including Defence, Transport and Healthcare in the Middle East region;
Global Services	BPO services for private sector customers predominantly in the UK, India and North America; and
Corporate	Central and head office costs

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 2014 £m	Non-current assets[1] 2014 £m	Revenue 2013 £m	Non-current assets[1] 2013 £m
United Kingdom	**1,917.8**	**485.2**	2,071.5	784.1
United States	**660.4**	**337.5**	706.5	423.7
Australia	**657.0**	**140.3**	833.0	167.0
Middle East	**267.2**	**13.6**	285.4	14.6
Other countries	**452.6**	**308.7**	387.8	391.9
Total	**3,955.0**	**1,285.3**	4,284.2	1,781.3

1 Non-current assets exclude financial instruments, deferred tax assets and loans to joint ventures and includes assets of £405.4m (2013: £nil) reclassified as held for sale.

Revenues from external customers are attributed to individual countries on the basis of the location of the customer.

Information About Major Customers

The Group has two major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were respectively £1,709.3m (2013: £1,807.0m) across Central Government and Local and Regional Government and £574.6m (2013: £643.2m) within the Americas segment.

5. Segmental Information (continued)

The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment:

Year ended 31 December 2014	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Revenue	961.4	959.8	708.1	706.0	260.4	359.3	–	3,955.0
Result								
Trading (loss)/profit[1]	(242.8)	(90.4)	16.5	(201.6)	(0.2)	(23.4)	(90.2)	(632.1)
Amortisation and impairment of intangibles arising on acquisition	(0.1)	(7.2)	(2.3)	(8.6)	–	(5.5)	–	(23.7)
Operating (loss)/profit before exceptional items	(242.9)	(97.6)	14.2	(210.2)	(0.2)	(28.9)	(90.2)	(655.8)
Exceptional (loss)/profit on disposal of subsidiaries and operations	1.9	0.4	–	–	–	(3.1)	(4.6)	(5.4)
Other exceptional operating items	(42.7)	(95.9)	(101.7)	(41.3)	(1.7)	(332.7)	(40.1)	(656.1)
Operating loss	(283.7)	(193.1)	(87.5)	(251.5)	(1.9)	(364.7)	(134.9)	(1,317.3)
Investment revenue								6.2
Finance costs								(42.9)
Loss before tax								(1,354.0)
Tax credit								6.9
Loss for the year								(1,347.1)

1 Trading (loss)/profit is defined as operating (loss)/profit before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Supplementary Information								
Interest in the profit of joint ventures	29.6	1.2	0.1	(0.9)	–	–	–	30.0
Depreciation of plant, property and equipment	(10.9)	(13.1)	(2.5)	(6.4)	(0.8)	(7.4)	(0.7)	(41.8)
Impairment of plant, property and equipment	(17.5)	(1.8)	–	(12.9)	–	(4.0)	(4.5)	(40.7)
Total depreciation and impairment of plant, property and equipment	(28.4)	(14.9)	(2.5)	(19.3)	(0.8)	(11.4)	(5.2)	(82.5)
Amortisation of intangible assets arising on acquisition	(0.1)	(1.7)	(2.3)	(2.2)	–	(5.1)	–	(11.4)
Exceptional impairment of intangible assets arising on acquisition	–	–	–	–	–	(5.0)	–	(5.0)
Impairment of intangible assets arising on acquisition	–	(5.5)	–	(6.4)	–	(0.4)	–	(12.3)
Exceptional impairment of other intangible assets	–	–	–	–	–	(1.0)	–	(1.0)
Amortisation of other intangible assets	(1.5)	(14.2)	(1.5)	(1.3)	(0.9)	(2.4)	(5.5)	(27.3)
Impairment and write down of other intangible assets	(2.9)	(11.0)	(3.1)	(0.2)	–	(5.8)	(3.3)	(26.3)
Total amortisation and impairment of intangible assets	(4.5)	(32.4)	(6.9)	(10.1)	(0.9)	(19.7)	(8.8)	(83.3)
Segment assets								
Interests in joint ventures	(7.0)	5.0	0.2	3.0	0.4	–	–	1.6
Other segment assets	135.1	431.9	458.9	236.3	99.7	394.5	178.9	1,935.3
Total segment assets	128.1	436.9	459.1	239.3	100.1	394.5	178.9	1,936.9
Unallocated assets								287.0
Consolidated total assets								2,223.9
Segment liabilities								
Segment liabilities	146.1	247.5	62.0	99.2	55.2	29.3	93.3	732.6
Unallocated liabilities								1,557.5
Consolidated total liabilities								2,290.1

Financial Statements

Notes to the consolidated financial statements continued

5. Segmental Information (continued)

Year ended 31 December 2013 (restated)	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Revenue	1,074.6	963.0	764.6	870.6	267.9	343.5	–	4,284.2
Result								
Trading profit/(loss)[1]	114.6	17.8	65.1	78.2	24.5	7.8	(50.6)	257.4
Amortisation and impairment of intangibles arising on acquisition	(0.4)	(1.7)	(11.3)	(2.4)	–	(5.6)	–	(21.4)
Operating profit/(loss) before exceptional items	114.2	16.1	53.8	75.8	24.5	2.2	(50.6)	236.0
Exceptional profit on disposal of subsidiaries and operations	23.2	(4.0)	–	–	–	–	–	19.2
Other exceptional operating items	(73.9)	(18.7)	–	(10.1)	–	(5.7)	(1.3)	(109.7)
Operating profit/(loss)	63.5	(6.6)	53.8	65.7	24.5	(3.5)	(51.9)	145.5
Investment revenue								5.2
Finance costs								(42.4)
Profit before tax								108.3
Tax charge								(9.9)
Profit for the year								98.4

1 Trading profit/loss is defined as operating profit/loss before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Supplementary information								
Interest in the profit of joint ventures	41.5	1.2	–	4.4	–	–	–	47.1
Depreciation of plant, property and equipment	(10.8)	(12.9)	(2.7)	(7.9)	(1.0)	(10.3)	(0.7)	(46.3)
Impairment of plant, property and equipment	(1.4)	–	–	(6.4)	–	–	–	(7.8)
Total depreciation and impairment of plant, property and equipment	(12.2)	(12.9)	(2.7)	(14.3)	(1.0)	(10.3)	(0.7)	(54.1)
Amortisation of intangible assets arising on acquisition	(0.4)	(1.7)	(11.3)	(2.4)	–	(5.6)	–	(21.4)
Amortisation of other intangible assets	(2.4)	(11.6)	(1.3)	(1.2)	(0.9)	(1.9)	(5.4)	(24.7)
Exceptional impairment of other intangible assets	–	–	–	(3.2)	–	–	–	(3.2)
Total amortisation and impairment of intangible assets	(2.8)	(13.3)	(12.6)	(6.8)	(0.9)	(7.5)	(5.4)	(49.3)
Segment assets								
Interests in joint ventures	(2.3)	3.7	0.2	6.5	–	–	–	8.1
Other segment assets	224.5	640.3	558.3	324.9	93.8	618.4	126.0	2,586.2
Total segment assets	222.2	644.0	558.5	331.4	93.8	618.4	126.0	2,594.3
Unallocated assets								214.6
Consolidated total assets								2,808.9
Segment liabilities								
Segment liabilities	(142.9)	(229.0)	(70.3)	(108.3)	(39.4)	(37.8)	(61.3)	(689.0)
Unallocated liabilities								(1,024.0)
Consolidated total liabilities								(1,713.0)

6. List of Principal Undertakings

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements.

A complete list of subsidiary and associated undertakings will be attached to the next Serco Group plc annual return to Companies House.

The percentage of equity capital held directly or indirectly by Serco Group plc is shown below, together with the location of incorporation and operation. The voting rights are the same as the percentage holding.

Principal Subsidiaries		2014	2013
United Kingdom	Serco Limited	100%	100%
Australia	Serco Australia Pty Limited	100%	100%
India	Intelenet Global Services Private Limited	100%	100%
USA	Serco Inc.	100%	100%

Principal joint venture undertakings		2014	2013
United Kingdom	AWE Management Limited	33%	33%
	Northern Rail Holdings Limited	50%	50%

All joint ventures are accounted for using the equity method, none have quoted shares and there are no significant restrictions on the ability of any of the joint ventures to pay dividends or repay amounts owed. All the subsidiaries of the Group have been consolidated.

All the principal subsidiaries of Serco Group plc and its joint venture undertakings are engaged in the provision of support services.

7. Joint Ventures

The Group has certain arrangements where control is shared equally with one or more parties. As each arrangement is a separate legal entity and legal ownership and control are equal with all other parties, there are no significant judgements required to be made.

AWE Management Limited and Northern Rail Holdings Limited are the only joint ventures which are material to the Group. Dividends of £16.8m (2013: £25.5m) and £8.9m (2013: £14.2m) respectively were received from these companies in the year.

Summarised financial information of the joint ventures which are material to the Group, being AWE Management Limited and Northern Rail Holdings Limited and an aggregation of the other joint ventures in which the Group has an interest is as follows:

31 December 2014

Summarised financial information	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Other joint venture arrangements (100% of results) £m	Group portion of material joint ventures[1] £m	Group portion of other joint venture arrangements[1] £m	Total £m
Revenue	989.3	577.5	397.0	618.5	179.8	798.3
Operating profit	54.9	17.7	23.8	27.2	10.7	37.9
Net investment revenue/(finance costs)	0.3	0.4	(1.4)	0.3	(0.6)	(0.3)
Income tax expense	(4.6)	(5.1)	(7.0)	(4.1)	(3.5)	(7.6)
Profit from continuing operations	50.6	13.0	15.4	23.4	6.6	30.0
Other comprehensive income/(expense)	–	0.8	(4.3)	0.4	(2.3)	(1.9)
Total comprehensive income	50.6	13.8	11.1	23.8	4.3	28.1
Non-current assets	583.7	10.5	44.9	199.8	18.1	217.9
Current assets	246.5	72.9	74.4	118.6	31.5	150.1
Current liabilities	(230.1)	(83.5)	(65.7)	(118.4)	(29.4)	(147.8)
Non-current liabilities	(583.3)	(6.0)	(51.1)	(197.5)	(21.1)	(218.6)
Net assets/(liabilities)	16.8	(6.1)	2.5	2.5	(0.9)	1.6
Proportion of Group ownership	33%	50%	–	–	–	–
Carrying amount of investment	5.5	(3.0)	(0.9)	2.5	(0.9)	1.6

1 Total results of the joint ventures multiplied by the respective proportion of Group ownership.

Financial Statements

Notes to the consolidated financial statements continued

7. Joint Ventures (continued)

Supplementary material	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Other joint venture arrangements (100% of results) £m	Group portion of material joint ventures[1] £m	Group portion of other joint venture arrangements[1] £m	Total £m
Cash and cash equivalents	106.1	33.5	41.0	52.1	19.1	71.2
Current financial liabilities excluding trade and other payables and provisions	(2.2)	(10.3)	(3.6)	(5.9)	(1.8)	(7.7)
Non-current financial liabilities excluding trade and other payables and provisions	–	(2.3)	(16.0)	(1.2)	(4.2)	(5.4)
Depreciation and amortisation	–	(4.3)	(6.4)	(2.2)	(2.6)	(4.8)
Interest income	0.3	0.5	0.3	0.4	0.1	0.5
Interest expense	–	(0.1)	(1.7)	(0.1)	(0.7)	(0.8)

1 Total results of the joint ventures multiplied by the respective proportion of Group ownership.

The financial statements of Northern Rail Holdings Limited are for a period which is different from that of the Group, being for the 52 week period ended 3 January 2015. 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.

Certain employees of the groups headed by AWE Management Limited and Northern Rail Holdings Limited are members of sponsored defined benefit pension schemes. Given the significance of the schemes to understanding the position of the joint ventures the following key disclosures are made:

Main assumptions: 2014	AWE Management Limited	Northern Rail Holdings Limited
Rate of salary increases (%)	3.0%	3.0%
Inflation assumption (CPI, %)	2.1%	2.1%
Discount rate (%)	3.8%	3.7%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.9	N/A
Future male industrial pensioners at 65 (years)	24.6	N/A

Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(1,708.7)	(902.9)
Fair value of scheme assets	1,125.6	640.6
Net amount recognised	(583.1)	(262.3)
Members' share of deficit	–	104.9
Franchise adjustments[1]	–	156.0
Related asset, right to reimbursement	583.1	–
Net retirement benefit obligation	–	(1.4)

1 The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

The Northern Rail defined benefit pension scheme uses a mortality rate multiplier of 98% based on the S1 normal males (heavy) table, adjusted for the geographic location of members.

AWE Management Limited is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of Northern Rail Holdings Limited covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

7. Joint Ventures (continued)

31 December 2013

Summarised financial information	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Other joint venture arrangements (100% of results) £m	Group portion of material joint ventures[1] £m	Group portion of other joint venture arrangements[1] £m	Group portion Total £m
Revenue	1,023.6	650.4	415.6	666.4	189.4	855.8
Operating profit	77.7	33.6	34.3	42.7	16.2	58.9
Net investment revenue/(finance costs)	0.3	0.6	(1.9)	0.4	(0.8)	(0.4)
Income tax expense	(11.1)	(9.4)	(7.0)	(8.4)	(3.0)	(11.4)
Profit from continuing operations	66.9	24.8	25.4	34.7	12.4	47.1
Other comprehensive (expense)/income	–	(2.6)	8.4	(1.3)	3.4	2.1
Total comprehensive income	66.9	22.2	33.8	33.4	15.8	49.2
Non-current assets	454.2	12.0	49.7	157.4	20.1	177.5
Current assets	163.2	90.2	83.9	99.5	36.7	136.2
Current liabilities	(147.3)	(95.2)	(77.8)	(96.7)	(34.9)	(131.6)
Non-current liabilities	(453.6)	(9.2)	(45.4)	(155.8)	(18.2)	(174.0)
Net assets	16.5	(2.2)	10.4	4.4	3.7	8.1
Proportion of Group ownership	33%	50%	–	–	–	–
Carrying amount of investment	5.5	(1.1)	3.7	4.4	3.7	8.1

Supplementary material	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Other joint venture arrangements (100% of results) £m	Group portion of material joint ventures £m	Group portion of other joint venture arrangements £m	Group portion Total £m
Cash and cash equivalents	39.3	49.0	28.0	37.6	12.7	50.3
Current financial liabilities excluding trade and other payables and provisions	(7.5)	(5.2)	(3.4)	(5.1)	(1.5)	(6.6)
Non-current financial liabilities excluding trade and other payables and provisions	–	(3.0)	(16.6)	(1.5)	(4.4)	(5.9)
Depreciation and amortisation	–	(3.4)	(8.2)	(1.7)	(3.3)	(5.0)
Interest income	0.3	0.4	0.1	0.3	0.1	0.4
Interest expense	–	–	2.0	–	(0.2)	(0.2)

1 Total results of the joint ventures multiplied by the respective proportion of Group ownership.

The financial statements of Northern Rail Holdings Limited are for the 52 week period ended 4 January 2014.

Financial Statements

Notes to the consolidated financial statements continued

7. Joint Ventures (continued)

Key disclosures with respect of the defined benefit pension schemes of material joint ventures:

Main assumptions: 2013	AWE Management Limited	Northern Rail Holdings Limited
Rate of salary increases (%)	3.5	3.4
Inflation assumption (CPI, %)	2.7	2.7
Discount rate (%)	4.8	4.7
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.7	N/a
Future male industrial pensioners at 65 (years)	24.5	N/a

Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(1,416.3)	(770.8)
Fair value of scheme assets	962.7	564.2
Net amount recognised	(453.6)	(206.6)
Members' share of deficit	–	82.6
Franchise adjustments[1]	–	120.2
Related asset, right to reimbursement	453.6	–
Net retirement benefit obligation	–	(3.8)

1 The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

The Northern Rail defined benefit pension scheme uses a mortality rate multiplier of 98% based on the S1 normal males (heavy) table, adjusted for the geographic location of members.

8. Acquisitions

On 2 January 2014, 70% of the share capital of MENA Business Services LLC was acquired. MENA is a regional provider of contact centre, training services and business consultancy outsourcing services, based in the Middle East. The initial cash consideration was £3.1m. Up to a further £2.1m is payable from 2015 to 2016, contingent on the financial performance of the acquired business. The provisional fair value of this deferred contingent consideration is £2.1m. Goodwill of £4.4m arose on the transaction. Net cash payments arising on the acquisition were £2.3m, representing cash consideration of £3.1m net of £0.8m of cash balances acquired.

The provisional value of goodwill of £4.4m arising from the acquisition represents future opportunities in the Middle East business consultancy outsourcing services market. None of the goodwill is expected to be deductible for corporate income tax purposes.

On 12 August 2014, 60% of the share capital of ANTAB Operation and Maintenance Establishment LLC was acquired. ANTAB is a provider of estates management and support services in the healthcare market, based in Saudi Arabia. The cash consideration was £1.2m. Net cash inflow arising on this acquisition was £0.1m, representing cash consideration of £1.2m net of £1.3m of cash balances acquired.

Prior Year Acquisitions

Deferred consideration payments of £4.3m were made in the period in relation to prior year acquisitions. This represented £3.0m in respect of the final payment in relation to the acquisition of Intelenet and £1.3m in respect of deferred consideration in relation to the acquisition of Collectica Limited (formerly Philips Collection Services Limited).

In 2013 deferred consideration payments were made in relation to prior year acquisitions, which totalled £18.6m. This represented £11.9m in relation to the acquisition of Intelenet and £6.7m in relation to the acquisition of Serco Listening Company Limited.

9. Disposals

On 10 March 2014 the Group disposed of its Braintree Community Hospital business to the Mid Essex Clinical Hospital Trust. There was a payment of £0.5m to the purchaser and the gain on disposal was £0.5m, reflecting the net liabilities disposed. On 19 June 2014, the Group disposed of its debt collection business, Collectica Limited. The initial cash consideration received was £6.8m and the resulting loss on disposal was £3.5m. On 30 September 2014, the Group disposed of its Sky Germany business for a consideration of £0.8m resulting in a loss on disposal of £3.1m. Details of these transactions are given below:

The net assets at the date of disposal were:	Collectica 2014 £m	Sky Germany 2014 £m	Other 2014 £m	Total 2014 £m	Total 2013 £m
Goodwill	3.4	–	–	3.4	15.7
Other intangible assets	0.2	–	–	0.2	0.5
Property, plant and equipment	–	0.2	–	0.2	0.7
Inventories	–	–	–	–	0.3
Trade and other receivables	6.3	0.2	–	6.5	11.0
Cash and cash equivalents	1.0	–	–	1.0	–
Trade and other payables	(1.6)	(0.1)	–	(1.7)	(4.2)
Tax liabilities	(0.1)	–	–	(0.1)	–
Provisions	–	–	–	–	(0.3)
Net assets disposed	9.2	0.3	–	9.5	23.7
The profit/(loss) on disposal is calculated as follows:					
Cash consideration	6.8	0.8	(0.5)	7.1	49.2
Less:					
Net assets disposed	(9.2)	(0.3)	–	(9.5)	(23.7)
Impairment of loan receivable in respect of prior year disposal	–	–	(4.6)	(4.6)	–
Disposal-related costs	(1.1)	(3.6)	6.3	1.6	(6.3)
(Loss)/profit on disposal	(3.5)	(3.1)	1.2	(5.4)	19.2
The net cash inflow/(outflow) arising on disposals is as follows:					
Consideration received	6.8	0.8	1.5	9.1	49.2
Less:					
Deferred consideration	–	(0.8)	0.5	(0.3)	(2.3)
Cash and cash equivalents disposed	(1.0)	–	–	(1.0)	–
Disposal-related costs paid during the period	(1.0)	(3.6)	(1.3)	(5.9)	(6.3)
Net cash inflow/(outflow) on disposal	4.8	(3.6)	0.7	1.9	40.6

Prior Year Disposals

There was a gain of £5.4m recognised in the period in relation to the disposal of the nuclear assurance technical consulting services business that had been sold in 2012, following the release of provisions which have become time expired. A loss of £0.1m was also made in relation to the finalisation of the costs of disposal of Ascot College. In the year, a loan receivable in respect of a business sold in the prior year was impaired by £4.6m.

In the period, deferred cash proceeds of £2.0m in relation to the prior year disposal of UK transport maintenance and technology business were received. £0.4m was also cash paid in relation to accrued disposal costs in relation to prior year transactions.

Financial Statements

Notes to the consolidated financial statements continued

10. Revenue

An analysis of the Group's revenue is as follows:

Year ended 31 December	2014 £m	2013 (restated) £m
Rendering of services	3,923.9	4,210.1
Revenue from long-term project-based contracts	31.1	74.1
Revenue as disclosed in the consolidated income statement	3,955.0	4,284.2
Investment revenue (note 14)	6.2	5.2
Operating lease income[1]	1.2	1.0
Total revenue as defined in IAS 18	3,962.4	4,290.4

1 Operating lease income is included within administrative expenses in the income statement.

11. Exceptional Items

Exceptional items are non-recurring items of financial performance that are outside of normal practice and material to the results of the Group either by virtue of size or nature. We believe these items require separate disclosure on the face of the income statement to assist in the understanding of the underlying performance of the Group.

Net Profit on Disposal of Subsidiaries and Operations

Year ended 31 December	2014 £m
Loss on disposal of Collectica Limited	(3.5)
Loss on disposal of Sky Germany business	(3.1)
Gain on disposal of Braintree Community Hospital business	0.5
Impairment of loan receivable in respect of prior year disposal	(4.6)
Prior period technical services disposal adjustment	5.4
Prior period Ascot College adjustment	(0.1)
Net loss on disposal of subsidiaries and operations	(5.4)

On 19 June 2014 the Group disposed of its debt collection business, Collectica Limited, which after disposal related costs, resulted in a loss on disposal of £3.5m. On 30 September 2014, the Group disposed of its Sky Germany business resulting in a loss on disposal of £3.1m. In the year there was also a £0.1m loss on disposal arising from the sale of Ascot College in 2013. These losses were offset by a gain of £0.5m on the disposal of the Braintree Community Hospital business on 10 March 2014 and a gain of £5.4m recognised in the period in relation to the disposal of the nuclear assurance technical consulting services business that had been sold in 2012, following the release of provisions which have become time expired. In the year, a loan receivable in respect of a prior year disposal in the prior year was impaired by £4.6m.

Year ended 31 December	2013 £m
Gain on disposal of UK transport maintenance business	23.2
Loss on disposal of occupational health business	(3.9)
Loss on disposal of Ascot College	(0.1)
Net profit on disposal of subsidiaries and operations	19.2

In November 2013 the Group completed the sale of its London streets maintenance and UK transport technology business to Cubic Corporation which, after disposal related costs, resulted in a profit on disposal of £23.2m. This was offset by a loss on the disposal of the occupational health business in October 2013 of £3.9m and Ascot College of £0.1m, which was sold in December 2013.

11. Exceptional Items (continued)

Other Exceptional Operating Items

Year ended 31 December	2014 £m	2013 £m
Costs associated with UK Government reviews	(9.2)	(11.6)
Settlement amounts relating to UK Government reviews	–	(66.3)
UK frontline clinical health contract provisions	(16.1)	(17.6)
Restructuring costs	(32.7)	(14.9)
Provision for settlement relating to DLR pension deficit funding dispute	(35.6)	–
Other provision for legal claims	(20.1)	–
Impairment and related charges of Australian rail business	(37.2)	(9.6)
Impairment of Global Services business transferred to assets held for sale	(39.2)	–
Impairment of goodwill	(466.0)	–
Deferred consideration relating to prior year acquisition	–	10.3
Other exceptional operating items	**(656.1)**	(109.7)

Costs Associated with UK Government Reviews
During the prior year, an investigation was undertaken by the Ministry of Justice into the billing practices in respect of the Electronic Monitoring (EM) contract. Additionally, the Cabinet Office undertook a wider review across other Serco contracts with UK Central Government. Serco also agreed with the UK Government to undertake a process of corporate renewal, to strengthen governance and transparency. During the year, there were exceptional costs totalling £9.2m (2013: £11.6m) associated with the UK Government reviews and the programme of corporate renewal. This reflected external costs incurred and included external adviser costs related to these reviews.

Settlement Amounts Relating to UK Government Reviews
In December 2013, following a review of the billing arrangements on the EM contract by the Ministry of Justice, a settlement of £64.3m was reached in respect of contractual claims. In addition, a £2.0m settlement was reached on the Prisoner Escort and Custody Services (PECS) contract which was also subject to Government review to reflect repayment of past profit earned on this contract. The settlement was full and final in respect of contractual claims with the proviso that additional payments might be sought in limited circumstances, such as if criminality were to be established; Serco continues to cooperate fully with the ongoing investigations by the Serious Fraud Office.

UK Frontline Clinical Health Contract Provisions
During 2014, there were additional exceptional provisions of £16.1m (2013: 17.6m), including an onerous contract provision of £13.7m to cover the anticipated future year loss from the unexpected increase in patient volumes in 2014 on the Suffolk Community Health contract. The provisions relate to the re-evaluation of the forecast losses of the UK clinical health operations, against which an exceptional onerous contract provision of £17.6m was made in the prior year and reflect the Group's withdrawal from the front-line UK clinical health market, with the future focus of the Group on Healthcare being on the provision of non-frontline health services.

This re-evaluation reflected reviews showing there are additional costs of delivering improved service levels and meeting performance obligations through to the end of the contracts. The Cornwall out-of-hours contract is being exited early in May 2015 and Braintree Clinical Services was disposed of in March 2014. The third loss-making contract, Suffolk Community Health, is being run through to the end of the contract term in September 2015.

Restructuring Costs
As a result of analysis of the cost structures in the businesses and initial actions from the Strategy Review, an exceptional restructuring charge of £32.7m was taken in the year reflecting £19.8m in relation to headcount reductions, £6.9m in relation to property-related exit costs and related asset impairments and £6.0m of adviser costs associated with the Strategy Review and the Contract and Balance Sheet Review. These have been treated as exceptional costs as they have arisen directly as a result of restructuring in response to the impact of the UK Government reviews and the Strategy Review.

Provision for Settlement Relating to DLR Pension Deficit Funding Dispute
In November 2014 the Group agreed to settle a dispute with the Trustees of the Docklands Light Railway (DLR) Pension Scheme over the extent of its liability to fund the deficit on the scheme. This had previously been included as a contingent liability in 2013 based on legal advice taken at the time. The settlement has resulted in a total exceptional charge inclusive of costs of £35.6m, consisting of the full and final settlement amount of £33.0m and costs of £2.6m. The settlement is to be paid over four equal annual instalments from January 2015 to January 2018 covering all past and any future DLR associated pension liabilities.

Other Provision for Legal Claims
An exceptional provision of £20.1m has been recognised for legal claims made against Serco for commercial disputes. This provision is based on legal advice received by the Company.

Impairment and Related Charges of Australian Rail Business
In 2014 the Group put the business up for sale and this is expected to complete in the first half of 2015. An impairment review was performed on the Australian rail business, Great Southern Rail, resulting in a charge totalling £37.2m (2013: £9.6m). This consisted of an impairment of £23.1m to reduce the carrying value of its net assets to the estimated recoverable amount and a charge of £14.1m in relation to the break costs of leases relating to the business.

Financial Statements

Notes to the consolidated financial statements continued

11. Exceptional Items (continued)

Impairment Relating to Global Services Business Transferred to Assets Held for Sale

As part of the Strategic Review certain assets have been designated as non-core and are disclosed in the balance sheet as held for sale. Consequently a calculation of the fair value of the Global Services businesses has been performed and resulted in an impairment of the carrying value of assets of £39.2m. This relates to an impairment of the UK part of the Global Services business.

Impairment of Goodwill

As goodwill is not amortised, it is tested for impairment annually or if there are indications that it might 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 and key risks. These forecasts include an appropriate level of new business wins and an assumption that the final year forecast continues on into perpetuity at a CGU specific terminal growth rate that does not exceed the forecast GDP growth for the relevant market of the business.

The output of the Strategic Review identified a non-cash exceptional impairment of goodwill of £466.0m in relation to the reduction in the carrying value of net assets to the estimated recoverable amounts in the CGUs of the Group. The impairments arise as a result of two key issues. Firstly, forecasts of cash flows have been significantly impacted by the Strategy Review undertaken during the year, and secondly, the discount rates applied in the impairment calculations have increased to reflect the changing level of risk associated with the business and the fall in the Group's market capitalisation. Further details are provided in Note 20.

Adjustment to Prior Year Acquisitions

In the prior year, on assessment against the earn-out criteria, an adjustment was made to the deferred consideration arising on the Intelenet acquisition in 2011 of £10.3m.

Tax Impact of Above Items

The tax impact of these exceptional items was a tax credit of £18.0m (2013: £28.8m). Further details are provided in note 16.

12. Operating Profit

Operating profit is stated after charging/(crediting):

Year ended 31 December	2014 £m	2013 £m
Research and development costs	**21.5**	20.0
Loss on disposal of intangible assets	**0.2**	1.0
Depreciation and impairment of property, plant and equipment (note 22)	**82.5**	54.1
Amortisation and impairment of intangible assets – arising on acquisition (note 21)	**28.7**	21.4
Amortisation, write down and impairment of intangible assets – other (note 21)	**54.6**	27.9
Staff costs (note 13)	**1,890.8**	1,999.2
Exceptional net loss/(profit) on disposal of subsidiaries and operations (note 11)	**5.4**	(19.2)
Goodwill impairment (note 20)	**466.0**	–
Allowance for doubtful debts charged to income statement (note 24)	**22.0**	0.4
Net foreign exchange credit	**32.6**	(7.7)
Movement on non-designated hedges and reclassified cash flow hedges	**(42.0)**	6.6
Minimum lease payments recognised as an operating lease expense	**105.0**	117.6
Operating lease income from sub-leases (note 10)	**(1.2)**	(1.0)

Amounts payable to Deloitte LLP and their associates by the Company and its subsidiary undertakings in respect of audit and non-audit services are shown below.

Year ended 31 December	2014 £m	2013 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	**1.3**	1.1
Fees payable to the Company's Auditor and their associates for other services to the Group:		
– audit of the Company's subsidiaries pursuant to legislation	**0.8**	0.8
Total audit fees	**2.1**	1.9
– Audit-related assurance services	**0.2**	0.2
– Taxation compliance services	**–**	0.1
– Other taxation advisory services	**0.4**	0.3
– Other services	**0.2**	0.3
Total non-audit fees	**0.8**	0.9

Fees payable to Deloitte LLP and their associates for non-audit services to the Company are not required to be disclosed separately because the consolidated financial statements are required to disclose such fees on a consolidated basis.

12. Operating Profit (continued)

Details of the Company's policy on the use of auditors for non-audit services and how the auditor's independence and objectivity was safeguarded are set out in the Corporate Governance Report on page 91. No services were provided pursuant to contingent fee arrangements.

13. Staff Costs

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

Year ended 31 December	2014 Number	2013 Number
UK Central Government	10,911	10,343
Local and Regional Government	9,889	10,569
Americas	9,479	9,293
AsPac	5,971	7,006
Middle East	3,318	2,946
Global Services	55,743	54,707
Unallocated	144	116
	95,455	94,980

Aggregate remuneration comprised:

Year ended 31 December	2014 £m	2013 £m
Wages and salaries	1,646.8	1,752.5
Social security costs	129.8	135.2
Other pension costs (note 34)	108.8	108.6
	1,885.4	1,996.3
Share-based payment expense (note 38)	5.4	2.9
	1,890.8	1,999.2

14. Investment Revenue

Year ended 31 December	2014 £m	2013 £m
Interest receivable on other loans and deposits	3.1	2.4
Net interest receivable on retirement benefit obligations (note 34)	3.1	2.3
Movement in discount on other debtors	–	0.5
	6.2	5.2

15. Finance Costs

Year ended 31 December	2014 £m	2013 £m
Interest payable on non-recourse loans	0.8	0.8
Interest payable on obligations under finance leases	3.2	2.5
Interest payable on other loans	29.4	31.5
Facility fees and other charges	9.5	6.1
Movement in discount on provisions and deferred consideration	–	1.5
	42.9	42.4

Financial Statements

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 2014 £m	Exceptional items 2014 £m	Total 2014 £m	Before exceptional items 2013 (restated) £m	Exceptional items 2013 £m	Total 2013 (restated) £m
Current income tax						
Current income tax charge/(credit)	45.3	(6.5)	38.8	31.6	–	31.6
Adjustments in respect of prior years	(15.9)	–	(15.9)	(9.2)	(0.2)	(9.4)
Deferred tax						
Current year (credit)/charge	(32.7)	(11.5)	(44.2)	18.4	(25.4)	(7.0)
Adjustments in respect of prior years	14.4	–	14.4	(2.1)	(3.2)	(5.3)
Tax (credit/charge)	11.1	(18.0)	(6.9)	38.7	(28.8)	9.9

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 2014 £m	Exceptional items 2014 £m	Total 2014 £m	Before exceptional items 2013 (restated) £m	Exceptional items 2013 £m	Total 2013 (restated) £m
(Loss)/profit before tax	(692.5)	(661.5)	(1,354.0)	198.8	(90.5)	108.3
Tax calculated at a rate of 21.5% (2013: 23.3%)	(148.9)	(142.2)	(291.1)	46.3	(21.1)	25.2
Expenses/(income) not deductible for tax purposes	40.5	104.0	144.5	(2.1)	0.6	(1.5)
UK unprovided deferred tax	109.8	24.4	134.2	–	–	–
Other unprovided deferred tax	28.2	2.2	30.4	3.8	–	3.8
Effect of the use of unrecognised tax losses	–	–	–	(0.1)	–	(0.1)
Impact of changes in statutory tax rates	–	–	–	4.0	3.6	7.6
Overseas rate differences	(9.2)	(6.4)	(15.6)	10.9	(0.8)	10.1
Other non-taxable income	(0.4)	–	(0.4)	–	(2.4)	(2.4)
Statutory tax benefits	(1.0)	–	(1.0)	(1.8)	(5.3)	(7.1)
Adjustments in respect of prior years	(1.5)	–	(1.5)	(11.3)	(3.4)	(14.7)
Adjustments in respect of equity accounted investments	(6.4)	–	(6.4)	(11.0)	–	(11.0)
Tax (credit)/charge	11.1	(18.0)	(6.9)	38.7	(28.8)	9.9

The income tax (credit)/charge for the year is based on the blended UK statutory rate of corporation tax for the period of 21.5% (2013: 23.3%). The impact of changes in statutory tax rates relates principally to the reduction of the UK corporation tax rate from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015, which was enacted on 17 July 2013.

16 (b) Income Tax Recognised in the SOCI

Year ended 31 December	2014 £m	2013 (restated) £m
Current tax		
Taken to retirement benefit obligations reserve	0.6	(1.1)
Deferred tax		
Relating to cash flow hedges	–	(0.1)
Taken to retirement benefit obligations reserve	(13.5)	4.1
	(12.9)	2.9

16 (c) Tax on Items Taken Directly to Equity

Year ended 31 December	2014 £m	2013 £m
Current tax		
Recorded in share-based payment reserve	–	(0.1)
Deferred tax		
Recorded in share-based payment reserve	(0.4)	(5.8)
	(0.4)	(5.9)

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:

	2014 £m	2013 (restated) £m
At 1 January – asset	(23.5)	(9.7)
Income statement credit (note 16)	(30.3)	(12.3)
Items recognised in equity and in other comprehensive income (note 16)	13.9	1.8
Exchange differences	3.2	(3.3)
Reclassified to assets held for sale	8.5	–
At 31 December – asset	**(28.2)**	(23.5)

The movement in deferred tax assets and liabilities during the year was as follows:

	Temporary differences on assets/ intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2014	8.6	(9.4)	6.9	(15.0)	(14.6)	(23.5)
(Credited)/charged to income statement (note 16a)	(1.9)	(1.4)	0.5	6.3	(33.8)	(30.3)
Items recognised in equity and in other comprehensive income (note 16b&c)	–	0.4	14.4	–	(0.9)	13.9
Exchange differences	1.6	(0.1)	(0.2)	–	1.9	3.2
Reclassified to assets held for sale	(0.8)	1.0	0.1	8.7	(0.5)	8.5
At 31 December 2014	**7.5**	**(9.5)**	**21.7**	**–**	**(47.9)**	**(28.2)**

Of the amount credited to the income statement, £0.5m has been taken to costs of sales in respect of the R&D Expenditure credit.

The movement in deferred tax assets and liabilities during the previous year was as follows:

	Temporary differences on assets/ intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments (restated) £m	Other temporary differences £m	Total £m
At 1 January 2013	21.3	(21.0)	6.3	(13.8)	(2.5)	(9.7)
(Credited)/charged to income statement (note 16a) (restated)	(9.9)	4.4	(1.2)	(1.2)	(4.4)	(12.3)
Items recognised in equity and in other comprehensive income (note 16b&c) (restated)	–	6.8	1.8	0.1	(6.9)	1.8
Exchange differences	(2.8)	0.4	–	(0.1)	(0.8)	(3.3)
At 31 December 2013	8.6	(9.4)	6.9	(15.0)	(14.6)	(23.5)

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:

	2014 £m	2013 £m
Deferred tax liabilities	9.2	34.4
Deferred tax assets	(37.4)	(57.9)
	(28.2)	(23.5)

The total deferred tax asset held by the Group at 31 December 2014 amount to £48.4m (2013: £57.9m) and include £37.4m (2013: £57.9m) shown above and £11.0m (2013: £nil) included within amounts held for sale on the balance sheet. The total deferred tax liability held by the Group at 31 December 2014 amount to £11.7m (2013: £34.3m) and include £9.2m (2013: £34.4m) shown above and £2.5m (2013: £nil) included within amounts held for sale on the balance sheet.

Notes to the consolidated financial statements continued

17. Deferred Tax (continued)

As at the balance sheet date, the group has unused tax losses (excluding assets held for sale) of £647.0m (2013: £200.7m) available for offset against future profits. A deferred tax asset has been recognised in respect of £53.5m (2013: £160.5m) of such losses of which £52.5m (net £10.5m) relates to losses incurred in the UK and £1.0m (net £0.2m) which relates to other jurisdictions. Recognition has been based on forecast future taxable profits. No deferred tax asset has been recognised in respect of the remaining losses (net £118.8m) and other timing differences (net £38.5m) as there is expected to be insufficient taxable profits available.

Losses of £0.9m (2013: £14.4m) expire within five years, losses of £nil (2013: £1.2m) expire within six to ten years, losses of £nil (2013: £7.0m) expire within 15–20 years, losses of £nil (2013: £1.0m) expire within 20–25 years and losses of £646.1m (2013: £177.1m) may be carried forward indefinitely.

In addition, as at the balance sheet date, the Group has the following in relation to held for sale assets:

Unused tax losses of £51.6m (2013: £nil) available for offset against future profits. No deferred tax asset has been recognised in respect of these losses (net £13.7m) and other timing differences (net £9.1m) as there is expected to be insufficient taxable profits available. Losses of £20.7m (2013: £nil) expire within five years, losses of £16.6m (2013 £nil) expire within six to ten years, losses of £1.9m (2013 £nil) expire within 11–15 years, losses of £12.4m (2013 £nil) expire within 16-20 years.

18. Dividends

	2014 £m	2013 £m
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2013 of 7.45p per share on 487.4m ordinary shares (2013: Final dividend for the year ended 31 December 2012 of 7.45p per share on 488.3m ordinary shares)	**36.4**	36.4
Interim dividend for the year ended 31 December 2014 of 3.10p per share on 538.4m ordinary shares (2013: Interim dividend for the year ended 31 December 2013 of 3.10p per share on 486.9m ordinary shares)	**16.7**	15.1
	53.1	51.5
Proposed final dividend for the year ended 31 December 2014 of nil per share (2013: 7.45p on 487.4m ordinary shares)	**–**	36.4

A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust (note 37).

19. Earnings per Share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 *Earnings per Share*.

The calculation of the basic and diluted EPS is based on the following data:

Number of shares	2014 Millions	2013 Millions
Weighted average number of ordinary shares for the purpose of basic EPS	**521.5**	489.0
Effect of dilutive potential ordinary shares: share options	**–**	11.6
Weighted average number of ordinary shares for the purpose of diluted EPS	**521.5**	500.6

Earnings per share **EPS**	Earnings 2014 £m	Per share amount 2014 Pence	Earnings 2013 (restated) £m	Per share amount 2013 (restated) Pence
Earnings for the purpose of basic EPS	**(1,347.3)**	**(258.35)**	98.4	20.12
Effect of dilutive potential ordinary shares	**–**	**–**	–	(0.46)
Diluted EPS	**(1,347.3)**	**(258.35)**	98.4	19.66
Basic EPS Excluding Exceptional Items				
Earnings for the purpose of basic EPS	**(1,347.3)**	**(258.35)**	98.4	20.12
Add back exceptional operating items	**661.5**	**126.84**	90.5	18.51
Add back tax on exceptional items	**(18.0)**	**(3.45)**	(28.8)	(5.89)
Earnings excluding exceptional operating items for the purpose of basic EPS	**(703.8)**	**(134.96)**	160.1	32.74

19. Earnings per Share (continued)

At 31 December 2014 options over 1,477,411 (2013: nil) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

A further 8.7m shares are potentially dilutive but are not included in the above calculation due to the loss making position in the year.

20. Goodwill

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2013	1,312.1	–	1,312.1
Disposals	(15.7)	–	(15.7)
Exchange differences	(25.6)	–	(25.6)
At 1 January 2014	1,270.8	–	1,270.8
Additions	4.4	–	4.4
Disposals	(3.4)	–	(3.4)
Exchange differences	20.2	(5.4)	14.8
Impairment (exceptional)	–	(466.0)	(466.0)
Transfer to held for sale	(618.8)	339.7	(279.1)
At 31 December 2014	**673.2**	**(131.7)**	**541.5**

As a result of the reorganisation of the Group in the year, certain contracts and businesses have transferred between CGUs and these have been reflected in the information below. Part of this reorganisation led to the splitting of the Local Services CGU into several separate CGUs. However, as the new Local Services CGUs all operate within similar markets, with similar drivers, the assumptions applied to these CGUs are the same and they continue to be disclosed here as a single group of CGUs. The Germany CGU has been integrated within one of these new CGUs and as cash flows are no longer independent the goodwill has transferred across. In addition, the expected sale of a significant portion of both the Global Services and Local Services CGUs results in the transfer of an element of the goodwill balance to held for sale.

As goodwill is not amortised, it is tested for impairment annually or if there are indications that it might be impaired. The recoverable amount of each CGU is based on value in use calculations derived from forecast cash flows based on past experience, adjusted to reflect market trends, economic conditions and key risks. These forecasts include an appropriate level of new business wins and an assumption that the final year forecast continues on into perpetuity at a CGU specific growth rate.

In the current year, a material impairment of goodwill was noted during the review process, which arises as a result of two key issues. Firstly, forecasts of cash flows have been significantly impacted by the strategy review undertaken during the year which has changed the outlook of the Group, and secondly, the discount rates applied in the impairment calculations have increased to reflect the changing level of risk associated with the business. This level of risk is directly linked to the performance of the business following the impact of the UK Government review at the end of 2013. Finally, as a result of the transfer of elements of the Global Services and Local Services goodwill balances to held for sale we have assessed the fair value of these balances and made any additional impairment charges as required. The total impairment charge has been treated as 'exceptional' and separated on the face of the income statement from the other results of the Group on the grounds that it is non-recurring in nature and outside of the normal course of the business.

A goodwill balance remains in the Healthcare CGU despite the exit from frontline clinical health services due to the positive cash flows from other parts of the CGU and expected levels of growth. Movements in the balance since the prior year end can be seen as follows:

	Goodwill balance 31 December 2013 £m	Additions 2014 £m	Disposals 2014 £m	Exchange differences 2014 £m	Transfers 2014 £m	Impairment 2014 £m	Transfer to held for sale 2014 £m	Goodwill balance 2014 £m	Headroom on impairment analysis 2014 £m
UK Central Government									
Justice and Immigration[1]	46.0	–	(3.4)	–	7.0	–	–	49.6	147.0
Local and Regional Government									
Health	79.5	–	–	–	4.0	(22.9)	–	60.6	–
Local Services	116.9	–	–	(0.5)	5.8	(57.6)	(46.1)	18.5	–
Germany	17.6	–	–	(0.8)	(16.8)	–	–	–	–
Global Services	513.3	4.4	–	0.1	–	(284.8)	(233.0)	–	–
Americas	385.9	–	–	18.4	–	(100.7)	–	303.6	–
AsPac	103.3	–	–	(2.9)	–	–	–	100.4	314.8
Middle East	8.3	–	–	0.5	–	–	–	8.8	136.5
	1,270.8	4.4	(3.4)	14.8	–	(466.0)	(279.1)	541.5	598.3

1 Formerly known as Home Affairs.

Notes to the consolidated financial statements continued

20. Goodwill (continued)

Included above is the detail of the headroom on the CGUs existing at the year end. For those CGUs which were impaired in the year, no headroom exists and therefore any reduction in forecasts or unfavourable movements in key assumptions would lead to an additional impairment. Headroom shown in respect of the other CGUs 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 headroom in the Justice and Immigration CGU exists despite the future losses reflected in the onerous contract provisions seen in note 30 as a result of the CGU being in a net liability position. This is due to the cash payments related to the onerous contract provisions being removed from the terminal year as they are not expected in perpetuity.

The key assumptions applied in the impairment review are set out below:

	Discount rate 2014 %	Discount rate 2013 %	Terminal growth rates 2014 %	Terminal growth rates 2013 %
UK Central Government				
Justice and Immigration	**9.2**	9.1	**1.9**	2.2
Local and Regional Government				
Health	**9.7**	9.1	**1.9**	2.2
Local Services	**9.7**	9.1	**1.9**	2.2
Germany	**–**	8.6	**–**	2.0
Global Services	**12.4**	12.5	**4.6**	4.0
Americas	**13.3**	10.5	**2.0**	2.4
AsPac	**12.4**	10.4	**2.3**	3.0
Middle East	**9.0**	8.6	**2.2**	3.0

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 advisors and are adjusted for risks specific to the market in which the CGU operates. The increases noted in the table above reflect the increased level of risk in the business, partly as a result of the decline in market capitalisation, and partly as a result of the increased level of risk perceived by the market in the business model. The Global Services discount rate disclosed is a blended rate covering different geographic regions within the CGU and the decrease in the year reflects a change in mix of the expected cash flows.

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.

The decrease in rates noted year on year are partly due to a fall in long-term inflation rates, and partly as a result of the Strategy Review.

Sensitivity Analysis

Sensitivity analysis has been performed for each key assumption and the Justice and Immigration, AsPac and Middle East CGUs are not impaired following any reasonably possible change in a key assumption. Given the movements in the key assumptions in the current year, we have considered a 2% movement in discount rates and a 1% movement in terminal growth rates to be reasonably possible. The removal of future revenues assumed in the impairment models have also been considered. These are fully expected to be generated from future contract wins, but for the purpose of sensitivity analysis we have assumed that it is reasonably possible that half of these cash flows are not included.

20. Goodwill (continued)

The impact of changes in key assumptions on the impaired CGUs is as follows:

- Health: The CGU represents the UK healthcare market segment. A 2% increase in the discount rate gives rise to an additional impairment of £16m and a 1% decline in the terminal growth rate leads to an additional impairment of £7m. If there were both a 2% increase in the discount rate and a 1% decline in the terminal growth rates an additional impairment charge of £19m would occur. The removal of half of uncontracted future cash flows creates an additional impairment of £34m, if all other assumptions remain unchanged.
- Local Services: Includes services provided to local authorities in respect of leisure, environmental and facilities management, both in the UK and in Europe. A 2% increase in the discount rate leads to a £4m impairment in the current goodwill balance on the remaining Local Services CGU, while a 1% decline in terminal growth impairs the balance by £2m. If both assumptions were to move adversely, a total impairment of £6m would arise. If half of uncontracted future cash flows were not to be achieved, £17m of the goodwill balance is impaired.
- Global Services: The CGU is a single reportable segments as defined by IFRS 8 *Operating segments* and due to the expected sale of a significant portion of the business, the impairment charge is limited by the estimated sales proceeds and therefore a reasonably possible adverse movement in the key assumptions has no impact on the impairment of this CGU, including uncontracted revenues.
- Americas: If the terminal growth rate were to fall by 1%, the impairment charge would increase by £39m, whereas a 2% increase in the discount rate results in an additional impairment charge of £86m. If both assumptions moved adversely by these rates, the impairment charge would increase by £107m. This CGU is also a single reporting segment. The removal of half of uncontracted future cash flows creates an additional impairment of £28m, if all other assumptions remain unchanged.

21. Other Intangible Assets

	Acquisition related		Other			
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	Pension related intangibles £m	Total £m
Cost						
At 1 January 2014	137.2	1.2	151.6	68.8	15.7	374.5
Eliminated on disposal	(1.0)	–	–	–	–	(1.0)
Additions from internal development	–	–	12.7	3.7	–	16.4
Additions from external acquisition	–	0.4	4.6	–	–	5.0
Disposals	(19.8)	–	(3.4)	(2.0)	–	(25.2)
Reclassification to held for sale assets	(2.0)	–	(19.7)	(0.2)	–	(21.9)
Reclassification from/(to) other intangible asset categories	–	–	0.2	(0.2)	–	–
Reclassification to property, plant and equipment	–	–	(0.5)	(0.1)	–	(0.6)
Write down of assets under construction	–	–	–	(2.9)	–	(2.9)
Exchange differences	2.4	–	1.4	0.2	–	4.0
At 31 December 2014	116.8	1.6	146.9	67.3	15.7	348.3
Accumulated amortisation and impairment						
At 1 January 2014	69.6	0.8	79.5	24.2	14.7	188.8
Eliminated on disposal	(0.8)	–	–	–	–	(0.8)
Exceptional impairment charge	4.7	0.3	1.0	–	–	6.0
Impairment charge	12.3	–	17.5	5.9	–	35.7
Amortisation charge – internal development	–	–	16.1	7.9	–	24.0
Amortisation charge – external	11.1	0.3	2.3	–	1.0	14.7
Disposals	(19.8)	–	(3.1)	(1.0)	–	(23.9)
Reclassification to held for sale assets	(1.8)	–	(14.9)	(0.2)	–	(16.9)
Reclassification from/(to) other intangible asset categories	–	–	1.6	(1.6)	–	–
Reclassification to property, plant and equipment	–	–	(0.5)	–	–	(0.5)
Exchange differences	1.0	–	1.0	0.4	–	2.4
At 31 December 2014	76.3	1.4	100.5	35.6	15.7	229.5
Net book value						
At 31 December 2014	40.5	0.2	46.4	31.7	–	118.8
Average remaining life						
At 31 December 2014	3 years	2 years	4 years	4 years	0 year	4 years

Financial Statements

Notes to the consolidated financial statements continued

21. Other Intangible Assets (continued)

	Acquisition related		Other			
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £'m	Pension related intangibles £m	Total £m
Cost						
At 1 January 2013	147.2	72.0	137.4	71.2	15.7	443.5
Eliminated on disposal	–	–	(0.1)	(1.4)	–	(1.5)
Additions from internal development	–	–	25.5	2.3	–	27.8
Disposals	–	(71.1)	(13.8)	(2.9)	–	(87.8)
Reclassification (to)/from property, plant and equipment	–	(0.4)	7.4	0.7	–	7.7
Exchange differences	(10.0)	0.7	(4.8)	(1.1)	–	(15.2)
At 31 December 2013	137.2	1.2	151.6	68.8	15.7	374.5
Accumulated amortisation and impairment						
At 1 January 2013	56.4	66.4	74.8	17.7	12.5	227.8
Eliminated on disposal	–	–	–	(1.0)	–	(1.0)
Exceptional impairment charge	–	–	3.2	–	–	3.2
Amortisation charge – internal development	–	–	7.4	10.1	–	17.5
Amortisation charge – external	16.5	4.9	5.0	–	2.2	28.6
Disposals	–	(71.1)	(12.9)	(2.4)	–	(86.4)
Reclassification from property, plant and equipment	–	–	4.9	–	–	4.9
Exchange differences	(3.3)	0.6	(2.9)	(0.2)	–	(5.8)
At 31 December 2013	69.6	0.8	79.5	24.2	14.7	188.8
Net book value						
At 31 December 2013	67.6	0.4	72.1	44.6	1.0	185.7
Average remaining life						
At 31 December 2013	4 years	3 years	5 years	5 years	1 year	5 years

The balances provided in respect of Development expenditure have been separated from Software and IT in the prior year comparatives above in order to provide better information and included in Software, IT and other development expenditure is an amount of £14.3m (2013: £16.2m) in respect of leased intangibles.

Following the progress made on the review of the Group's strategic direction and a review of the balance sheet position following a downturn in performance, a significant level of impairment has been charged. Significant items included within the impairment charge relate to:

- impairment of customer relationships in Global Services and AsPac following the change in markets of focus for the Group;
- impairment of certain assets developed as tools and customer solutions for Global Services which are no longer expected to obtain the level of benefits originally expected; and
- impairment of certain software, both internally generated and outright purchased, across the business due to abandonment.

Customer relationships are amortised over the average length of contracts acquired. The Group is carrying £40.5m (2013: £67.6m) in relation to Customer relationships. A further £0.2m (2013: £nil) is held within assets reclassified to held for sale.

Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £11.4m (2013: £21.4m).

The value of internally generated intangible assets as at 31 December 2014 was approximately £31.7m (2013: £44.6m) in development expenditure and £43.1m (2013: £60.4m) in software and IT, of which £2.5m (2013: £nil) is classified as held for sale.

22. Property, Plant and Equipment

	Freehold land and buildings £m	Short-leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2014	5.4	61.4	299.0	365.8
Arising on acquisition	–	0.3	1.4	1.7
Additions	0.2	3.6	38.8	42.6
Reclassification from intangible assets	–	0.1	0.5	0.6
Reclassification to held for sale assets	–	(18.5)	(199.6)	(218.1)
Disposals	–	(5.3)	(21.0)	(26.3)
Eliminated on disposal	–	(0.1)	(0.4)	(0.5)
Exchange differences	0.1	0.8	(1.1)	(0.2)
At 31 December 2014	5.7	42.3	117.6	165.6
Accumulated depreciation and impairment				
At 1 January 2014	2.1	31.9	155.0	189.0
Arising on acquisition	–	0.3	0.9	1.2
Charge for the year – impairment (exceptional)	0.5	6.6	11.5	18.6
Charge for the year – impairment	0.2	2.9	19.0	22.1
Charge for the year – depreciation	0.3	5.9	35.6	41.8
Reclassification from intangible assets	–	–	0.5	0.5
Reclassification to held for sale assets	–	(12.4)	(111.2)	(123.6)
Disposals	–	(4.7)	(16.2)	(20.9)
Eliminated on disposal	–	(0.1)	(0.2)	(0.3)
Exchange differences	–	0.4	(1.6)	(1.2)
At 31 December 2014	3.1	30.8	93.3	127.2
Net book value				
At 31 December 2014	2.6	11.5	24.3	38.4

	Freehold land and buildings £m	Short-leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2013	4.8	59.1	297.3	361.2
Additions	0.1	7.0	62.5	69.6
Reclassification from/(to) intangible assets	0.8	6.9	(15.4)	(7.7)
Disposals	–	(7.9)	(29.4)	(37.3)
Eliminated on disposal	–	(0.4)	(1.4)	(1.8)
Exchange differences	(0.3)	(3.3)	(14.6)	(18.2)
At 31 December 2013	5.4	61.4	299.0	365.8
Accumulated depreciation and impairment				
At 1 January 2013	1.9	32.1	150.3	184.3
Charge for the year – impairment (exceptional)	–	–	6.4	6.4
Charge for the year – impairment	–	–	1.4	1.4
Charge for the year – depreciation	0.3	7.8	38.2	46.3
Reclassification from/(to) intangible assets	0.1	0.1	(5.1)	(4.9)
Disposals	–	(6.2)	(25.9)	(32.1)
Eliminated on disposal	–	(0.2)	(0.9)	(1.1)
Exchange differences	(0.2)	(1.7)	(9.4)	(11.3)
At 31 December 2013	2.1	31.9	155.0	189.0
Net book value				
At 31 December 2013	3.3	29.5	144.0	176.8

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £48.6m (2013: £57.0m) in respect of assets held under finance leases, of which £40.5m (2013: £nil) is classified as held for sale.

The carrying amount of the Group's Short-leasehold building improvements includes an amount of £0.3m (2013: £0.4m) in respect of assets held under finance leases.

Financial Statements

Notes to the consolidated financial statements continued

23. Inventories

	2014 £m	2013 £m
Service spares	**22.3**	33.8
Parts awaiting installation	**5.7**	10.4
Work in progress	**3.2**	5.2
	31.2	49.4

Total inventories held by the Group at 31 December 2014 amount to £33.9m (2013: £49.4m) and include £31.2m (2013: £49.4m) shown above and £2.7m (2013: £nil) included within amounts held for sale on the balance sheet.

Following the completion of the Contract and Balance Sheet Reviews, an impairment charge of £16.9m was made.

24. Trade and Other Receivables

	2014 £m	2013 £m
Trade and other receivables: non-current		
Amounts owed by joint ventures	**9.0**	9.5
Loans receivable (note 29)	**–**	3.3
Other investments	**3.9**	0.6
Other receivables	**25.2**	64.9
	38.1	78.3

	2014 £m	2013 £m
Trade and other receivables: current		
Trade receivables	**146.8**	210.7
Accrued income	**217.3**	341.0
Prepayments	**71.1**	90.1
Amounts recoverable on long-term contracts (note 25)	**5.7**	8.3
Amounts owed by joint ventures	**0.1**	0.4
Loans receivable (note 29)	**1.0**	2.5
Security deposits	**0.2**	0.2
Other receivables	**56.6**	111.2
	498.8	764.4

Total trade and other receivables held by the Group at 31 December 2014 amount to £682.7m (2013: £842.7m) and include £536.9m (2013: £842.7m) shown above and £145.8m (2013: £nil) included within amounts held for sale on the balance sheet.

Included within current other receivables are capitalised bid costs of £8.5m (2013: £15.0m) and phase in costs of £17.6m (2013: £49.9m) that are realised as a part of the normal operating cycle of the Group. These assets represent up-front investment in contracts which are expected to provide benefits over the life of those contracts. Following the completion of the balance sheet and contract reviews, an impairment charge of £19.4m was made. In addition to the above, capitalised bid costs of £5.4m (2013: £nil) and phase in costs of £5.1m (2013: £nil) are held within assets held for sale.

Following the completion of the Contract and Balance Sheet Reviews, an impairment charge of £75.2m was also made in respect of accrued income; £21.6m in respect of trade receivables; £6.2m in respect of other receivables and £9.5m in respect of prepayments.

Also included within current other receivables are deferred transaction costs of £4.1m (2013: £nil) which will be taken as a reduction to share premium on completion of those deals.

The Group has a receivables financing facility of £60.0m, of which £32.8m had been utilised at 31 December 2014 (31 December 2013: £27.1m utilised). This is a UK facility provided on a non-recourse basis with all relevant debtors requiring approval in advance by the facility provider.

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 21 days (2013: 24 days) and no interest is charged on overdue amounts.

24. Trade and Other Receivables (continued)

Each customer has an external credit score which determines the level of credit provided. However, the majority of our customers either have a sovereign credit rating as a result of being government organisations or are blue chip private sector companies. Of the trade receivables balance at the end of the year, £65.2m (2013: £63.6m) is due from agencies of the UK Government, the Group's largest customer. A further £5.4m (2013: £nil) of trade receivables due from agencies of the UK Government is held within assets held for sale. There are no other customers who represent more than 5% of the total balance of trade receivables. 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 2014, a total of £4.4m (2013: £2.5m) of trade receivables held by the Group were considered to be impaired and include £1.8m (2013: £2.5m) shown below and £2.6m (2013: £nil) included within amounts held for sale. 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 £26.1m as of 31 December 2014 (2013: £4.7m) and included £23.5m (2013: £4.7m) as shown below and £2.6m (2013: £nil) of provision for trade receivables held for sale.

The ageing of trade receivables is as follows:

	2014 £m	2013 £m
Neither impaired nor past due	**97.3**	125.3
Not impaired but overdue by less than 30 days	**32.4**	48.8
Not impaired but overdue by between 30 and 60 days	**16.9**	20.3
Not impaired but overdue by more than 60 days	**21.9**	18.5
Impaired	**1.8**	2.5
Allowance for doubtful debts	**(23.5)**	(4.7)
	146.8	210.7

Of the total overdue trade receivable balance 24.4% (2013: 30.3%) relates to the UK, US or Australian governments, and a further 26.7% (2013: 15.2%) 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 are as follows:

	2014 £m	2013 £m
At 1 January	**4.7**	5.3
Charged to income statement	**22.0**	0.4
Utilised	**(1.6)**	(0.5)
Exchange differences	**1.0**	(0.5)
Reclassified to held for sale	**(2.6)**	–
At 31 December	**23.5**	4.7

Included in the other receivables balance at the end of the year is a further £79.7m (2013: £98.6m) due to agencies of the UK Government; with a further £4.4m (2013: £nil) having being reclassified to assets held for sale.

25. Long-term Contracts

	2014 £m	2013 £m
Contracts in progress at the balance sheet date:		
Amounts due from long-term project-based contract customers included in trade and other receivables	**5.7**	8.3
	5.7	8.3
Long-term project-based contract costs incurred plus recognised profits less recognised losses to date	**113.9**	239.7
Less: progress payments	**(108.2)**	(231.4)
	5.7	8.3

As at 31 December 2014, the Group had £nil (2013: £0.4m) of contract retentions held by customers.

Financial Statements

Notes to the consolidated financial statements continued

26. Cash and Cash Equivalents

	Sterling 2014 £m	Other currencies 2014 £m	Total 2014 £m	Sterling 2013 £m	Other currencies 2013 £m	Total 2013 £m
Customer advance payments[1]	–	0.2	0.2	–	10.2	10.2
Other cash and short-term deposits	82.3	97.6	179.9	28.5	86.4	114.9
Total cash and cash equivalents	**82.3**	**97.8**	**180.1**	28.5	96.6	125.1

1 Customer advance payments totalling £0.2m (2013: £10.2m) are encumbered cash balances. A further £8.4m (2013: £nil) of encumbered cash has been reclassified as held for sale.

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.

Total cash and cash equivalents held by the Group at 31 December 2014 amount to £202.5m (2013: £125.1m) and include £180.1m (2013: £125.1m) shown above and £22.4m (2013: £nil) included within amounts held for sale on the balance sheet.

27. Trade and Other Payables

	2014 £m	2013 £m
Trade and other payables: Current		
Trade payables	**99.8**	169.9
Other payables	**112.6**	128.9
Accruals	**308.3**	288.9
Deferred income	**61.2**	56.4
	581.9	644.1

The average credit period taken for trade purchases is 25 days (2013: 33 days).

	2014 £m	2013 £m
Trade and other payables: Non-current		
Other payables	29.7	34.1
	29.7	34.1

Total trade and other payables held by the Group at 31 December 2014 amount to £715.3m (2013: £678.2m) and include £611.6m (2013: £678.2m) shown above and £103.7m (2013: £nil) included within amounts held for sale on the balance sheet.

28. Obligations under Finance Leases

	Minimum lease payments 2014 £m	Present value of minimum lease payments 2014 £m	Minimum lease payments 2013 £m	Present value of minimum lease payments 2013 £m
Amounts payable under finance leases:				
Within one year	**10.4**	**9.6**	16.9	14.9
Between one and five years	**17.5**	**16.8**	52.6	48.3
After five years	**0.1**	**0.1**	5.0	4.8
	28.0	**26.5**	74.5	68.0
Less: future finance charges	**(1.5)**	**–**	(6.5)	–
Present value of lease obligations	**26.5**	**26.5**	68.0	68.0
Less: amount due for settlement within one year (shown under current liabilities)	**(10.4)**	**(9.6)**	(16.9)	(14.9)
Amount due for settlement after one year	**16.1**	**16.9**	51.1	53.1

Total obligations under finance leases held by the Group at 31 December 2014 amount to £63.6m (2013: £68.0m) and include £26.5m (2013: £68.0m) shown above and £37.1m (2013: £nil) included within amounts held for sale on the balance sheet.

Finance lease obligations are secured by the lessors' title to the leased assets.

The Directors estimate that the fair value of the Group's lease obligations approximates their carrying amount.

29. Loans

	Non-recourse loans 2014 £m	Other loans 2014 £m	Total 2014 £m	Non-recourse loans 2013 £m	Other loans 2013 £m	Total 2013 £m
Loans are repayable as follows:						
On demand or within one year[1]	3.7	43.7	47.4	2.9	46.8	49.7
Between one and two years	3.7	32.1	35.8	3.0	20.7	23.7
Between two and five years	9.4	302.0	311.4	8.4	277.0	285.4
After five years	7.2	419.3	426.5	6.0	437.7	443.7
	24.0	797.1	821.1	20.3	782.2	802.5
Less: assets classified as held for sale	(24.0)	(0.8)	(24.8)	–	–	–
Less: amount due for settlement within one year (shown within current liabilities)	–	(43.9)	(43.9)	(2.9)	(49.3)	(52.2)
Less: Amounts shown in receivables (note 24)	–	1.0	1.0	–	5.8	5.8
Amount due for settlement after one year	–	753.4	753.4	17.4	738.7	756.1

1 Included in loans repayable on demand or within one year are loan receivable amounts of £1.0m (2013: £2.5m).

The carrying amounts and fair values of the loans are as follows:

	Carrying amount 2014 £m	Fair value 2014 £m	Carrying amount 2013 £m	Fair value 2013 £m
Non-recourse loans	–	–	20.3	20.4
Other loans	797.3	806.8	788.0	775.8
Loans receivable	(1.0)	(1.0)	(5.8)	(5.8)
	796.3	805.8	802.5	790.4

The fair values are based on cash flows discounted using a market rate appropriate to the loan. All loans are held at amortised cost.

Analysis of Net Debt

	At 1 January 2014 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions[1] £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2014 £m
Cash and cash equivalents	125.1	74.1	(22.4)	2.1	(1.0)	2.2	–	180.1
Loan receivables	5.8	(0.2)	–	–	–	–	(4.6)	1.0
Non-recourse loans	(20.3)	(3.7)	24.0	–	–	–	–	–
Other loans	(788.0)	18.8	0.8	–	–	(32.5)	3.6	(797.3)
Obligations under finance leases	(68.0)	18.2	37.1	–	–	(0.1)	(13.7)	(26.5)
	(745.4)	107.2	39.5	2.1	(1.0)	(30.4)	(14.7)	(642.7)

	At 1 January 2013 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions[1] £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2013 £m
Cash and cash equivalents	142.8	(1.8)	–	–	–	(15.9)	–	125.1
Loan receivables	1.2	4.6	–	–	–	–	–	5.8
Non-recourse loans	(25.1)	4.9	–	–	–	(0.1)	–	(20.3)
Other loans	(700.7)	(103.6)	–	–	–	16.3	–	(788.0)
Obligations under finance leases	(50.2)	4.9	–	–	–	0.3	(23.0)	(68.0)
	(632.0)	(91.0)	–	–	–	0.6	(23.0)	(745.4)

1 Acquisitions represent the net cash/(debt) acquired on acquisition.

In the current year, a change was adopted in relation to the presentation of capitalised finance costs, incurred in the raising of debt. As a result, an amount of £4.6m has been reclassified from trade and other receivables to loans, and this movement is included in non-cash items above. The prior year has not been restated.

Financial Statements

Notes to the consolidated financial statements continued

30. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2013	13.3	7.9	14.9	20.1	56.2
Derecognised on disposal of subsidiary	–	(0.3)	–	–	(0.3)
Charged to income statement	5.8	0.2	21.7	7.8	35.5
Released to income statement	–	(0.1)	(4.6)	(7.4)	(12.1)
Utilised during the year	(2.7)	(2.5)	(5.9)	(6.0)	(17.1)
Unwinding of discount	–	0.2	0.2	–	0.4
Exchange differences	(0.7)	(0.1)	(0.4)	(0.3)	(1.5)
At 1 January 2014	15.7	5.3	25.9	14.2	61.1
Reclassified from trade and other receivables[1]	–	–	(3.9)	–	(3.9)
Recognised on acquisition of subsidiary	0.2	0.1	–	–	0.3
Charged to income statement – exceptional	8.8	2.2	19.4	57.7	88.1
Charged to income statement – other	19.8	15.1	456.7	41.5	533.1
Released to income statement	(0.2)	(0.1)	(3.5)	(4.2)	(8.0)
Utilised during the year	(7.7)	(1.7)	(36.3)	(5.1)	(50.8)
Transferred to trade payables	–	–	–	(8.2)	(8.2)
Assets held for sale	(1.7)	–	(21.5)	(6.8)	(30.0)
Unwinding of discount	–	0.1	–	–	0.1
Exchange differences	0.2	0.5	(6.4)	1.8	(3.9)
At 31 December 2014	**35.1**	**21.5**	**430.4**	**90.9**	**577.9**
Analysed as:					
Current	**6.8**	**6.8**	**136.3**	**55.8**	**205.7**
Non-current	**28.3**	**14.7**	**294.1**	**35.1**	**372.2**

1 £3.9m has been reclassified from accrued income.

Total provisions held by the Group at 31 December 2014 amount to £607.9m (2013: £61.1m) and include £577.9m (2013: £61.1m) shown above and £30.0m (2013: £nil) included within amounts held for sale on the balance sheet.

Contract provisions relate to provisions for loss making onerous contracts. The present value of the estimated future cash outflows 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 material. Following a downturn in performance for certain contracts and the strategy review currently being undertaken, a full analysis was performed of the future profitability of all contracts with marginal performances and of the balance sheet items directly linked to these contracts.

There remains a level of uncertainty over the amount and timing of the related cash flows as a result of the matters set out in note 3. Due to the significant size of the balance, 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.

The Contract and Balance Sheet Review also highlighted the need for additional provisions where parts of the business are no longer considered to be core. This resulted in an increase in various other provisions, as explained below.

Further details relating to Onerous Contract Provisions are described in the Finance Review section of the Strategic Report under the heading 'Onerous Contract Provisions and Related Impairments' including all sections up to, but not including, 'Onerous Contract Provisions Projected Utilisation.'

Employee related provisions are for long-term service awards and terminal gratuities liabilities which have been accrued and are based on contractual entitlement, together with an estimate of the probabilities that employees will stay until retirement and receive all relevant amounts. There are also amounts included in relation to restructuring.

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 outflows required to settle the lease obligations as they fall due.

Other provisions are held for legal and other costs that the Group expects to incur over an extended period. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

31. Capital and Other Commitments

	2014 £m	2013 £m
Capital expenditure contracted but not provided:		
– Property, plant and equipment	**4.4**	3.0
– Intangible assets	**0.8**	10.3

Of the above, £2.6m (2013: £nil) in relation to property, plant and equipment commitment is associated with assets which have been reclassified as held for sale.

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:

	2014 £m	2013 £m
Within one year	**69.6**	74.1
Between one and five years	**160.3**	172.1
After five years	**57.5**	68.6
	287.4	314.8

Principal lease commitments are within the Serco Global Services segment, with future minimum lease payments totalling £95.8m (2013: £114.0m). These leases relate primarily to administrative and operational buildings.

Of the above, £97.9m (2013: £nil) is associated with assets which have been reclassified as held for sale. Of this, £14.2m is due within one year, £44.3m is due between one and five years and the remaining £39.4m is due after five years.

32. Contingent Liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £26.2m (2013: £26.0m). The actual commitment outstanding at 31 December 2014 was £21.4m (2013: £22.6m).

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 2014 was £192.1m (2013: £119.9m).

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.

On 31st May 2011, we filed a claim with the Authority for Advance Rulings to seek to confirm that Serco was not required to withhold Indian income tax from the purchase price on the acquisition of Intelenet. The AAR declined to rule on the matter, so Serco filed a claim with the High Court to decide on the matter or direct the AAR to rule on the matter. The High Court has currently reserved judgment. Should the matter be decided against Serco, it would be liable for unprovided tax of £27m together with accrued interest to 31 December 2014 of £11m. Having taken appropriate professional advice, Serco considers it likely that it will ultimately be successful in this matter.

In December 2013, following a review of billing arrangements on the EM contract by the Ministry of Justice, a settlement of £64.3m was reached in respect of contractual claims. In addition, a £2.0m settlement was reached on the Prisoner Escort and Custody Services (PECS) contract which was also subject to Government review to reflect repayment of past profits earned on this contract. The settlement was full and final in respect of contractual claims with the proviso that additional payments might be sought in limited circumstances, such as if criminality was to be established. Serco continues to cooperate fully with the ongoing investigations by the Serious Fraud Office.

33. Financial Risk Management

33. a) Fair Value of Financial Instruments

i) Hierarchy of fair value

The classification of the fair value measurement falls into three levels, based on the degree to which the fair value is observable. The levels are as follows:

Level 1: 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 ; and
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 2014 and the comparison fair values for loans and finance leases, are all considered to fall into Level 2. There have been no transfers between levels in the year.

Financial Statements

Notes to the consolidated financial statements continued

33. Financial Risk Management (continued)

33. a) Fair Value of Financial Instruments (continued)

The Group held the following financial instruments which fall within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* at 31 December:

	Carrying amount (measurement basis)		Comparison fair value	Carrying amount (measurement basis)		Comparison fair value
	Amortised cost 2014 £m	Fair value – Level 2 2014 £m	Level 2 2014 £m	Amortised cost 2013 £m	Fair value – Level 2 2013 (restated) £m	Level 2 2013 £m
Financial assets						
Financial assets – current						
Cash and bank balances	180.1	–	180.1	125.1	–	125.1
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	5.6		–	8.6	
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	0.1		–	–	
Forward foreign exchange contracts	–	0.2		–	0.1	
Loans and receivables						
Trade receivables (note 24)	146.8	–	146.8	210.7	–	210.7
Loan receivables (note 24)	1.0	–	1.0	2.5	–	2.5
Security deposits (note 24)	0.2	–	0.2	0.2	–	0.2
Amounts owed by joint ventures (note 24)	0.1	–	0.1	0.4	–	0.4
Financial assets – non-current						
Derivative instruments in designated hedge accounting relationships						
Cross currency swap	–	7.0		–	–	
Loans and receivables						
Loan receivables (note 24)	–	–	–	3.3	–	3.3
Other investments (note 24)	3.9	–	3.9	0.6	–	0.6
Amounts owed by joint ventures (note 24)	9.0	–	9.0	9.5	–	9.5
Financial liabilities – current						
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	(17.3)		–	(19.6)	
Derivative instruments in designated hedge accounting relationships						
Cross Currency Swaps	–	(0.3)		–	(0.3)	
Forward foreign exchange contracts	–	(0.1)		–	(0.3)	
Financial liabilities at amortised cost						
Trade payables (note 27)	(99.8)	–	(99.8)	(169.9)	–	(169.9)
Loans (note 29)	(43.9)	–	(43.9)	(52.2)	–	(59.3)
Obligations under finance leases (note 28)	(9.6)	–	(9.6)	(14.9)	–	(14.9)
Financial liabilities – non-current						
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	–		–	(20.7)	
Interest rate swaps	–	–		–	(0.1)	
Derivative instruments in designated hedge accounting relationships						
Cross Currency Swaps	–	–		–	(0.3)	
Financial liabilities at amortised cost						
Loans (note 29)	(753.4)	–	(762.9)	(756.1)	–	(736.8)
Obligations under finance leases (note 28)	(16.9)	–	(16.9)	(53.1)	–	(53.1)

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.

33. Financial Risk Management (continued)

33. a) Fair Value of Financial Instruments (continued)

ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments results in a net liability of £4.8m (2013: £32.6m) comprising non-current assets of £7.0m (2013: £nil), current assets of £5.9m (2013: £8.7m), current liabilities of £17.7m (2013: £20.2m) and non-current liabilities of £nil (2013: £21.1m).

	1 January 2014 £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 2014 £m
Currency swaps	(0.6)	7.4	–	6.8
Forward foreign exchange contracts	(31.9)	0.2	20.1	(11.6)
Interest rate swaps	(0.1)	–	0.1	–
	(32.6)	7.6	20.2	(4.8)

	1 January 2013 £m	Movement in fair value of derivatives designated in hedge accounting relationships (restated) £m	Movement in fair value of derivatives not designated in hedge accounting relationships (restated) £m	31 December 2013 £m
Currency swaps	(0.6)	–	–	(0.6)
Forward foreign exchange contracts	(34.8)	–	2.9	(31.9)
Interest rate swaps	(0.1)	–	–	(0.1)
	(35.5)	–	2.9	(32.6)

As a result of a prior year adjustment (see note 4), £1.0m of movement in fair value of derivatives designated in hedge accounting relationships was moved to movement in fair value of derivatives not designated in hedge accounting relationships.

The fair value of financial liabilities at fair value through profit and loss is £17.3m (2013: £40.4m (restated)) 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.

33 (b) Financial Risk

The Board is ultimately responsible for ensuring that financial and non-financial risks are monitored and managed within acceptable and known parameters. The Board delegates authority to the executive team to manage financial risks. The Group's treasury function acts as a service centre and operates within clearly defined guidelines and policies that are approved by the Board. The guidelines and policies define the financial risks to be managed, specify the objectives in managing these risks, delegate responsibilities to those managing the risks and establish a control framework to regulate treasury activities to minimise operational risk.

33 (c) Liquidity risk

i) Credit facilities

The Group maintains committed credit facilities to ensure that it has sufficient liquidity to maintain its ongoing operations. As at 31 December, the Group's committed bank credit facilities and corresponding borrowings were as follows:

	Currency	Amount 2014 millions	Drawn 2014 £m	Undrawn 2014 £m	Total facility 2014 £m
Syndicated revolving credit facility	GBP	730.0	185.0	545.0	730.0

	Currency	Amount 2013 millions	Drawn 2013 £m	Undrawn 2013 £m	Total facility 2014 £m
Syndicated revolving credit facility	GBP	730.0	175.0	555.0	730.0

The £730.0m syndicated revolving credit facility was signed in March 2012 and matures in March 2017. It is unsecured and contains financial and non-financial covenants and obligations typical of these arrangements.

Financial Statements

Notes to the consolidated financial statements continued

33. Financial Risk Management (continued)

33 (c) Liquidity risk (continued)

In addition to the banking facility the Group has outstanding US private placements of £584.8m which will be repaid as bullet repayments between 2015 and 2024.

In addition to the bank and private placement facilities the Group has a £60.0m receivables financing facility (2013: £60.0m) of which £32.8m (2013: £27.1m) 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 2014	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 27)	99.8	–	–	–	99.8
Obligations under finance leases (note 28)	10.4	10.1	7.4	0.1	28.0
Loans[1]	43.9	32.1	304.6	420.1	800.7
Future loan interest	25.4	22.4	61.2	48.0	157.0
Derivative financial liabilities settled on net basis	15.6	–	–	–	15.6
Derivatives settled on gross basis					
Outflow	457.5	35.1	111.3	–	603.9
Inflow	(461.0)	(37.2)	(116.6)		(614.8)
	191.6	62.5	367.9	468.2	1,090.2

1 Loans are stated gross of capitalised finance costs.

At 31 December 2013	On demand or within one year (restated) £m	Between one and two years (restated) £m	Between two and five years £m	After five years £m	Total (restated) £m
Trade payables (note 27)	169.9	–	–	–	169.9
Obligations under finance leases (note 28)	16.9	19.9	32.7	5.0	74.5
Loans (note 29)	52.2	27.0	285.4	443.7	808.3
Future loan interest	24.8	23.0	60.7	59.8	168.3
Derivative financial liabilities settled on net basis	12.7	13.8	7.6	–	34.1
Derivatives settled on gross basis					
Outflow	528.2	10.6	–	–	538.8
Inflow	(529.2)	(10.3)	–	–	(539.5)
	275.5	84.0	386.4	508.5	1,254.4

The presentation of the undiscounted cash flows of financial liabilities has been restated for 2013 to include the gross cash flows of derivatives that are not settled net.

Gross cash flows in the table above relating to forward foreign exchange contracts total £447.9m (inflows) and £444.2m (outflows) all on demand or within one year (2013: £521.8m (inflow) and £520.4 (outflow), on demand or within 1 year, and £3.2m (inflow) and £3.3m (outflow) between one to two years).

Total loans on demand or within one year for the Group amount to £44.7m at December 2014 of which £43.9m is included above and £0.8m is classified as held for sale.

33. Financial Risk Management (continued)

33 (d) Foreign Exchange Risk

i) Transactional

It is the Group's policy to hedge material transactional exposures using forward foreign exchange contracts to fix the functional currency value of non-functional currency cash flows. At 31 December 2014, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or highly probable forecast transactions.

ii) Translational

Where possible the Group will raise external funding to match the currency profile of its foreign operations in order to mitigate translation exposure. If matched funding is not possible, currency derivatives may be used to protect against movements in foreign exchange.

iii) Hedge accounting

For the purposes of hedge accounting, hedges are classified as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Page 208 details the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS 39.

At 31 December 2014, the Group held cross currency swaps designated as cash flow hedges against $231.0m 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 is as follows:

Maturity	Notional amount USD m	2014 Receivable USD interest rate %	Payable GBP interest rate %	Notional amount USD m	2013 Receivable USD interest rate %	Payable GBP interest rate %
August 2015	**11.0**	**5.7**	**5.7**	22.0	5.7	5.7
May 2016	**50.0**	**3.6**	**4.3**			
May 2018	**100.0**	**4.4**	**4.9**			
October 2019	**70.0**	**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 businesses and highly probable forecast foreign currency trade receipts in the Indian business. The net notional amounts are summarised by currency below:

	2014 £m	2013 (restated) £m
Sterling	**(8.5)**	(14.7)
US Dollar	**(2.9)**	10.0
Euro	**4.4**	4.5
Indian Rupee	**7.0**	–

As a result of a prior year adjustment (see note 4), the 2013 numbers have been adjusted to exclude the derivatives that did not qualify for hedge accounting.

All derivatives designated as cash flow hedges are highly effective and as at 31 December 2014 a net fair value loss of £4.9m (2013: £2.2m (restated)) has been deferred in hedging reserve. During the course of the year to 31 December 2014, £2.7m (2013: £0.9m (restated)) of fair value losses were transferred to the hedging reserve, and £nil (2013: £nil (restated)) reclassified to the consolidated income statement.

iv) Currency sensitivity

The Group's currency exposures in respect of monetary items at 31 December 2014 that result in net currency gains and losses in the income statement and equity arise principally from movement in US Dollar and Indian Rupee exchange rates. At 31 December 2014, if both had weakened by 10% against Sterling, with all other variables held constant, post-tax profit for the year would have increased by £13.0m (2013: £17.1m increase (restated)), comprising USD £19.7m increase and INR £6.7m decrease and equity would have decreased by £0.4m (2013: £0.9m decrease (restated)), comprising USD £0.4m.

The underlying currency exposures are £217.0m (2013: £364.0m) for USD, and a £53.3m (2013: £110.5m) for INR. These exposures are principally the result of prior year adjustments, which resulted in exposures previously treated as being hedged becoming unhedged at 31 December 2014 (see note 4).

Financial Statements

Notes to the consolidated financial statements continued

33. Financial Risk Management (continued)

33 (e) Interest Rate Risk

The Group's policy is to minimise the impact of interest rate volatility on earnings to provide an appropriate level of certainty to cost of funds. Exposure to interest rate risk arises principally on changes to US Dollar and Sterling interest rates.

i) Interest rate management

An analysis of financial assets and liabilities exposed to interest rate risk is set out below:

Financial assets	Floating rate 2014 £m	Fixed rate 2014 £m	Weighted average interest rate 2014 %	Floating rate 2013 £m	Fixed rate 2013 £m	Weighted average interest rate 2013 %
Cash and cash equivalents	**180.1**	**–**	**–**	125.1	–	–
Other loan receivables	**1.0**	**–**	**–**	1.1	4.7	3.30
	181.1	**–**		126.2	4.7	

Financial liabilities	Floating rate 2014 £m	Fixed rate 2014 £m	Weighted average interest rate 2014 %	Floating rate 2013 £m	Fixed rate 2013 £m	Weighted average interest rate 2013 %
Non-recourse Sterling loans	**–**	**–**	**–**	–	20.3	3.62
Sterling loans	**205.3**	**16.6**	**2.72**	200.1	33.2	2.30
US Dollar loans	**–**	**568.2**	**4.12**	1.5	541.6	4.09
Other loans	**10.6**	**–**	**–**	11.6	–	–
	215.9	**584.8**		213.2	595.1	

Total cash and cash equivalents held by the Group at 31 December 2014 amount to £202.5m (2013: £125.1m) and include £180.1m (2013: £125.1m) shown above and £22.4m (2013: £nil) included within amounts held for sale on the balance sheet.

Total floating rate and fixed rate loans held by the Group at 31 December 2014 amount to £216.7m (2013: £213.2m) and £608.8m (2013: £595.1m) respectively and include £215.9m (2013: £213.2m) and £584.8m (2013: £595.1m) shown above and £0.8m (2013: £nil) and £24.0m (2013: nil) included within amounts held for sale on the balance sheet.

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 £26.5m (2013: £68.0m) of amounts payable under finance leases, which are subject to fixed rates of interest.

ii) Interest rate swaps

Interest rate swaps outstanding at 31 December 2014 relate to interest rate risk management on debt held locally within the Group.

Maturity	Notional Value 2014 USD m	Payable USD interest rate 2014 %	Receivable USD interest rate 2014 %	Receivable JPY interest rate 2014 %
January 2015	**1.3**	**6.30**	**3 month USD LIBOR + 2.0**	**–**

Maturity	Notional Value 2013 USD m	Payable USD interest rate 2013 %	Receivable USD interest rate 2013 %	Receivable JPY interest rate 2013 %
March 2014	0.5	6.89	–	3 month JPY LIBOR + 1.0
January 2015	2.5	6.30	3 month USD LIBOR + 2.0	–

iii) Interest rate sensitivity

The effect of a 100 basis point increase in LIBOR rates on the net financial liability position at the balance sheet date, with all other variables held constant, would have resulted in a reduction in post-tax profit for the year to 31 December 2014 of £0.1m (2013: £0.7m).

33. Financial Risk Management (continued)

33 (f) Credit Risk

The Group's principal financial assets are cash and cash equivalents and trade and other receivables.

Credit risk is the risk that a counterparty could default on its contractual obligations. In this regard, the Group's principle exposure is to cash and cash equivalents, derivative transactions and trade receivables.

The Group's trade receivables credit risk is relatively low given that a high proportion of our customer base are Government bodies with strong sovereign, or sovereign like, credit ratings. However, where the assessed credit worthiness of a customer, Government or non-government, falls below that considered acceptable, appropriate measures are taken to mitigate against the risk of contractual default using instruments such as credit guarantees.

The Group's Treasury function only transacts with counterparties that comply with Board policy. The credit risk is measured by way of a counterparty credit rating and as a minimum any counterparty must have a long term public rating of 'Single A' from any two recognised rating agencies. Pre-approved limits are set based on a rating matrix and exposures monitored accordingly. The Group also employs the use of set-off rights in some agreements.

33 (g) Capital Risk

The 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:

	2014 £m	2013 £m
Cash and cash equivalents	**(180.1)**	(125.1)
Loans	**796.3**	802.5
Obligations under finance leases	**26.5**	68.0
Equity	**(66.2)**	1,095.9
Capital	**576.5**	1,841.3

Notes to the consolidated financial statements continued

34. Retirement Benefit Schemes

The Group has accounted for pensions in accordance with IAS 19 Employee Benefits. The Group operates a number of defined benefit schemes and defined contribution schemes. The pension charge for the year ended 31 December 2014 (excluding pension arrangements operated by joint ventures), was £108.8m (2013: £108.6m).

34 (a) Defined Benefit Schemes

The Group operates defined benefit schemes for qualifying employees of its subsidiaries in the UK and Europe.

The assets of the funded schemes are held independently of the Group's assets in separate trustee administered funds. The trustees of the pension fund are required by law to act in the interest of the fund and of all relevant stakeholders in the scheme. The trustees of the pension fund are responsible for the investment policy with regard to the assets of the fund. The Group's major schemes are valued by independent actuaries annually using the projected unit credit actuarial cost method. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions primarily regarding discount rates used in determining the present value of benefits, projected rates of salary growth, and 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 different defined benefit schemes are not offset unless the Group has a legally enforceable right to use the surplus in one scheme to settle obligations in the other scheme and intends to exercise this right.

In accounting for the defined benefit schemes, the Group has applied the following principles.

- Asset recognised for SPLAS is based on assumption that 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.

The schemes in the UK typically expose the Company to actuarial risks such as: investment risk, interest rate risk, longevity risk and salary risk.

- *Investment Risk*

The present value of the defined benefit schemes' liability is calculated using a discount rate determined by reference to high quality corporate bond yields; if the return on plan assets is below this rate, a deficit will be created.

- *Interest risk*

A decrease in the bond interest rate will increase the scheme liability but this will be partially offset by an increase in the return of the plan's debt investments.

- *Longevity risk*

The present value of the defined benefit plan liability is calculated by reference to the best estimate of the mortality of plan participants both during and after their employment. An increase in the life expectancy of the plan participants will increase the plan's liability.

- *Salary risk*

The present value of the defined benefit scheme liability is calculated by reference to the future salaries of plan participants, as such, an increase in the salary of the plan participants will increase the plan's liability.

i) Balance sheet values

The amounts recognised in the balance sheet are grouped together as follows:

Contract specific

These are pre-funded defined benefit schemes. The Group has obligations to contribute variable amounts to the pension schemes over the terms of the related contracts. At rebid, any deficit or surplus would be expected to transfer to the next contractor. The Group has recognised as a liability the defined benefit obligation less the fair value of scheme assets that it will fund over the period of the contracts with a corresponding amount recognised as intangible assets at the start of the contracts. Subsequent actuarial gains and losses in relation to the Group's share of the pension obligations have been recognised in the SOCI. The intangible assets are amortised over the term of the contracts.

Non-contract specific

These consist of two pre-funded defined benefit schemes (the funding policy is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis) and an unfunded defined benefit scheme. These schemes do not relate to any specific contract. Any liabilities arising are recognised in full.

34. Retirement Benefit Schemes (continued)

34 (a) Defined Benefit Schemes (continued)

ii) Triennial funding valuation

Among our non-contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The estimated actuarial deficit of SPLAS as at 31 December 2014 was approximately £5.0m (2013: £13.0m). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2012 and resulted in an actuarially assessed deficit of £24m. Following this review, the Group agreed with the Trustees to make a small increase in contributions, bringing cash contributions of up to 33% of members' pensionable salaries until 2021. The level of benefits and contributions under the scheme is kept under continual review in light of the needs of the business and changes to pension legislation.

The assets and liabilities of the schemes at 31 December are:

	Contract specific 2014 £m	Non-contract specific 2014 £m	Total 2014 £m
Scheme assets at fair value			
Equities	48.1	38.5	86.6
Bonds except LDI	44.3	15.6	59.9
Liability driven investments (LDI)	12.8	1,252.8	1,265.6
Gilts	22.2	–	22.2
Property	3.5	–	3.5
Cash and other	3.5	31.0	34.5
Annuity policies	–	23.9	23.9
Fair value of scheme assets	134.4	1,361.8	1,496.2
Present value of scheme liabilities	(161.3)	(1,231.3)	(1,392.6)
Net amount recognised	(26.9)	130.5	103.6
Franchise adjustment[1]	22.9	–	22.9
	(4.0)	130.5	126.5
Analysed as:			
Net pension liability	(4.0)	(13.4)	(17.4)
Net pension asset	–	143.9	143.9

1 The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

	Contract specific 2013 £m	Non-contract specific 2013 £m	Total 2013 £m
Scheme assets at fair value			
Equities	93.4	36.0	129.4
Bonds except LDI	40.6	13.7	54.3
Liability driven investments (LDI)	13.6	1,048.9	1,062.5
Gilts	42.5	–	42.5
Property	9.1	–	9.1
Cash and other	25.9	25.0	50.9
Annuity policies	2.1	22.3	24.4
Fair value of scheme assets	227.2	1,145.9	1,373.1
Present value of scheme liabilities	(267.8)	(1,091.2)	(1,359.0)
Net amount recognised	(40.6)	54.7	14.1
Members' share of deficit	–	3.7	3.7
Franchise adjustment[1]	35.1	–	35.1
	(5.5)	58.4	52.9
Analysed as:			
Net pension liability	(5.5)	(5.8)	(11.3)
Net pension asset	–	64.2	64.2
Related assets			
Intangible assets (note 21)	1.0	–	1.0

1 The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

Liabilities in relation to unfunded schemes included above amount to £0.3m (2013: £0.3m).

Financial Statements

Notes to the consolidated financial statements continued

34. Retirement Benefit Schemes (continued)

34 (a) Defined Benefit Schemes (continued)

The Serco Pension and Life Assurance Scheme (SPLAS) has a Liability Driven Investment (LDI) strategy which aims to reduce volatility risk by better matching assets to liabilities. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays. The value of these investments vary in line with gilt yields, which has dropped from 3.62% p.a. to 2.45% p.a. during 2014 resulting in a significant increase in these assets. The increase in the value of LDI investments was greater than the increase in scheme liabilities as the reduction in gilt yields was greater than the fall in yields of high quality corporate bonds resulting in a significant increase in the surplus in the year.

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.

In some schemes, employee contributions vary over time to meet a specified proportion of the overall costs, including a proportion of any deficit. The liabilities recognised in the balance sheet for these schemes are net of the proportion attributed to employees. In addition, the amounts charged to the income statement for these schemes are net of the proportion attributed to employees. The amounts attributed to employees are shown separately in the reconciliation of changes in the fair value of scheme assets and liabilities.

The amounts recognised in the financial statements for the year are analysed as follows:

	Contract specific 2014 £m	Non-contract specific 2014 £m	Total 2014 £m
Recognised in the income statement			
Current service cost – employer	7.7	8.8	16.5
Past service cost	–	2.5	2.5
Administrative expenses and taxes	2.1	3.5	5.6
Recognised in arriving at operating profit	9.8	14.8	24.6
Interest income on scheme assets – employer	(10.6)	(51.3)	(61.9)
Interest on franchise adjustment	(1.6)	–	(1.6)
Interest cost on scheme liabilities – employer	12.1	48.3	60.4
Finance income	(0.1)	(3.0)	(3.1)
Included within the SOCI			
Actual return on scheme assets	29.8	242.4	272.2
Less: interest income on scheme assets	(10.6)	(52.2)	(62.8)
	19.2	190.2	209.4
Effect of changes in demographic assumptions	–	3.2	3.2
Effect of changes in financial assumptions	(42.9)	(116.8)	(159.7)
Effect of experience adjustments	4.2	(4.3)	(0.1)
Remeasurements recognised in the SOCI	(19.5)	72.3	52.8
Change in franchise adjustment	17.4	–	17.4
Change in members' share	–	(3.9)	(3.9)
Actuarial gains/(losses) on reimbursable rights	17.4	(3.9)	13.5
Total pension (loss)/gain recognised in the SOCI	(2.1)	68.4	66.3

34. Retirement Benefit Schemes (continued)

34 (a) Defined Benefit Schemes (continued)

	Contract specific 2013 £m	Non-contract specific 2013 £m	Total 2013 £m
Recognised in the income statement			
Current service cost – employer	9.3	10.8	20.1
Curtailment gain	–	(2.4)	(2.4)
Settlement gain	–	(0.1)	(0.1)
Administrative expenses and taxes	0.9	3.2	4.1
Recognised in arriving at operating profit	10.2	11.5	21.7
Interest income on scheme assets – employer	(9.2)	(48.0)	(57.2)
Interest on franchise adjustment	(2.4)	–	(2.4)
Interest cost on scheme liabilities – employer	11.9	45.4	57.3
Finance expense/(income)	0.3	(2.6)	(2.3)
Included within the SOCI			
Actual return on scheme assets	20.0	22.0	42.0
Less: interest income on scheme assets	(9.2)	(48.8)	(58.0)
	10.8	(26.8)	(16.0)
Effect of changes in demographic assumptions	8.8	(9.2)	(0.4)
Effect of changes in financial assumptions	12.5	(9.1)	3.4
Effect of experience adjustments	8.8	34.5	43.3
Remeasurements recognised in the SOCI	40.9	(10.6)	30.3
Change in IFRIC 14	–	(0.9)	(0.9)
Change in franchise adjustment	(35.6)	–	(35.6)
Change in members' share	–	(0.6)	(0.6)
Actuarial losses on reimbursable rights	(35.6)	(1.5)	(37.1)
Total pension gain/(loss) recognised in the SOCI	5.3	(12.1)	(6.8)

Changes in the fair value of scheme liabilities are analysed as follows:

	Contract specific £m	Non-contract specific £m	Total £m
At 1 January 2013	280.4	1,115.3	1,395.7
Current service cost – employer	9.3	10.8	20.1
Current service cost – employee	–	0.2	0.2
Scheme participants' contributions	0.7	0.8	1.5
Interest cost – employer	11.9	45.4	57.3
Interest cost – employee	–	1.0	1.0
Benefits paid	(4.4)	(37.8)	(42.2)
Effect of changes in demographic assumptions	(8.8)	9.2	0.4
Effect of changes in financial assumptions	(12.5)	9.1	(3.4)
Effect of experience adjustments	(8.8)	(34.5)	(43.3)
Plan curtailments	–	(2.4)	(2.4)
Plan settlements	–	(25.9)	(25.9)
At 31 December 2013	267.8	1,091.2	1,359.0
At 1 January 2014	**267.8**	**1,091.2**	**1,359.0**
Current service cost – employer	**7.7**	**8.8**	**16.5**
Current service cost – employee	**–**	**0.2**	**0.2**
Past service costs	**–**	**2.5**	**2.5**
Scheme participants' contributions	**0.8**	**0.4**	**1.2**
Interest cost – employer	**12.1**	**48.3**	**60.4**
Interest cost – employee	**–**	**1.1**	**1.1**
Benefits paid	**(4.1)**	**(39.1)**	**(43.2)**
Effect of changes in demographic assumptions	**–**	**(3.2)**	**(3.2)**
Effect of changes in financial assumptions	**42.9**	**116.8**	**159.7**
Effect of experience adjustments	**(4.2)**	**4.3**	**0.1**
Eliminated on disposal of a pension scheme	**(161.7)**	**–**	**(161.7)**
At 31 December 2014	**161.3**	**1,231.3**	**1,392.6**

Financial Statements

Notes to the consolidated financial statements continued

34. Retirement Benefit Schemes (continued)

34 (a) Defined Benefit Schemes (continued)

Changes in the fair value of scheme assets are analysed as follows:

	Contract specific £m	Non-contract specific £m	Total £m
At 1 January 2013	198.3	1,155.8	1,354.1
Interest income on scheme assets – employer	9.2	48.0	57.2
Interest income on scheme assets – employee	–	0.8	0.8
Administrative expenses and taxes	(0.9)	(3.2)	(4.1)
Employer contributions	13.4	34.0	47.4
Contributions by employees	0.8	0.9	1.7
Benefits paid	(4.4)	(37.8)	(42.2)
Return on scheme assets less interest income	10.8	(26.8)	(16.0)
Plan settlements	–	(25.8)	(25.8)
At 31 December 2013	227.2	1,145.9	1,373.1
At 1 January 2014	**227.2**	**1,145.9**	**1,373.1**
Interest income on scheme assets – employer	**10.6**	**51.3**	**61.9**
Interest income on scheme assets – employee	**–**	**0.9**	**0.9**
Administrative expenses and taxes	**(2.1)**	**(3.5)**	**(5.6)**
Employer contributions	**13.3**	**15.4**	**28.7**
Contributions by employees	**0.8**	**0.7**	**1.5**
Benefits paid	**(4.1)**	**(39.1)**	**(43.2)**
Return on scheme assets less interest income	**19.2**	**190.2**	**209.4**
Eliminated on disposal of a pension scheme	**(130.5)**	**–**	**(130.5)**
At 31 December 2014	**134.4**	**1,361.8**	**1,496.2**

Changes in the franchise adjustment is analysed as follows:

	Total £m
At 1 January 2013	68.3
Interest on franchise adjustment	2.4
Taken to SOCI	(35.6)
At 31 December 2013	35.1
At 1 January 2014	**35.1**
Interest on franchise adjustment	**1.6**
Taken to SOCI	**17.4**
Eliminated on disposal of scheme	**(31.2)**
At 31 December 2014	**22.9**

On 7 December 2014, the DLR contract and its associated defined benefit pension scheme ceased to be part of the Serco Group. As a result, Serco ceased to be a participating employer in the DLR pension scheme. This has resulted in a reduction in the fair value of scheme assets of £130.5m, present value of scheme liabilities of £161.7m and the franchise adjustment of £31.2m.

In addition to this, the NPL contract and its associated defined benefit pension scheme ceased to be part of the Serco Group on 1 January 2015. As at 31 December 2014, the group consolidated balance sheet included the scheme's fair value of scheme assets of £104.6m, present value of scheme liabilities of £127.5m and franchise adjustment of £22.9m.

Employer contributions for non-contract specific schemes in 2013 included a £19.7m special contribution. The special pension contributions of £19.7m related to a £16.8m payment to fund the deficit on the Vertex pension fund prior to its transfer into the Group's largest defined benefit scheme, Serco Pension and Life Assurance Scheme (SPLAS), and £2.9m in relation to deficit recovery funding of the Walsall defined benefit pension scheme. The Vertex payment enabled their separate defined benefit scheme to be closed and thereby reduces ongoing administration costs.

The normal contributions expected to be paid during the financial year ending 31 December 2015 are £13.5m (financial year ended 31 December 2014: £27.3m).

The average duration of the benefit obligation at the end of the reporting period is 18.3 years (2013: 17.8 years).

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 2014 in respect to inflation, interest, bond yields and equity performance when selecting the expected return on assets assumptions.

34. Retirement Benefit Schemes (continued)

34 (a) Defined Benefit Schemes (continued)

The expected yield on bond investments with fixed interest rates is derived from their market value. The yield on equity investments contains an additional premium (an 'equity risk premium') to compensate investors for the additional anticipated risks of holding this type of investment, when compared to bond yields. Management have concluded that an appropriate equity risk premium is 4.6% (2013: 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 scheme.

	2014 %	2013 %
Main assumptions:		
Rate of salary increases	**2.70**	3.20
Rate of increase in pensions in payment	**2.00 (CPI) and 3.00 (RPI)**	2.50 (CPI) and 3.30 (RPI)
Rate of increase in deferred pensions	**2.10 (CPI) and 3.10 (RPI)**	2.60 (CPI) and 3.40 (RPI)
Inflation assumption	**2.10 (CPI) and 3.10 (RPI)**	2.60 (CPI) and 3.40 (RPI)
Discount rate	**3.60**	4.60

	2014 Years	2013 Years
Post-retirement mortality:		
Current pensioners at 65 – male	**22.5**	22.5
Current pensioners at 65 – female	**25.0**	24.9
Future pensioners at 65 – male	**24.3**	24.2
Future pensioners at 65 – female	**27.0**	26.9

Management considers the significant actuarial assumptions with regards to the determination of the defined benefit obligation to be the discount rate, inflation, the rate of salary increases and mortality.

Sensitivity analysis is provided below, based on reasonably possible changes of the assumptions occurring at the end of the reporting period, assuming all other assumptions are held constant.

The sensitivities have been derived in the same manner as the defined benefit obligation as at 31 December 2014 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 2014 is calculated on the actuarial assumptions agreed as at that date. The sensitivities are calculated by changing each assumption in turn following the methodology above with all other things held constant. The change in the defined benefit obligation from updating the single assumption represents the impact of that assumption on the calculation of the defined benefit obligation.

Assumption	Assumption 2014	Change in assumption	Change in present value of scheme liabilities 2014	Change in present value of scheme liabilities 2013
Discount rate	**3.6%**	+0.5%	**(9%)**	(9%)
		(0.5%)	**+10%**	+10%
Inflation	**2.1% (CPI)**	+0.5%	**+9%**	+9%
	3.1% (RPI)	(0.5%)	**(8%)**	(8%)
Rate of salary increase	**2.7%**	+0.5%	**+1%**	+1%
		(0.5%)	**(1%)**	(1%)
Mortality	**20.3–27.9**[1]	Increase by one year	**+2%**	+2%

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

Management acknowledges that the method used of presuming that all other assumptions remaining constant has inherent limitation given that it is more likely for a combination of changes, but highlights the value of each individual risk and is therefore a suitable basis for providing this analysis.

Notes to the consolidated financial statements continued

34. Retirement Benefit Schemes (continued)

34 (b) Defined Contribution Schemes

The Group paid employer contributions of £84.2m (2013: £86.9m) into UK and other defined contribution schemes and foreign state pension schemes.

Pre-funded defined benefit schemes treated as defined contribution

Serco accounts for certain pre-funded defined benefit schemes relating to contracts as defined contribution schemes because the contributions are fixed until the end of the current concession and at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

35. Share Capital

	2014 £m	Number 2014 Millions	2013 £m	Number 2013 Millions
Issued and fully paid:				
499,328,896 (2013: 498,462,508) ordinary shares of 2p each at 1 January	**10.0**	**499.3**	10.0	498.5
Issued on the exercise of share options and the share placement	**1.0**	**50.0**	–	0.8
549,265,547 (2013: 499,328,896) ordinary shares of 2p each at 31 December	**11.0**	**549.3**	10.0	499.3

The Company has one class of ordinary shares which carry no right to fixed income.

On 7 May 2014, 49,932,918 new ordinary shares of 2p each were placed by Merrill Lynch International (BofA Merrill Lynch) and J.P. Morgan Cazenove, raising net proceeds of £156.3m. During the year 3,733 (2013: 866,388) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares.

36. Share Premium Account

	2014 £m	2013 £m
At 1 January	**327.8**	326.5
Premium on shares issued	**0.1**	1.3
At 31 December	**327.9**	327.8

37. Reserves

37 (a) Retirement Benefit Obligations Reserve

The retirement benefit obligations reserve represents the actuarial gains and losses recognised in respect of annual actuarial valuations for defined benefit retirement schemes, the fair value adjustments on reimbursable rights and the related movements in deferred tax balances.

37 (b) Share-based Payment Reserve

The share-based payment reserve represents credits relating to equity-settled share-based payment transactions and any gain or loss on the exercise of share options satisfied by own shares.

37 (c) Own Shares Reserve

The own shares reserve represents the cost of shares in Serco Group plc purchased in the market and held by the Serco Group plc Employee Share Ownership Trust (ESOT) to satisfy options under the Group's share options schemes. At 31 December 2014, the ESOT held 10,659,290 (2013: 11,883,973) shares equal to 1.9% of the current allotted share capital (2013: 2.4%). The market value of shares held by the ESOT as at 31 December 2014 was £17.1m (2013: £59.3m).

37 (d) Hedging and Translation Reserve

The hedging and translation reserve represents foreign exchange differences arising on translation of the Group's overseas operations and movements relating to cash flow hedges.

38. Share-based Payment Expense

The Group recognised the following expenses related to equity-settled share-based payment transactions:

	2014 £m	2013 £m
Long Term Incentive Scheme and Plan	**0.1**	0.1
Performance Share Plan	**5.5**	1.5
Deferred Bonus Plan	**–**	(0.9)
Sharesave 2012	**(0.2)**	2.2
	5.4	2.9

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 2014 Thousands	Weighted average exercise price 2014 £	Number of options 2013 Thousands	Weighted average exercise price 2013 £
Outstanding at 1 January	**1,469**	**3.24**	2,472	2.56
Granted during the year	**–**	**–**	–	–
Exercised during the year	**(536)**	**2.81**	(797)	1.58
Lapsed during the year	**(597)**	**3.11**	(206)	1.53
Outstanding at 31 December	**336**	**4.16**	1,469	3.24

Of these options 335,886 (2013: 1,468,534) were exercisable at the end of the year, with a weighted average exercise price of £4.16 (2013: £3.24).

The options outstanding at 31 December 2014 had a weighted average contractual life of 2.7 years (2013: 2.0 years). The exercise prices for options outstanding at 31 December 2014 ranged from £3.39 to £4.55 (2013: £2.17 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 £3.45 (2013: £5.73).

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.

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 2014 Thousands	Weighted average exercise price 2014 £	Number of options 2013 Thousands	Weighted average exercise price 2013 £
Outstanding at 1 January	**488**	**Nil**	917	Nil
Granted during the year	**–**	**–**	62	Nil
Exercised during the year	**(212)**	**Nil**	(332)	Nil
Lapsed during the year	**–**	**–**	(159)	Nil
Outstanding at 31 December	**276**	**Nil**	488	Nil

Of these options, 275,831 (2013: 425,953) were exercisable at the end of the year. The options outstanding at 31 December 2014 had a weighted average contractual life of 2.30 years (2013: 2.38 years).

There were no new options granted under either LTIS or LTIP during the year.

Financial Statements

Notes to the consolidated financial statements continued

38. Share-based Payment Expense (continued)

Transformational Share Scheme

Awards made to eligible employees under the Transformational Share Scheme are structured as options with a £nil exercise price and are exercisable after the third anniversary of the grant.

The employee must exercise the options no later than 30 days after the vesting date. Furthermore, if the eligible employee leaves the Group before the options vest, the options may be forfeited.

	Number of options 2014 Thousands	Weighted average exercise price 2014 £	Number of options 2013 Thousands	Weighted average exercise price 2013 £
Outstanding at 1 January	–	–	33	Nil
Granted during the year	–	–	–	–
Exercised during the year	–	–	(26)	Nil
Lapsed during the year	–	–	(7)	Nil
Outstanding at 31 December	–	–	–	–

None of these options were exercisable at the end of the year (2013: none). The options outstanding at 31 December 2014 had a weighted average contractual life of 0 year (2013: 0 year).

The Group has no plan to use the Transformational Share Scheme in the future.

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 are 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 2014 Thousands	Weighted average exercise price 2014 £	Number of options 2013 Thousands	Weighted average exercise price 2013 £
Outstanding at 1 January	10,471	0.02	10,084	0.02
Granted during the year	5,077	0.02	4,399	0.02
Exercised during the year	(128)	0.02	(535)	0.02
Lapsed during the year	(4,677)	0.02	(3,477)	0.02
Outstanding at 31 December	**10,743**	**0.02**	10,471	0.02

Of these options 170,654 (2013: 292,203) were exercisable at the end of the year. The options outstanding at 31 December 2014 had a weighted average contractual life of 8.61 years (2013: 8.37 years).

In the year, twelve grants were made, of which three grants were non-performance buy out awards to the new executives and another four were non-performance restricted share awards to eligible employees. Total non-performance options account for two third of the total options granted in the year. The remaining five performance based awards split between the four performance measures with Absolute Share Price and TSR performance conditions each attached to 35.5% of options, another 22.4% subject to EPS growth performance conditions and the remaining 6.6% subject to Strategic Objectives performance conditions.

The options subject to Absolute Share Price and TSR performance conditions were valued using the Monte Carlo Simulation model. The options subject to EPS growth and Strategic Objectives performance conditions were deemed to have fair values equal to their face value less the present value of any dividend payments not received over the vesting period.

The Monte Carlo Simulation model is considered to be the most appropriate for valuing options granted under schemes where there are changes in performance conditions by which the options are measured, such as for the Absolute Share Price or TSR based awards.

38. Share-based Payment Expense (continued)

Performance Share Plan (PSP) (continued)

The inputs into the Monte Carlo Simulation model for options granted during the year with Absolute Share Price performance conditions are:

	2014
Weighted average share price	362p
Weighted average exercise price	2p
Expected volatility	28.4%
Annual Dividend Yield	2.9%
Expected life	4 years
Risk free rate	1.62%

The inputs into the Monte Carlo Simulation model for options granted during the year with TSR performance conditions are:

	2014	2013
Weighted average share price	362p	618p
Weighted average exercise price	2p	2p
Expected volatility	29.7%	22.5%
Annual Dividend Yield	N/a	N/a
Expected life	3 years	3 years
Risk free rate	1.33%	0.2%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

The assumptions for options granted during the year with EPS growth and Strategic Objectives performance conditions are:

	2014	2013[1]
Weighted average share price	362p	618p
Weighted average exercise price	2p	2p
Expected volatility	N/a	N/a
Annual Dividend Yield	N/a	N/a
Expected life	3–5 years	3 years
Risk free rate	N/a	N/a

1 EPS growth performance conditions only

The weighted average fair value of options granted under this scheme in the year is £2.23 (2013: £4.83).

Financial Statements

Notes to the consolidated financial statements continued

38. Share-based Payment Expense (continued)

Deferred Bonus Plan (DBP)

Under the DBP, eligible employees are entitled to use up to 50% of their earned annual bonus to purchase shares in the Group at market price. Provided they remain in employment for this period, the shares are retained for that period and the two performance measures (which are the same as the PSP scheme, being TSR and EPS growth) have been met, the Group will make a matching share award. For shares purchased by employees in 2011, the match was on a basis of two times the gross bonus deferred.

	Number of options 2014 Thousands	Weighted average exercise price 2014 £	Number of options 2013 Thousands	Weighted average exercise price 2013 £
Outstanding at 1 January	825	Nil	1,058	Nil
Granted during the year	–	–	390	Nil
Exercised during the year	–	–	(91)	Nil
Lapsed during the year	(474)	Nil	(532)	Nil
Outstanding at 31 December	351	Nil	825	Nil

None of these options were exercisable at the end of the year (2013: none). The options outstanding at 31 December 2014 had a weighted average contractual life of 0.7 year (2013: 1.2 years).

There were no new options granted under Deferred Bonus Plan in the year.

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 2014 Thousands	Weighted average exercise price 2014 £	Number of options 2013 Thousands	Weighted average exercise price 2013 £
Outstanding at 1 January	5,132	5.14	6,012	5.14
Granted during the year	–	–	–	–
Exercised during the year	(1)	5.14	(23)	5.14
Lapsed during the year	(2,256)	5.14	(857)	5.14
Outstanding at 31 December	2,875	5.14	5,132	5.14

Of these options, none (2013: none) were exercisable at the end of the year. The options outstanding at 31 December 2014 had a weighted average contractual life of 1.4 years (2013: 2.4 years). Given that options granted under the Sharesave plan can be exercised at any time after vesting, management consider the Binomial Lattice model to be appropriate to value the options granted under this scheme. The Binomial Lattice model allows exercise over a window in time, from vesting date to expiry date and assumes option holders make economically rational exercise decisions.

There were no new options granted under Sharesave Plan in the year.

39. Related Party Transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings are disclosed below.

Trading transactions

During the year, Group companies entered into the following material transactions with joint ventures:

	2014 £m	2013 £m
Royalties and management fees receivable	**1.7**	2.1
Dividends receivable	**34.8**	51.5
	36.5	53.6

The following receivable balances were held relating to joint ventures:

	2014 £m	2013 £m
Current:		
Loans and other receivables	**0.1**	0.4

	2014 £m	2013 £m
Non-current:		
Loans and other receivables	**9.0**	9.5

Joint venture receivable and loan amounts outstanding have arisen from transactions undertaken during the general course of trading, are unsecured, and will be settled in cash. Interest arising on loans is based on LIBOR, or its equivalent, with an appropriate margin. No guarantee has been given or received. No provisions are required for doubtful debts in respect of the amounts owed by the joint ventures.

Remuneration of key management personnel

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance.

The remuneration of the key management personnel of the Group is set out below in aggregate for each of the categories specified in IAS 24 Related Party Disclosures:

	2014 £m	2013 £m
Short-term employee benefits	**8.4**	10.9
Post-employment benefits	**0.1**	0.1
Share-based payment charge/(credit)	**0.9**	(0.7)
	9.4	10.3

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2014: 19 individuals, 2013: 16 individuals).

Financial Statements

Notes to the consolidated financial statements continued

40. Notes to the Consolidated Cash Flow Statement

Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

Year ended 31 December	2014 Before Exceptional Items £m	2014 Exceptional Items £m	2014 Total £m	2013 Before Exceptional Items £m	2013 Exceptional Items £m	2013 Total £m
Operating profit for the year	(655.8)	(661.5)	(1,317.3)	236.0	(90.5)	145.5
Adjustments for:						
Share of profits in joint ventures	(30.0)	–	(30.0)	(47.1)	–	(47.1)
Share-based payment expense	5.4	–	5.4	2.9	–	2.9
Exceptional impairment of goodwill	–	466.0	466.0	–	–	–
Exceptional impairment of property, plant and equipment	–	18.6	18.6	–	6.4	6.4
Exceptional impairment of intangible assets	–	6.0	6.0	–	3.2	3.2
Impairment and write down of intangible assets – other	38.6	–	38.6	–	–	–
Impairment of property, plant and equipment – other	22.1	–	22.1	1.4	–	1.4
Depreciation of property, plant and equipment	41.8	–	41.8	46.3	–	46.3
Amortisation of intangible assets	38.7	–	38.7	46.1	–	46.1
Exceptional loss/(profit) on disposal of subsidiaries and operations	–	0.8	0.8	–	(19.2)	(19.2)
Exceptional impairment of loan receivable	–	4.6	4.6	–	–	–
Loss on disposal of intangible assets	0.2	–	0.2	1.0	–	1.0
Increase/(decrease) in provisions	472.6	85.5	558.1	(11.2)	18.6	7.4
Increase in deferred consideration in relation to prior year acquisition	4.0	–	4.0	–	–	–
Release of deferred consideration in relation to prior year acquisition – exceptional	–	–	–	–	(10.3)	(10.3)
Other non cash movements	–	–	–	(7.9)	–	(7.9)
Impairment of working capital items (non cash)	148.8	–	148.8	–	–	–
Total non cash items	772.2	581.5	1,353.7	78.6	(1.3)	77.3
Operating cash inflow/(outflow) before movements in working capital	86.4	(80.0)	6.4	267.5	(91.8)	175.7
(Increase)/decrease in inventories	(1.4)	–	(1.4)	7.2	–	7.2
Decrease/(increase) in receivables	8.7	18.8	27.5	(66.0)	–	(66.0)
Increase/(decrease) in payables	9.7	20.8	30.5	(78.6)	(11.6)	(90.2)
Movements in working capital	17.0	39.6	56.6	(137.4)	(11.6)	(149.0)
Cash generated by operations	103.4	(40.4)	63.0	130.1	(103.4)	26.7
Tax repaid/(paid)	0.1	–	0.1	(18.8)	–	(18.8)
Net cash inflow/(outflow) from operating activities	103.5	(40.4)	63.1	111.3	(103.4)	7.9

Additions to fixtures and equipment during the year amounting to £12.5m (2013: £23.1m) were financed by new finance leases.

41. Assets held for sale

As part of the Strategic Review certain assets and liabilities have been designated as non-core and are held for sale. As at 31 December 2014 the following businesses have been disclosed as held for sale: National Physical Laboratory, Great Southern Rail, the UK environmental and leisure businesses, the offshore BPO business and the majority of the UK private BPO business.

While a significant portion of the Global Services CGU has been transferred to held for sale, as it does not represent the whole of a separate line of business, it is not appropriate to treat as a discontinued operation.

	Note	At 31 December 2014 £m
Assets		
Goodwill	20	279.1
Other intangible assets	21	5.0
Property, plant and equipment	22	94.5
Deferred tax assets	17	11.0
Other non-current assets	24	26.8
Inventories	23	2.7
Current tax		4.2
Cash and cash equivalents	26	22.4
Other current assets	24	119.0
Assets classified as held for sale		564.7
Liabilities		
Other current liabilities	27	(96.1)
Current tax liabilities		(21.8)
Provisions	30	(30.0)
Obligations under finance leases	28	(37.1)
Loans	29	(24.8)
Deferred tax liabilities	17	(2.5)
Other non-current liabilities	27	(7.6)
Liabilities directly associated with assets classified as held for sale		(219.9)

Financial Statements

Notes to the consolidated financial statements continued

42. Segmental Information as Reported to the Board in 2014

The tables below reflect the information reported to the Board for the purposes of resource allocation and assessment of segment performance in 2014. The definition of the segments focus on the geographic spread of the business in order to gain advantage of local market and customer understanding. Some of these segments were redefined in 2014 and the tables below and their comparatives have been restated for those changes reflected in the information reported to the board. Note 5 of these financial statements shows the view of the business going forwards and therefore include additional reorganisations that will be reflected in information reported to the Board in 2015.

Changes from the segments defined in the prior year financial statements include the separation of the UK & Europe division into two new divisions – UK Central Government and UK & Europe Local & Regional Government. This follows the Cabinet Office review across Serco contracts with UK Central Government, which resulted in Serco's agreement with the UK Government to undertake a process of corporate renewal, to strengthen governance and transparency which included the separation of the UK & Europe segment into these two new segments.

Other 2014 reorganisations of business units and changes of reporting to the Board include the separation of the former AMEAA segment into the new AsPac and Middle East segments, and the transfer of citizen services contracts from Global Services to UK Central Government.

The prior year comparative segment information has been restated to reflect these changes.

The Group's reportable operating segments under IFRS 8 Operating Segments are:

Reportable segments	Operating segments
UK Central Government	Frontline services for sectors including Defence, Justice & Immigration, Citizen Services and Transport delivered predominantly to UK Central Government;
UK and Europe Local and Regional Government	Frontline services for sectors including Health, Local Government Direct Services, Transport and BPO services delivered to UK & European public sector customers;
Americas	Professional, technology and management 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	Frontline services for sectors including Defence, Justice & Immigration, Transport, Healthcare and Citizen Services in the Asia Pacific region including Australia, New Zealand and Hong Kong;
Middle East	Frontline services for sectors including Defence, Transport and Healthcare in the Middle East region;
Global Services	BPO services for both public and private sector customers predominantly in the UK, India and North America; and
Corporate	Central and head office costs

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 2014 £m	Non-current assets[1] 2014 £m	Revenue 2013 (restated) £m	Non-current assets[1] 2013 £m
United Kingdom	**1,917.8**	**485.2**	2,071.5	784.1
United States	**660.4**	**337.5**	706.5	423.7
Australia	**657.0**	**140.3**	833.0	167.0
Middle East	**267.2**	**13.6**	285.4	14.6
Other geographies	**452.6**	**308.7**	387.8	391.9
Total	**3,955.0**	**1,285.3**	4,284.2	1,781.3

1 Non-current assets exclude financial instruments, deferred tax assets and loans to joint ventures and includes assets of £405.4m (2013: £nil) reclassified as held for sale.

Revenues from external customers are attributed to individual countries on the basis of the location of the customer.

Information about Major Customers

The Group has two major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were respectively £1,709.3m (2013: £1,807.0m) across Central Government and Local and Regional Government and £574.6m (2013: £643.2m) within the Americas segment.

42. Segmental Information as Reported to the Board in 2014 (continued)

The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment:

Year ended 31 December 2014

	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Revenue	926.4	749.1	708.1	624.8	243.7	702.9	–	3,955.0
Result								
Trading (loss)/profit[1]	(242.7)	(43.3)	16.5	(200.3)	(4.6)	(67.5)	(90.2)	(632.1)
Amortisation and impairment of intangibles arising on acquisition	(0.1)	(0.5)	(2.3)	(8.6)	–	(12.2)	–	(23.7)
Operating (loss)/profit before exceptional items	(242.8)	(43.8)	14.2	(208.9)	(4.6)	(79.7)	(90.2)	(655.8)
Exceptional (loss)/profit on disposal of subsidiaries and operations	1.9	0.4	–	–	–	(3.1)	(4.6)	(5.4)
Other exceptional operating items	(7.5)	(131.1)	(101.7)	(41.3)	(1.7)	(332.7)	(40.1)	(656.1)
Operating loss	(248.4)	(174.5)	(87.5)	(250.2)	(6.3)	(415.5)	(134.9)	(1,317.3)
Investment revenue								6.2
Finance costs								(42.9)
Loss before tax								(1,354.0)
Tax credit								6.9
Loss for the year								(1,347.1)

1 Trading (loss)/profit is defined as operating (loss)/profit before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Supplementary Information								
Interest in the profit of joint ventures	23.3	7.5	0.1	(0.9)	–	–	–	30.0
Depreciation of plant, property and equipment	(10.7)	(12.4)	(2.5)	(6.4)	(0.8)	(8.3)	(0.7)	(41.8)
Impairment of plant, property and equipment	(17.5)	(0.6)	–	(12.9)	–	(5.2)	(4.5)	(40.7)
Total depreciation and impairment of plant, property and equipment	(28.2)	(13.0)	(2.5)	(19.3)	(0.8)	(13.5)	(5.2)	(82.5)
Amortisation of intangible assets arising on acquisition	(0.1)	(0.1)	(2.3)	(2.2)	–	(6.7)	–	(11.4)
Exceptional impairment of intangible assets arising on acquisition	–	–	–	–	–	(5.0)	–	(5.0)
Impairment of intangible assets arising on acquisition	–	(0.4)	–	(6.4)	–	(5.5)	–	(12.3)
Amortisation of other intangible assets	(0.8)	(12.1)	(1.5)	(1.3)	(0.9)	(5.2)	(5.5)	(27.3)
Exceptional impairment of other intangible assets	–	–	–	–	–	(1.0)	–	(1.0)
Impairment and write down of other intangible assets	(2.9)	(1.5)	(3.1)	(0.2)	–	(15.3)	(3.3)	(26.3)
Total amortisation and impairment of intangible assets	(3.8)	(14.1)	(6.9)	(10.1)	(0.9)	(38.7)	(8.8)	(83.3)
Segment assets								
Interests in joint ventures	6.3	(8.3)	0.2	3.0	0.4	–	–	1.6
Other segment assets	123.3	390.6	458.9	236.3	99.7	447.5	179.0	1,935.3
Total segment assets	129.6	382.3	459.1	239.3	100.1	447.5	179.0	1,936.9
Unallocated assets								287.0
Consolidated total assets								2,223.9
Segment liabilities								
Segment liabilities	(119.4)	(195.4)	(62.0)	(99.2)	(55.2)	(108.2)	(93.2)	(732.6)
Unallocated liabilities								(1,557.5)
Consolidated total liabilities								(2,290.1)

Financial Statements

Notes to the consolidated financial statements continued

42. Segmental Information as Reported to the Board in 2014 (continued)

Year ended 31 December 2013 (restated)

	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Revenue	1,046.1	809.4	764.6	714.9	250.3	698.9	–	4,284.2
Result								
Trading profit/(loss)[1]	112.2	26.9	65.1	61.4	19.2	23.2	(50.6)	257.4
Amortisation and impairment of intangibles arising on acquisition	(0.3)	(0.3)	(11.3)	(2.4)	–	(7.1)	–	(21.4)
Operating profit/(loss) before exceptional items	111.9	26.6	53.8	59.0	19.2	16.1	(50.6)	236.0
Exceptional profit on disposal of subsidiaries and operations	–	19.2	–	–	–	–	–	19.2
Other exceptional operating items	(73.9)	(18.7)	–	(10.1)	–	(5.7)	(1.3)	(109.7)
Operating profit/(loss)	38.0	27.1	53.8	48.9	19.2	10.4	(51.9)	145.5
Investment revenue								5.2
Finance costs								(42.4)
Profit before tax								108.3
Tax charge								(9.9)
Profit for the year								98.4

1 Trading profit/(loss) is defined as operating profit/(loss) before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

	CG £m	LRG £m	Americas £m	AsPac £m	Middle East £m	Global Services £m	Corporate £m	Total £m
Supplementary Information								
Interest in the profit of joint ventures	35.8	6.9	–	4.4	–	–	–	47.1
Depreciation of plant, property and equipment	(10.2)	(12.7)	(2.7)	(7.9)	(1.0)	(11.1)	(0.7)	(46.3)
Impairment of plant, property and equipment	(1.4)	–	–	(6.4)	–	–	–	(7.8)
Total depreciation and impairment of plant, property and equipment	(11.6)	(12.7)	(2.7)	(14.3)	(1.0)	(11.1)	(0.7)	(54.1)
Amortisation of intangible assets arising on acquisition	(0.3)	(0.3)	(11.3)	(2.4)	–	(7.1)	–	(21.4)
Amortisation of other intangible assets	(2.5)	(11.5)	(1.3)	(1.2)	(0.9)	(1.9)	(5.4)	(24.7)
Exceptional impairment of other intangible assets	–	–	–	(3.2)	–	–	–	(3.2)
Total amortisation and impairment of intangible assets	(2.8)	(11.8)	(12.6)	(6.8)	(0.9)	(9.0)	(5.4)	(49.3)
Segment assets								
Interests in joint ventures	7.7	(6.3)	0.2	6.5	–	–	–	8.1
Other segment assets	194.5	500.9	558.3	324.9	93.8	787.8	126.0	2,586.2
Total segment assets	202.2	494.6	558.5	331.4	93.8	787.8	126.0	2,594.3
Unallocated assets								214.6
Consolidated total assets								2,808.9
Segment liabilities								
Segment liabilities	(114.0)	(175.0)	(70.3)	(108.3)	(39.4)	(120.7)	(61.3)	(689.0)
Unallocated liabilities								(1,024.0)
Consolidated total liabilities								(1,713.0)

Financial Statements

Company Balance Sheet

At 31 December

	Note	2014 £m	2013 £m
Fixed assets			
Investments in subsidiaries	44	**1,963.8**	815.5
Current assets			
Debtors: amounts due within one year	45	**10.1**	17.3
Debtors: amounts due after more than one year	45	**734.3**	1,174.0
Deferred tax	49	**–**	2.9
Derivative financial instruments due within one year	48	**5.1**	2.9
Derivative financial instruments due after more than one year	48	**7.0**	–
Cash at bank and in hand		**–**	0.7
		756.5	1,197.8
Total assets		**2,720.3**	2,013.3
Creditors: amounts falling due within one year			
Trade and other payables	46	**(236.6)**	(142.0)
Borrowings	47	**(150.0)**	(99.7)
Derivative financial instruments	48	**(1.8)**	(6.6)
		(388.4)	(248.3)
Net current assets		**368.1**	949.5
Amounts falling due after more than one year			
Borrowings	47	**(742.8)**	(726.5)
Amounts owed to subsidiary companies		**(874.7)**	(352.0)
Derivative financial instruments	48	**–**	(0.3)
		(1,617.5)	(1,078.8)
Total liabilities		**(2,005.9)**	(1,327.1)
Net Assets		**714.4**	686.2
Capital and reserves			
Called up share capital	50	**11.0**	10.0
Share premium account	51	**327.9**	327.8
Capital redemption reserve		**0.1**	0.1
Profit and loss account	52	**364.8**	363.7
Share-based payment reserve	53	**56.9**	55.3
Own shares reserve	–	**(64.5)**	(70.5)
Hedging and translation reserve	55	**18.2**	(0.2)
Total shareholders' funds		**714.4**	686.2

The financial statements (registered number 02048608) were approved by the Board of Directors on 12 March 2015 and signed on its behalf by:

Rupert Soames
Group Chief Executive Officer

Angus Cockburn
Group Chief Financial Officer

Financial Statements

Notes to the Company financial statements

43. Accounting Policies

The principal accounting policies adopted are set out below and have been applied consistently throughout the current and preceding year.

Basis of Accounting

The Company meets the definition of a qualifying entity under FRS 100 (Financial Reporting Standard 100) issued by the Financial Reporting Council. The financial statements have therefore been prepared in accordance with FRS 101 (Financial Reporting Standard 101) 'Reduced Disclosure Framework' as issued by the Financial Reporting Council.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash-flow statement, standards not yet effective, impairment of assets and related party transactions.

The financial statements have been prepared on the historical cost basis and on the going concern basis, except for the revaluation of certain financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services. The principal accounting policies adopted are the same as those set out in note 2 to the consolidated financial statements, except as noted below.

Fixed Asset Investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

44. Investments Held as Fixed Assets

	£m
Shares in subsidiary companies at cost:	
At 1 January 2013	811.8
Options over parent's shares awarded to employees of subsidiaries	3.7
At 1 January 2014	**815.5**
Options over parent's shares awarded to employees of subsidiaries	**4.6**
Additions:	
Serco Holdings Limited	**1,143.7**
Garden Funding Limited	**156.6**
Capital repayment – Garden Funding Limited	**(156.6)**
At 31 December 2014	**1,963.8**

Full details of the principal subsidiaries of Serco Group plc can be found in note 6 to the Group's consolidated financial statements. The Company directly owns 100% of the ordinary share capital of the following subsidiaries.

Name	% ownership
Serco Holdings Limited	100%
Garden Funding Limited	100%

45. Debtors

	2014 £m	2013 £m
Amounts due within one year		
Corporation tax recoverable	**6.1**	13.8
Other debtors	**4.0**	3.5
	10.1	17.3
Amounts due after more than one year		
Amounts owed by subsidiary companies	**730.2**	1,165.4
Amounts owed by joint ventures of Serco Group	**4.1**	4.0
Other debtors	**–**	4.6
	734.3	1,174.0
	744.4	1,191.3

46. Trade and Other Payables

	2014 £m	2013 £m
Amounts owed to subsidiary companies	223.3	128.1
Trade creditors	0.2	0.2
Accruals and deferred income	11.0	10.7
Other creditors including taxation and social security	2.1	3.0
	236.6	142.0

47. Borrowings

	2014 £m	2013 £m
Loans:	892.8	826.2
Less: amounts included in creditors falling due within one year – loans	(23.7)	(23.2)
Less: amounts included in creditors falling due within one year – bank loans and overdrafts	(126.3)	(76.5)
Amounts falling due after more than one year	742.8	726.5

	2014 £m	2013 £m
Loans:		
Within one year or on demand	150.0	99.7
Between one and two years	32.0	23.2
Between two and five years	291.4	265.6
After five years	419.4	437.7
	892.8	826.2

48. Derivative Financial Instruments

	Assets 2014 £m	Liabilities 2014 £m	Assets 2013 £m	Liabilities 2013 £m
Currency swaps	7.1	(0.3)	–	(0.6)
Forward foreign exchange contracts	5.0	(1.5)	2.9	(6.3)
	12.1	(1.8)	2.9	(6.9)
Analysed as:				
Non-current	7.0	–	–	(0.3)
Current	5.1	(1.8)	2.9	(6.6)
	12.1	(1.8)	2.9	(6.9)

The Company holds derivative financial instruments in accordance with the Group's policy in relation to its financial risk management. Details of the disclosures are set out in note 33 of the Group's consolidated financial statements.

Financial Statements

Notes to the Company financial statements continued

49. Deferred Tax Asset

	2014 £m	2013 £m
Capital allowances in excess of depreciation	–	0.2
Short term timing differences	–	2.7
	–	2.9

The movement in the deferred tax asset during the year was as follows:

	2014 £m	2013 £m
At 1 January	2.9	5.9
Charged to profit and loss account	(2.8)	(1.8)
Items taken directly to equity	(0.1)	(1.2)
At 31 December	–	2.9

The deferred tax not provided is as follows:

	2014 £m	2013 £m
Capital allowances in excess of depreciation	0.2	–
Short-term timing differences	1.4	–
Losses	14.4	–
At 31 December	16.0	–

50. Called up Share Capital

	2014 £m	Number 2014 Millions	2013 £m	Number 2013 Millions
Issued and fully paid:				
499,328,896 (2013: 498,462,508) ordinary shares of 2p each at 1 January	10.0	499.3	10.0	498.5
Issued on the exercise of share options and the share placement	1.0	50.0	–	0.8
549,265,547 (2013: 499,328,896) ordinary shares of 2p each at 31 December	11.0	549.3	10.0	499.3

The Company has one class of ordinary shares which carry no right to fixed income.

On 7 May 2014, 49,932,918 new ordinary shares of 2p each were placed by Merrill Lynch International (BofA Merrill Lynch) and J.P. Morgan Cazenove, raising net proceeds of £156.3m. During the year 3,733 (2013: 866,388) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares.

51. Share Premium Account

	2014 £m	2013 £m
At 1 January	327.8	326.5
Premium on shares issued	0.1	1.3
At 31 December	**327.9**	327.8

52. Profit and Loss Account

	2014 £m	2013 £m
At 1 January	363.7	355.6
Reclassification to hedging and translation reserve	(21.4)	–
(Loss)/Profit for the year	(79.7)	59.6
Issue of shares from share placement	155.3	–
Equity dividends	(53.1)	(51.5)
At 31 December	**364.8**	363.7

As permitted by Section 408 of the Companies Act 2006, the profit and loss account of the Company is not presented as part of these accounts.

53. Share-based Payment Reserve

	2014 £m	2013 £m
At 1 January	55.3	57.7
Options over parent's shares awarded to employees of subsidiaries	4.6	3.7
Share-based payment charge/(credit)	0.8	(0.8)
Share options to holders on exercise	(3.8)	(4.5)
Tax credit on items taken directly to equity	–	(0.8)
At 31 December	**56.9**	55.3

Details of the share-based payment disclosures are set out in note 38 of the Group's consolidated financial statements.

54. 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 2014, the ESOT held 10,659,290 (2013: 11,883,973) shares equal to 1.9% of the current allotted share capital (2013: 2.4%). The market value of shares held by the ESOT as at 31 December 2014 was £17.1m (2013: £59.3m).

55. Hedging and Translation Reserve

	2014 £m	2013 £m
At 1 January	(0.2)	1.9
Reclassification from profit and loss account	21.4	–
Fair value loss on cash flow hedges during the period	(3.0)	(1.0)
Net exchange loss on translation of foreign operations	–	(1.1)
At 31 December	**18.2**	(0.2)

Notes to the Company financial statements continued

56. Contingent Liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £26.2m (2013: £26.0m). The actual commitment outstanding at 31 December 2014 was £21.4m (2013: £22.6m).

The Company has provided certain financial guarantees and indemnities in respect of the loans, overdraft and bonding facilities, and other financial commitments of its subsidiaries. The total commitment outstanding as at 31 December 2014 was £189.6m (2013: £145.0m). These are not expected to result in any material financial loss.

In addition to this, the Company and its subsidiaries have provided performance guarantees and indemnities relating to performance bonds and letters of credit issued by its banks on its behalf, in the ordinary course of business. These are not expected to result in any material financial loss.

The Group is aware of claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

57. 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.

Financial Statements

Appendix: Supplementary Information

Five-year Record (unaudited)

	2014 £m	2013 (restated) £m	2012 (restated)[1] £m	2011 (restated)[1] £m	2010 (restated)[1] £m
Adjusted Revenue	**4,753**	5,140	4,910	4,607	4,327
Less: Share of revenue of joint ventures	**(798)**	(856)	(853)	(819)	(794)
Revenue	**3,955**	4,284	4,057	3,788	3,533
Adjusted Operating (Loss)/Profit[2]	**(580.4)**	293.7	329.1	249.5	259.8
Transaction-related costs	**(0.9)**	(3.5)	(3.7)	(3.9)	–
Share of interest and tax of joint ventures	**(7.9)**	(11.8)	(14.7)	(19.3)	(16.5)
Management estimate items relating to UK Government reviews[2]	**(42.9)**	(21.0)	–	–	–
Trading (Loss)/Profit[2]	**(632.1)**	257.4	310.7	226.3	243.3
Amortisation and impairment of intangibles arising on acquisition	**(23.7)**	(21.4)	(24.1)	(20.0)	(17.4)
Operating (loss)/profit before exceptional items	**(655.8)**	236.0	286.6	206.3	225.9
Exceptional (loss)/profit on disposal of subsidiaries and operations	**(5.4)**	19.2	5.6	–	–
Other exceptional operating items	**(656.1)**	(109.7)	(5.0)	–	–
Operating (loss)/profit	**(1,317.3)**	145.5	287.2	206.3	225.9
Net Finance cost	**(36.7)**	(37.2)	(42.2)	(36.5)	(31.5)
Exceptional other gain	**–**	–	51.1	–	–
(Loss)/profit before tax	**(1,354.0)**	108.3	296.1	169.8	194.4
Tax credit/(charge)	**6.9**	(9.9)	(39.0)	(28.7)	(39.0)
(Loss)/profit after tax	**(1,347.1)**	98.4	257.1	141.1	155.4
Recourse net debt	**(642.7)**	(725.1)	(606.9)	(669.8)	(303.6)
Net debt	**(642.7)**	(745.4)	(632.0)	(685.3)	(327.3)
	Pence	Pence	Pence	Pence	Pence
Trading (loss)/earnings per share	**(130.99)**	35.99	44.18	31.95	34.40
(Loss)/earnings per share before exceptional items	**(134.96)**	32.74	40.37	28.75	31.60
Basic (loss)/earnings per share	**(258.35)**	20.12	52.22	28.75	31.60
Dividend per share	**3.10**	10.55	10.10	8.40	7.35

1 Restated for IFRS 11 and IAS 19R and restatement of financial instruments.

2 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.

Financial Statements

Directors, Secretary and Advisors

Chairman
Alastair Lyons CBE

Directors
Mike Clasper CBE[1,2]
Rupert Soames OBE
Edward J Casey Jr
Angus Cockburn
Ralph D Crosby Jr[1]
Angie Risley[1]
Rachel Lomax[1]
Tamara Ingram[1]
Malcolm Wyman[1]

Secretary
David Eveleigh

1 Non-Executive Director
2 Senior Independent Director

Registered Office
Serco House
16 Bartley Wood Business Park
Bartley Way
Hook
Hampshire
RG27 9UY

Serco Group plc is registered in England and Wales, No. 2048608

Auditors
Deloitte LLP
2 New Street Square
London
EC4A 3BZ

Investment Bankers
N M Rothschild & Sons Limited
New Court
St Swithin's Lane
London
EC4N 8AL

Stockbrokers
J.P.Morgan Cazenove
25 Bank Street
London
E14 5JP

Bank of America Merrill Lynch
2 King Edward Street
London
EC1A 1HQ

Principal Bankers
HSBC Bank PLC
8 Canada Square
London
E14 5HQ

Solicitors
Clifford Chance LLP
10 Upper Bank Street
London
E14 5JJ

Registrars
Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Shareholder information

Group website

Go to www.serco.com to catch up on the current share price, latest news in the investors section and read the Annual Report and accounts.

Registrars

Administrative enquiries about the holding of Serco Group plc shares and enquiries in relation to the Serco Dividend Re-investment Plan (DRIP) should be directed to:

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
Tel: 0871 384 2932

There is a text phone available on 0871 384 2255 for shareholders with hearing difficulties.

Calls cost 8p per minute plus network extras.

Callers from outside the UK should use +44(0)121 415 7047.

Telephone lines are open 8.30am to 5.30pm Monday to Friday.

Dividend re-investment plan

You can elect to receive future dividends as shares rather than cash by participating in the DRIP. To register, request further information, or to obtain a copy of terms and conditions booklet and mandate form please contact Equiniti on 0871 384 2932. Alternatively, these can be downloaded from the website www.shareview.co.uk by choosing the Dividend Investment Plan heading the Product Centre section.

Dividends paid direct to your bank account

- Avoid the risk of cheques being lost in the post
- No need to present cheques for payment
- Dividend credited to your account on payment date

To set up a dividend mandate or to change your existing mandated details please register with the Shareholder Centre via the Shareview website or contact Equiniti on the number provided above.

Global payment services

For overseas shareholders in certain countries, Equiniti offers an Overseas Payment Service by arrangement with Citibank Europe PLC. This service offers shareholders the ability to have their dividend converted into their local currency and sent electronically to their local bank account. To sign up for this service, please contact Equiniti on 0871 384 2932 (+44(0)121 415 7047 if calling from outside the UK). Alternatively you can download an application form and terms and conditions from the website www.shareview.co.uk.

Electronic communication

You can register for electronic communications by visiting www.shareview.co.uk; you will need your shareholder reference number to sign up. After you have registered you will receive emails alerting you to communications as they become available.

Financial Statements

Shareholder information continued

Share dealing

Serco does not endorse any one service for the buying and selling of its shares. However, arrangements have been made with the following independent share dealing provider to offer all shareholders competitive charges.

Alternatively, if shareholders hold a share certificate they can also use any bank, building society or stockbroker offering share dealing facilities. Shareholders in any doubt about buying or selling their shares should seek professional financial advice.

Stocktrade

We have arranged a telephone sharedealing service with Stocktrade for purchases/sales of Serco Group plc shares. You should call +44 (0)131 240 0414 between 8.00am and 4.30pm, Monday to Friday and quote Serco dial and deal service. Commission is charged at 0.5% on amounts to £10,000 and 0.2% on the excess thereafter, subject to a minimum charge of £17.50. Further details and other dealing options can be found at www.stocktrade.co.uk/serco. This service is not available to US residents.

Please note that UK share purchases will be subject to 0.5% stamp duty.

Shareholder profile

The range and size of ordinary shareholding as at 31 December 2014 is set out below:

	Number of shareholders	%	Number of shares	%
1–1,000	4,288	55.50	1,664,888	0.30
1,001–5,000	2,483	32.14	5,280,551	0.96
5,001–10,000	368	4.76	2,476,855	0.45
10,001–100,000	375	4.85	11,078,488	2.02
100,001–500,000	115	1.49	24,873,737	4.53
500,001–1,000,000	38	0.49	27,122,445	4.94
1,000,001–10,000,000	42	0.54	118,191,360	21.52
10,000,001 and above	18	0.23	358,577,223	65.28
Total	**7,727**	**100.00**	**549,265,547**	**100.00**

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