

Registration number: 00242246

Serco Limited

Annual Report and Financial Statements

For the Year Ended 31 December 2019

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Serco Limited

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Serco Limited

Company Information

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Registered number 00242246

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Strategic Report for the Year Ended 31 December 2019

The Directors present their Strategic Report report for the year ended 31 December 2019.

Principal activity

The principal activity of Serco Limited (the 'Company') is to deliver essential services mainly in the public sector by effectively managing people, processes, technology and assets. Serco Limited supports governments, agencies and companies by offering operational, management and consulting expertise in the most important areas of public service, including transport, defence, health, justice and immigration, and citizens services.

The Company's immediate parent is Serco Holdings Limited. The ultimate parent and controlling party is Serco Group plc, a company incorporated in the United Kingdom and registered in England and Wales. Serco Group plc and its subsidiaries is referred to in this document as the Group.

Business review

Overview

Turnover for the Company for the year was up 9.2% from £1,266.3m to £1,382.6m driven by the full year impact of the acquisition of Carillion health facilities management contracts by the Company in July/August 2018 and new contract growth. The Company generated an operating profit, before net exceptional items, for the year of £13.0m (2018: loss of £12.5m). The operating profit, before exceptional items, was better than in the prior year as a result of the benefit of transformation and cost efficiency programmes. The full year profit from the acquisition of Carillion health facilities management contracts which incurred investment to mobilise and transition in 2018, as well as some improvement in the profitability of certain contracts. During the year net exceptional charges of £9.7m were incurred (2018: £39.3m). After exceptional items the operating profit of the Company for the financial year was £3.3m (2018: loss of £51.8m). The increase is as a result of improved operating profit before exceptional items, lower exceptional costs, and the exceptional pension charge recorded in 2018 which did not repeat.

Transformation activity came to an end during the year and the Company is focussed on its business development functions and bid pipeline, strengthening sector propositions, and consolidating differentiated capability to provide better outcomes and solutions to our customer. The Company continues to improve operational execution and drive further cost efficiencies in order to further improve underlying profitability. As at 31 December 2019 the estimated actuarial deficit of the Company's primary defined benefit scheme was £27.0m (2018: £27.8m).

UK & Europe

The majority of Serco Group plc's UK & Europe division trades through the Company, and the operations support public service delivery and outcomes across all five of the Group's chosen sectors: our Justice & Immigration business provides a wide range of services to support safeguarding society and reducing re-offending, from secure accommodation management through to housing and welfare services for asylum seekers; in Defence, we are trusted to deliver critical support services and operate sensitive facilities; our Health business provides primarily non-clinical support services to hospitals; and the Citizens Services business provides environmental and leisure services, as well as a wide range of other front, middle and back-office services to support public sector customers in the UK or European institutions.

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Business review (continued)

Turnover for 2019 was £1,242.0m (2018: £1,146.8m), an increase of 8.3% which makes up the majority of the revenue increase for the Company.

Trading profit is defined as IFRS operating profit excluding amortisation of intangibles arising on acquisition as well as exceptional items. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying trading profit additionally excludes contract and Balance Sheet review adjustments (principally onerous contract provision (OCP) releases or charges), and other material one-time items.

Middle East

Revenue for the year was £140.6m (2018: £119.5m), which included some volume growth of transport operations.

Principal risks and uncertainties

Risk management

The Company leverages the risk management processes of its ultimate parent company, Serco Group plc. The risk management policies of Serco Group plc are outlined in its Annual Report & Accounts dated 25 February 2020, are available on its website and are outlined below. As a listed company, the risk management policies of Serco Group plc are sufficient for the Company to rely upon in addressing the risks specific to the Company.

The Company's risk management process does not eliminate risk, it identifies risks, thoroughly understands them and their potential impact, and devises strategies for mitigating and managing them. In common with other large businesses which operate internationally, the Group has to manage and mitigate a large number of potential risks. As a business which serves Governments, the Company has greater exposure than many to some potential risks such as changes in Governments, but less than many to other risks such as the UK's proposed withdrawal from the European Union ("Brexit"), as the Company imports and exports very little across borders. As a business, risk management is a well established function, and significant effort is invested into identifying and managing risks. The business risks can be categorised and described in many different ways, but at the highest level can be thought of as external - essentially those risks that relate to the landscape in which business is done - and internal risks - those which arise as a consequence of the way services are delivered. The former includes political risks such as Brexit, changes in Governments and regulation; the latter includes risks such as cyber security, health and safety and growing profits in a sustainable way. Environmental, Social and Governance (ESG) risks, which are of a concern to many stakeholders, span both internal and external risks, by virtue of the fact that the external risk of regulation impinges on internal risks of the way the business is run. Whilst Governance and Social risks apply to all the Group's businesses, the Environmental footprint varies enormously between businesses. The following pages describe in considerable detail how risk is thought about and managed.

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Risk management response

The challenge created by both the external and internal risks is outlined and the response to them is captured in the Principal Risks and Uncertainties on page 5. The Company's sustainability commitments and approach to ESG matters are documented in the Corporate Responsibility Section of the Strategic Report on page 91 in the Serco Group plc Annual Report & Accounts and in the Group's full Corporate Responsibility Report which is available on the Group's website. Although the core risk processes and risk lifecycle have remained fundamentally unchanged in 2019, steps have been taken to strengthen the Group's Enterprise Risk Management function through the bringing together of Risk, Compliance Assurance, Insurance and Business Continuity teams and by strengthening our risk management capability. Looking forward to 2020, the priority will be the continued evolution of an Enterprise Risk Management strategy. The initial focus is to drive improved consistency across each of the divisions, deliver refreshed standards, policies and training and to make improvements to the risk management tools.

Risk management approach

The risk management process seeks to identify, understand, mitigate and manage risks at all levels of the business, reflecting the nature of the activities being undertaken and the level of control considered necessary to protect the Company's interests and those of its stakeholders. A bottom-up review of risks is undertaken, with Business Units identifying the main threats to achievement of objectives, documenting and analysing the potential impact, and defining clear actions to reduce the likelihood of those risks materialising and/or the financial impact if they should still occur. This exercise is completed using the Serco risk management lifecycle process which is mandated throughout the Company to ensure a consistent approach to identifying, analysing, monitoring and reporting risks and to provide assurance that the risk mitigation in place is effective and appropriate.

The Business Unit risks are consolidated and reported to Divisional leadership teams in a check and challenge capacity to ensure that risks on the Business Unit risk registers accurately reflect the concerns of local senior leadership. Once approved, the Divisional Risks are reviewed by the Group's ERM team and help inform the principal risk updates which are presented quarterly to the Group Risk Committee ("GRC"). The Board of Serco Group plc are updated after each meeting. The Group's Executive Committee, of which two of the Company's Directors are members of, reviews risk themes regularly throughout the year and conducts an annual risk workshop that includes a review of the principal risks as well as a review of emerging risk topics and their impact on the risk profile. For the Group's principal risks Subject Matter Experts (SMEs) are in place and a nominated sponsor from the Group's Executive Committee is allocated to each, supporting their review and management. Detailed reviews of the Group's principal risks are carried out as part of the GRC reporting schedule, as well as divisional "deep-dives" delivered by the Divisional CEOs. Each of the principal risks has an appetite statement to determine the nature and amount of risk that the Group is willing to accept as well as informing the decision-making as to the level of resource required for mitigation. These statements are aligned to our Values, Code of Conduct and other ethical requirements to support and drive the right risk culture within the Group.

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Summary of principal risks and uncertainties

Principal risks, as described below, have been reviewed by the Group's Executive Committee, GRC and the Board. Each risk is classified as a strategic, financial, operational, people, hazard, or legal and compliance risk. The risks are described on the following pages, together with the relevant strategic business objectives, key risk drivers, the Group-wide material controls which have been put in place to mitigate principal risks and the mitigation priorities to improve the effectiveness of the controls. Failure to deliver expected benefits from transformation risk has been removed from the principal risk profile to reflect good progress made and in recognition of the benefits returned to the organisation. In addition, a new people risk has been included acknowledging the value placed on the workforce and the importance of succession planning for business-critical roles on both the Group's Executive Committee and across the business. Particular focus has been given to the management and oversight of Health and Safety priorities, currently captured under Catastrophic risk, to ensure that they retain appropriate visibility and priority. The external and internal environment has also been assessed to anticipate both risks and opportunities and to increase the ability to pre-empt, convert or exploit them. As part of this review the potential implications of the UK's withdrawal from the European Union ("Brexit") continues to be monitored and its impact on the Group. Reiterating the position outlined in the 2018 Annual Report, it is believed that Brexit will not directly impact the Group to a material extent. This is based on regular assessment and review of the Group's UK and EU contracts, its supply chain, workforce requirements and regulatory obligations. By operating many contracts across diverse geographies outside of Europe, the Group has a natural hedge from material Brexit risks that may arise. In addition to the principal risks and uncertainties already identified, there may be other risks, either unknown, or currently believed to be immaterial, which could turn out to be material. These risks, whether they materialise individually or simultaneously, could significantly affect the Group's business and financial results.

Brexit

The Company makes specific reference below to the Brexit and the current assessment of its impact on the Company. The UK formally left the European Union following the result of the General election in December 2019. The transition period is expected to end on 31 December 2020 and the current shape of the economic and political partnership between the UK and EU is not known. Notwithstanding this, the Company's direct exposure to Brexit is small as the Company, and the Group of which it is a subsidiary of, neither exports nor imports to any significant degree; the Group of which the Company is a subsidiary of has a business in continental Europe which is conducted through long-established local subsidiaries; and employs relatively few continental European citizens in the UK. The Group continues to monitor the potential implications of the UK's withdrawal from the European Union and its impact and continues to believe that Brexit will not impact the Group to a material extent. This is based on regular assessment and review of the UK and EU contracts, supply chain, workforce requirements and regulatory obligations. By operating many contracts across diverse geographies outside of Europe, the Group has a natural hedge from material Brexit risks that may arise.

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Risks associated with the coronavirus outbreak

Coronavirus (COVID-19) was originally identified as a disease in China late in 2019. Following global transmission of the disease early in 2020, Europe and other continents began identifying cases which continued to rise in number such that on 12 March 2020 the World Health Organisation characterised the outbreak of COVID-19 as a global pandemic. As the impact of COVID-19 arose subsequent to the Company's year-end it is considered to be a non-adjusting post balance sheet event, and as a result, no amounts related to the impact of COVID-19 have been included in these financial statements, nor have any amendments been made to the carrying value of items on the Balance Sheet. Based on an initial assessment, since most of the contracts delivered by the Company are critical services for governments, which have continued to operate during the pandemic, the impact of COVID-19 is projected to be limited to a small number of contracts. The most likely negative impacts from COVID-19 include, but are not be limited to a reduction in profit margins as a result of higher absenteeism, a reduction in services for volume based contracts or a reduction in the pipeline of opportunities as new business and Government outsourcing is delayed. The risk is mitigated to some degree in the short-term through the Company's provision of assistance to governments in their response to the pandemic. In addition, the Company has already been involved in supporting the NHS's Test and Trace programme, establishing COVID-19 test centres and other COVID-19 work supporting the Government, although given the exceptional circumstances, the Company has agreed to perform such contracts on an open-book basis and at margins below normal expectations.

The principal risks outlined below are as disclosed within the Group's Annual Report and Accounts and, since their disclosure, have been assessed against the impact from the COVID-19 pandemic. The key risk drivers, mitigating controls and priorities remain largely unchanged, however have a greater focus on the impact from COVID-19 in the short to medium term. They remain applicable to the Company, which benefits from the Group's risk management programme, and the management of these from a Group perspective is relevant as the Company places reliance on a letter of support from its ultimate parent, Serco Group plc (see note 2).

Strategic risks

Failure to grow profitably

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

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

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

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Key risk drivers:

- **External factors reducing the pipeline of opportunities** - political and policy changes in our markets (such as changes in policy about the private provision of public services, changes following elections in federal or state governments, or decisions such as Brexit) may make it more difficult for us to win in some geographies or result in fewer opportunities.
- **Failure to be competitive** - lack of appropriate references and value propositions for the markets in which we compete, or an insufficient understanding of our competitive environment may put us at a disadvantage to our competitors.
- **Inability to meet customer and solution requirements during design, implementation and delivery** - executing our bids in an unsatisfactory manner by not understanding the strategic needs of the customer, mispricing bids, developing inefficient or non-innovative solutions and misunderstanding risks, may prevent us from achieving our growth ambitions.
- **Ineffective business development** - poor account management, market shaping, proposition development and visibility of pipeline opportunities may affect our ability to set and meet targets for growth as well as drive process improvements.

Material controls:

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

Mitigation priorities:

- Review pipeline opportunities to ensure all market activity is accurately captured and that budgets are allocated accordingly.
- Review portfolio for new attractive organic expansion areas.
- Continue to improve leveraging of Serco best practice and innovation, as well as refine bid solution processes and SME resources to ensure our propositions remain competitive.
- Continue to adopt a robust qualification processes so that Business Development resources are focused on the most attractive opportunities.
- Continued focus on account management for major bids, as well as re-bids to ensure existing clients are experiencing good service from Serco and fully understand the value and quality of our services.
- Review and consider appropriate inorganic growth opportunities as the market continues to develop.

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Failure to manage our reputation

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

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

Key risk drivers:

- **Failure to clearly define what Serco stands for and how we wish to be seen** - may result in inconsistent communication and misunderstanding by our key stakeholders.
- **Not understanding our customers' and stakeholders' expectations** - may result in a failure to recognise changes in our business environment or our customers' priorities.
- **Insufficient focus on articulating and evidencing the benefits of private provision of public services** - may result in an imbalanced public discourse and a misunderstanding of what Serco contributes to customers and service delivery.
- **Failure to manage incidents appropriately** - may result in us not responding in a collaborative approach with our customers, or not communicating in an open and ethical manner to key stakeholders.

Material controls:

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

Mitigation priorities:

- Continual refinement and improvement of existing communication and marketing controls and approaches.
- Continued and heightened efforts to explain and evidence the benefits and innovations that Serco brings to the provision of public services.
- Recently relaunched Serco Institute to trial and publish innovative thinking in public service delivery.

Financial control failure

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

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Financial control failure (continued)

During 2019 the new finance operating model within our UK Division was being embedded, and as a result of progressing through three reporting periods with the transformed model being operational, management believe that the risk of financial control failure has reduced from the higher levels which existed during the transformation phase. Work continues to ensure that the new operating model is sustainable and effective, and the Company is working closely with its third-party service provider to ensure this is the case.

Key risk drivers:

- **Not setting the right tone from the top** - if we do not set the right tone from the top, we may fail to embed finance policy, processes and controls.
- **Poor financial processes** – if processes are poorly designed, then inaccuracies and fraud may occur.
- **Inadequate financial controls within the business** – if controls are inadequate we may fail to provide adequate protection from sabotage of systems, fraud and error.
- **Challenges of new finance operating model** - poor service delivery may lead to an unstable financial control environment due to an increased workload on the Serco finance community.

Material controls:

- Group Governance and Finance strategy.
- Serco Management System (SMS) – finance processes and controls.
- Standardised reporting, forecasting and financial processes.
- Standardised financial systems and data structures.
- Skilled and adequately trained finance staff.
- Governance and review procedures associated with managing the quality of finance services delivered by the Company's third-party supplier.

Mitigation priorities:

- Continue to embed transformed new finance operating model and monitor delivery and risks of outsourced Finance Centre of Excellence.
- Continuously improve forecasting and reporting processes and outputs to deliver better insight into contract operations.
- Deliver global finance process improvement and efficiency through automation and robotics.
- Further embed billing assurance programme.
- Ensure talent is retained within the finance function through initiatives such as opportunities for personal development and improved training.
- Continuously improve the Company's financial assurance programme.

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Major information security breach

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

Whilst our ongoing mitigation measures continue to deliver clear benefits, the external threats continue to evolve in complexity and sophistication. In addition, the GDPR legislation has introduced unprecedented scrutiny and associated fines in relation to data protection issues. Serco has continued to implement robust internal controls and process improvements resulting in a steady state view of the overall risk.

Key risk drivers:

- **Non-compliant systems** - if our systems are non-compliant with Serco policies and standards and regulatory requirements for the protection of sensitive information, we are susceptible to breaches and penalties.
- **Non-compliance with policies and standards** – if staff do not comply with Serco policies and standards, then they may accidentally release sensitive information to third parties.
- **Vulnerability of systems and information** – if we do not identify sensitive information and protect and test the vulnerability of our systems, then we are potentially exposed to a breach.
- **Unauthorised use of systems** – if we do not implement effective personnel vetting and access restriction processes and controls, then unauthorised use of our systems may occur.
- **Inadequate incident monitoring and response** – if we do not monitor our systems and re-mediate and repel attacks, then we may fail to minimise the impact of any breach.
- **Increased regulatory scrutiny** - if we do not manage our data obligations and educate our workforce then we may be in breach of GDPR.

Material controls:

- Enterprise Architecture Boards & Solution Review meetings.
- Serco Management System (“SMS”).
- IT security infrastructure, processes and controls.
- Privileged User Management and Two Factor Authentication for our centralised managed systems.
- External assessments and scenario based cyber security testing.
- Third-party due diligence checks for key suppliers.
- Active monitoring by our Security Operations Centres and Computer Security Incident Response Team processes.
- Standardised HR processes.
- Cyber security awareness training part of our Serco Essentials training programme.
- Regular Phishing and Executive Committee training exercises.

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Mitigation priorities:

- Retooling for our Security Operations Centres to maintain effective risk identification.
- Continued routine vigilance and proactive vulnerability identification coordinated through our Security Operations Centres.
- Continued use of global key security risk indicators to support mitigation priorities.
- Leveraging Cloud adoption to ensure standardised control mechanisms.

Contract non-compliance, non-performance or misreporting

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

The reporting structure, the systems and the monthly business performance review which is conducted at contract, Business Unit and Division level across our business provides a rigour that allows senior management visibility of contract performance or compliance issues early.

Key risk drivers:

- **Poor understanding of contract obligations** - may result in staff failing to acknowledge and act on obligations or a failure to provide adequate resources to deliver against contractual obligations.
- **Poor systems/IT** - unreliable or incorrectly configured systems may result in late or incorrect data being produced.
- **Lack of process and controls** - poorly documented or poorly communicated processes may lead to deliberate or unintentional misreporting or contract non-compliance.
- **Ineffective assurance and human error** - insufficient oversight and assurance of contract performance, could lead to contract non-compliance, non-performance or a misreporting of performance.
- **Poor leadership and culture** - if our leaders do not align with our Values, and staff feel under pressure to meet challenging operational targets and/or performance indicators, then deliberate misreporting may occur.

Material controls:

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

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Mitigation priorities:

- Continued Contract Management training (Global and Divisional).
- Ongoing development and continued exercise to roll out and embed use of contract performance dashboard ("Gauge").
- Continued process improvement activity to drive consistent approach to risk assessment.
- Continued execution of divisional operational excellence improvement plans.
- More in depth contract KPI reviews.
- Ongoing and continued ethics, business conduct and compliance training.

Failure of business critical partner, sub-contractor or supplier

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

A programme for quantifying our supplier exposure and establishing appropriate mitigation actions was initiated with an extensive exercise identifying the business-critical suppliers across all divisions in 2018. This programme has continued to mature through 2019 with delivery of targeted reviews across the business.

Key risk drivers:

- **Ineffective procurement and supply chain governance** – resulting from non-compliance to standards and lack of consequence management.
- **Identification of significant suppliers** – a failure to identify our critical suppliers may result in lack of focused oversight and understanding of the impacts on Serco should they fail to deliver our customer critical services.
- **Limited oversight** - resulting in poor sourcing, contracting and monitoring of business-critical business partners, sub-contractors and suppliers as well as the potential for engaging in ineffective or onerous contracts with suppliers or sub-contractors.
- **Lack of resilience in the supply chain** – exposing us to potential service provision or financial losses should they have ineffective Business Continuity and Disaster Recovery plans.

Material controls:

- Serco Management System (SMS) – procurement policy, standards and procedures.
- Sourcing standards and procedures in each region.
- Identification and maintenance of business-critical partner, sub-contractor and supplier list.
- Contracts with appropriate Key Performance Indicators /Service Level Agreements etc.
- Financial and ethical health checks and monitoring in the UK, North America and AsPac.

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Mitigation priorities:

- Plan to roll out enhanced processes to critical suppliers including contract compliance, risk management and supplier performance management.
- Improve auditing of business-critical sub-contractor and supplier business continuity plans.
- Ongoing monitoring of impact of Brexit on supply chain and working with the Cabinet Office on risk mitigation and contingency against critical goods and services.

Failure to act with integrity

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

Building on work in 2018 we have rolled out improved ethics training, strengthened our internal capability through professional qualifications and reinforced our strong tone at the top.

Key risk drivers:

- **Failure to communicate** – if we do not define and communicate our values and expected standards adequately, our staff and third parties will fail to understand these, which may result in inappropriate leadership actions and low engagement with our values.
- **Our ways of working do not align with our values** – staff or third parties being unaware of and/or not reflecting our values may result in poor decision-making, unacceptable business conduct, and unethical or illegal behaviour bringing our operations into disrepute.
- **Direct or indirect contribution to human rights abuse** – staff either directly or indirectly contributing to human rights (including slavery and forced labour) abuses may result in a breach of laws/regulations.

Material controls:

- Top-level commitment/tone from the top.
- Strong, meaningful and understood values.
- Code of Conduct.
- Corporate Governance with oversight by the Corporate Responsibility Committee (CRC). The CRC has explicit responsibility to oversee how we embed our values across the business.
- Delegated Authority Matrix (DAM).
- Serco Management System (SMS).

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- Financial controls and processes, with segregation of duties for core financial controls.
- Gifts and Hospitality process and registers.
- Risk management procedures.
- Third-party due diligence.
- Leadership Academy.
- People development and remuneration.
- Corporate investigations.
- Speak Up process ("Ethicspoint").

Mitigation priorities:

- Delivery of the Deferred Prosecution Agreement project plan with oversight from DPA project steering group.
- Formal separation of Group HSE from Ethics function.
- Implementation of improved divisional ethics and compliance risk management processes.
- Further development of Speak Up dashboard and reporting.
- Embed use of Conflict of Interest registers.
- Refinement of divisional ethics and compliance risk assessments.
- Implementation of improved due diligence processes.
- Continued refresh of Serco Essentials training.
- Evaluate effectiveness of internal culture assessment processes.

Failure to attract, engage and retain key talent

It is our ambition to be one of the best managed companies in the sector and, notwithstanding our framework of people processes, systems and controls, there is a risk that we are unable to attract, engage and retain an appropriately sized, qualified and competent workforce and Management Team. This would restrict Serco's ability to deliver on its customer obligations, execute its strategy and achieve its business objectives whilst driving employee pride in the organisation.

This risk specifically includes consideration of key people reliance in our leadership and executive teams including succession planning for our senior management team and other business critical roles.

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Key risk drivers:

- **Development** - failure to develop leadership and management capability resulting in regretted attrition.
- **Talent & Succession** - failure to identify and develop talent and, as a result, talent pools do not support succession planning.
- **Engagement** - failure to engage with and listen to staff, particularly those in critical roles.
- **Reward** - remuneration packages fail to keep pace with external markets.
- **Recruitment** - failure to attract and recruit the right people with appropriate skills and experience leads to early attrition.
- **Attraction** - failure to attract suitable and diverse candidates of the right calibre with the required experience/qualifications.

Material controls:

- Talent Management & Succession Processes.
- Leadership capability development.
- Targeted retention arrangements.
- Critical Resource Planning.
- Annual Performance Management process.
- Exit Interviews.
- Viewpoint survey and action plans.
- Technology to support recruitment, onboarding and induction.
- Structured and targeted training and development processes.
- Annual engagement survey to all employees.

Mitigation priorities:

- Continued development of detailed succession plans for all identified business critical roles.
- Take action on areas of improvement identified in 2019 engagement survey.
- Continue to improve understanding of local employment markets.
- Complete benchmarking activity to ensure market competitive reward packages.
- Continue to monitor channels to access external talent in chosen markets.
- Ongoing use and analysis of exit interviews for senior regretted leavers.
- Continued use of Colleague Connexions.

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Catastrophic incident

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

Management of our health, safety and environmental commitments remains a core priority and so whilst the nature of this risk is broad and focuses on a significant event it is important to highlight that it also includes mitigations to secure the safety and wellbeing of every employee, service user and relevant third party and to execute our duty of care obligations.

Each Division is continuing to assess risks at a contract level to ensure that all relevant material risks have been identified and to assess and assure mitigations, including insurance cover, are appropriate. Contracts considered inherently high risk have been reviewed. Significant work has also been completed in the review of and testing of business continuity plans.

Key risk drivers:

- **Factors resulting in unsafe conditions** – a lack of identification and assessment of risks, sudden equipment failure or inadequate security may result in poor mitigation of and/or response to a serious event.
- **Ineffective or inadequate policies, standards and procedures** – if procedures/systems are not aligned with industry standard or customer expectations, an unacceptable level of safety management may occur.
- **Lack of capability and experience** – if resources lack current competency in specialist/regulatory requirements this may result in a serious event.
- **Lack of safety cultural alignment** – a safety culture which does not reflect our Values and fails to engage our staff and work safely may result in a serious event.
- **Insufficient safety management oversight** - devolved compliance of regulations to sector-specific Subject Matter Experts without appropriate safety management oversight may result in safety management systems which are not fit for purpose.
- **Inadequate response to a catastrophic event** – if our contingency plans do not provide an adequate response to an event then escalation of an event or prolonged disruption may occur.

Material controls:

- Serco (Health, Safety and Environmental) HSE Strategy.
- Effective and engaged safety culture.
- Regular safety communications and maintenance of safety awareness.
- Competency-based recruitment programme.
- Role description and competency definition.
- Serco Essentials training.
- Safety training and individual development plans and processes based on role and operational risk.
- Access to subject matter expertise.
- Safety Management System (policy and procedures).

Strategic Report

for the Year Ended 31 December 2019

- Planned and preventative inspections, maintenance and repair programmes.
- Third-party ethical due diligence process.
- Assure - Serco's incident and compliance reporting system.
- Incident/Near-miss investigations.
- Business Life cycle Review Team ("BLRT") process.
- Divisional Performance Reporting ("DPR") process.
- Crisis and incident emergency response plans and testing.
- Business Continuity plans and testing.
- Risk transfer via insurance where appropriate.

Mitigation priorities:

- Continue to embed updated health and safety strategy.
- Continue to embed 'just' culture.
- Deliver 2020 high visibility safety campaign in all divisions.
- Maintain divisional safety tours and safety moments.
- Formal split of Group HSE from Ethics function and creation of global Head of Health & Wellbeing role to drive wellbeing agenda and ensure the Safety element of this risk receives appropriate focus a corporate level.
- Continued training in insurance and contractual risk management.
- Complete second phase controls review and alignment of insurance.
- Review levels and adequacy of compliance assurance.

Material legal and regulatory compliance failure

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

Various laws and regulations that apply across the business continue to be subject to increased focus and attention, including Anti-bribery and Corruption laws, Market Abuse Regulation, Data and Privacy laws, Modern Slavery, Trade Compliance and Human Rights.

Strategic Report

for the Year Ended 31 December 2019

Key risk drivers:

- **Lack of governance and oversight** - may result in a failure to identify potential or actual legal or regulatory breaches resulting in a failure to respond appropriately or confirm compliance with legal and regulatory requirements.
- **Failure to comply with the SMS and contractual obligations** - may result in compliance failures for Group-wide material legal and regulatory requirements.
- **Failure to identify and respond to material changes in legal and regulatory requirements, including Brexit** - complex and emerging new laws may result in key subject matter experts within the business not remaining up to date and failure to comply with material legal and regulatory obligations.
- **Lack of awareness by employees of the legal and regulatory requirements placed upon them and the business** - may result in lack of identification and subsequent compliance to requirements.
- **Inadequate provision of systems and tools** - may result in ineffective methods to support the management and reporting of legal and regulatory compliance.
- **Legal or regulatory compliance failure by a third-party supplier/agent/partner** - may result in Serco being held responsible for their failure under customer contracts.
- **Class action litigation and increasing regulatory fines** - particularly in relation to data privacy, employment/pensions.
- **Compliance with SFO DPA obligations.**

Material controls:

- Automated alerts on material legal and regulatory obligations and changes.
- Legal and contracts experts aligned to various specialist areas across the business.
- Investment Committee and Business Lifecycle Review Team (BLRT) bid process and governance.
- Third-party ethical and general due diligence on all suppliers.
- Serco Management System (SMS) including various policies and operating procedures guiding and regulating conduct.
- Case management software and analytics.
- Legal training.
- Serco Essentials training.
- External and Internal audits.
- Compliance assurance processes and procedures.
- Regular reporting to Board and Executive Committee on legal issues and new laws across the Group.
- Speak up process and case management system ("EthicsPoint").

Strategic Report

for the Year Ended 31 December 2019

- EU-Exit Working Group reviewing Brexit related risks.
- Oxford Saïd Business School Senior Management and Contract Director training on legal and contract issues and best practice.
- Group and Divisional Standard Operating Procedures.

Mitigation priorities:

- Delivery of Deferred Prosecution Agreement project plan with oversight from DPA project steering group.
- Horizon scanning on key potential new laws and regulations, including Brexit.
- Greater use of data and trend analysis to inform Key Risk Indicators.
- Embedding risk-based third party due diligence.
- Improve review of key controls within SMS as the basis for ongoing compliance assurance.
- Continuing development of Serco Essentials training programmes.
- Continue and improve key contract and compliance assurance reviews on legal compliance.

SFO investigation

The Company's 2018 Annual report documented the ongoing investigation by the UK Serious Fraud Office ("SFO") which was announced in November 2013. This investigation concluded on 4 July 2019 when Serco Geografix Ltd ("SGL"), one of the subsidiaries of Serco Group plc ("Serco", "Serco Group" or "the Group"), entered into a Deferred Prosecution Agreement ("DPA") with the SFO following the full cooperation with the SFO's investigation.

Serco Geografix Ltd has taken responsibility under the terms of the DPA for three offences of fraud and two of false accounting committed between 2010 and 2013 related to the reporting to the UK Ministry of Justice ("MoJ") of the levels of profitability of Serco's Electronic Monitoring (EM) contract. These issues were reported by Serco to the SFO and the MoJ in November 2013. SGL paid a fine of £19.2m together with £3.7m related to the SFO's investigation costs. The DPA lasts for three years until July 2022. The fine reflected a discount of 50% as a result of Serco's self disclosure of the conduct, as well as its significant and substantial cooperation with the investigation. No compensation or disgorgement of profit were payable to the MoJ because the SFO agreed that Serco had already fully compensated the Department in respect of the offences as part of a £70m settlement paid by Serco to the MoJ in December 2013.

The SFO recognised the significant steps Serco took to reform itself, including the thorough implementation under independent supervision of a comprehensive Corporate Renewal Programme approved by the UK Government. This programme included over 80 actions and initiatives, and included rewriting its system of management control, as well as strengthening its bidding, contract management, internal audit and management assurance processes. The DPA is accompanied by an undertaking by SGL's ultimate parent entity, Serco Group plc, with the SFO ("the Undertaking"), to guarantee SGL's performance of its obligations including payment of the fine, full cooperation with the SFO and other foreign and domestic law enforcement and regulatory authorities, self-reporting of any evidence or allegation of serious or complex fraud, and ethics and compliance programme enhancements of a type largely identical to those agreed to by SGL as well as agreeing to report annually to the SFO and the Cabinet Office on the Group's ethics and compliance programme.

The Group is focused on the delivery of its obligations under the DPA and Undertaking. Serco Group plc Board oversight of the DPA and Undertaking commitments has been strengthened and both the Group's Board and GRC regularly review the DPA plan.

Strategic Report

for the Year Ended 31 December 2019

Corporate Governance Arrangements

As required under the Companies (Miscellaneous Reporting) Regulations 2018, this section of the Directors Report describes the corporate governance arrangements of the Company during the financial year.

The Directors confirm that the Company has applied all of the Principles set out in the Wates Corporate Governance Principles for Large Private Companies 2018, a copy of which is available at www.frc.org.uk.

1. Purpose and Leadership

The Board of the Company is collectively responsible for promoting the success of the Company and ensuring that its values, strategy and culture align with that purpose. The purpose of the Company is set out on page 2 of these accounts, and the values, strategy and culture of the Company are aligned with that of the Company's ultimate parent company, Serco Group plc. Further information concerning the values, strategy and culture of the Group are provided in the 2019 Serco Group plc Annual Report and Accounts.

2. Board Composition

The Board of the Company's ultimate parent company, Serco Group plc, has delegated responsibility to the Executive Committee of Serco Group plc to ensure the effective direction and control of the business.

The Executive Committee has approved internal guidelines for the constitution of subsidiary boards which take into consideration the value and strategic importance of the contracts which operate through each subsidiary and the level of oversight required. This ensures that the Board of the Company is of an appropriate size and structure, and has an appropriate combination of skills, experience and knowledge to promote accountability and to provide constructive challenge to achieve effective decision making, and that the level of understanding is relevant to the Company's business needs and stakeholder interests.

The Board of Serco Group plc is committed to improving gender and ethnic diversity on the Serco Group plc Board and in the senior management population within the Group from which appointments to the Board of the Company are selected, and further details of how the Serco Group plc Board Diversity Policy is reviewed and assessed can be found on page 119 of the 2019 Serco Group plc Annual Report and Accounts.

Details of how the Board of the Company are supported in continued investment in personal and professional development is provided on page 81 of the 2019 Serco Group plc Annual Report and Accounts.

3. Director Responsibilities

The internal affairs of the Company are governed by the management framework of its ultimate parent company, Serco Group plc, (the Serco Management System ('SMS')). The SMS ensures clear levels of accountability and governance through policies, standards and procedures concerning:

- Business Conduct and Ethics
- Business Continuity and Crisis Management
- Business Development
- Finance

Strategic Report

for the Year Ended 31 December 2019

- Governance
- Health, Safety and Environment
- Information Integrity
- Information Technology
- Operations
- People
- Procurement and Supply Chain
- Risk Management
- Security

The policy statements can be found on the Serco Group plc website, www.serco.com.

4. Opportunity and Risk

The SMS includes policies, standards and procedures to identify future opportunities for innovation and entrepreneurship, and to ensure that business development is managed through organisational structures with clearly defined responsibilities and decision points. A specific procedure describes reserved powers and delegated powers of authority that apply within the Serco Group and its subsidiaries, including processes for approval of business opportunities of a certain value.

The Company leverages the risk management processes of its ultimate parent company, Serco Group plc, see pages 3 to 19 of this Annual Report for further details.

5. Remuneration

Remuneration structures for the Board of the Company are set in accordance with People policies contained in the SMS of the Group. The Board of the Company does not receive any additional remuneration in connection with their appointment to the Board, and remuneration and benefits are set so as to be appropriate to attract, retain and motivate, taking into account:

- (a) market competitiveness in base salary and benefits
- (b) any local legislation regarding fairness and equality
- (c) the scope and scale of the role
- (d) individual performance and potential, as well as
- (f) business affordability.

Variable remuneration seeks to recognise performance against pre-determined goals aligned to the business strategy, and rewards contributions to core values. The Group has a structured Performance and Development Review process for managing effective performance and development, aligned to behaviours, purpose, values and strategy which feeds into remuneration decisions as appropriate.

Strategic Report

for the Year Ended 31 December 2019

6. Stakeholder Relationships and Engagement

The Company leverages the Environmental, Social and Governance agenda of its ultimate parent company, Serco Group plc, which is driven by the Corporate Responsibility Framework of the Group. Further information is available on the Serco Group plc website, www.serco.com.

The SMS includes workforce policies and procedures for reporting concerns regarding violations of Group values, policies or the Group Code of Conduct.

The Board of the Company is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and must have regard to their views when taking decisions. The ways in which interests of stakeholders have been considered and the manner in which engagement is achieved is set out on pages 22 to 28.

Section 172 (1) Statement Board Engagement with Stakeholders

The Board is committed to enhancing engagement with all our stakeholders, and as well as acting in the best interest of the Company, the Board looks to the activities undertaken by the Board of Directors of Serco Group plc (the 'Serco Group plc Board'), the Company's ultimate parent company, in engaging with the Group's wider stakeholders. In addition to the methods of engagement described below, the interests of the Company's stakeholder groups are considered for the Serco Group as a whole by the Serco Group plc Board through a combination of:

- Regular reports and presentations at scheduled Serco Group plc Board and Committee meetings, including operational reports presented by the Chief Executive and updates from senior management on health and safety, ethics and compliance, people matters (including employee engagement) and investor feedback.
- A rolling agenda of matters to be considered by the Serco Group plc Board and Committees throughout the year, including a strategy review which considers the purpose of the Company and strategy to be followed by the Group, which is supported by a budget for the following year and a medium-term financial plan.
- Formal consideration of large bids and other matters, including any factors which are relevant to major decisions taken by the Serco Group plc Board through the year in line with the regularly reviewed Delegation of Authority and Terms of Reference for each Serco Group plc Board Committee.
- The risk management process and other routine agenda items of the Serco Group plc Audit Committee, Corporate Responsibility Committee, Group Risk Committee and Remuneration Committee, as described in the Serco Group plc 2019 Annual Report and Accounts.

As with other large and complex companies, the Directors of the Company fulfil their duties partly through a governance framework that delegates day-to-day decision-making. The Serco Group plc Board recognises that such delegation needs to be much more than simple financial authorities. Presented in the Serco Group plc 2019 Annual Report and Accounts is a summary of the governance structure which covers the values and behaviours expected of our employees; the standards they must adhere to; how the Group as a whole engages with stakeholders; and how the Serco Group plc Board looks to ensure that we have a robust system of control and assurance processes (see pages 76 to 95 of the Serco Group plc Annual Report and Accounts).

Strategic Report

for the Year Ended 31 December 2019

The Group's Corporate Responsibility (CR) framework, of which the Company forms part, is structured around our key stakeholders and progress and performance in delivering The Group's CR agenda is set out in the CR section of Serco Group plc 2019 Annual Report and Accounts. The following disclosure describes how the Board has had regard to the matters set out in section 172(1) (a) to (f), and forms the Directors' statement required under section 414CZA of the Companies Act 2006.

Stakeholder group - Our owners

Engagement with and receiving the support of our ultimate parent company and its owners is a key factor in achieving our ambitions. We seek long-term relationships based on transparency, honesty and clarity - all of which are critical for building trust.

Stakeholder concerns

The Serco Group plc shareholders are concerned with a broad range of issues, including operational and financial performance, developments in our markets for public services, the execution and delivery of our strategy, the sustainability of our business, and the impact Serco has on the communities we serve and the environment in which we operate. Performance developments are comprehensively assessed in the Strategic Report of the Serco Group plc 2019 Annual Report and Accounts more widely, including the Key Performance Indicators section and the broader discussion and analysis.

How the Board engages with stakeholders

- The financial results of the components making up the Company are reviewed according to delegated authorities on a monthly basis.
- The Group Chief Executive and Group Chief Financial Officer and other members of the Serco senior management team, including Directors of the Company, attend monthly divisional performance reviews and divisional executive management team meetings to discuss financial and operational developments in the business.
- The Investor Relations team provides regular reports to the Serco Group plc Board, which includes activities within the Company.

Key topics of engagement

- The Company's performance against the strategy of the wider Group.
- Developments in our customer markets and the competitive landscape.
- Opportunities for acquisitions.
- Capital allocation considerations.

How stakeholder interests influence Board discussions and principal decisions

- The Serco Group plc shareholders' opinions were, and continue to be, taken into consideration by the Serco Group plc when developing and reviewing the Group's strategy and performance and these guiding principles are reflected in the strategy of the Company.

Stakeholder group - Our people

Our people are at the heart of our business and, as a Company, we are the sum of the efforts, energy and values of our people, who are critical to achieving our mission of improving the lives of citizens and service users around the world.

Strategic Report

for the Year Ended 31 December 2019

Stakeholder concerns

Through the annual Group-wide Viewpoint survey and other dialogue with our colleagues, we know that our people feel passionately about the place they work and the services that they deliver. As you would expect for a business as diverse as that of the Group, our colleagues express their opinions across a very wide range of areas. However there are currently three main areas of concern raised by colleagues on a regular basis: connection and collaboration within Serco, individual recognition, and having a voice in the decision making within the business. The Group's People Report, available on the Group's website, sets out the work being undertaken to make Serco a better, safer and more inclusive place to build a career.

How the Board engages with stakeholders

- Feedback is sought from our people annually through the Group-wide engagement survey, Viewpoint, supplemented with more frequent 'pulse' surveying in selected parts of the business.
- Kirsty Bashforth, Non-Executive Director of Serco Group plc, was appointed as the Group's lead representative on the Board for Employee Voice and reports to the Serco Group plc Board the feedback received from our people at engagement activities attended throughout the year as part of the Employee Voice and Colleague ConneXions initiatives.
- The Serco Inclusion Hub was introduced in across the Group during the year to provide a platform for our employee networks, Serco Inspire, Serco Unlimited, Serco Embrace and In@Serco, to better coordinate and collaborate. Regular reports on the activities of each network are provided to the Serco Group plc Board through the regular People reports provided by the Group HR Director. Operational people matters are considered at monthly divisional executive management team meetings attended by the Directors of the Company during the year.
- Members of the Company's Board and the Executive Directors of Serco Group plc meet with employees during contract visits and with senior management monthly at divisional performance review and divisional executive management team meetings.

Key topics of engagement

- Global focus areas for diversity and inclusion: Gender, Disability, Multicultural and LGBT+.
- Matters impacting employees on the frontline of our contracts.
- Talent and leadership succession.
- Review of pension provisions.
- Feedback received from employees through the Viewpoint survey and the actions proposed by management in response.

How stakeholder interests influence Board discussions and principal decisions

- The Serco Group plc Board considered the impact to employees of the Company of restructuring activities that have taken place during the year, such as the IT and Procurement Transformation programmes, the development opportunities that potential acquisitions and contract bids would afford our employees, and the impact on the Company's ability to attract and retain staff.
- Discussions of the Company Board and the Serco Group plc Board have been better informed due to the deeper understanding of the work undertaken by our employees, which has been developed during contract visits undertaken in each Division. At these contract visits and events, the Directors meet and hear directly from Serco employees on a variety of topics.

Strategic Report

for the Year Ended 31 December 2019

Stakeholder group - Our customers

As an international B2G business our customers are many and varied, consisting of local, regional, national governments and agencies, those receiving our services at a contract level versus those procuring the services, and those who use the services we provide on behalf of our customers. Our business is built on our ability to retain existing and win new customers. As such, understanding, engaging with, and responding to customer needs is a critical priority.

Stakeholder concerns

While the demands vary significantly, at the most basic level our customers seek to procure from us quality public service delivery, at a price they feel represents value for money. This requires us to have both deep understanding of their sector specific needs, as well as technical and commercial nous as to how to deliver public services most efficiently. In addition, there are significant regional and sector specific priorities, that vary enormously and also change over time. For example, the increasing demand for the employment of nationals in the Middle East and the increasing drive for social value outcomes in the UK. It is critical that we maintain a detailed appreciation of these so that we can respond accordingly.

How the Board engages with stakeholders

- The Group Chief Executive and Group Chief Financial Officer meet directly with different customers across all our regions on a regular basis.
- Members of the Serco Group plc Board regularly, and throughout the year, visit our different international operations and contracts where they engage directly with customers.
- Our Group-wide 'Operational Report' gives updates and feedback on our markets, customers, and operational performance to the Serco Group plc Board at every meeting. The Company's directors present regularly to the Serco Group plc Board on the same. Other colleagues also present regularly on operations, customer satisfaction and Business Development.
- The annual Strategy Planning process is a bottom-up exercise including every part of the business, taking into account both existing and future customer needs and trends over the next 5 years. This process culminates in a day-long Group-wide Board Strategy Day during which the Serco Group plc debate current and future customer requirements at length.
- Attendance by the Serco Group plc Directors at Serco-led and other industry events, including events run by the Serco Institute on public policy priorities such as Social Value, which customers both attend and speak at.

Key topics of engagement

- Customer and Serco strategy and operational performance.
- The procurement processes employed by key customers, such as the Outsourcing Playbook in the UK.
- New and future customer requirements and trends, such as focus on environmental, social, and governance matters.
- Specific business development opportunities.
- The overall performance of the sector.
- Serco innovations in response to customer trends and needs.

Strategic Report

for the Year Ended 31 December 2019

How stakeholder interests influence Board discussions and principal decisions

- The Serco Group plc Board deployed their customer insight to positive effect in decisions relating to our submission of our largest bids over the year and the nature of our proposals, which they scrutinise.
- Following customer engagement and insight gathered from the annual strategy process, the Serco Group plc Board provided guidance on our strategy, strategic decisions, as well as resource allocation, and prioritisation across our markets and customers in 2019-20.
- The Serco Group plc Board continued to drive the Executive Directors of Serco Group plc and in turn the Directors of the Company to act on new customer trends and priorities as a result of engagement in 2019. For example, our plans on sustainability, social value, and voluntary, community, and social enterprise organisations.

Stakeholder group - Our suppliers

Suppliers have an important role to play in Serco being a superb provider of public services. We aim to build honest, respectful and transparent relationships with suppliers who follow regulatory compliance and share our ethical standards and commitment to sustainability throughout the supply chain.

Stakeholder concerns

Our suppliers are concerned with the ease of doing business with Serco, responsible business practices, conduct and ethics, driving innovation, building long-term relationships, fair business terms, and receiving prompt payment.

How the Board engages with stakeholders

- Direct engagement via the Group Chief Executive and Group Chief Financial Officer.
- Regular reports to the Serco Group plc Board from senior management and discussion at monthly divisional performance review and divisional executive management team meetings attended by the Directors of the Company concerning operational matters on specific business units.
- Regular reports to the Serco Group plc Board from the Group Director, Enterprise Risk, the Group Director, Business Compliance and Ethics, and the Director of Procurement concerning management and assessment of suppliers.
- Regular reports from individual business units, including creditor payable days.

Key topics of engagement

- Due diligence processes.
- Supplier relationships.
- Supply chain management.
- Fair payment practices.

How stakeholder interests influence Board discussions and principal decisions

- The management of suppliers has been discussed at the Serco Group plc Board level and the Procurement Transformation programme was endorsed by the Serco Group plc Board in recognition of the need to improve supplier management processes.
- Key risks in relation to the supply chain were considered by the Serco Group plc Board when approving the approach to due diligence of suppliers, which was revised during the year.

Strategic Report

for the Year Ended 31 December 2019

- Feedback on the financial performance of key suppliers was considered periodically during the year, with performance being discussed at the Group Audit and Group Risk Committees, and feedback provided to the Serco Group plc Board concerning the discussions.

Stakeholder group - Our communities and environment

Our communities comprise those living and working in close geographic proximity to our operations, those for whom we provide services on behalf of our government customers, and those who represent the needs of our communities, including charities and local government. Operating amongst and on behalf of our communities, we strive to maintain a deep understanding of the complex social challenges that impact them, whilst recognising our responsibility to contribute to the sustainability and wellbeing of society and the economy wherever we operate. We are also committed to limiting the impact of our operations on the environment through more sustainable business practices for our customers and stakeholders, including our communities.

Stakeholder concerns

Our communities are primarily concerned with the impact of our operations on the local society, the economy, and the environment - locally and beyond - and that we operate and conduct our business as a respectful and responsible neighbour.

How the Board engages with stakeholders

- The Serco Group plc Board receives regular operational reports from the Group Chief Executive.
- Regular reports to the Serco Group plc Board from senior management and discussion at monthly divisional performance review and divisional executive management team meetings attended by the Directors of the Company concerning operational matters on specific business units.
- Meeting with users of the services we provide on behalf of our customers during contract visits by the Serco Group plc Board.
- Attendance by the Serco Group plc Board at Serco Institute events.

Key topics of engagement

- Further information on our engagement concerning Corporate Responsibility (CR) matters is provided in the CR Report within the Group's Annual Report.
- Political environment.
- Impact to the community of pursuing business development opportunities.

How stakeholder interests influence Board discussions and principal decisions

- The Serco Group plc Board gave careful consideration to issues under our immigration contracts in the UK, including asylum seekers who are housed under the Home Office COMPASS contract and the situation of managing those individuals that overstay beyond the permitted terms of their asylum application.
- The Serco Group plc Board had regular discussion during the year on the issues in prisons under our justice contracts in the UK, including physical assaults, violence and impact on communities.
- Meeting with users of the services we provide on behalf of our customers during contract visits by the Directors of the Company and the Directors of Serco Group plc facilitates a deeper discussion of operational matters. In considering business development proposals from senior management, this also enables the directors to better assess service user needs and the ability to provide the services under the contract to the standards expected and identify any gaps in capabilities.

Serco Limited

Strategic Report

for the Year Ended 31 December 2019

Approved by the Board on 26 June 2020 and signed on its behalf by:



..
N Crossley
Director

....

Directors' Report

for the Year Ended 31 December 2019

The Directors present their report and the financial statements for the year ended 31 December 2019.

Directors of the company

The Directors, who held office during the year, were as follows:

K D Craven

N Crossley

A A Kirby (appointed 29 July 2019)

New shares allotted

There were no new ordinary shares allotted in the current and prior year.

Going concern

The Company has net current assets of £149.4m as at 31 December 2019 including a £133m intercompany receivable which is repayable on demand although not intended to be recalled in the next year (2018: £236.8m) and a loss for the year then ended of £1.2m (2018: £35.4m). The Company's financial forecasts for the period of going concern indicate that the Company has sufficient financial resources to meet its financial obligations as they fall due during the period of assessment, considered to be twelve months from the signing date of these financial statements. In light of the COVID-19 pandemic, the Company has considered the potential range of impacts on the financial forecasts which indicate that it will continue to have sufficient resources to meet its financial obligations as they fall due. However, given the uncertainties in respect of the pandemic, the potential impact on the Company's health and leisure contracts which have been impacted, and the dependency on the availability of the intercompany financing facility that the Company uses to meet its day to day working capital requirements, the Company has obtained a letter of support from the Group's ultimate parent, Serco Group plc.

Serco Group plc has indicated its intention to continue to make available such funds as are needed by the Company for the period of this assessment.

The Directors of the Company have been made aware of the Going Concern assessment which has been performed in respect of the Group. The Directors believe they are able to place reliance on this letter of support for the following reasons.

Most of the Group's contracts deliver critical services to Governments and the delivery requirements of these have not been impacted by COVID-19. However, a small number of contracts within the Group have been impacted by; lower volumes within its UK Transport business; higher levels of absenteeism and increased service performance in its UK Health contracts; closure of operations including leisure centres in the UK and the Driver Examination Services contract in Canada; and delays in project work such as the delivery of the Antarctic Supply Research Vessel in Australia. The negative impact from these contracts has been offset to some extent by additional services being delivered to assist Governments with their management and recovery from the COVID-19 pandemic, and financial support from its customers. It is evident that the most significant impact on the Group's operations has been within the UK.

Directors' Report

for the Year Ended 31 December 2019

Going concern (continued)

In order to model severe but plausible scenarios to stress test the potential impact of COVID-19 on the Group's forecast, the Group have considered, amongst other scenarios, lower passenger volumes on the Group's train operating contracts, higher costs within the Health portfolio and prolonged closure of leisure centres in the UK, without mitigations such as the Coronavirus Job Retention Scheme and Emergency Measures Agreements within the rail contracts being in place. The Group has reviewed the impact on overseas operations and considered the impact of a second wave in Australia which may impact the ability to deliver operations within contact centres, or drive higher absenteeism in the delivery of its larger operations such as the Fiona Stanley Hospital or Department of Immigration and Border Protection contracts.

After considering these severe but plausible scenarios and with the mitigations available to the Group, the forecasts indicate sufficient capacity in the Group's financing facilities and associated covenants. In order to satisfy themselves that they have adequate resources for the future, the Group has reviewed its existing debt levels, the committed funding and liquidity positions under its debt covenants, and its ability to generate cash from trading activities and working capital requirements. The Group's current principal debt facilities as at 31 May 2020 comprised a £250m revolving credit facility, a 3 year term acquisition facility of £45m and £222m of US private placement notes. As at 31 May 2020, the Group had £517m of committed credit facilities and committed headroom of £230m. In undertaking this review the Group has considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review for the Group, the assessment period is considered that to be the period ending 31 December 2021.

As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue, although at the date of approval of these financial statements, they have no reason to believe that it will not do so. Consequently, the directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

Proposed dividend

The Directors do not recommend the payment of a dividend (2018: £nil).

Employment of disabled persons

Full and fair consideration is given to applications for employment made by the disabled, having regard to their aptitude and ability. Appropriate training is arranged, including retraining of employees who have become disabled.

Employee involvement

Managers are tasked with developing employees' awareness of factors affecting business and matters concerning them as employees and noting employees' views so that they can be taken in to account when making decisions that may affect them or the business. Regular meetings are held with employee representatives where trade union or staff associations are recognised or where works councils are constituted.

Political contributions

The Company made no political donations or incurred any political expenditure during the year (2018: £nil).

Directors' Report

for the Year Ended 31 December 2019

Disclosure of information to the auditors

The directors have taken steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditor is aware of that information. The directors confirm that there is no relevant information that they know of and of which they know the auditor is unaware.

Risks and uncertainties

A review of risks is undertaken in the Strategic Report.

Post balance sheet events

Coronavirus (COVID-19) was originally identified as a disease in China late in 2019. Following global transmission of the disease early in 2020, Europe and other continents began identifying cases which continued to rise in number such that on 12 March 2020 the World Health Organisation characterised the outbreak of COVID-19 as a global pandemic. As the impact of COVID-19 arose subsequent to the Company's year-end it is considered to be a non-adjusting post balance sheet event, and as a result, no amounts related to the impact of COVID-19 have been included in these financial statements, nor have any amendments been made to the carrying value of items on the Balance Sheet. Based on an initial assessment, since most of the contracts delivered by the Company are critical services for governments, which have continued to operate during the pandemic, the impact of COVID-19 is projected to be limited to a small number of contracts. The most likely negative impacts from COVID-19 include, but are not be limited to a reduction in profit margins as a result of higher absenteeism, a reduction in services for volume based contracts or a reduction in the pipeline of opportunities as new business and Government outsourcing is delayed. The risk is mitigated to some degree in the short-term through the Company's provision of assistance to governments in their response to the pandemic. In addition, the Company has already been involved in supporting the NHS's Test and Trace programme, establishing COVID-19 test centres and other COVID-19 work supporting the Government, although given the exceptional circumstances, the Company has agreed to perform such contracts on an open-book basis and at margins below normal expectations.

During May 2020, the Company agreed to dispose of its interest in the Viapath joint venture which provides pathology services to certain hospitals in the UK. As part of the disposal, the Company will receive payments totalling £15.1m which includes amounts in respect of historic profit share, loans held between the Company and the JV and an amount in relation to the Company's interest in the JV. The Company's interest in Viapath ceased with effect from 31 May 2020. No amounts relating to the disposal are included in the Company's financial results for the year ending 31 December 2019. The transaction results in underlying trading profit being recognised of £2.0m with the remainder being recognised as exceptional.

Reappointment of auditors

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

Approved by the Board on 26 June 2020 and signed on its behalf by:



.....
N Crossley
Director

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Strategic Report, the Directors' 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 they have elected to prepare the financial statements in accordance with United Kingdom Accounting Standards and applicable law (United Kingdom Generally Accepted Accounting Practice), including FRS 101 'Reduced Disclosure Framework' ('FRS 101').

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SERCO LIMITED

Opinion

We have audited the financial statements of Serco Limited (the 'Company') for the year ended 31 December 2019, which comprise the Profit and Loss Account, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity, and related notes, including the accounting policies in note 2.

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of its loss for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

Strategic Report and Directors' Report

The Directors are responsible for the Strategic Report and the Directors' Report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the Strategic Report and the Directors' Report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the Strategic Report and the Directors' Report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SERCO LIMITED

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 32, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A further description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.



John Luke (Senior Statutory Auditor)
For and on behalf of KPMG LLP, Statutory Auditor

15 Canada Square
London
United Kingdom
E14 5GL

26 June 2020
Date:.....

Serco Limited

Profit and Loss Account for the Year Ended 31 December 2019

	<i>Note</i>	<i>2019 £ m</i>	<i>2018 £ m</i>
Turnover	4	1,382.6	1,266.3
Cost of sales		<u>(1,265.3)</u>	<u>(1,176.0)</u>
Gross profit		117.3	90.3
Administrative expenses		(91.3)	(90.2)
Amortisation of intangible fixed assets	14	(13.0)	(12.5)
Impairment of intangible assets		-	(0.1)
Exceptional net loss on disposal of operations	5	-	(0.5)
Other exceptional operating items	6	<u>(9.7)</u>	<u>(38.8)</u>
Operating profit/(loss)	7	3.3	(51.8)
Interest receivable and similar income	10	7.0	5.3
Interest payable and similar charges	11	<u>(6.8)</u>	<u>(2.9)</u>
Profit/(loss) before tax		3.5	(49.4)
Tax on profit/(loss) on ordinary activities	12	<u>(4.7)</u>	<u>14.0</u>
Loss for the year		<u><u>(1.2)</u></u>	<u><u>(35.4)</u></u>

The above results were derived from continuing operations.

The notes on pages 40 to 91 form an integral part of these financial statements.

Statement of Comprehensive Income

for the Year Ended 31 December 2019

	<i>Note</i>	<i>2019</i> <i>£ m</i>	<i>2018</i> <i>£ m</i>
Loss for the year		<u>(1.2)</u>	<u>(35.4)</u>
Other comprehensive (expense)/income for the year:			
Items that will not be reclassified subsequently to profit or loss			
Actuarial gain on reimbursable rights*		0.1	0.1
Tax related to items not reclassified*	13	2.7	(9.1)
Net actuarial (loss)/gain on defined benefit pension schemes*	23	<u>(17.6)</u>	<u>51.4</u>
Total		(14.8)	42.4
Items that may be reclassified subsequently to profit or loss			
(Loss)/gain on cash flow hedges (net)**		<u>(0.2)</u>	<u>0.1</u>
Total other comprehensive (expense)/income		<u>(15.0)</u>	<u>42.5</u>
Total comprehensive (expense)/income for the year		<u>(16.2)</u>	<u>7.1</u>

* Recorded in retained earnings in the Consolidated Statement of Changes in Equity.

** Recorded in hedging and translation reserve in the Consolidated Statement of Changes in Equity.

Serco Limited

Balance Sheet

as at 31 December 2019

Registration number: 00242246

	Note	2019 £ m	2018 £ m
Fixed assets			
Goodwill	14	6.8	6.8
Intangible assets	14	39.4	48.4
Tangible assets	15	277.8	41.9
Investments	16	3.5	3.5
		<u>327.5</u>	<u>100.6</u>
Current assets			
Stocks	17	9.4	11.0
Debtors: amounts falling due within one year	18	202.8	254.4
Debtors: amounts falling due after more than one year	18	134.0	175.3
Deferred tax assets	13	20.9	18.0
Corporation tax asset		0.1	4.9
Derivative financial instruments	26	0.1	0.3
Cash at bank and in hand	19	25.7	-
Defined benefit pension asset	23	78.3	85.8
		<u>471.3</u>	<u>549.7</u>
Total assets		<u>798.8</u>	<u>650.3</u>
Creditors: Amounts falling due within one year			
Creditors: amounts falling due within one year	20	(288.2)	(260.7)
Bank overdrafts		-	(4.3)
Corporation tax liabilities		(3.3)	(3.1)
Derivative financial instruments	26	(0.1)	-
Provisions	22	(30.3)	(44.8)
		<u>(321.9)</u>	<u>(312.9)</u>
Net current assets		<u>149.4</u>	<u>236.8</u>
Total assets less current liabilities		<u>476.9</u>	<u>337.4</u>
Creditors: Amounts falling due after more than one year			
Creditors: amounts falling due after more than one year	21	(291.0)	(142.0)
Provisions	22	(20.3)	(30.0)
		<u>(311.3)</u>	<u>(172.0)</u>
Defined benefit pension liability	23	(23.7)	(14.4)

The notes on pages 40 to 91 form an integral part of these financial statements.

Serco Limited

Balance Sheet

as at 31 December 2019

Registration number: 00242246

	Note	2019 £ m	2018 £ m
Net assets		<u>141.9</u>	<u>151.0</u>
Capital and reserves			
Called up share capital	24	0.8	0.8
Share premium reserve		1,108.9	1,108.9
Other reserves		-	0.2
Profit and loss account		<u>(967.8)</u>	<u>(958.9)</u>
Shareholders' funds		<u>141.9</u>	<u>151.0</u>

These financial statements were approved by the Board on 26 June 2020 and signed on its behalf by:



.....
N Crossley
Director

The notes on pages 40 to 91 form an integral part of these financial statements.

Serco Limited

Statement of Changes in Equity for the Year Ended 31 December 2019

	<i>Called up share capital £ m</i>	<i>Share premium reserve £ m</i>	<i>Other reserves £ m</i>	<i>Profit and loss account £ m</i>	<i>Total £ m</i>
At 1 January 2018	0.8	1,108.9	0.1	(974.4)	135.4
Total comprehensive income for the financial year	-	-	0.1	7.0	7.1
Credits in relation to share-based payments	-	-	-	8.5	8.5
At 31 December 2018	<u>0.8</u>	<u>1,108.9</u>	<u>0.2</u>	<u>(958.9)</u>	<u>151.0</u>
At 31 December 2018	0.8	1,108.9	0.2	(958.9)	151.0
IFRS 16 adjustment	-	-	-	1.9	1.9
At 1 January 2019 (As restated*)	0.8	1,108.9	0.2	(957.0)	152.9
Total comprehensive expense for the financial year	-	-	(0.2)	(16.0)	(16.2)
Credits in relation to share-based payments	-	-	-	5.2	5.2
At 31 December 2019	<u>0.8</u>	<u>1,108.9</u>	<u>-</u>	<u>(967.8)</u>	<u>141.9</u>

* Opening reserves have been restated to reflect the adoption of IFRS 16 with effect from 1 January 2019. See note 2.

The notes on pages 40 to 91 form an integral part of these financial statements.

Notes to the Financial Statements

for the Year Ended 31 December 2019

1 General information

The Company is a private company limited by share capital, incorporated and domiciled in United Kingdom.

The address of its registered office is:

Serco House

16 Bartley Wood Business Park

Bartley Way

Hook

Hampshire

RG27 9UY

United Kingdom

The registered company number is 00242246. The nature of the Company's operations and its principal activities are set out in the Strategic Report on page 2.

These financial statements are presented in pounds Sterling because that is the currency of the primary economic environment in which the Company operates.

The level of rounding is to the nearest thousand ('m) unless otherwise stated.

2 Accounting policies

Summary of significant accounting policies and key accounting estimates

The principal accounting policies applied in the preparation of these financial statements are set out below.

These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

The Company meets the definition of a qualifying entity under FRS 100 (Financial Reporting Standard 100) issued by the Financial Reporting Council. These financial statements were prepared in accordance with Financial Reporting Standard 101 'Reduced Disclosure Framework'.

The Company has net current assets of £149.4m as at 31 December 2019 and a loss for the year ended of £1.2m. The financial statements have been prepared on a going concern basis which the directors then consider to be appropriate for the following reasons.

The Company's forecasts are dependent on continued financial support from Serco Group plc, including additional financing and the continued availability of the intercompany financing facility that the company uses to meet its day to day working capital requirements. On this basis Serco Limited has adequate resources for the foreseeable future in order to meet its liquidity and working capital requirements. The Directors have reviewed the existing funding arrangements and ability to generate cash from trading activities.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Basis of preparation (continued)

Serco Group plc has indicated its intention to continue to make available such funds as are needed by the company for the period covered by the forecasts. Serco Group plc's current principal facilities include a revolving credit facility of £250m in December 2018 with a maturity date of December 2023 and a new £45m term loan facility in order to fund the purchase of Naval Systems Business Unit in May 2019, the facility matures in August 2022.

As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so. Consequently, the directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

Summary of disclosure exemptions

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, fair value measurement, standards not yet effective, impairment of assets and related party transactions.

This is because the Company is included within the consolidated financial statements of Serco Group plc which are available from the address provided in note 28.

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 goods and services.

Going concern

The Company has net current assets of £149.4m as at 31 December 2019 including a £133m intercompany receivable which is repayable on demand although not intended to be recalled in the next year (2018: £236.8m) and a loss for the year then ended of £1.2m (2018: £35.4m). The Company's financial forecasts for the period of going concern indicate that the Company has sufficient financial resources to meet its financial obligations as they fall due during the period of assessment, considered to be twelve months from the signing date of these financial statements. In light of the COVID-19 pandemic, the Company has considered the potential range of impacts on the financial forecasts which indicate that it will continue to have sufficient resources to meet its financial obligations as they fall due. However, given the uncertainties in respect of the pandemic, the potential impact on the Company's health and leisure contracts which have been impacted, and the dependency on the availability of the intercompany financing facility that the Company uses to meet its day to day working capital requirements, the Company has obtained a letter of support from the Group's ultimate parent, Serco Group plc.

Serco Group plc has indicated its intention to continue to make available such funds as are needed by the Company for the period of this assessment.

The Directors of the Company have been made aware of the Going Concern assessment which has been performed in respect of the Group. The Directors believe they are able to place reliance on this letter of support for the following reasons.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Going concern (continued)

Most of the Group's contracts deliver critical services to Governments and the delivery requirements of these have not been impacted by COVID-19. However, a small number of contracts within the Group have been impacted by; lower volumes within its UK Transport business; higher levels of absenteeism and increased service performance in its UK Health contracts; closure of operations including leisure centres in the UK and the Driver Examination Services contract in Canada; and delays in project work such as the delivery of the Antarctic Supply Research Vessel in Australia. The negative impact from these contracts has been offset to some extent by additional services being delivered to assist Governments with their management and recovery from the COVID-19 pandemic, and financial support from its customers. It is evident that the most significant impact on the Group's operations has been within the UK.

In order to model severe but plausible scenarios to stress test the potential impact of COVID-19 on the Group's forecast, the Group have considered, amongst other scenarios, lower passenger volumes on the Group's train operating contracts, higher costs within the Health portfolio and prolonged closure of leisure centres in the UK, without mitigations such as the Coronavirus Job Retention Scheme and Emergency Measures Agreements within the rail contracts being in place. The Group has reviewed the impact on overseas operations and considered the impact of a second wave in Australia which may impact the ability to deliver operations within contact centres, or drive higher absenteeism in the delivery of its larger operations such as the Fiona Stanley Hospital or Department of Immigration and Border Protection contracts.

After considering these severe but plausible scenarios and with the mitigations available to the Group, the forecasts indicate sufficient capacity in the Group's financing facilities and associated covenants. In order to satisfy themselves that they have adequate resources for the future, the Group has reviewed its existing debt levels, the committed funding and liquidity positions under its debt covenants, and its ability to generate cash from trading activities and working capital requirements. The Group's current principal debt facilities as at 31 May 2020 comprised a £250m revolving credit facility, a 3 year term acquisition facility of £45m and £222m of US private placement notes. As at 31 May 2020, the Group had £517m of committed credit facilities and committed headroom of £230m. In undertaking this review the Group has considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review for the Group, the assessment period is considered that to be the period ending 31 December 2021.

As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue, although at the date of approval of these financial statements, they have no reason to believe that it will not do so. Consequently, the directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

Exemption from preparing group accounts

The financial statements contain information about Serco Limited as an individual company and do not contain consolidated financial information as the parent of a group.

The Company is exempt under section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its ultimate parent, Serco Group plc, a company incorporated in United Kingdom and registered in England & Wales.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Adoption of new and revised standards

IFRS 16 Leases

IFRS 16 Leases (effective 1 January 2019), specifies how to recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset is of a low value. Lessors continue to classify leases as operating or finance, with the IFRS 16 approach to lessor accounting remaining substantially unchanged from its predecessor, IAS 17.

Under the applicable transition rules a lessee shall either apply IFRS 16 with full retrospective effect or alternatively not restate comparative information but recognise the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application, subject to the Company's application of the following expedients:

- No reassessment is required as to whether a contract is, or contains, a lease at the date of initial application.
- No reassessment is required for:
 - leases with a lease term end date within one year of the date of initial application; or
 - leases for low value assets, which the Group considers to be those with an initial cost value less than £5,000 except for circumstances where those assets form part of a bundle of leased assets accounted for as a single lease contract.
- The Company has adopted the modified retrospective transition approach and as such the valuation of the right of use asset at 1 January 2019 is calculated as if the lease had always existed and hence the net book value of the asset on 1 January 2019 is based on the assumption of straight line amortisation.
- The lease liability at 1 January 2019 will be calculated as the present value of future payments in relation to the lease, discounted at the applicable incremental borrowing rate.

The impact for the Company of adopting IFRS 16 is as follows:

	As at 1 January 2019
	£m
Retained earnings at 31 December 2018	(958.9)
Lease liability recognised	(37.8)
Right of use asset recognised, net of impairments (Note 15)	35.3
Impact of IFRS 16 on opening provisions	4.4
Adjustment to retained earnings due to the implementation of IFRS 16	1.9
Retained earnings at 1 January 2019	(957.0)

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

The impact of IFRS 16 on the Company's income statement is to increase finance costs and improve trading profit as lease costs are replaced with a lower depreciation charge.

In calculating the lease liability to be recognised on transition, the Company used a weighted average incremental borrowing rate on 1 January 2019 of 3.50%. Applying this weighted average incremental borrowing rate to the operating lease commitments recognised as at 31 December 2018 gives a liability of £29.2m. This differs from the lease liability recognised as a result of transitioning to IFRS16 for the following reasons:

	£m
Minimum lease payments under non-cancellable operating leases recognised in accordance with IAS 17 Leases as at 31 December 2018:	
Within one year	16.6
Between one and five years	11.9
After five years	2.4
	<hr/> 30.9
Operating lease commitments discounted at the weighted average incremental borrowing rate	29.2
Finance leases as at 31 December 2018	14.5
Less: leases ending within 12 months of the transition date to IFRS16 covered by the practical expedient	(13.8)
Add: leases classifying as sub-leases from Group company not previously included as operating lease commitments	7.9
Lease liability on transition to IFRS 16	<hr/> 37.8 <hr/>

The implementation of IFRS16 Leases has required the Company to make a number of judgements and estimates. The key judgements applied relate to the likelihood of lease extension options being exercised, the certainty of the exercise of termination options and the identification of leases embedded within other contracts. The key estimates used in assessing the impact of adopting the new standard are the incremental borrowing rates applied in calculating the present value of future lease payments to identify the lease liability at 1 January 2019.

In addition to the areas where a financial impact has been identified as a result of adoption of IFRS16 as identified above, there are certain accounting policies which are new or change existing policies applied by the Company and may have an impact on the future financial performance of the Company. The policies in these areas to be adopted by the Company are set out below:

- (i) Lease amendments. Where changes in a lease occur, this will trigger a reassessment of the lease liability. Changes in the lease liability will be recognised via an adjustment to the right of use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, any remaining amount of the remeasurement will be recognised in profit or loss.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

- (ii) Lease incentives. Where a lease incentive is received prior to the commencement of a lease, the amount is offset against the right of use asset at inception. Where a lease includes a period or periods of reduced or free rentals, these are included in the calculation of the present value of the lease liability on inception.
- (iii) Variable lease payments. Where a contract to lease an asset has a pricing mechanism that allows for changes after the commencement date, other than those that change simply due to the passage of time, it is considered to have variable lease payments. These payments will depend on an index or rate and are included in the calculated lease liability at the lease commencement date according to the rate or index as at that date.
- (iv) Sub-leases. Where a group entity leases an asset and this asset is subsequently leased to another entity, this is considered to be a sub-lease if the original head lease remains in place. In this instance the entity which has entered into the head lease is acting as both a lessee and a lessor simultaneously. As a result, the head lease is accounted for in accordance with the group's lease accounting policy. When acting as a lessor, there is a requirement to determine whether the sub-lease is an operating lease or a finance lease, with the accounting following this determination.
- (v) Separate lease and non-lease components. Lease contracts can often contain elements related to the use of an asset and elements that are unrelated, for example where a property lease also includes a charge for insurance or maintenance. The lease component and the associated non-lease component are accounted for as a single lease component.
- (vi) Lease terminations. Where a lease is terminated before the end of the lease term the right of use asset is disposed of with the carrying value being charged to the income statement whilst the lease liability is extinguished from the balance sheet resulting in a credit to the income statement. The net charge or credit to the income statement is added to any cost of exiting the lease to result in a profit or loss on lease termination.

Revenue recognition

Repeat service based contracts

The majority of the Company's contracts are repeat service based contracts where value is transferred to the customer over time as the core services are delivered and therefore in most cases revenue will be recognised on the output basis, with revenue linked to the deliverables provided to the customer. Where any price step downs are required in a contract accounted for under the output basis and output is not decreasing, revenue will require deferral from initial years to subsequent years in order for revenue to be recognised on a consistent basis.

There are certain contracts where a separate performance obligation has been identified for services where the pattern of delivery differs to the core services and which are capable of being distinct. In these instances, where the transfer of control is most closely aligned to our efforts in delivering the service, then the input method is used to measure progress, and revenue is recognised in direct proportion to costs incurred. Where deemed appropriate, the Company will utilise the practical expedient within IFRS15, allowing revenue to be recognised at the amount which the Company has the right to invoice, where that amount corresponds directly with the value to the customer of the Company's performance completed to date.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Repeat service based contracts (continued)

Under IFRS15, unless upfront fees received from customers including transition payments can be clearly attributable to a distinct service the customer is obtaining, then such payments do not constitute a separate performance obligation and instead are deferred and spread over the life of the core services.

Any changes to the enforceable rights and obligations with customers and/or an update to the transaction price will not be recognised as revenue until there is evidence of customer agreement in line with the Company's policies. Any variable amounts will only be recognised where it is highly probable that a significant reversal will not occur.

Where the Company is required to assess whether it is acting as principal or as an agent in respect of goods or services procured for customers, the Company is acting as principal if it is in control of a good or a service prior to transferring to the customer and an agent where it is arranging for those goods or services to be provided to the customer without obtaining control.

Long-term project based contracts

The Company has a limited number of project based long-term contracts. Revenue associated with these contracts is recognised at the point in time when control over the deliverable is passed to the customer or where the Company has a legally enforceable right to remuneration for the work completed to date.

Contract modifications

When a modification to an existing contract is approved, the Company first assesses whether it adds distinct goods or services to the existing contract that are priced commensurate with the stand-alone selling prices for those goods or services. If this is the case then the modification is accounted for prospectively as a separate contract. If the pricing is not commensurate with the stand-alone selling prices for the goods or services and the new goods or services are not distinct from those in the original contract then this is considered to form part of the original contract. Pricing is updated for the entirety of the revised contract and any historic adjustments recognised as a result are recognised through opening retained earnings. If the pricing is not commensurate with the stand-alone selling prices for the goods or services and the new goods or services are distinct from those in the original contract then this is considered to represent the termination of the original contract and the creation of a new contract which is accounted for prospectively from the date of modification.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Other

Sales of goods are recognised when goods are delivered and title has passed.

The transaction price allocated to future performance obligations disclosed in the financial statements includes estimated variable income where the contractual agreement requires a stand ready obligation to provide future goods or services and no separate purchase decision is required based on the terms of the existing contract and customary business practices.

Interest income is accrued for on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the right to receive payment has been established.

The Company has no material exposure to returns or refunds.

Contract costs

Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Bid costs are amortised over the duration of the contract to which they relate in equal annual instalments. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

Contract costs are charged to the income statement as incurred, including the necessary accrual for costs which have not yet been invoiced, unless the expense relates to a specific time frame covering future periods.

Contract costs can only be capitalised when the expenditure meets all of the following three criteria and are not within the scope of another accounting standard, such as inventories, intangible assets, or property, plant and equipment:

- The costs relate directly to a contract. These include: direct labour, being the salaries and wages of employees providing the promised services to the customer; direct materials such as supplies used in providing the promised services to a customer; and other costs that are incurred only because an entity entered into the contract, such as payments to subcontractors.
- The costs generate or enhance the resources used in satisfying performance obligations in the future. For initial contract costs capitalised, such costs only fall into one of the following two categories: the mobilisation of contract staff, being the costs of moving existing contract staff to other Group locations; or directly incremental costs incurred in meeting contractual obligations incurred prior to contract delivery, which are required to ensure a proper handover from the previous contractor. Redundancy costs are never capitalised.
- The costs are expected to be recovered, i.e. the contract is expected to be profitable after amortising the capitalised costs.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

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 Payment, leasing transactions that are within the scope of IAS17 Leases, or the calculation of net realisable value under IAS 2 Inventories or value in use under IAS 36 Impairment of Assets.

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 Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for accounting purposes.

Deferred tax assets are generally recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which these items can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of an asset and liability in a transaction other than a business combination and, at the time of the transaction, affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be utilised.

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

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 Company intends to settle its current tax assets and liabilities on a net basis.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Tax (continued)

As an interpretation, IFRIC 23 Uncertainty over Income Tax Treatments clarifies the application of the recognition and measurement criteria of IAS12, when there is uncertainty over income tax treatments yet to be accepted by tax authorities. The interpretation has an effective date of 1 January 2019 and is not expected to have a significant impact on the Company's financial statements.

Retirement benefit costs

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

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit actuarial cost method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and are presented in the statement of comprehensive income.

Both current and past service costs are the amounts recognised in the income statement, reflecting the expense associated with the individuals. Current service cost represents the increase in the present value of the scheme liabilities expected to arise from employee service in the current period. Past service cost is recognised immediately. Gains and losses on curtailments or settlements are recognised in the income statement in the period in which the curtailment or settlement occurs.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to the present value of available refunds (which is only recognised to the extent that the Group has an unconditional right to receive it) and reductions in future contributions to the scheme. To the extent that an economic benefit is available as a reduction in future contributions and there is a minimum funding requirement required of the Company, 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.

Multi-employer pensions

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. The Company accounts for these schemes as if they were defined contribution schemes in accordance with IAS 19 where the legal responsibility for settlement resides in another group entity and there is no contractual agreement for charging the net defined benefit cost associated with the Company.

Foreign currency transactions and balances

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 (SOC1). Income and expense for overseas operations are translated at the average exchange rates for the period.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

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.

The fair values associated with material business combinations are valued by external advisers and any amount of consideration which is contingent in nature is evaluated at the end of each reporting period, based on internal forecasts.

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.

Depreciation

Depreciation is charged so as to write off the cost of assets, other than land and properties under construction over their estimated useful lives, as follows:

<i>Asset class</i>	<i>Depreciation method and rate</i>
Freehold buildings	2.5%
Short-leasehold assets	The higher of 10% or the rate produced by the lease term
Machinery	15% - 20%
Motor vehicles	10% - 50%
Furniture	10%
Office equipment	20% - 33%
Leased equipment	The higher of the rate produced by the lease term or useful life

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement. Given that there is limited history of material gains or losses on disposal of fixed assets, the level of judgement involved in determining the depreciation rates is not considered to be significant.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Other intangible assets

Material intangible assets are grouped into classes of similar nature and use and separately disclosed. Other intangible assets are amortised from the date of completion.

Customer relationships can arise on the acquisition of subsidiaries and represent the incremental value expected to be gained as a result of existing contracts in the purchased business. These assets are amortised over the average length of the related contracts.

Licences comprise premiums paid for the acquisition of licences, while franchises represent costs incurred in obtaining franchise rights arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the respective licence or franchise.

Software and IT represent computer systems and processes used by the Company in order to generate future economic value through normal business operations. The underlying assets are amortised over the average length of the related contracts.

Development expenditure is capitalised as an intangible asset only if all of certain conditions are met, with all research costs and other development expenditure being expensed when incurred. The period of expected benefit, and therefore period of amortisation, is typically between three and eight years. The capitalisation criteria are as follows:

- an asset is created that can be separately identified, and which the Company intends to use or sell;
- the finalisation of the asset is technically feasible and the Company 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.

Investments

Fixed asset investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

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 Company'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 Company'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 Company'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.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Investments in joint ventures (continued)

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 Company'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 Company transacts with a joint venture, profits and losses are eliminated to the extent of the Company's interest in that arrangement.

Determining whether joint control exists requires a level of judgement, based upon specific facts and circumstances which exist at the year end.

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the company considers these to be insurance arrangements and accounts for them as such. In this respect, the company treats the guarantee contract as a contingent liability until such time as it becomes probable that the company will be required to make a payment under the guarantee.

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.

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 Company 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 Company are with government organisations and therefore historic levels of default are relatively low and as a result the risks associated with this judgement are not considered to be significant.

When a trade receivable is expected to be uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously provided for or written off are credited against administrative expenses.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Financial instruments

Where financial assets are not measured at fair value through profit and loss (FVTPL), there is a requirement to assess the carrying value of the assets by reference to the expected credit loss (ECL) associated with the asset. Under the ECL model, the Company calculates the allowance for credit losses by considering, on a discounted basis, the shortfall in cash receipts it would incur in various default scenarios and multiplying the shortfalls by the probability of each scenario occurring. The allowance is the sum of the probability weighted outcomes.

The primary financial assets carried by the Company which are not measured at FVTPL are trade receivables and intercompany receivables. The Company's customer base is predominantly Government or Government-backed, and as a result, the Company's ECL at any given point in time across the entirety of the customer base is immaterial.

Trade payables

Trade creditors are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade creditors are recognised initially at the transaction price and subsequently measured at amortised cost using the effective interest method.

Stock

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.

Leases (applicable to 2018 under IAS17 Leases)

On entering into a lease, a lease liability is recorded equal to the value of future lease payments discounted at the appropriate incremental borrowing rate and simultaneously a right of use asset is created representing the right conferred to control the manner of use of the leased asset.

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 and corresponding assets are depreciated on a straight-line basis over the lease term.

The lease term is measured as the non-cancellable period of a lease, together with both periods covered by an option to extend the lease if it is reasonably certain that the option will be exercised and periods covered by an option to terminate the lease if it is reasonably certain that the option will not be exercised. The lease term is reassessed if an event occurs which causes either the non-cancellable period to change, or another event occurs which changes the assessment of the likelihood of exercising an option included in the lease.

All changes to leases are accounted for on a prospective basis from the point at which the change is triggered.

Where, on inception, the term of a lease is less than twelve month or the value of the leased asset is less than £5,000, or both, rentals payable under the lease are charged to the income statement on a straight-line basis over the term of the relevant lease.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Loans and borrowing costs

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 Company has an obligation to make a cash outflow as a result of a past event. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the balance sheet date when settlement is considered to be likely.

Onerous contract provisions (OCPs) arise when the unavoidable costs of meeting contractual obligations exceed the remuneration expected to be received. Unavoidable costs include total contract costs together with a rational allocation of shared costs that can be directly linked to fulfilling contractual obligations which have been systematically allocated to OCPs on the basis of key cost drivers except where this is impracticable, where contract revenue is used as a proxy to activity. The provision is calculated as the lower of 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 it is likely that such an extension will be made, any loss expected to be made during the extension period, is included within the calculation. However, where a profit can be reasonably expected in the extension period, no credit is taken on the basis that such profits are uncertain given the potential for the customer to either not extend or offer an extension under lower pricing terms.

Asset impairment

The Company reviews the carrying amounts of its tangible and intangible assets (including goodwill) at each reporting period, together with any other assets under the scope of IAS36 Impairment of Assets, in order to assess whether there is any indication that those assets have suffered an impairment loss. As the impairment of assets has been identified as both a key source of estimation uncertainty and a critical accounting judgement, further details around the specific judgements and estimates can be seen in note 3.

If any indication of impairment exists, the recoverable amount of the asset is estimated in order to determine if there is any impairment loss. Goodwill is assessed for impairment annually, irrespective of whether there are any indicators of impairment. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the CGU to which the asset belongs.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Asset impairment (continued)

Recoverable amount is defined as the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value with reference to pre-tax discount rates that reflect the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount is estimated to be less than the carrying amount of the asset, the carrying amount is impaired to its recoverable amount. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amount of the other assets in the CGU on a pro-rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for indications that the loss has decreased or no longer exists. Where an impairment loss subsequently reverses, the carrying amount is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised in prior years.

At each reporting date, the Company assesses whether there is an indication that a previously recognised impairment loss has reversed because of a change in the estimates used to determine the impairment loss. If there is such an indication, and the recoverable amount of the impaired asset, or CGU, subsequently increases, then the impairment loss is generally reversed.

Impairment losses and reversals are recognised immediately within administrative expenses within the income statement unless it is considered to be an exceptional item.

Share capital

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of the direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement is on a present value basis.

Defined benefit obligations arising from contractual obligations

Where the Company 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 Company's right to manage and operate the contract, is amortised over the contract period. The Company'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 Company's share of pension obligations are recognised within Other Comprehensive Income.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

Share based payments

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of Binomial Lattice, Black Scholes or Monte Carlo Simulation models depending on the type of scheme, as set out in note 35 of Serco Group plc financial statements. 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.

Derivative financial instruments and hedging activities

The Company enters into a variety of derivative financial instruments to manage the exposure to interest rate, foreign exchange risk and price risk, including currency swaps, foreign exchange forward contracts, interest rate swaps and commodity future contracts. Further details of derivative financial instruments are given in note 30 of Serco Group plc financial statements.

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 Company 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 Company 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 Company 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 26.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Hedge accounting is discontinued when the Company 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.

Notes to the Financial Statements

for the Year Ended 31 December 2019

2 Accounting policies (continued)

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 Company 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.

Net investments in foreign operations

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity and accumulated in the hedging and translation reserve. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss and is included in the 'net exchange gain/loss on translation of foreign operations' line item.

Gains and losses on the hedging instrument relating to the effective portion of the hedge accumulated in the foreign currency translation reserve are reclassified to profit or loss in the same way as exchange differences relating to the foreign operations.

Dividend payable

Dividends are recorded in the Company's financial statements in the period in which they are declared, appropriately authorized and no longer at the discretion of the Company.

3 Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Company'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.

Provisions for onerous contracts

Determining the carrying value of onerous contract provisions requires assumptions and complex judgements to be made about the future performance of the Group's contracts. The level of uncertainty in the estimates made, either in determining whether a provision is required, or in the calculation of a provision booked, is linked to the complexity of the underlying contract and the form of service delivery. Due to the level of uncertainty and combination of variables associated with those estimates there is a significant risk that there could be material adjustments to the carrying amounts of onerous contract provisions within the next financial year.

Notes to the Financial Statements

for the Year Ended 31 December 2019

3 Critical accounting judgements and key sources of estimation uncertainty (continued)

Provisions for onerous contracts (continued)

During the year, the Group's existing OCPs have continued to be utilised with the closing balance being significantly lower than at the prior year-end. The Group does not expect to enter into new OCPs, however given the nature of the Group's operations, there is an inherent risk that a contract can become onerous. The Group operates a large number of long-term contracts at different phases of their contract life cycle. Within the Group's portfolio, there are a small number of contracts where the balance of risks and opportunities indicates that they might be onerous if transformation initiatives or contract changes are not successful. The Group has concluded that these contracts do not require an onerous contract provision on an individual basis. Following the individual contract reviews, the Group has also undertaken a top down assessment which assumes that, whilst the contracts may not be onerous on an individual basis, as a portfolio there is a risk that at least some of the transformation programmes or customer negotiations required to avoid a contract loss, will not be fully successful, and it is more likely than not that one or more of these contracts will be onerous.

Therefore, in considering the Group's overall onerous contract provision, the Group has made a best estimate of the provision required to take into consideration this portfolio risk. As a result, the risk of OCPs and the monitoring of individual contracts for indicators remains a critical estimate for the Group. The amount recognised in the year is £6.2m at the Trading Profit level within the Corporate costs segment, which after this charge is therefore £51.7m (2018: £40.1m).

Major sources of uncertainty which could result in a material adjustment within the next financial year are:

- The ability of the company to maintain or improve operational performance to ensure costs or performance related penalties are in line with expected levels.
- Volume driven revenue and costs being within the expected ranges.
- The outcome of matters dependent on the behaviour of the customer, such as a decision to extend a contract where it has the unilateral right to do so.
- The outcome of open claims made by or against a customer regarding contractual performance.
- The ability of suppliers to deliver their contractual obligations on time and on budget.

In the current year, an amount of £2.4m was charged to historic provisions, and releases of £6.6m have been made. No charges have been made to material new onerous contract provisions during the current year. Further details are provided in the Finance Review within the Strategic Report of Serco Group Plc financial statements. All of these revisions have resulted from triggering events in the current year, either through changes in contractual positions or changes in circumstances which could not have been reasonably foreseen at the previous balance sheet date. To mitigate the level of uncertainty in making these estimates Management regularly compares actual performance of the contracts against previous forecasts and considers whether there have been any changes to significant judgements. A detailed bottom up review of the provisions is performed as part of the Group's formal annual budgeting process.

The future range of possible outcomes in respect of those assumptions and significant judgements made to determine the carrying value of onerous contracts could result in either a material increase or decrease in the value of onerous contract provisions in the next financial year. The extent to which actual results differ from estimates made at the reporting date depends on the combined outcome and timing of a large number of variables associated with performance across multiple contracts.

Notes to the Financial Statements

for the Year Ended 31 December 2019

3 Critical accounting judgements and key sources of estimation uncertainty (continued)

Impairment of assets

Identifying whether there are indicators of impairment for assets involves a high level of judgement and a good understanding of the drivers of value behind the asset. At each reporting period an assessment is performed in order to determine whether there are any such indicators, which involves considering the performance of our business and any significant changes to the markets in which we operate.

We seek to mitigate the risk associated with this judgement by putting in place processes and guidance for the finance community and internal review procedures.

Determining whether assets with impairment indicators require an actual impairment involves an estimation of the expected value in use of the asset (or CGU to which the asset relates). The value in use calculation involves an estimation of future cash flows and also the selection of appropriate discount rates, both of which involve considerable judgement. The future cash flows are derived from approved forecasts, with the key assumptions being revenue growth, margins and cash conversion rates. Discount rates are calculated with reference to the specific risks associated with the assets and are based on advice provided by external experts. Our calculation of discount rates are performed based on a risk free rate of interest appropriate to the geographic location of the cash flows related to the asset being tested, which is subsequently adjusted to factor in local market risks and risks specific to the Company and the asset itself. Discount rates used for internal purposes are post tax rates, however for the purpose of impairment testing in accordance with IAS 36 Impairment of Assets we calculate a pre-tax rate based on post tax targets.

There was an impairment of intangible assets during the year of £nil (2018: £0.1m). There was an impairment of property, plant and equipment assets during the year of £2.3m (2018: £nil). Further details of these impairments can be seen in notes 14 and 15 to the financial statements.

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 and outside of the normal operating practice of the Company to be suitable for separate presentation. Further details can be seen in notes 5 and 6.

Retirement benefit obligation

Identifying whether the Company has a retirement benefit obligation as a result of contractual arrangements entered into requires a level of judgement, largely driven by the legal position held between the Company, the customer and the relevant pension scheme. Information relating to the retirement benefit obligations of Serco Group plc and its subsidiaries can be found in note 31 of the Serco Group plc financial statements. Information relating specifically to the pension schemes in which the Company participates can be found in note 23.

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates.

In accounting for the defined benefit schemes, the Company has applied the following principles:

- The asset recognised for the Serco Pension and Life Assurance Scheme is equal to the full surplus that will ultimately be available to the Company as a future refund.
- No pension assets are invested in the Company's own financial instruments or property.
- Pension annuity assets are remeasured to fair value at each reporting date based on the share of the defined benefit obligation covered by the insurance contract.

Notes to the Financial Statements

for the Year Ended 31 December 2019

4 Turnover

The analysis of the Company's turnover for the year from continuing operations is as follows:

	2019 £ m	2018 £ m
Turnover as disclosed in the profit and loss account	1,382.6	1,266.3
Interest receivable and similar income (note 10)	7.0	5.3
	<u>1,389.6</u>	<u>1,271.6</u>

The Company manages its business on an operating segment basis and these segments are the basis on which the Company reports its segment information. The Company's reportable operating segments are as follows:

- UK & Europe. Services for sectors including Citizen Services, Defence, Health, Justice & Immigration and Transport delivered to UK Government, UK devolved authorities and other public sector customers in the UK and Europe; and
- Middle East. Frontline services for sectors including Defence, Transport and Health in the Middle East region.

The analysis of the Company's turnover for the year by primary geographical market is as follows:

	2019 £ m	2018 £ m
UK & Europe	1,242.0	1,146.8
Middle East	140.6	119.5
	<u>1,382.6</u>	<u>1,266.3</u>

The analysis of the Company's turnover for the year by geographical location is as follows:

	2019 £ m	2018 £ m
United Kingdom	1,203.2	1,127.6
Other	179.4	138.7
	<u>1,382.6</u>	<u>1,266.3</u>

Turnover is shown by geographical origin. Turnover analysed by geographical destination is not materially different. The majority of turnover in the Company is recognised over time.

Notes to the Financial Statements

for the Year Ended 31 December 2019

4 Turnover (continued)

Transaction price allocated to remaining performance obligations

The following table shows the transaction price allocated to remaining performance obligations. This represents revenue expected to be recognised in subsequent periods arising on existing contractual arrangements.

	2019 £ m	2018 £ m
Less than 1 year	1,168.1	1,089.6
Between 1 - 5 years	3,241.9	2,609.4
More than 5 years	4,257.9	3,463.6
	<u>8,667.9</u>	<u>7,162.6</u>

5 Exceptional net loss on disposal of operations

During the year the Company had no loss on disposal of operations:

	2019 £ m	2018 £ m
Disposal of the Anglia Support Partnership	<u>-</u>	<u>(0.5)</u>

In October 2018 the Anglia Support Partnership contract was disposed of, resulting in a net cash outflow of £0.3m with a loss on disposal of £0.5m. Further details are provided below.

	2019 £ m	2018 £ m
Consideration	-	-
Less:		
Net assets disposed	-	(0.1)
Consideration	<u>-</u>	<u>(0.4)</u>
Income statement impact of disposal	<u>-</u>	<u>(0.5)</u>

The net cash outflow arising on the disposal of the Anglia Support Partnership contract is as follows:

	2019 £ m	2018 £ m
Consideration	-	-
Less: Disposal costs	<u>-</u>	<u>(0.3)</u>
Net cash flow on disposal	<u>-</u>	<u>(0.3)</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

6 Other exceptional operating items

Exceptional items are non-recurring items of financial performance that are outside of normal practice and material to the results of the Company either by virtue of size or nature. These items require separate disclosure on the face of the profit and loss account to assist in the understanding of the underlying performance of the Company.

	2019 £ m	2018 £ m
Restructuring costs	9.7	27.7
Increase in onerous lease provision	-	1.8
Cost of Guaranteed Minimum Pension equalisation	-	9.3
Exceptional operating items	9.7	38.8

The Company is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions, external advisory fees and other incremental costs. Due to the nature and scale of the impact of the transformation phase of the Strategy Review the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non business as usual costs. In 2019, a charge of £9.7m (2018: £27.7m) arose in relation to the restructuring programme resulting from the Strategy Review.

On 26 October 2018, the High Court handed down a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should equalise pension benefits for men and women in relation to guaranteed minimum pension ("GMP") benefits. The judgement had implications for many defined benefit schemes, including those in which Serco Limited participates. In 2018 a cost of £9.3m was recognised pre-tax as an exceptional expense to reflect the Company's liability in respect of this ruling. No such expense was recorded in 2019.

An additional charge of £1.8m was recorded in 2018 in respect of an onerous lease provision. The Company had no costs of this nature in 2019.

Notes to the Financial Statements

for the Year Ended 31 December 2019

7 Operating profit/(loss)

Operating profit/(loss) is stated after (crediting)/charging:

	2019 £ m	2018 £ m
Research and development costs	(0.1)	(0.3)
*Operating lease expense - property	9.9	2.4
*Operating lease expense - plant and machinery	1.1	5.7
Staff costs (note 8)	645.8	647.1
Amortisation of other intangible assets (note 14)	13.0	12.5
Impairment of other intangible assets	-	0.1
Depreciation of tangible fixed assets - owned (note 15)	9.8	10.2
Depreciation of tangible fixed assets - leased (note 15)	33.8	1.2
Net loss on disposal of operations (note 5)	-	0.5
Other exceptional operating items excluding impairment of goodwill (note 6)	9.7	38.8
Net foreign exchange (gain)/loss	<u>(1.0)</u>	<u>1.2</u>

The Committee limits the non-audit work undertaken by the External Auditor and monitors the non-audit fees paid during the year. Amounts payable to KPMG LLP and their associates by the Company in respect of non-audit services are shown within the group financial statements. Audit fees £480,000 (2018: £230,000).

* Operating lease expense relates to short term leases under IFRS 16.

8 Staff costs

The average number of persons employed by the Company (including directors) during the year was 22,864 (2018: 21,795). The aggregate payroll costs (including directors' remuneration) were as follows:

	2019 £ m	2018 £ m
Wages and salaries	564.1	541.9
Social security costs	47.8	47.1
Staff pensions	28.7	49.6
Share-based payment expenses	<u>5.2</u>	<u>8.5</u>
	<u>645.8</u>	<u>647.1</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

8 Staff costs (continued)

The share-based payment expense for the year ended 31 December 2019 decrease arose from equity-settled share-based payment charges related to the following plans in Serco Group plc share schemes: the Performance Share Plan (PSP) and the Deferred Bonus Plan. The majority of the charge in the year related to the PSP.

Under the PSP, eligible employees have been granted options with an exercise price of two to zero pence. Awards vest after the performance period of two to five years and are subject to the achievement of four performance measures with the exception of new non-performance awards granted in 2018. These non-performance options are only subject to continued employment on vesting dates which vary from two to five 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. Additional measures linked to Strategic Objectives were introduced for new grants in 2018. If the options remain unexercised after a period of ten years from the date of grant, the options expire.

At the end of 2019, all remaining options had lapsed. The options outstanding at 31 December 2018 had a weighted average contractual life of 0.37 years and an exercise price of £3.88.

In 2018 the weighted average share price at the date of exercise approximated to the weighted average share price during the year, which was £0.95.

9 Directors' remuneration

The directors' remuneration for the year was as follows:

	2019 £ m	2018 £ m
Directors' remuneration	<u>2.6</u>	<u>1.5</u>

Retirement benefits are accruing to the following number of directors under:

	2019 No.	2018 No.
Long term incentive schemes	3	2
Defined benefit schemes	<u>-</u>	<u>-</u>

The number of directors who exercised share options was:

	2019 No.	2018 No.
Exercised share options	<u>2</u>	<u>1</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

9 Directors' remuneration (continued)

The aggregate of remuneration and amounts receivable under long term incentive schemes of the highest paid director was £1.9m (2018: £0.7m), and company pension contributions of £nil (2018: £nil) were made to a money purchase scheme on his behalf.

During the year, the highest paid director exercised share options and received shares under a long term incentive scheme.

10 Interest receivable and similar income

	2019 £ m	2018 £ m
Interest receivable from group undertakings	4.8	4.6
Net interest receivable on retirement benefit assets	<u>2.2</u>	<u>0.7</u>
	<u>7.0</u>	<u>5.3</u>

11 Interest payable and similar charges

	2019 £ m	2018 £ m
Other interest payable	1.2	0.4
Interest payable to group undertakings	3.3	2.0
Interest payable under finance leases	<u>2.3</u>	<u>0.5</u>
	<u>6.8</u>	<u>2.9</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

12 Tax on profit/(loss) on ordinary activities

Tax charged/(credited) in the profit and loss account

	<i>2019</i> <i>£ m</i>	<i>2018</i> <i>£ m</i>
Current taxation		
UK corporation tax	0.4	0.6
Adjustments in respect of prior years	4.4	(0.8)
Consortium relief	-	(2.1)
	<u>4.8</u>	<u>(2.3)</u>
Deferred taxation		
Arising from origination and reversal of temporary differences	(0.2)	(11.7)
Adjustments in respect of prior years	0.1	-
Total deferred taxation	<u>(0.1)</u>	<u>(11.7)</u>
Tax expense/(income) in the profit and loss account	<u><u>4.7</u></u>	<u><u>(14.0)</u></u>

Factors affecting current tax charge for the year

The tax on profit before tax for the year is higher than the standard rate of corporation tax in the UK (2018 - lower than the standard rate of corporation tax in the UK) of 19% (2018 - 19%).

Notes to the Financial Statements

for the Year Ended 31 December 2019

12 Tax on profit/(loss) on ordinary activities (continued)

The differences are reconciled below:

	2019 £ m	2018 £ m
Profit/(loss) before tax	3.5	(49.4)
Corporation tax at standard rate	0.6	(9.4)
Expenses not deductible for tax purposes	1.9	3.0
Group relief with no consideration	(3.8)	3.0
Unrelieved tax losses	2.2	2.0
Adjustment in respect of deferred tax on pensions	2.7	(10.1)
Unprovided deferred tax	0.4	(1.8)
Other non taxable income	(1.5)	(1.4)
Impact of changes in statutory tax rates	-	1.4
Adjustment in respect of prior years	4.5	(0.7)
Statutory tax benefits	(2.2)	-
Overseas rate differences	(0.1)	-
Total tax charge/(credit)	4.7	(14.0)

13 Deferred tax

The movement in the deferred tax asset in the year is as follows:

	2019 £ m	2018 £ m
At 1 January	18.0	17.7
Deferred tax credited to profit and loss account	0.1	11.7
Deferred tax liability arising on acquisition	-	(2.3)
Items taken directly to equity - retirement benefit obligations reserve	2.7	(9.1)
Tax taken directly to reserves - hedge reserve	0.1	-
	20.9	18.0

Of the amount credited to the income statement, £0.1m credit (2018: credit of £0.1m) has been taken to cost of sales in respect of the R&D Expenditure credit.

Notes to the Financial Statements

for the Year Ended 31 December 2019

13 Deferred tax (continued)

	2019 £ m	2018 £ m
Difference between accumulated depreciation and amortisation and capital allowances	0.5	8.2
Share based payments and employee benefits	6.1	1.5
Movement in retirement benefit obligations	(8.8)	(11.8)
Other temporary differences	23.2	20.1
Derivative financial instruments	(0.1)	-
	<u>20.9</u>	<u>18.0</u>

Factors affecting future tax rate

A reduction in the UK corporation tax rate from 19% to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. The March 2020 Budget announced that a rate of 19% would continue to apply with effect from 1 April 2020, and this change was substantively enacted on 17 March 2020. The impact of this on the tax charge would be an increase of £3.6m in the deferred tax credit recognised in the income statement and a decrease of £1.1m in the deferred tax credit recognised directly in equity. This would have the effect of increasing the deferred tax asset by £2.5m.

Unprovided deferred tax

	2019 £ m	2018 £ m
Temporary differences on assets/liabilities	20.1	13.7
Share based payments and employee benefits	-	3.5
Other temporary differences	88.6	82.1
	<u>108.7</u>	<u>99.3</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

14 Goodwill and other intangible assets

	<i>Goodwill</i> £ m	<i>Licence</i> £ m	<i>Software</i> £ m	<i>Development expenditure</i> £ m	<i>Customer relationships</i> £ m	<i>Total</i> £ m
Cost						
At 1 January 2019	239.2	0.1	78.6	36.2	13.8	367.9
Additions	-	-	4.1	0.3	-	4.4
Disposals	-	-	(0.4)	-	-	(0.4)
Reclassification	-	(0.1)	0.1	16.1	-	16.1
Foreign exchange	-	-	(0.1)	(0.1)	-	(0.2)
At 31 December 2019	<u>239.2</u>	<u>-</u>	<u>82.3</u>	<u>52.5</u>	<u>13.8</u>	<u>387.8</u>
Amortisation						
At 1 January 2019	232.4	0.1	49.4	30.1	0.7	312.7
Amortisation charge	-	-	7.6	4.3	1.2	13.1
Reclassification	-	(0.1)	0.1	16.0	-	16.0
Foreign exchange	-	-	(0.1)	(0.1)	-	(0.2)
At 31 December 2019	<u>232.4</u>	<u>-</u>	<u>57.0</u>	<u>50.3</u>	<u>1.9</u>	<u>341.6</u>
Net book value						
At 31 December 2019	<u>6.8</u>	<u>-</u>	<u>25.3</u>	<u>2.2</u>	<u>11.9</u>	<u>46.2</u>
At 31 December 2018	<u>6.8</u>	<u>-</u>	<u>29.2</u>	<u>6.1</u>	<u>13.1</u>	<u>55.2</u>

Included in the carrying amount of licences, software and development expenditure is an amount of £nil (2018: £3.6m) in respect of leased intangibles.

Notes to the Financial Statements
for the Year Ended 31 December 2019

15 Property, plant and equipment

	<i>Land and buildings owned £ m</i>	<i>Land and buildings leased £ m</i>	<i>Furniture, fittings and equipment owned £ m</i>	<i>Furniture, fittings and equipment leased £ m</i>	<i>Motor vehicles owned £ m</i>	<i>Motor vehicles leased £ m</i>	<i>Total £ m</i>
Cost or valuation							
At 1 January 2019	3.9	0.3	39.1	14.2	17.4	59.8	134.7
Opening adjustment - IFRS16	-	76.1	-	3.3	-	14.2	93.6
Reclassifications	0.2	(0.2)	4.2	(4.2)	21.5	(21.5)	-
Additions	0.1	233.8	6.4	-	3.0	4.6	247.9
Disposals	-	(3.3)	(6.6)	(1.3)	(0.5)	(0.7)	(12.4)
Foreign exchange movements	-	(0.6)	(0.1)	(0.1)	(0.1)	-	(0.9)
At 31 December 2019	<u>4.2</u>	<u>306.1</u>	<u>43.0</u>	<u>11.9</u>	<u>41.3</u>	<u>56.4</u>	<u>462.9</u>
Depreciation							
At 1 January 2019	2.4	0.3	29.9	10.5	6.2	43.5	92.8
Opening adjustment - IFRS16	-	49.1	-	1.6	-	7.6	58.3
Reclassifications	0.2	(0.2)	4.2	(4.2)	20.6	(20.6)	-

Notes to the Financial Statements

for the Year Ended 31 December 2019

15 Property, plant and equipment (continued)

	<i>Land and buildings owned £ m</i>	<i>Land and buildings leased £ m</i>	<i>Furniture, fittings and equipment owned £ m</i>	<i>Furniture, fittings and equipment leased £ m</i>	<i>Motor vehicles owned £ m</i>	<i>Motor vehicles leased £ m</i>	<i>Total £ m</i>
Charge for the year	0.2	24.1	6.5	1.3	3.1	8.4	43.6
Eliminated on disposal	-	(3.2)	(6.6)	(1.3)	(0.1)	(0.5)	(11.7)
Impairment	(0.2)	-	0.1	-	2.1	0.3	2.3
Foreign exchange movements	-	(0.1)	(0.1)	-	-	-	(0.2)
At 31 December 2019	<u>2.6</u>	<u>70.0</u>	<u>34.0</u>	<u>7.9</u>	<u>31.9</u>	<u>38.7</u>	<u>185.1</u>
Carrying amount							
At 31 December 2019	<u>1.6</u>	<u>236.1</u>	<u>9.0</u>	<u>4.0</u>	<u>9.4</u>	<u>17.7</u>	<u>277.8</u>
At 31 December 2018	<u>1.5</u>	<u>-</u>	<u>9.2</u>	<u>3.7</u>	<u>11.2</u>	<u>16.3</u>	<u>41.9</u>

Serco Limited

Notes to the Financial Statements

for the Year Ended 31 December 2019

16 Investments

Subsidiaries

£ m

Cost or valuation

At 1 January 2019

3.5

At 31 December 2019

3.5

Details of undertakings

The companies listed below are the subsidiaries and joint venture undertakings of Serco Limited. The percentage of equity capital directly or indirectly held by the Company is shown below. The companies are incorporated and principally operate in the United Kingdom.

Undertaking		Activity	Address	Country of incorporation	Class of shares held	Proportion of voting rights and shares held	
						2019	2018
Serco Limited	Geografix	Design, Manufacture, sale and leasing of electronic tagging equipment	Serco House, 16, Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY, United Kingdom	United Kingdom	Ordinary	100%	100%
Serco Environmental Services Limited		Provision of environmental cleaning services	Serco House, 16, Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY, United Kingdom	United Kingdom	Ordinary	100%	100%
Viapath Group LLP		Provision of pathology services	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	United Kingdom	Partnership units	33%	33%
Viapath LLP	Analytics	Provision of pathology tests	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	United Kingdom	Partnership units	33%	33%

Serco Limited

Notes to the Financial Statements

for the Year Ended 31 December 2019

16 Investments (continued)

Viapath LLP	Services	Provision of laboratory facilities and pathology platforms	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	United Kingdom	Partnership units	33%	33%
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Viapath Analytics LLP and Viapath Services LLP are indirect subsidiaries of Serco Limited. During May 2020, the Company agreed to dispose of its interest in the Viapath joint venture which provides pathology services to certain hospitals in the UK.

17 Stock

	2019 £ m	2018 £ m
Service spares	7.6	5.9
Parts awaiting installation	1.8	2.8
Work in progress	-	2.3
	<u>9.4</u>	<u>11.0</u>

There is no material difference between the value of stocks and their replacement cost.

18 Debtors

	2019 £ m	2018 £ m
Debtors: amounts falling due within one year		
Amounts owed by group companies	5.3	19.9
Trade debtors	105.3	116.2
Other debtors	9.2	7.8
Prepayments	24.8	26.7
Contract asset	<u>58.2</u>	<u>83.8</u>
	<u>202.8</u>	<u>254.4</u>

All amounts owed by group companies are due within 30 days of the balance sheet date and do not bear interest.

Deferred bid and phase in costs are held within contract assets as due within one year. These assets represent up-front investment in contracts which are recoverable and expected to provide benefits over the life of those contracts. Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

Serco Limited

Notes to the Financial Statements

for the Year Ended 31 December 2019

18 Debtors (continued)

The trade debtors balance is stated after an allowance for doubtful debts of £2.7m (2018: £1.3m). Movements on the Company's allowance for doubtful debts are as follows:

	2019 £ m	2018 £ m
At 1 January	1.3	0.5
Charged to profit and loss account	1.4	2.1
Utilised	-	(1.3)
	<u>2.7</u>	<u>1.3</u>

Contract assets

	2019 £ m	2018 £ m
Accrued income and unbilled receivables	46.4	69.6
Capitalised bid costs	1.3	1.9
Capitalised mobilisation and phase in costs	10.5	12.2
Other contract asset	-	0.1
	<u>58.2</u>	<u>83.8</u>

Deferred bid and phase in costs are held within contracts assets as due within one year as they are realised as part of the normal operating cycle of the Company.

	2019 £ m	2018 £ m
Debtors: amounts falling due after more than one year		
Amounts owed by group companies	133.0	170.9
Other debtors	1.0	4.4
	<u>134.0</u>	<u>175.3</u>

In 2017 a loan of £150.0m was with Serco Holdings Limited, and during the year this was novated to Serco Group Plc, which has no fixed repayment date and bears interest based on LIBOR plus 2%. All other amounts owed by group companies have no fixed repayment date and bear interest based on LIBOR minus 0.2%.

	2019 £ m	2018 £ m
Debtors: amounts falling due within one year	202.8	254.4
Debtors: amounts falling due after more than one year	134.0	175.3
	<u>336.8</u>	<u>429.7</u>

Serco Limited

Notes to the Financial Statements

for the Year Ended 31 December 2019

19 Cash and cash equivalents

	2019 £ m	2018 £ m
Cash at bank	<u>25.7</u>	<u>-</u>

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.

20 Creditors: Amounts falling due within one year

	2019 £ m	2018 £ m
Trade creditors	47.2	39.6
Amounts owed to group companies	16.1	31.1
Other taxes and social security	34.3	32.7
Other creditors	23.0	20.8
Accruals	98.4	100.4
Contract liability	18.2	30.5
Leases (2018: Finance Lease Liabilities)	<u>51.0</u>	<u>5.6</u>
	<u>288.2</u>	<u>260.7</u>

Amounts owed to group companies are due within 30 days of the balance sheet date and do not bear interest.

21 Creditors: Amounts falling due after more than one year

	2019 £ m	2018 £ m
Amounts owed to group companies	49.9	72.5
Other creditors	-	1.4
Contract liabilities	43.2	59.2
Leases (2018: Finance Lease Liabilities)	<u>197.9</u>	<u>8.9</u>
	<u>291.0</u>	<u>142.0</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

21 Creditors: Amounts falling due after more than one year (continued)

	2019 £ m	2018 £ m
Creditors: amounts falling due within one year	288.2	260.7
Creditors: amounts falling due after more than one year	291.0	142.0
	<u>579.2</u>	<u>402.7</u>

Amounts owed to group companies have no fixed repayment date and bear interest based on 1 month LIBOR plus 2%.

Finance lease liabilities (under IAS 17)

Finance lease liabilities under IAS 17 were payable as at 31 December 2018 as follows:

	Minimum lease payments	Interest	Present value
2018	£m	£m	£m
Within one year or on demand	5.9	(0.4)	5.5
Between two to five years	8.6	(0.5)	8.1
Over five years	0.9	-	0.9
	<u>15.4</u>	<u>(0.9)</u>	<u>14.5</u>

Finance lease obligations are secured by the lessors' title to the leased assets. The most significant leases are for land and buildings.

The directors estimate that the fair value of the Company's lease obligations approximates to their carrying amount.

Notes to the Financial Statements

for the Year Ended 31 December 2019

22 Provisions

	<i>Property</i> <i>£ m</i>	<i>Contract</i> <i>£ m</i>	<i>Employee</i> <i>benefits</i> <i>£ m</i>	<i>Other</i> <i>provisions</i> <i>£ m</i>	<i>Total</i> <i>£ m</i>
At 1 January 2019	10.1	36.6	16.2	11.9	74.8
Opening Adjustment - IFRS16 (note 2)	-	(4.4)	-	-	(4.4)
Charged to the profit and loss account	1.5	2.4	3.8	9.8	17.5
Charged to the profit and loss account - Exceptional item	-	-	0.4	-	0.4
Released to the profit and loss account	(0.9)	(6.6)	(0.1)	(2.4)	(10.0)
Released to the profit and loss account - Exceptional item	-	-	(0.3)	(0.6)	(0.9)
Utilised	(0.7)	(19.2)	(4.7)	(2.7)	(27.3)
Utilised interest	-	(0.1)	-	-	(0.1)
Unwinding of discount	1.1	-	-	-	1.1
Exchange difference	-	-	(0.5)	-	(0.5)
At 31 December 2019	<u>11.1</u>	<u>8.7</u>	<u>14.8</u>	<u>16.0</u>	<u>50.6</u>
Non-current liabilities	<u>5.6</u>	<u>0.6</u>	<u>13.9</u>	<u>0.2</u>	<u>20.3</u>
Current liabilities	<u>5.5</u>	<u>8.1</u>	<u>0.9</u>	<u>15.8</u>	<u>30.3</u>

Total provisions held by the Company at 31 December 2019 amount to £50.6m (2018: £74.8m) and include £50.6m (2018: £74.8m) shown above and £nil (2018: £nil) included within amounts held for sale on the balance sheet.

Contract provisions relate to onerous contracts which will be utilised over the life of each individual contract, up to a maximum of 2 years from the balance sheet date. 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. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. In 2019, additional charges have been made in respect of future losses on a number of onerous contracts totalling £2.4m (2018: £5.1m), all of which related to existing OCPs.

A full analysis is performed at least annually of the future profitability of all contracts with marginal performances and of the balance sheet items directly linked to these contracts.

Notes to the Financial Statements

for the Year Ended 31 December 2019

22 Provisions (continued)

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. The provisions will be utilised over various periods driven by local legal or regulatory requirements, the timing of which is not certain.

Property provisions relate to leased properties which are either underutilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be generated in the future. The provision has been calculated based on the discounted cash outflows required to settle the lease obligations as they fall due, with the longest running lease ending in November 2035.

Other provisions are held for legal and other costs that the Company 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 and will be utilised with reference to the specific facts and circumstances, with the majority expected to be settled by 30 September 2026.

23 Pension and other schemes

Defined benefit pension schemes

i) Characteristics and risks

The Company contributes to defined benefit schemes for qualifying employees in the UK. The normal contributions expected to be paid during the financial year ending 31 December 2020 are £6.8m (2019: £3.3m).

Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2018 and resulted in an actuarially assessed deficit of £26.0m for funding purposes. Pension obligations are valued separately for accounting and funding purposes and there is often a material difference between these valuations. As at 31 December 2019 the estimated actuarial deficit of SPLAS was £27.0m (2018: £27.8m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £78.3m. The primary reason a difference arises is that pension scheme accounting requires the valuation to be performed on the basis of a best estimate whereas the funding valuation used by the trustees makes more prudent assumptions. A revised schedule of contributions for SPLAS was agreed during 2019, with 30.8% of pensionable salaries due to be paid from 1 November 2019, changing to 30.3% from 1 November 2020. The schedule of contributions also determined that additional shortfall contributions were required - a total of £5.2m of these have already been made, with further amounts of £4m due in both March 2020 and March 2021 then £1.7m for the years 2022 to 2028, however following the Covid-19 pandemic declared in March 2020, the 2020 payments were reduced, and to date a total of £1m of the amount originally agreed for March 2020 has been paid. SPLAS operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation (principally the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004).

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities. Pension fund trustees are required to: prepare a statement of funding principles; obtain regular actuarial valuations and reports; put in place a recovery plan addressing any funding shortfall; and send regular summary funding statements to members of the scheme.

The assets of funded schemes are held independently of the Company's assets in separate trustee administered schemes. The trustees of each pension scheme are required by law to act in the interest of the scheme and of all relevant stakeholders in the scheme. The trustees of the pension schemes are responsible for the investment policy with regard to the assets of the scheme. The Company's major schemes are valued by independent actuaries annually using the projected unit credit actuarial cost method for accounting purposes. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions including: discount rates to determine the present value of benefits; projected rates of salary growth; and life expectancy of pension plan members. Discount rates are based on the market yields of high-quality corporate bonds in the country concerned. Pension assets and liabilities in the different defined benefit schemes are not offset.

The schemes typically expose the Company to risks that impact the financial performance and position of the Company and may affect the amount and timing of future cash flows. The key risks are set out below:

- **Investment risk.** The schemes hold assets with which to discharge the future liabilities of these schemes. Any decline in the value of these investments directly impacts on the ability of the scheme to meet its commitments and could require the Company to fund this shortfall in future years. As a result of the SPLAS's investment strategy, which aims to reduce volatility risk by better matching assets to liabilities, 45% of the scheme's assets are annuity policies and 55% are Liability Driven Investments (LDIs). The annuity policies result in an insurer funding the future benefit payments to the relevant members and therefore eliminate the risk of changes in the future value of the benefits to the scheme. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays and are therefore linked to the key drivers of the scheme's liabilities. The value of these investments vary in line with gilt yields, which have decreased from 2.86% pa. to 2.05% pa. during 2019 resulting in an increase in the value of these assets. SPLAS previously identified an investment strategy consisting of Multi-Asset Absolute Return (MAAR), Buy and Maintain credit (B&M) and LDI. SPLAS began to wind down its previous investment strategy in late 2016, with assets transferred to a passive LDI portfolio managed by BlackRock, over the course of late 2016 and early 2017. This ensures that the scheme remains protected against changes to interest rates and long-term inflation expectations, with the funding level therefore being relatively stable. The Buy and Maintain credit implementation comprises of four branches, the final of which is expected to complete during the second half of 2020, market conditions permitting.
- **Interest risk.** The present value of the defined benefit schemes' liabilities are calculated using a discount rate determined by reference to high quality corporate bond yields and therefore a decrease in the bond interest rate will increase the scheme liabilities. This will be partially offset by an increase in the return of the schemes' debt investments.
- **Longevity risk.** The present value of the defined benefit scheme' liabilities are calculated by reference to the best estimate of the mortality of the schemes' participants both during and after their employment. An increase in the life expectancy of the schemes' participants will increase the schemes' liabilities.
- **Salary risk.** The present value of the defined benefit schemes' liabilities are calculated by reference to the future salaries of the schemes' participants, as such, an increase in the salary of the schemes' participants will increase the schemes' liabilities.

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

The defined benefit schemes are grouped together as follows:

- **Contract specific.** These are pre-funded defined benefit schemes. The Company has obligations to contribute variable amounts to the pension schemes over the terms of the related contracts as defined by the contract and scheme rules. At rebid, any deficit or surplus would be expected to transfer to the next contractor. At the start of these relevant contracts the Company recognised the defined benefit obligation less the fair value of scheme assets with a corresponding amount recognised as an intangible asset. Subsequent actuarial gains and losses in relation to the Company's share of the pension obligations have been recognised in the SOCI. The intangible assets are amortised over the initial term of the contracts with none remaining at the current or prior year end. Where the relevant scheme has a deficit which is not required to be fully funded by the Company an adjustment is made to limit the amount recognised in the Company's balance sheet by way of a franchise adjustment'. Under contractual arrangements the Company makes contributions under Admitted Body status to a number of sections of the Local Government Pension Scheme for the period to the end of the relevant customer contracts. The Company will only participate in the Local Government Pension Schemes for a finite period up to the end of the contracts. The Company is required to pay regular contributions as decided by the respective Scheme Actuary and as detailed in each scheme's Schedule of Contributions. In addition, the Company may be required to pay some or all of any deficit (as determined by the respective Scheme Actuary) that is remaining at the end of the contract. In respect of this, the Company recognises a sufficient level of provision in these financial statements based on the IAS 19 valuation at the reporting date and contractual obligations.
- **Non contract specific.** These do not relate to any specific contract and consist of two pre-funded defined benefit schemes. The funding policy for the pre-funded schemes is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis. One of these schemes is SPLAS and the other is a non-contract specific section of the Railways Pension Scheme (RPS). There is no residual liability to fund a deficit of the RPS at the end of the franchise period and any costs are shared 60% by the employer and 40% by the members.

ii) Events in the year

In June 2019, the company and the Trustees of SPLAS finalised the 2018 valuation. This led to a new schedule of contributions. Following a 60-day consultation, most active SPLAS members agreed to a small increase in their own contributions, enabling a reduction in employer contributions.

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

iii) Value recognised in total Comprehensive income in the year

The amounts recognised in the financial statements for the year are analysed as follows:

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>2019</i>	<i>2019</i>	<i>2019</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Recognised in the income statement			
Current service cost - employer	0.3	3.2	3.5
Past service credit	0.2	1.2	1.4
Administrative expenses and taxes	-	2.0	2.0
	<u>0.5</u>	<u>6.4</u>	<u>6.9</u>
Recognised in arriving at operating profit			
Interest income on scheme assets - employer	(0.3)	(37.6)	(37.9)
Interest cost on scheme liabilities - employer	0.3	35.4	35.7
Finance income	<u>-</u>	<u>(2.2)</u>	<u>(2.2)</u>

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>2019</i>	<i>2019</i>	<i>2019</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Included within the SOCI			
Actual return on scheme assets	1.5	125.3	126.8
Less: interest income on scheme assets	(0.3)	(37.6)	(37.9)
Effect of changes in financial assumptions	(1.4)	(143.8)	(145.2)
Effect of experience adjustments	-	(1.6)	(1.6)
Effect of changes in demographic assumptions	(0.3)	40.6	40.3
Total pension gain recognised in the SOCI	<u>(0.5)</u>	<u>(17.1)</u>	<u>(17.6)</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>2018</i>	<i>2018</i>	<i>2018</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Recognised in the income statement			
Current service cost - employer	0.3	4.6	4.9
Past service credit	-	9.3	9.3
Administrative expenses and taxes	-	3.9	3.9
Recognised in arriving at operating profit	<u>0.3</u>	<u>17.8</u>	<u>18.1</u>
Interest income on scheme assets - employer	<u>(0.3)</u>	<u>(33.3)</u>	<u>(33.6)</u>
Interest cost on scheme liabilities - employer	<u>0.3</u>	<u>32.6</u>	<u>32.9</u>
Finance income	<u>-</u>	<u>(0.7)</u>	<u>(0.7)</u>

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>2018</i>	<i>2018</i>	<i>2018</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Included within the SOCI			
Actual return on scheme assets	(0.3)	40.7	40.4
Less: interest income on scheme assets	(0.3)	(33.3)	(33.6)
Effect of changes in financial assumptions	0.6	74.0	74.6
Effect of experience adjustments	-	(30.0)	(30.0)
Total pension gain recognised in the SOCI	<u>-</u>	<u>51.4</u>	<u>51.4</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

iv) Balance sheet values

The assets and liabilities of the schemes at 31 December are:

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>2019</i>	<i>2019</i>	<i>2019</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Equities	5.7	43.9	49.6
Bonds except LDI	3.4	297.9	301.3
Liability driven investments (LDI)	-	447.5	447.5
Property	0.9	-	0.9
Cash and other	1.8	5.1	6.9
Annuity policies	-	614.0	614.0
Fair value of scheme assets	11.8	1,408.4	1,420.2
Present value of scheme liabilities	(12.6)	(1,353.0)	(1,365.6)
Net retirement benefit asset	(0.8)	55.4	54.6
Net pension liability	(0.8)	(22.9)	(23.7)
Net pension asset	-	78.3	78.3
Net retirement benefit asset	(0.8)	55.4	54.6

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>2018</i>	<i>2018</i>	<i>2018</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Equities	5.2	39.9	45.1
Bonds except LDI	2.8	93.4	96.2
Liability driven investments (LDI)	-	580.7	580.7
Property	0.4	-	0.4
Cash and other	1.8	20.1	21.9
Annuity policies	-	600.2	600.2
Fair value of scheme assets	10.2	1,334.3	1,344.5
Present value of scheme liabilities	(10.2)	(1,262.9)	(1,273.1)
Net retirement benefit asset	-	71.4	71.4
Net pension liability	-	(14.4)	(14.4)
Net pension asset	-	85.8	85.8
Net retirement benefit asset	-	71.4	71.4

The SPLAS Trust Deed gives the Group an unconditional right to a refund of surplus assets, assuming the full settlement of plan liabilities in the event of a plan wind-up. Pension assets are deemed to be recoverable and there are no adjustments in respect of minimum funding requirements as economic as benefits are available to the Company either in the form of future refunds or in the form of possible reductions in future contributions.

As required by IAS19, the Group has considered the extent to which the pension plan assets should be classified in accordance with the fair value hierarchy of IFRS13. Virtually all equity and debt instruments have quoted prices in active markets. Annuity policies and property assets can be classified as Level 3 instruments, and LDIs are classified as Level 2.

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

Changes in the fair value of scheme liabilities are analysed as follows:

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
At 1 January 2018	10.4	1,340.9	1,351.3
Current service cost - employer	0.3	4.6	4.9
Past service costs	-	9.3	9.3
Scheme participants' contributions	-	0.2	0.2
Interest cost- employer	0.3	32.6	32.9
Benefits paid	(0.2)	(80.7)	(80.9)
Effect of changes in financial assumptions	(0.6)	(74.0)	(74.6)
Effect of experience adjustments	-	30.0	30.0
At 31 December 2018	<u>10.2</u>	<u>1,262.9</u>	<u>1,273.1</u>
At 1 January 2019	<u>10.2</u>	<u>1,262.9</u>	<u>1,273.1</u>
Current service cost - employer	0.3	3.2	3.5
Past service costs	0.2	1.2	1.4
Scheme participants' contributions	0.1	0.2	0.3
Interest cost- employer	0.3	35.4	35.7
Benefits paid	(0.2)	(54.9)	(55.1)
Effect of changes in financial assumptions	1.4	143.8	145.2
Effect of changes in demographic assumptions	0.3	(40.6)	(40.3)
Effect of experience adjustments	-	1.8	1.8
At 31 December 2019	<u>12.6</u>	<u>1,353.0</u>	<u>1,365.6</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

Changes in the fair value of scheme assets are analysed as follows:

	<i>Contract specific</i>	<i>Non contract specific</i>	<i>Total</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
At 1 January 2018	10.4	1,367.7	1,378.1
Interest income on scheme assets - employer	0.3	33.3	33.6
Administrative expenses and taxes	-	(3.9)	(3.9)
Employer contributions	0.1	10.3	10.4
Contributions by employees	0.1	0.3	0.4
Benefits paid	(0.2)	(80.7)	(80.9)
Return on scheme assets less interest income	(0.5)	7.3	6.8
At 31 December 2018	<u>10.2</u>	<u>1,334.3</u>	<u>1,344.5</u>
At 1 January 2019	<u>10.2</u>	<u>1,334.3</u>	<u>1,344.5</u>
Interest income on scheme assets - employer	0.3	37.6	37.9
Administrative expenses and taxes	-	(2.0)	(2.0)
Employer contributions	0.2	5.3	5.5
Contributions by employees	0.1	0.3	0.4
Benefits paid	(0.2)	(54.8)	(55.0)
Return on scheme assets less interest income	1.2	87.7	88.9
At 31 December 2019	<u>11.8</u>	<u>1,408.4</u>	<u>1,420.2</u>

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

v) Actuarial assumptions

The assumptions set out below are for SPLAS, which reflects 93% of total liabilities and 94% of total assets of the defined benefit pension scheme in which the Company participates. The significant actuarial assumptions with regards to the determination of the defined benefit obligation are set out below.

The Company has updated its approach to setting RPI and CPI inflation assumptions in light of the RPI reform proposals published on 4 September 2019 by the UK Chancellor and UK Statistics Authority.

The Company continued to set RPI inflation in line with the market break even expectations less an inflation risk premium. The inflation risk premium has increased from 0.2% at 31 December 2018 to 0.4% at 31 December 2019, reflecting an allowance for additional market distortions caused by the RPI reform proposals. For CPI, the Company reduced the assumed difference between RPI and CPI by 0.4% to an average of 0.6% per annum. The estimated impact is an increase of £20m in the defined benefit obligation in respect of the SPLAS scheme.

The average duration of the benefit obligation at the end of the reporting period is 16.8 years (2018: 16.1 years).

	2019	2018
	%	%
Rate of salary increases	2.70	2.80
Rate of increase in pensions in payment	2.20 (CPI) and 3.00 (RPI)	2.20 (CPI) and 3.00 (RPI)
Rate of increase in deferred pensions	2.30 (CPI) and 3.30 (RPI)	2.20 (CPI) and 3.20 (RPI)
Inflation assumption	2.20 (CPI) and 3.20 (RPI)	2.30 (CPI) and 3.30 (RPI)
Discount rate	2.1	2.90

Post retirement mortality

	2019	2018
	Years	Years
Current pensioners at 65 - male	21.6	22.6
Current pensioners at 65 - female	24.1	25.1
Future pensioners at 65 - male	23.8	24.4
Future pensioners at 65 - female	26.2	27.0

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

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 2019 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 2019 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.

	2019	2018
	£m	£m
Discount rate - 0.5% increase	(106.3)	(102.8)
Discount rate - 0.5% decrease	120.3	112.2
Inflation - 0.5% increase	86.3	66.9
Inflation - 0.5% decrease	(81.0)	(64.7)
Rate of salary increase - 0.5% increase	2.3	2.4
Rate of salary increase - 0.5% decrease	(2.1)	(2.3)
Mortality - one year age rating	47.9	39.9

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.

The expected yield on bond investments with fixed interest rates is derived from their market value. The yield on equity investments contains an additional premium (an 'equity risk premium') to compensate investors for the additional anticipated risks of holding this type of investment, when compared to bond yields. The Company applies an equity risk premium of 4.6% (2018: 4.6%).

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by the scheme.

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 2019 in respect to inflation, interest, bond yields and equity performance when selecting the expected return on assets assumptions.

Notes to the Financial Statements

for the Year Ended 31 December 2019

23 Pension and other schemes (continued)

Defined contribution pension scheme

The Company paid employer contributions of £22.2m (2018: £19.3m) into UK and other defined contribution schemes and foreign state pension schemes.

The Company 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.

24 Share capital

Allotted, called up and fully paid shares

	2019		2018	
	No.	£	No.	£
Ordinary share capital of £1 each	<u>800,766</u>	<u>800,766</u>	<u>800,766</u>	<u>800,766</u>

25 Contingent liabilities

The Company, together with its ultimate parent and certain other subsidiaries, is included within interest pooling arrangements involving cross guarantee structures. The overdraft balance was £nil at 31 December 2018 (2018: £4.3m).

Serco Limited is a cross-guarantor with other group companies on a joint and several basis in respect of the borrowing facilities of the Serco Group. These relate to bank debt facilities and US private placement bonds. As at 31 December 2019, the total facility amounts were £250m (2018: £250m) for the RCF and £213m (2018: £242m) for the US private placements.

The Company is aware of claims and potential claims which involve or may involve legal proceedings against the Company. The Directors are of the opinion, having regard to legal advice received and the Company's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Company's financial position.

In May 2019, the Group entered into a new £45m term loan facility in order to fund the purchase of Naval Systems Business Unit. The facility matures in August 2022.

In December 2018 the Group entered into a £250m revolving credit facility with a maturity date of December 2023.

The Company is a cross-guarantor on both the revolving credit facility and the term loan facility.

Notes to the Financial Statements

for the Year Ended 31 December 2019

26 Derivatives financial instruments

The following table provides a reconciliation by risk category of components of equity and analysis of other comprehensive income items (net of tax) resulting from hedge accounting:

	<i>2019 Assets</i>	<i>2019 Liabilities</i>	<i>2018 Assets</i>	<i>2018 Liabilities</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Forward foreign exchange contracts	0.1	(0.1)	0.3	-
	<i>2019 Assets</i>	<i>2019 Liabilities</i>	<i>2018 Assets</i>	<i>2018 Liabilities</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Analysed as				
Non-current	-	-	0.1	-
Current	0.1	(0.1)	0.2	-
	0.1	(0.1)	0.3	-

The Company is exposed to foreign currency transaction risk on costs. Any material transactional exposure that does arise is hedged by the Group Treasury function using forward foreign currency contracts. Hedges on highly probable forecast transactions or commitments have been designed as cash flow hedges. All currency derivatives designated as cash flow hedges are highly effective and the fair value gain of £0.1m arising in the year (2018: £0.3m) has been deferred in equity.

Notes to the Financial Statements

for the Year Ended 31 December 2019

27 Post balance sheet events

Coronavirus (COVID-19) was originally identified as a disease in China late in 2019. Following global transmission of the disease early in 2020, Europe and other continents began identifying cases which continued to rise in number such that on 12 March 2020 the World Health organisation characterised the outbreak of COVID-19 as a global pandemic. As the impact of COVID-19 arose subsequent to the Company's year-end it is considered to be a non-adjusting post balance sheet event, and as a result, no amounts related to the impact of COVID-19 have been included in these financial statements, nor have any amendments been made to the carrying value of items on the Balance Sheet. Based on an initial assessment, since most of the contracts delivered by the Company are critical services for governments, which have continued to operate during the pandemic, the impact of COVID-19 is projected to be limited to a small number of contracts. The most likely negative impacts from COVID-19 include, but are not be limited to a reduction in profit margins as a result of higher absenteeism, a reduction in services for volume based contracts or a reduction in the pipeline of opportunities as new business and Government outsourcing is delayed. The risk is mitigated to some degree in the short-term through the Company's provision of assistance to governments in their response to the pandemic. In addition, the Company has already been involved in supporting the NHS's Test and Trace programme, establishing COVID-19 test centres and other COVID-19 work supporting the Government, although given the exceptional circumstances, the Company has agreed to perform such contracts on an open-book basis and at margins below normal expectations.

During May 2020, the Company agreed to dispose of its interest in the Viapath joint venture which provides pathology services to certain hospitals in the UK. As part of the disposal, the Company will receive payments totalling £15.1m which includes amounts in respect of historic profit share, loans held between the Company and the JV and an amount in relation to the Company's interest in the JV. The Company's interest in Viapath ceased with effect from 31 May 2020. No amounts relating to the disposal are included in the Company's financial results for the year ending 31 December 2019. The transaction results in underlying trading profit being recognised of £2.0m with the remainder being recognised as exceptional.

28 Parent and ultimate parent undertaking

The Company's immediate parent is Serco Holdings Limited.

The ultimate parent and controlling party is Serco Group plc, a company incorporated in the United Kingdom and registered in England and Wales, Serco Group plc is the parent undertaking of the smallest and largest group to consolidate these financial statements. These financial statements are available upon request from the Company Secretary, Serco Group plc, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY.