Serco Limited

Annual Report and Financial Statements

for the year ended 31 December 2017

A company registered in England and Wales, number 00242246

Serco Limited Annual Report and Financial Statements 2017

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Company Information

Registered office

Serco House
16 Bartley Wood Business Park
Bartley Way
Hook
Hampshire
RG27 9UY
United Kingdom

Auditor

KPMG LLP
15 Canada Square
London
E14 5GL
United Kingdom

Directors' Report for the year ended 31 December 2017

The Directors present the annual report and financial statements for the Company for the year ended 31 December 2017.

Directors of the Company

The Directors who held office during the year and to the date of this report were as follows:

G Leach
E Benison (resigned 30 September 2017)
K Craven
N Crossley

New shares allotted

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

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2017, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014'; namely assessing the applicability of the going concern basis, the review period and disclosures.

The Directors have undertaken a rigorous assessment of going concern and liquidity, taking into account financial forecasts for the period to 30 June 2019. In order to satisfy ourselves that we have adequate resources for the future, the Directors have reviewed the strength of the Company's balance sheet, the recoverability of assets and availability of funding through the Group's existing facilities. The Company has received a letter of support from Serco Group plc that confirms it will make cash or equity funds available to the company to allow it to meet its financial obligations as and when they fall due over the period up to 12 months from the date of the signing of these accounts. Whilst the letter of support does not give rise to any legal obligation the Directors are satisfied that it provides sufficient assurance of the intent of the parent to continue to support the business.

The Directors have a reasonable expectation that the Company will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

Proposed dividend

The directors do not recommend the payment of a dividend (2016: £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 (2016: £nil).

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditor is unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Risks and uncertainties

A review of risks is undertaken in the Strategic Report.

Post balance sheet events

Serco has been working closely with the Special Managers and Liquidators of Carillion, together with all other relevant parties, to agree acquisition terms enabling the various contract to transfer. We are now anticipating that we will take responsibility for facilities management services at six major NHS hospital sites: Great Western Hospital in Swindon; Darent Valley Hospital in Dartford; James Cook University Hospital in Middlesbrough; Harplands Hospital in Stoke-on-Trent; The Langlands Unit of Queen Elizabeth University Hospital in Glasgow; and Addenbrooke's Treatment Centre in Cambridge. The first contract, Great Western Hospital in Swindon, transferred recently, and the remainder, subject to signing of the relevant contracts, are expected to do so over the coming weeks.

Each of the remaining five contracts still require a separate transaction and novation; if all six contracts transfer to Serco, the total annual revenue would be around £70m and the estimated Underlying Trading Profit, including an appropriate allocation of charges for shared support services and other incremental overheads, would be approximately £4m, the aggregate consideration payable, assuming all of the relevant contracts are transacted and novated, would be approximately £16m. As there would only be a part-year trading contribution in 2018, after the costs of the transition and integration phase that would be completed over the coming months, this would likely result in a small negative impact on Serco's net profitability for the 2018 financial year; this has been taken into account in our guidance as stated in today's update on trading. The transactions would be immediately accretive to earnings following the completion of the integration phase.

Appointment of Auditor

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 29 June 2018 and signed on its behalf by:

N Crossley
Director

Strategic Report for the year ended 31 December 2017

The Directors present their Strategic Report for the year ended 31 December 2017.

Principal activity

The principal activity of 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, science, employment and offender management.

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.

Business review

Overview

Turnover for the Company for the year was down 3.8% from £1,266.9m to £1,218.9m as a result of organic decline from net contract attrition. The Company generated an operating loss, before net exceptional items, for the year of £14.4m (2016: profit of £30.5m). The operating result was lower than in the prior year as a result of the impact of contract attrition and in-contract reductions and the lower profitability from new contracts in their initial transition and transformation stages. The non-repeat of certain costs and impairments that occurred in 2016 and the progress made on cost efficiencies in 2017 only partially offset these areas of profit reduction. During the year net exceptional charges of £15.1m were incurred (2016: £22.0m). After exceptional items the operating loss of the Company for the financial year was £29.5m (2016: £8.5m profit).

Net assets of the Company have decreased by 40.4% to £171.8m (2016: £288.1m), primarily as a result of the £106.2m reduction in net pension scheme assets to £26.8m. In June 2017, the Trustees of the Group's primary defined benefit pension scheme entered into a bulk annuity purchase whereby an insurer will fund future benefit payments to the relevant members. The liability to pay the members remains with the pension scheme which continues to include the relevant pension liabilities, but an insurance asset is held which is an equal and opposite amount to the liability. This removes the risk of longevity and investment movements for this portion of the scheme on a funding basis, and also removes the accounting risk of movements in underlying assumptions on the liabilities. The transaction resulted in a significant reduction in the surplus of the pension scheme under IFRS accounting convention, but resulted in a reduction in the deficit that is actuarially assessed for funding purposes of approximately £12m. As at 31 December 2017 the estimated actuarial deficit of this scheme was £33.7m (2016: £42.6m).

Transformation continued in the year and will carry on through 2018, increasingly this will be focused on re-building the Company's business development functions and bid pipeline, strengthening our sector propositions, and consolidating our differentiated capability in order to win. We will also continue to improve operational execution and drive further cost efficiencies. Only when these transformational elements are all in place will we be able to harvest the financial benefit. A significant step taken in 2017 was the merger of the Company's UK and European operating divisions to create a single, integrated business, Serco UK & Europe. This combined the two previous divisions of UK Central Government and UK & Europe Local & Regional Government – and will simplify and improve the efficiencies and capabilities of our operations in the region, in particular as we continue to drive transformation benefits across the Group as a whole.

The Company continues to assess the potential impact of Brexit. Our business directly serving European bodies is unlikely to be greatly affected, as it is served by EU-resident companies. We believe Brexit may have an impact on labour cost and availability in the UK if EU citizens cannot come to UK to work in essential frontline service roles. The greatest impact for us is that UK Central Government is largely focused upon the overwhelming need to manage Brexit, which has been described by the Head of the Civil Service as the greatest peacetime challenge ever faced by the Civil Service, and it is clear that their priority is going to be focused in this direction for several years to come. However, in the medium term the repatriation of swathes of regulatory functions may lead to important opportunities, and many of our largest customers – most notably the Ministry of Defence, the Ministry of Justice and the Home Office – still have pressing needs to reduce costs and increase efficiency.

UK & Europe

The majority of Serco'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 reoffending, from secure accommodation management through to housig 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 Citizen Services business provides environmental and leisure services, as well as a wide range of other front, middle and back-office services to support public sector customers in the UK or European institutions.

Revenue for 2017 was £1,104.6m (2016: £1,165.6m), a decline of 5.2%. Drivers of the reduction included: in our Health business, we ceased to recognise as revenue the value of goods purchased on our customers' behalf following changes to two procurement services contracts; in our Defence business, the phased transfer back during 2016 of services that Serco had previously been providing to the Defence Science & Technology Laboratory (DSTL) and for Defence Business Services (DBS); we also saw reduced volumes in our Child Maintenance Group operations, and the ending or reduced scale of various other BPO and IT support services contracts. These revenue reductions were partially offset from growth elsewhere, namely the start of hospital facility management services for Barts Health NHS Trust and University Hospital Southampton NHS Foundation Trust, as well as some growth in our European agency operations and from the new Skills Support for the Workforce (SSW) contracts.

Within Underlying Trading Profit there was £42.8m of OCP utilisation (2016: £48.4m), which served to offset the Division's loss-making operations, principally COMPASS UK asylum seeker support services, Future Provision of Marine Services (FPMS), Lincolnshire Country Council, and the Prisoner Escort & Custody Services (PECS) contracts.

Middle East

Revenue for the year was £114.3m (2016: £98.4m), an increase of 16.2%, partly driven by the strengthening of local currencies against Sterling. Growth came from new contracts for facilities management at Dubai.

Principal risks and uncertainties

Risk management approach

The Company is faced with a number of challenges and risks due to the diverse services provided.

Brexit, is just one example, where today there are few conclusions as to the real impacts, both negative and positive, on our economic landscape in the UK and Europe.

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

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

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

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

Management oversight and risk appetite

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

The Serco Group Risk Committee, (initiated in 2016, as a focused committee that previously was covered as part of the responsibilities of the Group's Corporate Responsibility and Risk Committee) is now fully embedded, reporting quarterly to the Board, and this has improved our management oversight on the principal risks.

'Deep Dives' into a number of principal risks are carried out during the year, together with a review of the operating environment to determine any changes to our 'Top 10' risks.

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

Principal risks

Failure to grow profitably

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

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

Key risk drivers:

- Lack of opportunities in chosen markets – some market sectors may not have a favourable policy of private sector provision of public services, reducing pipeline opportunities.
- External factors reducing the pipeline of opportunities – political and policy changes in our markets (such as changes in federal or state governments, or decisions such as Brexit) may make it more difficult for us to win in some geographies, or result in fewer opportunities.
- Failure to be competitive – lack of appropriate references and value proposition for the markets in which we compete, may put us at a disadvantage to our competitors.
- Inability to meet customer and solution requirements during design, implementation and delivery – executing our bids in an unsatisfactory manner by not understanding the strategic needs of the customer, mispricing bids, developing inefficient or non-innovative solutions, and misunderstanding risks, may prevent us from achieving our growth ambitions.
- Ineffective business development – poor account management, market shaping, proposition development and visibility of pipeline opportunities will affect our ability to set targets for growth, understand business wins and drive process improvements.
- Failure to obtain or capitalise on benefits from our Transformation Programme – (see 'Failure of deliver expected benefits from Transformation Programme').

Material controls:

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

Mitigation priorities:

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

Failure to manage our reputation

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

Key risk drivers:

- Failure to clearly define what Serco stands for and how we wish to be seen – may result in inconsistent communication and misunderstanding by our key stakeholders.
- Not understanding our customers' and stakeholders' expectations – may result in a failure to recognise changes in our business environment or our customers' priorities.
- Failure to manage incidents appropriately – may result in us not responding in a collaborative approach with our customers, or communicate in an open and ethical manner to key stakeholders.

Material controls:

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

Mitigation priorities:

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

Failure to deliver expected benefits from Transformation

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

Key risk drivers:

- Non-delivery of required benefits – we fail to achieve the expected benefits due to poor programme management and/or solution design.
- Severe disruption to the business – we fail to coordinate and prioritise the various programme objectives due to poor integration across activities and inadequate programme management, and we negatively impact on 'Business As Usual' activities.
- Watering down of value / ambition of Serco Operating model – due to a sum of compromises across the organisation and the possible misalignment across the Divisions.
- Failure of the businesses to understand the imperative to change – due to ineffective communication from the leadership teams.
- Failure to comply with new operating model – due to ineffective enforcement of the model and changes not embedded into the business.
- Failure to communicate the change and impact of the change to clients – potentially causing opposing short term drivers.

Material controls:

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

Mitigation priorities:

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

Financial control failure

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

Key risk drivers:

- Not setting the right tone from the top – without which, we may fail to embed the finance policy, processes and controls.
- Poor financial processes – if processes are poorly designed, then inaccuracies and fraud may occur.
- Inadequate financial controls within the business if controls are inadequate we may fail to provide adequate protection from sabotage of systems, fraud and error.
- Impact of Transformation Programme activities - programme activities may lead to poor change control or an unstable financial control environment due to an increased workload on the finance community.
- Failure of Finance Transformation Programme - we do not transform the finance processes and controls, and fail to deliver expected benefits.

Material controls:

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

Mitigation priorities:

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

Major information security breach

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

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

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

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

Contract non-compliance, non-performance or misreporting

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

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

Key risk drivers:

- Poor leadership and culture – if our leaders do not align with our Values, and staff feel under pressure to meet challenging operational targets and/or performance indicators, then deliberate misreporting may occur.
- Lack of process and controls – poorly documented or poorly communicated processes may lead to deliberate or unintentional misreporting or contract non-compliance.

- Ineffective assurance and human error – insufficient oversight and assurance of contract performance, could lead to contract non-compliance, non-performance or a misreporting of performance.
- Poor understanding of contract obligations – may result in staff failing to acknowledge and act on obligations or a failure to provide adequate resources to deliver against contractual obligations.
- Poor systems/IT – unreliable or incorrectly configured systems may result in late or incorrect data produced.

Material controls:

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

Mitigation priorities:

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

Failure of business critical partner, sub-contractor or supplier

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

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

Key risk drivers:

- Ineffective procurement and supply chain governance – no Group functional owner for procurement resulting in inconsistencies in implementation of standards, potential non- compliance to those standards and lack of consequence management for non-compliance.
- Identification of significant suppliers – a failure to identify who are our critical suppliers may result in lack of focused oversight, and understanding of the impacts on Serco should they fail to deliver our customer critical service.
- Limited oversight – resulting in poor sourcing, contracting and monitoring of business critical 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 Standard Operating Procedure.
- Supplier Management Standard Operating Procedure.
- Maintenance of business critical partner, sub-contractor and supplier list.
- Compliance Assurance Testing.
- Consequence management.
- Financial health checks and monitoring.
- Supplier performance and risk reviews.
- Supplier Business Continuity Plan audits.

Mitigation priorities:

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

Failure to act with integrity

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

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

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

Catastrophic incident

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

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

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

Material legal and regulatory compliance failure

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

Key risk drivers:

- Lack of governance and oversight – may result in a failure to identify potential or actual breaches to legal requirements and result in a failure to respond appropriately, or weaken our ability to confirm compliance with legal and regulatory requirements.
- Failure to comply with the SMS and contractual obligations – may result in compliance failures for Serco's material legal and regulatory requirements.
- Failure to identify and respond to material changes in legal and regulatory requirements – may result in key subject matter experts within the business not remaining up to date and we then fail to comply with material legal and regulatory obligations.
- Lack of awareness by employees of the legal and regulatory requirements placed upon them – may result in lack of identification and subsequent compliance to requirements.
- Inadequate provision of systems and tools – may result in ineffective methods to support the management of legal and regulatory compliance.

Material controls:

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

Mitigation priorities:

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

SFO investigation

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

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

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

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

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

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

Approved by the Board on 29 June 2018 and signed on its behalf by:

N Crossley
Director

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Accounting Standards (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 apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- 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 also responsible for 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 2017 which comprise the Profit and Loss Account and Other 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 2017 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

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 twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

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.

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 15, 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 fuller 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.

Anna Jones

Anna Jones (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London

E14 5GL

29 June 2018

Profit and Loss Account for the year ended 31 December 2017

	Note	Before exceptional items 2017 £ m	Exceptional items 2017 £ m	Total 2017 £ m	Before exceptional items 2016 (restated*) £ m	Exceptional items 2016 £ m	Total 2016 (restated*) £ m
Turnover	4	1,218.9	-	1,218.9	1,266.9	-	1,266.9
Cost of sales*		(1,131.3)	-	(1,131.3)	(1,114.4)	-	(1,114.4)
Gross profit		**87.6**	-	**87.6**	**152.5**	-	**152.5**
Administrative expenses*		(87.2)	-	(87.2)	(105.7)	-	(105.7)
Amortisation of intangible fixed assets	14	(14.8)	-	(14.8)	(16.3)	-	(16.3)
Exceptional net profit on disposal of operations	5	-	1.6	1.6	-	2.3	2.3
Other exceptional operating items	6	-	(16.7)	(16.7)	-	(24.3)	(24.3)
Operating profit/(loss)	7	**(14.4)**	**(15.1)**	**(29.5)**	**30.5**	**(22.0)**	**8.5**
Interest receivable and similar income	10	8.2	-	8.2	14.5	-	14.5
Interest payable and similar charges	11	(3.6)	-	(3.6)	(12.2)	-	(12.2)
(Loss)/profit before tax		**(9.8)**	**(15.1)**	**(24.9)**	**32.8**	**(22.0)**	**10.8**
Tax on (loss)/profit	12	11.3	(19.8)	(8.5)	(3.7)	1.8	(1.9)
(Loss)/profit for the financial year		**1.5**	**(34.9)**	**(33.4)**	**29.1**	**(20.2)**	**8.9**

* Costs included within cost of sales and administrative expenses have been reallocated, resulting in a restatement. See note 1.

The above results were derived from continuing operations.

The accompanying notes are an integral part of these financial statements.

Statement of Comprehensive Income for the year ended 31 December 2017

	Note	2017 £ m	2016 £ m
(Loss)/profit for the year		**(33.4)**	**8.9**
Other comprehensive (expense)/income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial (loss)/gain on defined benefit pension schemes [1]	22	(107.4)	11.8
Tax relating to items not reclassified [1]	13	18.1	(0.8)
Items that may be reclassified subsequently to profit or loss:			
Fair value (loss)/gain on cash flow hedges [2]		(0.2)	0.1
Total other comprehensive (expense)/income		**(89.5)**	**11.1**
Total comprehensive (expense)/income for the year		**(122.9)**	**20.0**

[1] Recorded in retained earnings in the Consolidated Statement of Changes in Equity.

[2] Recorded in hedging and translation reserve in the Consolidated Statement of Changes in Equity.

Statement of Changes in Equity for the Year Ended 31 December 2017

	Called up share capital £ m	Share premium £ m	Hedging and translation reserve £ m	Retained earnings £ m	Total £ m
At 31 December 2015	**0.8**	**1,108.9**	**0.1**	**(846.3)**	**263.5**
Total comprehensive income for the financial year	-	-	0.2	19.8	20.0
Credit in relation to share-based payments	-	-		4.6	4.6
At 31 December 2016	**0.8**	**1,108.9**	**0.3**	**(821.9)**	**288.1**
Total comprehensive expense for the financial year	-	-	(0.2)	(122.7)	(122.9)
Credit in relation to share-based payments	-	-		6.6	6.6
At 31 December 2017	**0.8**	**1,108.9**	**0.1**	**(938.0)**	**171.8**

Balance Sheet as at 31 December 2017

	Note	31 December 2017 £ m	31 December 2016 £ m
Fixed assets			
Other intangible fixed assets	14	43.3	46.7
Property, plant and equipment	15	40.2	39.5
Investments	16	3.5	3.5
		87.0	**89.7**
Current assets			
Stocks	17	8.7	9.0
Debtors: amounts due within one year	18	348.8	385.4
Debtors: amounts falling due after more than one year	18	323.3	409.3
Deferred tax assets: amounts falling due after more than one year	13	17.7	9.7
Corporation tax asset		2.1	-
Derivative financial instruments	26	0.2	0.4
Cash at bank and in hand		-	7.6
		700.8	**821.4**
Total assets		**787.8**	**911.1**
Creditors: amounts falling due within one year			
Bank overdraft		(72.0)	-
Creditors: amounts falling due within one year	19	(357.5)	(400.3)
Corporation tax liability		(2.7)	(2.2)
Derivative financial instruments	26	(0.1)	-
Provisions	21	(74.3)	(90.4)
		(506.6)	**(492.9)**
Net current assets		**194.2**	**328.5**
Creditors: amounts falling due after more than one year			
Creditors: amounts due after more than one year	20	(59.6)	(145.5)
Provisions	21	(76.6)	(117.7)
		(136.2)	**(263.2)**
Defined benefit pension asset	22	41.8	150.4
Defined benefit pension liability	22	(15.0)	(17.3)
Net assets		**171.8**	**288.1**
Capital and reserves			
Called up share capital	23	0.8	0.8
Share premium		1,108.9	1,108.9
Hedging and translation reserve		0.1	0.3
Retained earnings		(938.0)	(821.9)
Shareholder's funds		**171.8**	**288.1**

The financial statements (registered number 00242246) were approved by the Board of Directors on 29. June 2018 and signed on its behalf by:

....

N Crossley
Director

Notes to the Financial Statements for the year ended 31 December 2017

1 General information

Serco Limited is a company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 1, and registered company number is 00242246. The nature of the Company's operations and its principal activities are set out in the Strategic Report on pages 4 to 14.

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

2 Accounting policies

The principal accounting policies adopted are set out below and have been applied consistently throughout the current and preceding year, unless otherwise stated.

Basis of accounting

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

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash flow statement, 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 29.

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.

None of the changes to UK GAAP that became effective in the current reporting period have had a significant impact on the Company's financial statements.

Prior year restatement: Reallocation of costs between cost of sales and administrative expenses

The Company has undergone a programme of work on its financial data structures to appropriately allocate and charge costs to the relevant divisions and between cost of sales and administrative expenses. As a result of the activities performed in this area, the Company's classification of cost items in the income statement has changed. The prior periods' results have been restated to reflect the cost items identified which should have been reallocated in 2016.

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

The impact on the relevant line items in the consolidated income statement for the year ended 31 December 2016 is as follows:

	Year ended 31 December 2016 as previously stated £m	Adjustment £m	Year ended 31 December 2016 as restated £m
Cost of sales	(1,121.0)	6.6	(1,114.4)
Gross profit	145.9	6.6	152.5
General and administrative expenses	(99.1)	(6.6)	(105.7)

Prior year restatement: Goodwill opening cost and accumulated depreciation balance

A restatement is required to the closing 31 December 2016 and opening 1 January 2017 goodwill balance within note 14 of the accounts to correct for the sale of the private sector BPO business which took place over the course of 2015 and 2016.

The impact on the relevant line items in the financial statements at year ended 31 December 2016 is as follows:

	2016 as previously stated £m	Adjustment £m	2016 as restated £m
Cost at 31 December 2016	(373.7)	141.3	(232.4)
Accumulated amortisation and impairment at 31 December 2016	(373.7)	141.3	(232.4)

No restatement is required to either the balance sheet or the income statement as a result of this since there is no net book value impact.

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2017, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014'; namely assessing the applicability of the going concern basis, the review period and disclosures.

The Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2019. In order to satisfy ourselves that we have adequate resources for the future, the Directors have reviewed the strength of the Company's balance sheet, the recoverability of assets and availability of funding through the Group's existing facilities. The Company has received a letter of support from Serco Group plc that confirms it will make cash or equity funds available to the company to allow it to meet its financial obligations as and when they fall due over the period up to 12 months from the date of the accounts. Whilst the letter of support does not give rise to any legal obligation the Directors are satisfied that it provides sufficient assurance of the intent of the parent to continue to support the business. The Directors have also reviewed the principal risks considered on pages 5 to 13 of the Strategic Report and taken account of the results of sensitivity testing.

The Directors have a reasonable expectation that the Company will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

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 the United Kingdom and registered in England and Wales.

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 IAS 17 *Leases*, or the calculation of net realisable value under IAS 2 *Inventories* or value in use under IAS 36 *Impairment of Assets*.

Turnover

Turnover is measured as the fair value of the consideration received or receivable and represents amounts due for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Calculating the fair value of turnover typically does not require a high level of judgement, the exceptions to this are the following areas:

- **Uncontracted variations or claims.** Where work has been performed outside of the normal contracting framework at the request of the customer or a claim has been made for work performed but is in dispute, judgement is required in order to determine whether there is sufficient certainty that the Company will be financially compensated. Turnover is only recognised to the extent that it has been orally agreed by the customer or is virtually certain of being received and turnover recognised in this manner is not considered to be significant to the Company's results.
- **Payments by results contracts.** When returns are directly linked to performance, through cost savings or other customer driven key performance indicators over a period of time an estimate is made of the likelihood of achieving the necessary level of performance when the period covers a financial year end. Turnover is only recognised when the required level of performance it is reasonably certain of being achieved and such payment mechanisms do not represent a significant proportion of annual turnover.
- **Long term contracts.** Turnover and profit is recognised for certain long term project based contracts based on the stage of completion of the contract activity. The assessment of the stage of completion requires the exercise of judgement and is measured by the proportion of costs incurred compared to the estimated whole life contract costs, except where whole life contract costs exceed the contract value, in which case the excess is expensed immediately. The Company has a limited number of long term contracts for the provision of complex, project-based services. Where the outcome of such long term project based contracts can be measured reliably, turnover and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date in accordance with IAS 18 *Revenue* and IAS 11 *Construction Contracts*. This is normally measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs, but where a more accurate basis is available that alternative methodology is used. Contract costs include a rational allocation of overheads. Where the outcome of a long term project based contract cannot be estimated reliably, contract turnover is recognised to the extent that it is probable that contract costs will be recovered. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that the total contract costs will exceed total contract turnover, the expected loss is recognised as an expense immediately. Such amounts are not discounted.

While each of these areas requires a high level of judgement, only long term contract accounting could have a significant impact on the Company's financial results or position. However, the only turnover associated with these contracts are earned on loss making contracts with onerous loss provisions and as a result we do not identify this as a separate item for disclosure in note 3.

Turnover on repeat service based contracts is recognised as services are provided in line with the transfer of control to the customer. Where initial contract costs (phase in costs) are paid for by the customer, turnover is recognised when the related costs are incurred.

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

Dividend income

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

Interest income

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

Deferred tax

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits.

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits.

Recognition has been recognised based on forecast future taxable profits. Further details on taxes are disclosed in note 13.

Current tax

Liabilities for tax contingencies require management judgement and estimates in respect of tax audits and also tax exposures in each of the jurisdictions in which we operate. Management is also required to make an estimate of the current tax liability together with an assessment of the temporary differences that arise as a consequence of different accounting and tax treatments. Key judgement areas include the correct allocation of profits and losses between the countries in which we operate and the pricing of intercompany services. Where management conclude that a tax position is uncertain, a current tax liability is held for anticipated taxes that are considered probable based on the current information available.

These liabilities can be built up over a long period of time but the ultimate resolution of tax exposures usually occurs at a point in time, and given the inherent uncertainties in assessing the outcomes of these exposures, these estimates are prone to change in future periods. It is not currently possible to estimate the timing of potential cash outflows, but on resolution, to the extent this differs from the liability held, this will be reflected through the tax charge/(credit) for that year. Each potential liability and contingency is revisited on an annual basis and adjusted to reflect any changes in positions taken by the company, local tax audits, the expiry of the statute of limitations following the passage of time and any change in the broader tax environment. The total current tax liability at December 2017 was £2.7m (2016: £2.2m).

On the basis of the currently available information, the Company does not anticipate a material change to the estimated liability in the coming year.

Foreign currencies

Transactions in currencies other than Sterling are recorded at the rates of exchange on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Gains and losses arising on retranslation are included in the net profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity through the statement of comprehensive income (SOCI). Income and expense for overseas operations are translated at the average exchange rates for the period.

Goodwill

Goodwill arising on the acquisition of businesses is capitalised on the balance sheet in accordance with IAS 38 *Intangible Assets* and IFRS 3 *Business Combinations*. Goodwill represents the excess of consideration paid over the fair value of assets acquired. Goodwill is reviewed for impairment at least annually. Any impairment is recognised immediately in the profit and loss account and is not subsequently reversed. On disposal the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Property, plant and equipment

Assets held for use in the rendering of services, or for administrative purposes, are stated in the balance sheet at cost, net of accumulated depreciation and any provision for impairment. Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

Depreciation is provided on a straight-line basis at rates designed to reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:

Freehold buildings	2.5%
Short-leasehold assets	The higher of 10% or the rate produced by the lease term
Machinery	15% - 20%
Motor vehicles	10% - 50%
Furniture	10%
Office equipment	20% - 33%
Leased equipment	The higher of the rate produced by the lease term or useful life

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account. 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.

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.

Licences comprise premiums paid for the acquisition of licences. These are amortised on a straight-line basis over the life of the licence.

Software represents 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 period from which the Company expects to benefit, which is typically between three and eight years.

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

- an asset is created that can be separately identified, and which the 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.

Whilst licence assets will arise from specific transactions and can be clearly identified, both software and development type assets can include a significant level of internal costs an determining whether these are directly incremental to the creation of a specific asset requires a high level of judgement (further detail of which is provided in note 3).

Trademarks, licences and customer related intangible assets have a finite useful life and are carried at cost less accumulated amortisation and any accumulated impairment losses.

Asset impairment

The Company reviews the carrying amounts of its tangible and intangible assets at each reporting period, together with any other assets under the scope of IAS 36 *Impairment of Assets*, in order to assess whether there is any indication that those assets have suffered an impairment loss. As the impairment of the 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. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs.

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

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

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

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

Investments in subsidiaries

Fixed asset investments are stated at historical cost less provision for impairment.

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. 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. Details of the unconsolidated joint ventures are provided in note 16.

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.

Bid costs and phase in costs

All bid costs are expensed through the profit and loss account up to the point where contract award (or full recovery of costs) is virtually certain, being the point at which the Company has at least reached preferred bidder status. Bid costs incurred after this point are then capitalised within trade and other receivables. On contract award these bid costs are amortised through the profit and loss account over the contract period by reference to the stage of completion of the contract activity at the balance sheet date. Bid costs are only capitalised to the extent that it is expected that the related contract will generate sufficient future economic benefits to at least offset the amortisation charge.

Phase in costs that are incremental and directly related to the initial set-up of contracts are capitalised within trade and other receivables and are recognised on a straight line basis over the life of the contract, except where they are specifically reimbursed as part of the terms of the contract when they are recognised as turnover.

Determining whether bid and phase in costs are recoverable involves a high level of judgement as it requires a forecast to be prepared for the expected future profitability of the contract, taking into account the likely future costs and revenues associated with the services not yet performed.

Stocks

Stocks 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 stocks to their present location and condition.

Trade receivables

Trade receivables are recognised initially at cost (being the same as fair value) and subsequently at amortised cost less any provision for impairment, to ensure that amounts recognised represent the recoverable amount.

A provision for impairment arises when 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 profit and loss account 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 or are blue chip private sector companies and therefore historic levels of default are relatively low and as a result the risks associated with this judgement are not considered to be significant.

Trade receivables (continued)

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

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant changes in value and have a maturity of three months or less from the date of acquisition.

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. Further details of the judgements can be seen in note 3.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Company at fair value or, if lower, at the present value of minimum lease payments determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to the profit and loss account, unless they are directly attributable to a qualifying asset, in which case they are capitalised in accordance with the Company's general policy on borrowing costs.

Total rentals payable under operating leases are charged to the profit and loss account on a straight-line basis over the term of the relevant lease.

Loans

Loans are stated at amortised cost using the effective interest-rate method. Accrued interest is recorded separately from the associated borrowings with current liabilities.

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.

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

Retirement benefit costs (continued)

in full in the period in which they occur. They are recognised outside the profit and loss account and are presented in the SOCI.

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

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service costs, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds (which is only recognised to the extent that the Company 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.

Calculation of the amounts recognised in the financial statements in respect of defined benefit pension schemes requires a high level of judgement, as further explained in note 3.

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.

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree. Acquisition related costs are recognised in profit or loss as incurred.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition date fair value. Subsequent changes in fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (which is subject to a maximum of one year). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with the relevant accounting standards. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 (2008) *Business Combinations* are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

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 26.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured 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 or firm commitments (fair value hedges) or hedges of highly probable forecast transactions or hedges of firm commitments (cash flow hedges).

Derivative financial instruments and hedging activities (continued)

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 the 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 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 profit and loss account relating to the hedged item.

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 profit and loss account as the recognised hedge 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.

Hedges of 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.

Dividends 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.

Share-based payments

The ultimate parent, Serco Group plc, makes equity-settled share-based payments to certain employees and operates an HMRC approved Save As You Earn (SAYE) share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight line basis over the vesting period, based on the Company's estimate of shares that will eventually vest. SAYE options are treated as cancelled when employees cease to contribute to the scheme, resulting in an acceleration of the remainder of the related expense.

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of the Binomial Lattice or Monte Carlo Simulation models depending on the type of scheme. Further details can be found in note 37 of the Serco Group plc financial statements. The expected life used in the models has been adjusted, based on management's best

Share-based payments (continued)

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.

3 Critical accounting judgments 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 judgments 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 whether provisions are required for loss making contracts requires significant judgements to be made regarding the ability of the company to maintain or improve operational performance. Judgements can also be made regarding the outcome of matters dependent on the behaviour of the customer in question or other parties involved in delivering the contract.

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

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

In the current year material revisions have been made to historic provisions, which have led to a charge to contract provisions of £17.4m and releases of £27.4m. 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 Company's formal annual budgeting process. The future range of possible outcomes in respect of those assumptions and significant judgements made to determine the carrying value of onerous contracts could result in either a material increase or decrease in the value of onerous contract provisions in the next financial year. The extent to which actual results differ from estimates made at the reporting date depends on the combined outcome and timing of a large number of variables associated with performance across multiple contracts. The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision.

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 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

Impairment of assets (continued)

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 £2.6m (2016: £nil). There were no impairments recognised in respect of property, plant and equipment assets (2016: £0.2m). 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 judgment involved in determining what to include in underlying profit. We consider items which are material, non-recurring and outside of the normal operating practice of the Company to be suitable for separate presentation.

Retirement benefit obligations

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. The Company's retirement benefit obligations and other pension scheme arrangements are covered in note 22.

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates (see note 22). The value of net retirement benefit obligations at the balance sheet date is an asset of £26.8m (2016: £133.0m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in note 22.

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

- Asset recognised for Serco Pension and Life Assurance Scheme (SPLAS) is based on the assumption that the full surplus will ultimately be available to the Company as a future refund of surplus.
- No foreign exchange item is shown in the disclosures as the non UK liabilities are not material.
- No pension assets are invested in the 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.

4 Turnover

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

	2017 £ m	2016 £ m
Turnover as disclosed in the profit and loss account	1,218.9	1,266.9
Interest receivable and similar income (note 10)	8.2	14.5
Total income as defined in IAS 18	**1,227.1**	**1,281.4**

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.

4 Turnover (continued)

An analysis of turnover by class of business is given below:

	2017 £ m	2016 £ m
UK & Europe	1,104.6	1,165.6
Middle East	114.3	98.4
Private Sector	-	2.9
	1,218.9	**1,266.9**

An analysis of turnover by geographical location is given below:

	2017 £ m	2016 £ m
United Kingdom	1,082.8	1,137.5
Other	136.1	129.4
	1,218.9	**1,266.9**

Turnover is shown by geographical origin. Turnover analysed by geographical destination is not materially different.

5 Exceptional net profit on disposal of operations

During the year the Company generated the following net exceptional profit on disposal of operations:

	2017 £ m	2016 £ m
Disposal of Service Glasgow LLP	1.6	-
Costs in connection with the disposal of part of the UK onshore business	-	(2.2)
Adjustment to prior period disposal of Occupational Health business	-	4.5
Net profit on disposal of operations	**1.6**	**2.3**

On 30 November 2017 the Company's interest in Service Glasgow LLP was disposed of, resulting in a profit on disposal of £1.6m. Further details are provided below.

	Service Glasgow LLP £ m
Consideration	1.6
Less assets disposed	-
Income statement impact of disposal	**1.6**

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.

	2017 £ m	2016 £ m
Impairment of investment in joint venture	-	5.5
Release of UK frontline clinical health contract provisions	(0.4)	(0.6)
Settlement of defined benefit pension obligations	(10.3)	10.7
Restructuring costs	27.4	12.7
Movement in fair value of assets transferred to held for sale	-	(4.0)
Exceptional operating items	**16.7**	**24.3**

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) to the Principal Civil Service Pension Scheme.

6 Other exceptional operating items (continued)

This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items.

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 2017, a charge of £27.4m (2016: £12.7m) arose in relation to the restructuring programme resulting from the Strategy Review.

In 2017 there were releases of provisions of £0.4m (2016: £0.6m) which were previously charged through exceptional items in relation to the exit of the UK Frontline Clinical Health contracts.

7 Operating (loss)/profit

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

	2017 £ m	2016 £ m
Research and development costs	1.7	3.6
Operating lease expense - property	13.9	16.9
Operating lease expense - plant and machinery	14.9	19.2
Staff costs (note 8)	633.9	615.0
Amortisation of other intangible assets (note 14)	14.8	16.3
Impairment of other intangible assets (note 14)	2.8	-
Depreciation of tangible fixed assets - owned (note 15)	5.2	5.9
Depreciation of tangible fixed assets - leased (note 15)	6.7	7.8
Impairment of tangible fixed assets (note 15)	-	0.2
Net profit on disposal of operations (note 5)	(1.6)	(2.3)
Other exceptional operating items excluding impairment of goodwill (note 6)	16.7	24.3
Net foreign exchange (gain)/loss	(2.3)	5.7

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 £230,000 (2016: £230,000).

8 Staff costs

The average number of persons employed by the Company (including directors) during the year was 21,846 (2016 (restated*): 21,390). The aggregate payroll costs (including directors' remuneration) were as follows:

	2017 £ m	2016 £ m
Wages and salaries	542.1	530.0
Social security costs	47.7	45.4
Staff pensions	37.5	35.0
Share-based payment expenses	6.6	4.6
	633.9	**615.0**

*Headcount reported in the prior year has been restated from providing full time equivalent data to the monthly average number of persons employed at each month end.

8 Staff costs (continued)

The share-based payment expense for the year ended 31 December 2017 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 pence. Awards vest after the performance period of three to five years and are subject to the achievement of four performance measures with the exception of new non-performance awards granted in 2014. These non-performance options are only subject to continued employment on vesting dates which vary from six months to three years after the grant dates.

On the performance related awards, the primary performance measure is TSR and the second performance measure is based on EPS growth. Two additional measures on new grants in 2014 were Absolute Share Price and Strategic Objectives. If the options remain unexercised after a period of ten years from the date of grant, the options expire.

The options outstanding at 31 December 2017 had a weighted average contractual life of 0.9 years (2016: 1.9 years). The exercise prices for options outstanding at 31 December 2017 ranged from £3.88 to £4.55 (2016: £3.88 to £4.55).

The weighted average share price at the date of exercise approximates to the weighted average share price during the year, which was £1.17 (2016: £1.13).

9 Directors' remuneration

The directors' remuneration for the year was as follows:

	2017 £ m	2016 £ m
Aggregate emoluments	2.6	2.5

During the year the number of directors who were receiving benefits and share incentives was as follows:

	2017 No.	2016 No.
Received or were entitled to receive shares under long-term incentive schemes	4	4
Exercised share options	2	1

In respect of the highest paid director:

	2017 £ m	2016 £ m
Remuneration	1.0	0.9
Company contributions to money purchase pension schemes	-	-

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

10 Interest receivable and similar income

	2017 £ m	2016 £ m
Bank interest receivable	0.1	0.1
Interest receivable from group undertakings	4.2	9.5
Net interest receivable on retirement benefit obligations	3.7	4.6
Other interest receivable	0.2	0.3
	8.2	**14.5**

11 Interest payable and similar charges

	2017 £ m	2016 £ m
Other interest payable	0.6	0.9
Interest payable to group undertakings	1.3	7.8
Borrowing costs	0.1	-
Interest payable under finance leases	1.2	1.4
Movement in discount on provisions	0.4	2.1
	3.6	**12.2**

12 Tax

Tax on loss on ordinary activities:

	Before exceptional items 2017 £ m	Exceptional items 2017 £ m	Total 2017 £ m	Total 2016 £ m
Current tax				
UK corporation tax	0.5	-	0.5	0.9
Adjustments in respect of prior years	-	-	-	1.7
Consortium relief	(2.0)	-	(2.0)	-
	(1.5)	-	(1.5)	2.6
Deferred tax				
Current year	(9.6)	19.8	10.2	(0.7)
Adjustments in respect of prior years	(0.2)	-	(0.2)	-
	(9.8)	19.8	10.0	(0.7)
Tax expense/(credit)	**(11.3)**	**19.8**	**8.5**	**1.9**

Factors affecting current tax charge for the year

The current tax charge is higher than the UK corporation tax rate of 19.25% (2016: 20.00%). The differences are reconciled below:

	Before exceptional items 2017 £ m	Exceptional items 2017 £ m	Total 2017 £ m	Total 2016 £ m
(Loss)/profit on ordinary activities before tax	(9.8)	(15.1)	(24.9)	10.8
Corporation tax at 19.25% (2016: 20.00%)	(1.9)	(2.9)	(4.8)	2.1
Expenses not deductible for tax purposes	3.4	-	3.4	3.6
Group relief with no consideration	-	-	-	0.3
Unrelieved tax losses	(0.8)	2.9	2.1	2.1
Effect of the use of unrecognised tax losses	(0.2)	-	(0.2)	-
Adjustment in respect of deferred tax on pensions	2.2	18.3	20.5	-
Overseas rate differences	-	-	-	(0.3)
Unprovided deferred tax	(14.2)	4.1	(10.1)	(13.0)
Other non taxable income	(0.8)	-	(0.8)	(0.5)
Impact of changes in statutory tax rates	1.2	(2.6)	(1.4)	5.6
RDEC credit written off	-	-	-	0.3
Irrecoverable overseas tax	-	-	-	-
Adjustment in respect of prior years	(0.2)	-	(0.2)	1.7
Total tax charge/(credit) on ordinary activities	**(11.3)**	**19.8**	**8.5**	**1.9**

13 Deferred tax

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

	2017 £ m	2016 £ m
At 1 January	9.7	10.5
Deferred tax (charged)/credited to profit and loss account	(10.1)	0.9
Items taken directly to equity - retirement benefit obligations reserve	18.1	(1.7)
At 31 December	**17.7**	**9.7**

Of the amount charged to the income statement, £0.1m (2016: credit of £0.2m) has been taken to cost of sales in respect of the R&D Expenditure credit.

	2017 £ m	2016 £ m
Difference between accumulated depreciation and amortisation and capital allowances	1.3	7.7
Share based payments and employee benefits	0.8	0.8
Movement in retirement benefit obligations	(4.3)	(20.3)
Other temporary differences	19.9	21.5
	17.7	**9.7**

In Summer 2016, UK Government announced a reduction in the UK corporation tax rate from 20% to 19% effective from April 2017. Further measures enacted during 2016 cut the rate further from April 2020 to 17%. These measures have reduced the company's 2017 current tax credit and will reduce the future current tax charge accordingly. The deferred tax balance at 31 December 2017 has been calculated reflecting these rates.

Unprovided deferred tax

	2017 £ m	2016 £ m
Temporary differences on assets/liabilities	23.0	11.1
Share based payments and employee benefits	1.1	2.4
Other temporary differences	81.7	83.1
	105.8	**96.6**

14 Goodwill and other intangible assets

	Goodwill (*restated) £ m	Licences, software and development expenditure £ m	Total £ m
Cost			
At 1 January 2017	232.4	120.6	353.0
Additions from internal development	-	9.8	9.8
Additions from external acquisition	-	4.3	4.3
Reclassification from plant, property and equipment	-	0.4	0.4
Research and development expenditure	-	0.4	0.4
Disposals	-	(13.1)	(13.1)
Exchange differences	-	(0.4)	(0.4)
At 31 December 2017	**232.4**	**122.0**	**354.4**
Accumulated amortisation and impairment			
At 1 January 2017	232.4	73.9	306.3
Amortisation charge - internal development	-	12.0	12.0
Amortisation charge - external	-	2.8	2.8
Reclassification from plant, property and equipment	-	0.4	0.4
Disposals	-	(12.9)	(12.9)
Impairment charge		2.8	2.8
Exchange differences	-	(0.3)	(0.3)
At 31 December 2017	**232.4**	**78.7**	**311.1**
Net book value			
At 31 December 2017	**-**	**43.3**	**43.3**
At 31 December 2016	-	46.7	46.7

*As explained in note 1, goodwill has been restated to reflect the disposal of the private sector BPO business in 2016. There is no change to the net book value as this was nil at the time of the disposals.

Included in licences, software and development expenditure is an amount of £6.1m (2016: £8.7m) in respect of leased intangibles.

The net book value of internally generated intangible assets at 31 December 2017 was approximately £10.3m (2016: £13.7m) in development expenditure and £24.4m (2016: £23.4m) for software.

15 Property, plant and equipment

	Freehold buildings £ m	Short-leasehold assets £ m	Machinery, motor vehicles, furniture and equipment £ m	Total £ m
Cost				
At 1 January 2017	3.8	14.0	123.4	141.2
Additions	0.5	0.4	11.4	12.3
Intercompany additions	-	0.6	-	0.6
Disposals	-	-	(23.7)	(23.7)
Reclassification to other intangible assets	-	(0.4)	-	(0.4)
Exchange differences	-	(0.1)	(0.1)	(0.2)
At 31 December 2017	**4.3**	**14.5**	**111.0**	**129.8**
Accumulated depreciation				
At 1 January 2017	2.3	10.7	88.7	101.7
Charge for the year - depreciation	0.2	1.2	10.5	11.9
Disposals	-	-	(23.5)	(23.5)
Reclassification to other intangible assets	-	(0.4)	-	(0.4)
Exchange differences	-	-	(0.1)	(0.1)
At 31 December 2017	**2.5**	**11.5**	**75.6**	**89.6**
Net book value				
At 31 December 2017	**1.8**	**3.0**	**35.4**	**40.2**
At 31 December 2016	1.5	3.3	34.7	39.5

The carrying amount of the Company's Machinery, motor vehicles, furniture and equipment includes an amount of £21.8m (2016: £23.9m) in respect of assets held under finance leases, of which £nil (2016: £nil) is classified as held for sale.

The carrying amount of the Company's Short-leasehold assets includes an amount of £0.1m (2016: £0.2m) in respect of assets held under finance leases, of which £nil (2016: £nil) is classified as held for sale.

16 Investments held as fixed assets

	Subsidiaries £ m	Joint ventures £ m	Total investments £ m
At 1 January 2017 and at 31 December 2017	3.5	-	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	Country of incorporation	Address	Class of shares held	Proportion of voting rights and shares held 2017	2016
Subsidiary undertakings						
Serco Geografix Limited	Design, manufacture, sale and leasing of electronic tagging equipment	United Kingdom	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom	Ordinary	100%	100%
Serco Environmental Services Limited	Provision of environmental cleaning services	United Kingdom	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom	Ordinary	100%	100%
Joint ventures						
Viapath Group LLP	Provision of pathology services	United Kingdom	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	Partnership units	33%	33%
Viapath Analytics LLP[1]	Provision of pathology tests	United Kingdom	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	Partnership units	33%	33%
Viapath Services LLP[1]	Provision of laboratory facilities and pathology platforms	United Kingdom	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	Partnership units	33%	33%

[1] Indirect subsidiaries of Serco Limited.

17 Stocks

	2017 £ m	2016 £ m
Service spares	5.1	4.8
Parts awaiting installation	2.1	2.3
Work in progress	1.5	1.9
	8.7	**9.0**

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

18 Debtors

a) Amounts falling due within one year

	2017 £ m	2016 £ m
Trade debtors	98.3	79.3
Amounts owed by group companies	131.5	170.4
Other debtors	12.0	22.3
Prepayments and accrued income	107.0	113.4
	348.8	**385.4**

The trade debtors balance is stated after an allowance for doubtful debts of £0.5m (2016: £2.0m). Movements on the Company's allowance for doubtful debts are as follows:

	2017 £ m	2016 £ m
At 1 January	2.0	9.6
Released to the profit and loss account	(1.1)	(0.6)
Utilised	(0.4)	(7.3)
Exchange differences	-	0.3
	0.5	**2.0**

The Company has a receivables financing facility of £30.0m (2016: £30.0m), which was un-utilised at 31 December 2017 (2016: £7.7m utilised). This is a UK facility provided on a non-recourse basis with all relevant debtors requiring approval in advance by the facility provider.

The amounts recoverable on long-term contracts balance at 31 December 2017 included £nil (2016: £77.6m) of long term project-based contracts costs incurred plus recognised profits less recognised losses to date and there were £nil (2016: £76.0m) of progress payments. There were £nil (2016: £nil) of contract retentions held by customers.

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

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

b) Amounts falling due after more than one year

	2017 £ m	2016 £ m
Amounts owed by group companies	316.6	406.2
Other debtors	6.7	3.1
	323.3	**409.3**

Amounts owed by group companies include a loan of £150.0m to Serco Holdings Limited, 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%.

19 Creditors: Amounts falling due within one year

	2017 £ m	2016 £ m
Trade creditors	42.8	45.3
Obligations under finance lease and hire purchase contracts	7.9	11.0
Amounts owed to group companies	139.3	157.7
Other taxes and social security	30.0	25.0
Other creditors	15.2	12.9
Accruals and deferred income	122.3	148.4
	357.5	**400.3**

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

20 Creditors: Amounts falling due after more than one year

	2017 £ m	2016 £ m
Obligations under finance lease and hire purchase contracts	11.2	14.5
Amounts owed to group companies	45.7	127.1
Other creditors	2.7	3.9
	59.6	**145.5**

Total creditors due in more than one year held by the Company at 31 December 2017 amount to £59.6m (2016: £145.5m) and include £59.6m (2015: £145.5m) shown above.

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

Obligations under finance leases and hire purchase contracts

2017	Minimum lease payments £ m	Present value of minimum lease payments £ m
Within one year or on demand	8.3	7.9
Between two and five years	10.3	9.9
Over five years	1.4	1.3
Less: future finance charges	(0.9)	-
	19.1	**19.1**

2016	Minimum lease payments £ m	Present value of minimum lease payments £ m
Within one year or on demand	11.7	10.9
Between two and five years	15.0	14.5
Over five years	-	-
Less: future finance charges	(1.3)	-
	25.4	**25.4**

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.

21 Provisions

	Contract £ m	Employee related £ m	Property £ m	Other £ m	Total £ m
At 1 January 2017	127.7	14.9	7.9	57.6	208.1
Transfer between categories	-	-	-	-	-
Charged to the profit and loss account - exceptional	-	4.5	1.4	-	5.9
Charged to the profit and loss account - other	17.4	3.0	1.4	7.4	29.2
Released to the profit and loss account - exceptional	(0.4)	(0.8)	-	(10.2)	(11.4)
Released to the profit and loss account - other	(30.2)	(0.7)	-	(2.9)	(33.8)
Utilised during the year	(42.8)	(1.0)	(0.6)	(2.0)	(46.4)
Unwinding of discount	0.4	-	-	-	0.4
Exchange differences	-	(1.1)	-	-	(1.1)
At 31 December 2017	**72.1**	**18.8**	**10.1**	**49.9**	**150.9**
Analysed as:					
Current	32.9	6.2	2.9	32.3	74.3
Non-current	39.2	12.6	7.2	17.6	76.6
	72.1	**18.8**	**10.1**	**49.9**	**150.9**

Total provisions held by the Company at 31 December 2017 amount to £150.9m (2016: £208.1m) and include £150.9m (2016: £208.1m) shown above and £nil (2016: £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 7 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 2017, additional charges have been made in respect of future losses on a number of onerous contracts totalling £17.4m, 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.

Due to the significant size of the balance and the inherent level of uncertainty over the amount and timing of the related cash flows upon which onerous contract provisions are based, if the expected operational performance varies from the best estimates made at the year end, a material change in estimate may be required. The key drivers behind operational performance is the level of activity to be serviced, which is often directed by the actions of the UK Government, and the efficiency of Company employees and resources.

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.

22 Pension and other schemes

22 (a) Defined benefit 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 2018 are £6.8m (2017: £9.4m).

Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2015 and resulted in an actuarially assessed deficit of £4.0m for funding purposes. Pension obligations are valued separately for accounting and funding purposes and there is often a material difference between these valuations. As at 31 December 2017 the estimated actuarial deficit of SPLAS was £33.7m (2016: £42.6m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £41.8m. The primary reason a difference arises is that pension scheme accounting requires the valuation to be performed on the basis of a best estimate whereas the funding valuation used by the trustees makes more prudent assumptions. A revised schedule of contributions for SPLAS was agreed during the year, with 29% of pensionable salaries due to be paid from 1 November 2017 to 31 October 2018 and 28% from 1 November 2018 to 18 December 2022. An additional shortfall contribution of £1.0m is due by 30 April 2018 and four further payments of £0.5m payable at the end of each April through to 2022. 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). 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 2.65% p.a. to 2.53% p.a. during 2017 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. As explained in section (a) ii), in the first half of 2017 the Trustee secured a buy-in of the majority of the pensioner members, resulting in a significant de-risking of the scheme's position, which has provided a secure match of that significant proportion of the scheme's liabilities.
- 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 scheme s' liabilities.

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 IAS19 valuation at the reporting date and contractual obligations.
- Non contract specific. These do not relate to any specific contract and consist of two pre-funded defined benefit schemes. 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 2017 the Trustees of SPLAS entered into a bulk annuity purchase whereby an insurer will fund future benefit payments to the relevant members, commonly referred to as a "buy-in". The liability to pay the members remains with SPLAS and therefore the pension scheme will continue to include the relevant pension liabilities. However, an insurance asset is held at fair value, which, in line with IAS19 for qualifying insurance policies, is deemed to be equal to the present value of the related obligations. This removes the risk of longevity and investment movements for this portion of the scheme on a funding basis, and also removes the accounting risk of movements in underlying assumptions on the liabilities. Of the total remeasurements recognised in the statement of other comprehensive income in the year ended 31 December 2017 of £107.4m, £95.0m related to the revaluation of the assets and liabilities as a result of this transaction. Whilst the impact substantially reduced the asset on an IAS19 valuation basis, on the actuarial basis adopted for scheme funding purposes the transaction decreased the deficit of the scheme by approximately £12m. As a result of the transaction, the scheme also exited a longevity swap arrangement early, at a cost borne by the scheme of £7.5m.

In 2016, certain active former members of SPLAS on a specific contract were transferred back to a Government backed pension scheme they had previously been members of. This resulted in contribution savings due to lower rates required under the Government Serco scheme and a curtailment gain of £1.9m was recognised in 2016. In 2017 certain of these deferred members transferred their accrued benefits from SPLAS to the Government scheme. The arrangements for this process had been made by a planned transfer on a bulk basis, which resulted in settlement accounting being applied in 2016 and an exceptional charge booked at the time. However, it was subsequently agreed that the Government would allow the transfer of members on an individual basis and as the members are taking an existing option to take an individual transfer out of the scheme, settlement accounting was no longer applicable following the change of arrangements in 2017. The impact of the individuals transferring out is now treated as a change in actuarial assumptions and impacts on reserves, not through the income statement. The remaining provision of £10.3m was therefore reversed through exceptional items in 2017. The impact of the transfer resulted in a charge to other comprehensive income of £5.1m, included within the effect of experience assumptions.

In November 2017 certain members of SPLAS agreed to transfer their active membership to defined contribution schemes and a curtailment gain of £2.0m is recognised in the year in the Company's income statement.

iii) Values recognised in total comprehensive income in the year

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

Recognised in the income statement	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
Current service cost – employer	0.4	7.6	8.0
Past service credit	-	0.3	0.3
Curtailment loss recognised	-	(2.0)	(2.0)
Administrative expenses and taxes	-	5.2	5.2
Recognised in arriving at operating profit	**0.4**	**11.1**	**11.5**
Interest income on scheme assets – employer	(0.3)	(41.3)	(41.6)
Interest cost on scheme liabilities – employer	0.3	37.6	37.9
Finance income	**-**	**(3.7)**	**(3.7)**

Included within the SOCI	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
Actual return on scheme assets	10.4	(50.7)	(40.3)
Less: interest income on scheme assets	(0.3)	(41.4)	(41.7)
	10.1	**(92.1)**	**(82.0)**
Effect of changes in demographic assumptions	-	1.0	1.0
Effect of changes in financial assumptions	(10.0)	(21.3)	(31.3)
Effect of experience adjustments	-	4.9	4.9
Total pension gain recognised in the SOCI	**0.1**	**(107.5)**	**(107.4)**

Recognised in the income statement	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
Current service cost – employer	-	7.4	7.4
Past service cost	-	(1.4)	(1.4)
Administrative expenses and taxes	-	5.4	5.4
Recognised in arriving at operating profit	**-**	**11.4**	**11.4**
Interest income on scheme assets – employer	-	(49.0)	(49.0)
Interest cost on scheme liabilities – employer	-	44.4	44.4
Finance income	**-**	**(4.6)**	**(4.6)**

Included within the SOCI	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
Actual return on scheme assets	-	285.2	285.2
Less: interest income on scheme assets	-	(49.0)	(49.0)
	-	**236.2**	**236.2**
Effect of changes in demographic assumptions	-	26.2	26.2
Effect of changes in financial assumptions	-	(279.3)	(279.3)
Effect of experience adjustments	-	28.7	28.7
Total pension (loss) / gain recognised in the SOCI	**-**	**11.8**	**11.8**

iv) Balance sheet values

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

Scheme assets at fair value	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
Equities	5.8	46.3	52.1
Bonds except LDI	2.1	20.8	22.9
Liability driven investments (LDI)	-	709.8	709.8
Gilts	0.2	-	0.2
Property	0.9	-	0.9
Cash and other	1.4	3.3	4.7
Annuity policies	-	587.5	587.5
Fair value of scheme assets	10.4	1,367.7	1,378.1
Present value of scheme liabilities	(10.4)	(1,340.9)	(1,351.3)
Net retirement benefit asset	**-**	**26.8**	**26.8**
Net pension liability	-	(15.0)	(15.0)
Net pension asset	-	41.8	41.8
Net retirement benefit asset	-	26.8	26.8

Scheme assets at fair value	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
Equities	-	43.3	43.3
Bonds except LDI	-	20.2	20.2
Liability driven investments (LDI)	-	1,390.6	1,390.6
Gilts	-	72.4	72.4
Cash and other	-	4.2	4.2
Annuity policies	-	20.0	20.0
Fair value of scheme assets	-	1,550.7	1,550.7
Present value of scheme liabilities	-	(1,417.7)	(1,417.7)
Net retirement benefit asset	**-**	**133.0**	**133.0**
Net pension liability	-	(17.4)	(17.4)
Net pension asset	-	150.4	150.4
Net retirement benefit asset	-	133.0	133.0

The SPLAS Trust Deed gives the Group an unconditional right to a refund of surplus assets, assuming the full settlement of plan liabilities in the event of a plan wind-up. As such, the Group recognises the surplus of scheme assets over liabilities on the balance sheet.

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

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

	Contract specific £m	Non contract specific £m	Total £m
At 1 January 2016	-	**1,188.4**	**1,188.4**
Current service cost – employer	-	7.4	7.4
Past service costs	-	0.4	0.4
Scheme participants' contributions	-	0.4	0.4
Interest cost – employer	-	44.4	44.4
Benefits paid	-	(45.9)	(45.9)
Effect of changes in demographic assumptions	-	(26.2)	(26.2)
Effect of changes in financial assumptions	-	279.3	279.3
Effect of experience adjustments	-	(28.7)	(28.7)
Plan settlements	-	(1.8)	(1.8)
At 31 December 2016	-	**1,417.7**	**1,417.7**
Current service cost – employer	0.4	7.6	8.0
Past service costs	-	0.3	0.3
Scheme participants' contributions	-	0.4	0.4
Interest cost – employer	0.3	37.6	37.9
Benefits paid	(0.3)	(77.5)	(77.8)
Effect of changes in demographic assumptions	-	(1.0)	(1.0)
Effect of changes in financial assumptions	10.0	21.3	31.3
Effect of experience adjustments	-	(4.9)	(4.9)
Plan curtailment	-	(2.0)	(2.0)
Disposal of scheme	-	(58.6)	(58.6)
At 31 December 2017	**10.4**	**1,340.9**	**1,351.3**

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

	Contract specific £m	Non contract specific £m	Total £m
At 1 January 2015	-	**1,304.3**	**1,304.3**
Interest income on scheme assets – employer	-	49.0	49.0
Administrative expenses and taxes	-	(5.4)	(5.4)
Employer contributions	-	11.9	11.9
Contributions by employees	-	0.6	0.6
Benefits paid	-	(45.9)	(45.9)
Return on scheme assets less interest income	-	236.2	236.2
At 31 December 2016	-	**1,550.7**	**1,550.7**
Interest income on scheme assets – employer	0.3	41.4	41.7
Administrative expenses and taxes	-	(5.2)	(5.2)
Employer contributions	0.3	8.6	8.9
Contributions by employees	-	0.4	0.4
Benefits paid	(0.3)	(77.5)	(77.8)
Return on scheme assets less interest income	10.1	(92.1)	(82.0)
Eliminated on disposal of a pension scheme	-	(58.6)	(58.6)
At 31 December 2017	**10.4**	**1,367.7**	**1,378.1**

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 average duration of the benefit obligation at the end of the reporting period is 17.9 years (2016: 17.7 years).

Main assumptions	2017 %	2016 %
Rate of salary increases	2.7	2.8
Rate of increase in pensions in payment	2.30 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.30 (RPI)
Rate of increase in deferred pensions	2.30 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.30 (RPI)
Inflation assumption	2.20 (CPI) and 3.20 (RPI)	2.30 (CPI) and 3.30 (RPI)
Discount rate	2.5	2.7

Post retirement mortality	2017 years	2016 years
Current pensioners at 65 - male	22.5	22.5
Current pensioners at 65 – female	25.1	25.0
Future pensioners at 65 – male	24.3	24.2
Future pensioners at 65 - female	26.9	26.9

Sensitivity analysis is provided below, based on reasonably possible changes of the assumptions occurring at the end of the reporting period, assuming all other assumptions are held constant. The sensitivities have been derived in the same manner as the defined benefit obligation as at 31 December 2017 where the defined benefit obligation is estimated using the Projected Unit Credit method. Under this method each participant's benefits are attributed to years of service, taking into consideration future salary increases and the scheme's benefit allocation formula. Thus, the estimated total pension to which each participant is expected to become entitled at retirement is broken down into units, each associated with a year of past or future credited service. The defined benefit obligation as at 31 December 2017 is calculated on the actuarial assumptions agreed as at that date. The sensitivities are calculated by changing each assumption in turn following the methodology above with all other things held constant. The change in the defined benefit obligation from updating the single assumption represents the impact of that assumption on the calculation of the defined benefit obligation.

	2017 £m	2016 £m
Discount rate - 0.5% increase	(106.3)	(115.1)
Discount rate - 0.5% decrease	120.2	130.9
Inflation - 0.5% increase	81.7	104.5
Inflation - 0.5% decrease	(76.5)	(86.2)
Rate of salary increase - 0.5% increase	3.0	7.1
Rate of salary increase - 0.5% decrease	(2.8)	(6.8)
Mortality - one year age rating	41.2	43.9

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.

22 (b) Defined contribution schemes

The Company paid employer contributions of £28.0m (2016: £35.0m) 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.

23 Called up share capital

Allotted, called up and fully paid shares

	2017 No. m	2017 £ m	2016 No. m	2016 £ m
Ordinary share capital of £1 each	0.8	0.8	0.8	0.8

24 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 2017 (2016: £nil).

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 2017, the total facility amounts were £480m (2016: £480m) for the RCF and £261m (2016: £290m) 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.

As we have disclosed before, we are under investigation by the Serious Fraud Office. In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract. We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and / or the Serco entities involved.

25 Commitments

Operating leases

The total future value of minimum lease payments under non-cancellable operating leases is as follows:

	2017 £ m	2016 £ m
Within one year	23.3	30.2
In two to five years	29.4	32.7
In over five years	8.4	3.1
	61.1	**66.0**

The most significant leases are for land and buildings, which account for £48.8m (2016: £55.3m) of the total lease commitment.

26 Derivative financial instruments

	2017 Assets £ m	2017 Liabilities £ m	2016 Assets £ m	2016 Liabilities £ m
Forward foreign exchange contracts	0.2	(0.1)	0.4	-

	2016 Assets £ m	2016 Liabilities £ m	2016 Assets £ m	2016 Liabilities £ m
Analysed as:				
Non-current	0.1	(0.1)	-	-
Current	0.1	-	0.4	-
	0.2	(0.1)	0.4	-

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 loss of £0.3m arising in the year (2016: £0.2m gain) has been deferred in equity.

28 Post balance sheet events

The Company signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The Company continues to work with the BPA and one of the portfolio contracts was acquired in June 2018, with the remaining expected to complete in 2018.

29 Control

The Company's immediate parent is Serco Holdings Limited registered at 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire RG27 9UY. 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.