Registration number: 00242246

Serco Limited

Annual Report and Financial Statements

For the Year Ended 31 December 2018

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Company Information

Directors	N Crossley K Craven
Company secretary	Serco Corporate Services Limited
Registered number	00242246
Registered office	Serco House 16 Bartley Wood Business Park Bartley Way Hook, Hampshire United Kingdom RG27 9UY
Auditors	KPMG LLP 15 Canada Square London United Kingdom E14 5GL

Strategic Report
for the Year Ended 31 December 2018

The Directors present their Strategic Report for the year ended 31 December 2018.

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 up 4.3% from £1,214.4m (restated) to £1,266.3m driven by the transfer of the Carillion health facilities management contracts and new contract growth, in particular annualising 2017's start of hospital facility management services for Barts Health NHS trust and University Hospital Southampton NHS Foundation Trust. The Company generated an operating loss, before net exceptional items, for the year of £12.5m (2017: £14.4m, 2017 restated: £21.2m). The operating loss, before exceptional items, was better than in the prior year as a result of the benefit of transformation and cost efficiency programmes in the division as well as some improvement in the profitability of certain contracts moving out of their transition stages, with these more than offsetting the impact of other contract attrition and the investment required to mobilise and transition the Carillion contracts. During the year net exceptional charges of £39.3m were incurred (2017: £15.1m). After exceptional items the operating loss of the Company for the financial year was £51.8m (2017: £29.5m, 2017 restated: £36.3m).

After restatement of 2017, net assets of the Company have increased by 11.5% to £151.0m (2017 restated: £135.4m), primarily as a result of the £44.6m increase in net pension scheme assets to £71.4m offset by the impact of the net loss for the year. As at 31 December 2018 the estimated actuarial deficit of the Group's primary defined benefit scheme was £27.8m (2017: £33.7m). Transformation continued in the year and will carry on through 2019, 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.

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 housing and welfare services for asylum seekers; in Defence, we are trusted to deliver critical support services and operate sensitive facilities; our Health business provides primarily non-clinical support services to hospitals; and the 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.

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Business review (continued)
Revenue for 2018 was £1,146.8m (2017 restated: £1,099.6m), an increase of 4.3%. Drivers of the increase are in line with the Company as a whole as revenue within the Middle East remained stable. Within Underlying Trading Profit there was £28.9m of OCP utilisation (2017: £42.8m), which served to offset the Division's loss-making operations, principally COMPASS UK asylum seeker support services, Lincolnshire Country Council, and the Prisoner Escort & Custody Services (PECS) contracts.

Trading Profit is defined as IFRS Operating Profit excluding amortisation of intangibles arising on acquisition as well as exceptional items. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract & Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges).

Middle East
Revenue for the year was £119.5m (2017 restated: £114.8m), which included some volume growth of transport operations.

Principal risks and uncertainties

Risk management approach

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.

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Brexit

We make specific reference below to the UK's proposed withdrawal from the European Union ("Brexit") and our current assessment of its impact on Serco Limited.

We recognise that significant uncertainty will remain until any Brexit proposal is fully agreed and understood, and as such our understanding of potential risks and impacts are being regularly reviewed and assessed. We have, for example, reviewed the potential impact of Brexit, including adverse economic consequences, on our existing contract base, workforce, bidding activities and supply chain. We do not believe that Serco Limited will be materially affected by the UK withdrawing from the European Union. This is based on the following key points:

- For our UK and EU contracts, operations are generally delivered locally in-country and are not critically dependant on a cross-border supply chain or workforce.
- By operating many contracts, Serco has a natural hedge from material Brexit risks that may therefore arise on a limited number of contracts only.
- Many of our existing contracts have provisions which allow for inflationary adjustments to fees charged by us.
- A 'hard' Brexit without a transition period and/or an orderly withdrawal may cause regulatory and compliance uncertainty on some limited UK contracts that require performance under EU regulation, bodies and/or standards; however, we believe such uncertainties will be addressed under proposed new UK regulations following any withdrawal.
- Tariffs will only affect a small number of UK contracts that require imported goods that cannot be procured locally.
- For our European business, Serco Limited conducts business through locally established companies in EU states through a branch which allows Serco Limited to continue to operate subject to the freedoms and rules of the Internal Market.
- Public procurement and bidding processes will remain broadly unaffected as local laws will continue to apply post-Brexit.
- We recognise that Brexit may delay existing public sector outsourcing contracts and/or reduce pipeline opportunities while the UK Government and the Civil Service focus on implementing Brexit withdrawal.
- We are not critically reliant on our workforce having to travel extensively between the EU and UK, or the need to source EU workers on UK contracts - any such requirements that do arise will raise a manageable administrative workload only.
- We are conducting a critical supply chain review, and to date we are broadly comfortable with our key UK suppliers' ability to maintain the provision of goods and services on key UK contracts.

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.

For our principal risks, we have Subject Matter Experts ("SMEs") and a nominated Executive Committee member allocated to each, supporting their review and management. Detailed reviews of these risks are carried out on a rolling basis and contribute to the risk reporting at the Serco Group plc Group Risk Committee ("GRC"). As well as individual 'deep-dives' carried out on each of our principal risks during the year, our divisional CEOs provide a 'deep-dive' of one of their material risks providing the opportunity for the GRC to challenge risks at Divisional level and to stress test the Group's principal risks.

This year we have enhanced our risk overviews with the introduction of a Key Risk Indicator dashboard. This enables the GRC to see 'at a glance' progress to our mitigation plans, our tolerance levels and other risk indicators such as outcomes relating to our three lines of defence activity. The dashboard has been refined during the year, and this is expected to continue as our maturity regarding indicators and performance measures increases.

Risk appetite

Our objective is to be a trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens. As such, we have a relatively low risk appetite to ensure that we can deliver on the wider value that we want to bring to governments, public services and to society.

The Serco Group plc Board considers the risk appetite of the Group which are directly relevant to the Company. Different risks will attract different levels of risk appetite, and the use of 'heat maps' help prioritise our risks using a combination of agreed impact and likelihood criteria. Each of our principal risks has an appetite statement to determine the nature and amount of risk that Serco Group plc is willing to accept as well as informing our decision-making as to the level of resource required 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 which directly influences the operations of the Company.

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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.

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

Key risk drivers:

- 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').

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Material controls:

- Serco Group and Divisional Strategy including annual strategy reviews, ensuring focus on and resource allocation to specific markets and geographies with the greatest growth potential.
- Serco Operating Model.
- Investment Committee.
- Serco Management System (SMS).
- Sector-specific Centres of Excellence (CoEs) and Value Propositions.
- Newly relaunched Serco Institute to develop thought leadership and innovation for our markets.
- Business Lifecycle Review Team (BLRT) process.
- Pipeline and Business Development (BD) spend reviews to ensure efficient deployment of resources.
- Divisional Performance Reporting (DPR) process.
- Annual Performance Reviews, Talent Reviews and Succession Planning processes.
- Ensure that the divisional and business unit BD leadership and resources are appropriate for the delivery of our growth strategy.

Mitigation priorities:

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

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Failure to manage our reputation

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

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

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

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

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.

Early momentum on key projects delivery at the end of 2017 (eg. UK divisions consolidation) meant benefits flowed early in 2018, this established momentum for the rest of the year. The full-year target was achieved by July which meant residual risk in-year was minimal.

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Key risk drivers:

- Non-delivery of required benefits - we fail to achieve the expected benefits due to ineffective portfolio management and governance.
- 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.
- 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 Target Operating Model and design principles.
- Portfolio programme management process.
- Stakeholder engagement and communication plans.
- Benefits management process.

Mitigation priorities:

- Key benefits embedded in 2019 budgets to further increase focus on delivery and achievement of benefit outcomes at all levels.
- Further refinements to benefits tracking and reporting including differentiation between budget supporting and budget enhancing benefits.
- Additional delivery assurance and supplier management activities built into portfolio and delivery management processes.

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.

During 2018, the Finance Transformation Programme has been completed for both our UK and AsPac Divisions. Finance Centres of Excellence were created for both Divisions which are now in a stabilisation phase. Finalising the transform ,

Key risk drivers:

- Not setting the right tone from the top - if we do not set the right tone from the top, we may fail to embed finance policy, processes and controls.
- Poor financial processes – if processes are poorly designed, then inaccuracies and fraud may occur.
- Inadequate financial controls within the business – if controls are inadequate we may fail to provide adequate protection from sabotage of systems, fraud and error.
- Impact of Finance 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:

- Company Governance and finance strategy.
- Finance Transformation Programme governance.
- 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.

Mitigation priorities:

- Deliver on final components of finance transformation.
- Embed transformed finance function and monitor delivery and risks of outsourced Finance Centre of Excellence.
- Continuously improve forecasting and reporting processes and outputs to deliver better insight into contract operations.
- Deliver global finance process improvement and efficiency through automation and robotics.
- Establish billing assurance programme.
- Ensure talent is retained within the finance function through initiatives such as opportunities for personal development and improved training.

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.

Whilst our ongoing mitigation measures continue to deliver clear benefits, the external threats continue to evolve in complexity and sophistication, resulting in a steady state view of the overall risk.

Key risk drivers:

- Non-compliant systems - if our systems are non-compliant with Serco policies and standards and regulatory requirements for the protection of sensitive information, we are susceptible to breaches and penalties.
- Non-compliance with policies and standards – if staff do not comply with Serco policies and standards, then they may accidentally release sensitive information to third parties.
- Vulnerability of systems and information – if we do not identify sensitive information and protect and test the vulnerability of our systems, then we are potentially exposed to a breach.
- Unauthorised use of systems – if we do not implement effective personnel vetting and access restriction processes and controls, then unauthorised use of our systems may occur.
- Inadequate incident monitoring and response – if we do not monitor our systems and 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 and Two Factor Authentication for our centralised managed systems.
- External assessments.
- Third-party due diligence checks for key suppliers.
- Active monitoring by our Security Operations Centres and Computer Security Incident Response Team processes.
- Standardised HR processes.
- Cyber security awareness training part of our Serco Essentials training programme.
- Regular Phishing training exercises.

Mitigation priorities:

- Routine vigilance and proactive vulnerability identification coordinated through our Security Operations Centre.
- Embed third-party due diligence checks for key suppliers.
- Embed the use of global key security risk indicators to support mitigation priorities.

Contract non-compliance, non-performance or misreporting

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

The reporting structure, the systems and the monthly business performance review which is conducted at contract, Business Unit and Division level across our business provides a rigour that allows senior management visibility of contract performance or compliance issues early. We have seen no major failures in 2018.

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

- Contract Management training (Global and Divisional).
- Development and global rollout of contract performance dashboard ('Gauge').
- Improve consistency of approach to risk assessment and controls across all divisions.
- Divisional operational excellence improvement plans.

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 on Serco.

An extensive exercise to identify business-critical suppliers across all divisions was concluded in Q3, and the trend is steady while controls are implemented and systematically tested. This trend will remain the case while we focus on our highest risk suppliers and test the effectiveness of controls implemented.

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

- Focus on highest-rated business-critical suppliers for roll out and testing of controls.
- Develop proposition for formal supplier and contract management framework.
- Audit business-critical sub-contractor and supplier business continuity plans.
- Risk assessment and mitigation of business-critical suppliers through the Sales and Bidding cycle.

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Failure to act with integrity

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

We have continued to entrench our values through explicit leadership behaviours and communications and celebration through the Pulse Awards.

Our key controls have been further embedded, including those for our due diligence processes and ethical risk assessment.

We have strengthened and further clarified our expected behaviours through updates of Code of Conduct and associated training.

Key risk drivers:

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

Material controls:

- Top level commitment/tone from the top.
- Strong, meaningful and understood Values.
- Code of Conduct.
- Corporate Governance with oversight by the Corporate Responsibility Committee (CRC).
- Delegated Authority Matrix (DAM).
- 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.
- Corporate investigations.
- Speak Up process (Ethicspoint).

Mitigation priorities:

- Adoption of online Conflict of Interest registers.
- Refinement of divisional ethics and compliance risk assessments.
- Review of due diligence processes.
- Continued refresh of Serco Essentials training.
- Evaluate effectiveness of internal culture assessment processes.

Catastrophic incident

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

Significant activity completed - frontline operational controls collated and self-assessed. Second line (insurance and contractual risk allocation) under review and improved.

Key risk drivers:

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

Material controls:

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

Mitigation priorities:

- Adoption of updated health and safety strategy.
- Ensure strategy workplans have specific focus on Catastrophic risk.
- Improve understanding through training in insurance and contractual risk management.
- Complete second line controls review and alignment of insurance.
- Review levels and adequacy of compliance assurance.

Material legal and regulatory compliance failure

Failure to comply with laws and regulations may cause significant loss and damage to the 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. 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.

Various laws and regulations that apply across the business continue to be subject to increased focus and attention, including anti-bribery and corruption laws, Market Abuse Regulations, data and privacy laws, modern slavery, trade compliance and human rights.

Our GDPR implementation programme continues to support the business and help drive increased focus on data protection laws.

Key risk drivers:

- Lack of governance and oversight - may result in a failure to identify potential or actual legal or regulatory breaches resulting in a failure to respond appropriately or confirm compliance with legal and regulatory requirements.
- Failure to comply with the SMS and contractual obligations - may result in compliance failures for the Company-wide material legal and regulatory requirements.
- Failure to identify and respond to material changes in legal and regulatory requirements – may result in key subject matter experts within the business not remaining up to date and we then fail to comply with material legal and regulatory obligations.
- Lack of awareness by employees of the legal and regulatory requirements placed upon them – may result in lack of identification and subsequent compliance to requirements.
- Inadequate provision of systems and tools – may result in ineffective methods to support the management and reporting of legal and regulatory compliance.
- Legal or regulatory compliance failure by a third-party supplier/agent/partner - may result in Serco being held responsible for their failure under customer contracts.

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Material controls:

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

Mitigation priorities:

- Horizon scanning on key potential new laws and regulations, including Brexit.
- Greater use of data and trend analysis to inform Key Risk Indicators.
- Launch of new Conflicts Group Standard Operating Procedure.
- Ongoing compliance activity.
- Refreshing Serco Essentials training programmes.
- Continuing key contract and compliance assurance reviews on legal compliance.
- Developing and embedding Serco Trading Principles.

SFO investigation

We remain under investigation by the UK Serious Fraud Office (SFO) which commenced in December 2013. We are cooperating fully with the SFO's investigation, but it is not possible to predict the outcome and timing. No conclusion has yet been reached. However, in the event that the SFO decides to prosecute, the range of possible adverse outcomes is any one or a combination of the following:

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- 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 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, a potential impact on existing contracts and a period of discretionary debarment from future contracts with 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 Company may be reduced, and the Company 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 Company faces any criminal convictions, debarment consequences or enters into a DPA, any such outcome could result in significant fines, a potential impact on existing contracts and have a material adverse impact on the Company's' ability to contract with the 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 28/06/2019 and signed on its behalf by:

N Crossley
Director

Directors' Report
for the Year Ended 31 December 2018

The Directors present their annual report and the financial statements for the year ended 31 December 2018.

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

N Crossley

K Craven

G Leach (resigned 31 October 2018)

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

Going concern
In assessing the basis of preparation of the financial statements for the year ended 31 December 2018, 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 2020. 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 (2017: £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 (2017: £nil).

Directors' Report
for the Year Ended 31 December 2018

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

Risks and uncertainties
A review of risks is undertaken in the Strategic Report.

Post balance sheet events
On 7 January 2019, Serco Limited signed a contract with the UK Home Office Visas and Immigration department to run two regions of the new Asylum Accommodation and Support Services Contract (AASC). Serco Limited continues to work through the anticipated financial impact that AASC will have on its results and financial position for 2019 and future years, particularly in relation to the lease of accommodation used to service the contract.

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

Approved by the Board on 28/06/2019 and signed on its behalf by:

....
N Crossley
Director

Statement of Directors' Responsibilities in respect of the Strategic Report, the Directors' Report and the Financial Statements

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 Reduced Disclosure Framework.

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are 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 2018 which comprise the Profit and Loss, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity and the 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 2018 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.

Other Matter

The impact of uncertainties due to the UK exiting the European Union on our audit

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the financial statements. All audits assess and challenge the reasonableness of estimates made by the directors, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the Company's future prospects and performance.

Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown. We applied a standardised firm-wide approach in response to that uncertainty when assessing the Company's future prospects and performance. However, no audit should be expected to predict the unknowable factors or all possible future implications for a Company and this is particularly the case in relation to Brexit.

Independent Auditor's Report to the Members of Serco Limited

Going concern

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

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

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

Strategic report and directors' report

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

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

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

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.

Independent Auditor's Report to the Members of Serco Limited

Directors' responsibilities

As explained more fully in their statement set out on page 22, 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
United Kingdom
E14 5GL

Date: 28 June 2019

Profit and Loss Account
for the Year Ended 31 December 2018

	Note	2018 £ m	2017 (restated*) £ m
Turnover	4	1,266.3	1,214.4
Cost of sales		(1,176.0)	(1,133.6)
Gross profit		90.3	80.8
Administrative expenses		(90.2)	(87.2)
Amortisation of intangible fixed assets	14	(12.5)	(14.8)
Impairment of intangible assets	14	(0.1)	-
Exceptional net (loss) / profit on disposal of operations	5	(0.5)	1.6
Other exceptional operating items	6	(38.8)	(16.7)
Operating loss	7	(51.8)	(36.3)
Interest receivable and similar income	10	5.3	8.2
Interest payable and similar charges	11	(2.9)	(3.3)
Loss before tax		(49.4)	(31.4)
Tax on loss	12	14.0	(8.5)
Loss for the year		(35.4)	(39.9)

The above results were derived from continuing operations.

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The notes on pages 31 to 85 form an integral part of these financial statements.

Statement of Comprehensive Income
for the Year Ended 31 December 2018

	Note	*2018* *£ m*	*2017 (restated*)* *£ m*
Loss for the year		(35.4)	(39.9)
Other comprehensive income/(expense) for the year:			
Items that will not be reclassified subsequently to profit or loss			
Actuarial gain on reimbursable rights[1]		0.1	-
Tax related to items not reclassified[1]	13	(9.1)	18.1
Net actuarial loss on defined benefit pension schemes[1]	22	51.4	(107.4)
Total		42.4	(89.3)
Items that may be reclassified subsequently to profit or loss			
Gain/(loss) on cash flow hedges (net)[2]		0.1	(0.2)
Total other comprehensive income/(expense)		42.5	(89.5)
Total comprehensive income/(expense) for the year		7.1	(129.4)

[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.

*Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The notes on pages 31 to 85 form an integral part of these financial statements.

Balance Sheet
as at 31 December 2018

Registration number: 00242246

	Note	At 31 December 2018 £ m	At 31 December 2017 (restated*) £ m	At 1 January 2017 (restated*) £ m
Fixed assets				
Goodwill	14	6.8	-	-
Intangible fixed assets	14	48.4	43.3	46.7
Tangible assets	15	41.9	37.7	39.9
Investments	16	3.5	3.5	3.5
		100.6	84.5	90.1
Current assets				
Stocks	17	11.0	8.7	9.0
Cash and cash equivalents		-	-	7.6
Debtors: amounts falling due within one year	18	254.4	355.6	373.6
Debtors: amounts falling due after more than one year	18	175.3	323.3	409.3
Deferred tax assets	13	18.0	17.7	9.7
Corporation tax asset		4.9	2.1	-
Derivative financial instruments	26	0.3	0.2	0.4
		463.9	707.6	809.6
Total assets		564.5	792.1	899.7
Creditors: amounts falling due within one year				
Bank overdrafts		(4.3)	(72.0)	-
Creditors: amounts falling due within one year	19	(260.7)	(365.3)	(319.0)
Corporation tax liabilities		(3.1)	(2.7)	(2.2)
Derivative financial instruments	26	-	(0.1)	-
Provisions	21	(44.8)	(67.4)	(100.6)
		(312.9)	(507.5)	(421.8)
Net current assets		151.0	200.1	387.8

The notes on pages 31 to 85 form an integral part of these financial statements.

Balance Sheet

as at 31 December 2018

Registration number: 00242246

	Note	At 31 December 2018 £ m	At 31 December 2017 (restated*) £ m	At 1 January 2017 (restated*) £ m
Creditors: amounts falling due after more than one year				
Creditors: amounts falling due after more than one year	20	(142.0)	(119.1)	(150.0)
Provisions	21	(30.0)	(56.9)	(143.1)
		(172.0)	(176.0)	(293.1)
Defined benefit pension asset	22	85.8	41.8	150.4
Defined benefit pension liability	22	(14.4)	(15.0)	(17.3)
Net assets		151.0	135.4	317.9
Capital and reserves				
Called up share capital	23	0.8	0.8	0.8
Share premium reserve		1,108.9	1,108.9	1,108.9
Other reserves		0.2	0.1	0.3
Profit and loss account		(958.9)	(974.4)	(792.1)
Shareholders' funds		151.0	135.4	317.9

* Balances as at 31 December 2017 and 1 January 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The financial statements were approved by the Board on 28/06/2019 and signed on its behalf by:

....
N Crossley
Director

The notes on pages 31 to 85 form an integral part of these financial statements.

Statement of Changes in Equity
for the Year Ended 31 December 2018

	Called up share capital £ m	*Share premium £ m*	*Hedging and translation reserve £ m*	*Retained earnings £ m*	*Total £ m*
At 1 January 2017	0.8	1,108.9	0.3	(821.9)	288.1
IFRS15 restatement	-	-	-	(29.9)	(29.9)
At 1 January 2017 (As restated*)	0.8	1,108.9	0.3	(851.8)	258.2
Total comprehensive expense for the financial year	-	-	(0.2)	(129.2)	(129.4)
Credit in relation to share-based payments	-	-	-	6.6	6.6
At 31 December 2017	0.8	1,108.9	0.1	(974.4)	135.4
At 1 January 2018	0.8	1,108.9	0.1	(974.4)	135.4
Total comprehensive income for the financial year	-	-	0.1	7.0	7.1
Credits in relation to share-based payments	-	-	-	8.5	8.5
At 31 December 2018	0.8	1,108.9	0.2	(958.9)	151.0

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The notes on pages 31 to 85 form an integral part of these financial statements.

Notes to the Financial Statements

for the Year Ended 31 December 2018

1 General information

The Company is a private company limited by share capital, incorporated and domiciled in 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 2 to 19.

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

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

2 Accounting policies

Summary of significant accounting policies and key accounting estimates

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

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

Notwithstanding net current assets of £151.0m as at 31/12/2018 and a loss for the year ended of £35.4m, the financial statements have been prepared on a going concern basis which the directors consider to be appropriate for the following reasons:

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

Serco Group plc has indicated its intention to continue to make available such funds as are needed by the company for the period covered by the forecasts. Serco Group plc's current principal facilities include a revolving credit facility of £250m.

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

Notes to the Financial Statements
for the Year Ended 31 December 2018

2 Accounting policies (continued)

Summary of disclosure exemptions

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash flow statement, fair value measurement, standards not yet effective, impairment of assets and related party transactions.

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

The financial statements have been prepared on the historical cost basis and on the going concern basis, except for the revaluation of certain financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2018, 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 2020. 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 2 to 19 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 United Kingdom and registered in England & Wales.

2 Accounting policies (continued)

Adoption of new and revised standards

IFRS9 Financial Instruments

IFRS9 Financial Instruments (effective 1 January 2018) replaces IAS39 and introduces new requirements for classifying and measuring financial instruments and puts in place a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

The impact of IFRS9 on the regular trading activities of the Company was immaterial. The key areas of focus for the Company under IFRS9 are:

- External loan receivables, including those from equity accounted entities.
- Debt refinancing not accounted for as a significant modification under IAS39.
- Expected credit losses being recognised on trade debtors and contract assets recognised under IFRS15.
- Intercompany loan recoverability.

IFRS9 replaces the 'incurred loss' model in IAS39 with an 'expected credit loss' model. The new model applies to financial assets that are not measured at FVTPL (fair value through profit and loss), including loans, lease and trade receivables, debt securities, contract assets under IFRS15 and specified financial guarantees and loan commitments issued. It does not apply to equity investments.

Under the expected credit loss model, the Company is required to calculate the allowance for credit losses by considering on a discounted basis the cash shortfalls it would incur in various default scenarios for prescribed future periods and multiplying the shortfalls by the probability of each scenario occurring. The allowance is the sum of these probability weighted outcomes. Because every loan and receivable carries with it some risk of default, it is expected that every such asset has a loss attached to it from the moment of its origination.

The financial assets held on the balance sheet have been reviewed in order to determine whether any loss is required to be recorded based on these expected credit losses. However, given the fact that the Company's customers are government it is unlikely that there will be a default as a result of credit risk. In most cases, each amount receivable has specific risk attached to recoverability which is most likely based on the services provided under the terms of the contract and, given the majority of receivables are backed by organisations with a sovereign credit rating, the counter party credit risk is not considered to be material.

Prior year restatement for the impact of IFRS15 Revenue from Contracts with Customers

IFRS15 Revenue from Contracts with Customers (effective 1 January 2018), provides a single, principles-based five step model to be applied to all sales contracts, based on the transfer of control of goods and services to customers. It replaces existing revenue recognition guidance for goods, services and construction contracts currently included in IAS11 Construction Contracts and IAS18 Revenue.

Under the transition rules, IFRS15 has been applied retrospectively to the prior period in accordance with IAS8 Accounting Policies, Changes in Accounting Estimates and Errors, subject to the following expedients:

Notes to the Financial Statements
for the Year Ended 31 December 2018

2 Accounting policies (continued)

- contracts completed prior to 1 January 2017 or that begin and end within the same annual reporting period have not been restated;
- for contracts that have variable consideration and which completed prior to 1 January 2018, the revenues recognised reflected the actual outcome, rather than being estimated and trued up; and
- the disclosures required for comparative periods in respect of amount of revenue allocated to the remaining performance obligations, and an explanation of when that amount is expected to be recognised, will not be made in the financial statements for the year ended 31 December 2018.

There was no material impact of applying the practical expedients noted above.

The cumulative effect of initial application of the standard has been applied as an adjustment to brought forward retained earnings as at 1 January 2017.

Impact on profit and loss account

	Year ended 31 December 2017 as previously stated £ m	*Adjustment £ m*	*Year ended 31 December 2017 as restated £ m*
Turnover	1,218.9	(4.5)	1,214.4
Cost of sales	(1,131.3)	(2.3)	(1,133.6)
Gross profit	87.6	(6.8)	80.8
Administrative expenses	(87.2)	-	(87.2)
Amortisation of intangible fixed assets	(14.8)	-	(14.8)
Exceptional net (loss) / profit on disposal of operations	1.6	-	1.6
Other exceptional operating items	(16.7)	-	(16.7)
Operating loss	(29.5)	(6.8)	(36.3)
Interest receivable and similar income	8.2	-	8.2
Interest payable and similar charges	(3.6)	0.3	(3.3)
Loss before tax	(24.9)	(6.5)	(31.4)
Tax on loss	(8.5)	-	(8.5)
Loss for the year	(33.4)	(6.5)	(39.9)

2 Accounting policies (continued)

Impact on statement of other comprehensive income

	Year ended 31 December 2017 as previously stated £ m	*Adjustment £ m*	*Year ended 31 December 2017 as restated £ m*
Loss for the year	(33.4)	(6.5)	(39.9)
Other comprehensive expense for the year:			
Items that will not be reclassified subsequently to profit or loss			
Tax related to items not reclassified	18.1	-	18.1
Net actuarial loss on defined benefit pension schemes	(107.4)	-	(107.4)
Total	(89.3)	-	(89.3)
Items that may be reclassified subsequently to profit or loss			
Loss on cash flow hedges (net)	(0.2)	-	(0.2)
Total other comprehensive expense	(89.5)	-	(89.5)
Total comprehensive expense for the year	(122.9)	(6.5)	(129.4)

Notes to the Financial Statements
for the Year Ended 31 December 2018

2 Accounting policies (continued)

Impact on balance sheet

	As at 31 December 2017 as previously stated £ m	*Adjustment £ m*	*As at 31 December 2017 as restated £ m*
Fixed assets			
Intangible fixed assets	43.3	-	43.3
Tangible assets	40.2	(2.5)	37.7
Investments	3.5	-	3.5
	87.0	(2.5)	84.5
Current assets			
Stocks	8.7	-	8.7
Debtors: amounts falling due within one year	348.8	6.8	355.6
Debtors: amounts falling due after more than one year	323.3	-	323.3
Deferred tax assets	17.7	-	17.7
Corporation tax asset	2.1	-	2.1
Derivative financial instruments	0.2	-	0.2
	700.8	6.8	707.6
Total assets	787.8	4.3	792.1
Creditors: amounts falling due within one year			
Bank overdrafts	(72.0)	-	(72.0)
Creditors: amounts falling due within one year	(357.5)	(7.8)	(365.3)
Corporation tax liabilities	(2.7)	-	(2.7)
Derivative financial instruments	(0.1)	-	(0.1)
Provisions	(74.3)	6.9	(67.4)
	(506.6)	(0.9)	(507.5)
Net current assets	194.2	5.9	200.1

Notes to the Financial Statements
for the Year Ended 31 December 2018

2 Accounting policies (continued)

	As at 31 December 2017 as previously stated £ m	*Adjustment £ m*	*As at 31 December 2017 as restated £ m*
Creditors: amounts falling due after more than one year			
Creditors: amounts falling due after more than one year	(59.6)	(59.5)	(119.1)
Provisions	(76.6)	19.7	(56.9)
	(136.2)	(39.8)	(176.0)
Defined benefit pension asset	41.8	-	41.8
Defined benefit pension liability	(15.0)	-	(15.0)
Net assets	171.8	(36.4)	135.4
Capital and reserves			
Called up share capital	0.8	-	0.8
Share premium reserve	1,108.9	-	1,108.9
Other reserves	0.1	-	0.1
Profit and loss account	(938.0)	(36.4)	(974.4)
Shareholders' funds	171.8	(36.4)	135.4

New standards and interpretations not applied: IFRS16 Leases

IFRS16 Leases

IFRS16 Leases (effective 1 January 2019), specifies how to recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset is of a low value. Lessors continue to classify leases as operating or finance, with the IFRS 16 approach to lessor accounting remaining substantially unchanged from its predecessor, IAS 17.

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

2 Accounting policies (continued)

- No reassessment is required as to whether a contract is, or contains, a lease at the date of initial application.
- No reassessment is required for:

  - leases with a lease term end date within one year of the date of initial application; or
  - leases for low value assets, which the Group considers to be those with an initial cost value less than £5,000 except for circumstances where those assets form part of a bundle of leased assets accounted for as a single lease contract.
- The Company has adopted the modified retrospective transition approach and as such the valuation of the right of use asset at 1 January 2019 is calculated as if the lease had always existed and hence the net book value of the asset on 1 January 2019 is based on the assumption of straight line amortisation.

The lease liability at 1 January 2019 will be calculated as the present value of future payments in relation to the lease, discounted at the applicable incremental borrowing rate.

The Company has taken advantage of disclosure exemptions in relation to the effect of IFRS 16.

Revenue recognition

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

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

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

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

Notes to the Financial Statements

for the Year Ended 31 December 2018

2 Accounting policies (continued)

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

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

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

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

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

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

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

The Company has no material exposure to returns or refunds.

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

2 Accounting policies (continued)

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

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

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

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 IFRS2 Share Based Payment, leasing transactions that are within the scope of IAS17 Leases, or the calculation of net realisable value under IAS2 Inventories or value in use under IAS36 Impairment of Assets.

Tax

The tax expense represents the sum of current tax expense and deferred tax expense.

Current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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

2 Accounting policies (continued)

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

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

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

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

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same tax authority where the Company intends to settle its current tax assets and liabilities on a net basis.

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

Retirement benefit costs

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

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

2 Accounting policies (continued)

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

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

Multi- employer pensions

Multi-employer pension schemes are classified as either a defined contribution pension scheme or a defined benefit pension scheme under the terms of the scheme. The Company accounts for these schemes as if they were defined contribution schemes in accordance with IAS 19 where the legal responsibility for settlement resides in another group entity and there is no contractual agreement for charging the net defined benefit cost associated with the Company.

Foreign currency transactions and balances

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

Goodwill

Goodwill is measured as the excess of the fair value of purchase consideration over the fair value of the net assets acquired and is recognised as an intangible asset when control is achieved. Negative goodwill is recognised immediately in the income statement. Fair value measurements are based on provisional estimates and may be subject to amendment within one year of the acquisition, resulting in an adjustment to goodwill.

Goodwill itself does not generate independent cash flows and therefore, in order to perform required tests for impairment, it is allocated at inception to the specific cash generating units (CGUs) or groups of CGUs which are expected to benefit from the acquisition.

On the disposal of a business which includes all or part of a CGU, any attributable goodwill is included in the determination of the profit or loss on disposal.

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

Notes to the Financial Statements
for the Year Ended 31 December 2018

2 Accounting policies (continued)

Property, plant and equipment

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

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

Depreciation

The principal annual rates used are:

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

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

Other intangible assets

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

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

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

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

Notes to the Financial Statements
for the Year Ended 31 December 2018

2 Accounting policies (continued)

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.

Investment

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

Investments in associates
An associate is an entity over which the Company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control. The results and assets and liabilities of associates are also incorporated in these financial statements using the equity method of accounting.

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.

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.

Notes to the Financial Statements

for the Year Ended 31 December 2018

2 Accounting policies (continued)

Cash and cash equivalents

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

Trade receivables

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

A provision for impairment arises where there is evidence that the Company will not be able to collect amounts due, which is achieved by creating an allowance for doubtful debts recognised in the income statement within administrative expenses.

Determining whether a trade receivable is impaired requires judgement to be applied based on the information available at each reporting date. Key indicators of impairment include disputes with customers over commercial positions, or where debtors have significant financial difficulties such as historic default of payments or information that suggests bankruptcy or financial reorganisation are a reasonable possibility. The majority of contracts entered into by the Company are with government organisations and therefore historic levels of default are relatively low and as a result the risks associated with this judgement are not considered to be significant.

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

Stock

Inventories are stated at the lower of cost and net realisable value and comprise service spares, parts awaiting installation and work in progress for projects undertaken for customers where payment is received on completion. Cost comprises direct materials and, where applicable, direct labour costs that have been incurred in bringing the inventories to their present location and condition.

Leases

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 income statement, 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 (see below).

Total rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

2 Accounting policies (continued)

Loans and borrowing costs

Loans

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

Loans are described as non recourse loans and classified as such only if no Group company other than the relevant borrower has an obligation, under a guarantee or other arrangement, to repay the debt.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised as an expense in the period in which they are incurred.

Provisions

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

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

Asset impairment

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

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

2 Accounting policies (continued)

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

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

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

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

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

Defined benefit obligations arising from contractual obligations

Where the Company takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract, the Group's share of the defined benefit obligation less its share of the pension scheme assets that it will fund over the period of the contract is recognised as a liability at the start of the contract with a corresponding amount being recognised as an intangible asset. The intangible asset, which reflects the Company's right to manage and operate the contract, is amortised over the contract period. The Company's share of the scheme assets and liabilities is calculated by reducing the scheme assets and liabilities by a franchise adjustment. The franchise adjustment represents the estimated amount of scheme deficit that will be funded outside the contract period. Subsequent actuarial gains and losses in relation to the Company's share of pension obligations are recognised within Other Comprehensive Income.

Share based payments

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of Binomial Lattice, Black Scholes or Monte Carlo Simulation models depending on the type of scheme, as set out in note 35 of Serco Group plc financial statements. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

2 Accounting policies (continued)

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the 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 30 of Serco Group plc financial statements.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Company designates certain derivatives as either hedges of the fair value of recognised assets or liabilities (fair value hedges) or hedges of highly probable forecast transactions or hedges of firm commitments (cash flow hedges).

At the inception of the hedge relationship, the Company documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Both at the inception of the hedge and on a periodic basis, the Company assesses whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

A derivative is presented as a non current asset or a non current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Derivatives, which mature within 12 months, are presented as current assets or current liabilities.

Details of the fair values of the derivative instruments used for hedging purposes and movements in the hedging and translation reserve in equity are detailed in the SOCI and described in note 26.

2 Accounting policies (continued)

Fair value hedges

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

Hedge accounting is discontinued when the Company de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss, in the same line of the income statement as the recognised hedged item.

Hedge accounting is discontinued when the Company de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

Net investments in foreign operations

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

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

Dividend payable

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

3 Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Company's accounting policies, which are described in note 2 above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements. As described below, many of these areas of judgement also involve a high level of estimation uncertainty.

Provisions for onerous contracts

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

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

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

In the current year, an amount of £5.1m was charged to historic provisions, and releases of £5m have been made. No charges have been made to new onerous contract provisions during the current year. Further details are provided in the Finance Review within the Strategic Report of Serco Group Plc financial statements. All of these revisions have resulted from triggering events in the current year, either through changes in contractual positions or changes in circumstances which could not have been reasonably foreseen at the previous balance sheet date. To mitigate the level of uncertainty in making these estimates Management regularly compares actual performance of the contracts against previous forecasts and considers whether there have been any changes to significant judgements. A detailed bottom up review of the provisions is performed as part of the Group's formal annual budgeting process.

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

Notes to the Financial Statements
for the Year Ended 31 December 2018

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

The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. Rates applied are in the range of 0.72% and 1.24%.

Impairment of assets

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

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

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

There was an impairment of intangible assets during the year of £0.1m (2017: £2.6m). There were no impairments recognised in respect of property, plant and equipment assets (2017: £nil). Further details of these impairments can be seen in notes 14 and 15 to the financial statements.

Separation of income statement items from underlying results

IAS 1 requires material items to be disclosed separately in a way that enables users to assess the quality of a company's profitability. In practice, these are commonly referred to as "exceptional" items, but this is not a concept defined by IFRS and therefore there is a level of judgement involved in determining what to include in underlying profit. We consider items which are material, non-recurring and outside of the normal operating practice of the Company to be suitable for separate presentation. Further details can be seen in note 5 and 6.

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

Retirement benefit obligation

Identifying whether the Company has a retirement benefit obligation as a result of contractual arrangements entered into requires a level of judgement, largely driven by the legal position held between the Company, the customer and the relevant pension scheme. The Company's retirement benefit obligations and other pension scheme arrangements are covered in note 31 of Serco Group Plc financial statements.

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

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

- The asset recognised for the Serco Pension and Life Assurance Scheme is equal to the full surplus that will ultimately be available to the Company as a future refund.
- No 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:

	2018 *£ m*	*2017 (restated*)* *£ m*
Turnover as disclosed in the profit and loss account	1,266.3	1,214.4
Interest receivable and similar income (note 10)	5.3	8.2
	1,271.6	1,222.6

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.

Notes to the Financial Statements
for the Year Ended 31 December 2018

4 Turnover (continued)

The analysis of the Company's turnover for the year by class of business is as follows:

	2018 £ m	2017 (restated*) £ m
UK & Europe	1,146.8	1,099.6
Middle East	119.5	114.8
	1,266.3	1,214.4

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

	2018 £ m	2017 (restated*) £ m
United Kingdom	1,127.6	1,077.8
Other	138.7	136.6
	1,266.3	1,214.4

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

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Transaction price allocated to remaining performance obligations

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

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

	2018 £ m
Less then 1 year	1,089.6
Between 1 - 2 years	780.9
Between 2 - 5 years	1,828.5
More than 5 years	3,463.6
	7,162.6

5 Exceptional net (loss)/profit on disposal of operations

During the year the Company generated the following net exceptional loss (2017: profit) on disposal of operations:

	2018 £ m	2017 £ m
Disposal of the Anglia Support Partnership	(0.5)	-
Disposal of Service Glasgow LLP	-	1.6
	(0.5)	1.6

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

	Anglia Support Partnership contract £ m
Consideration	-
Less:	
Net assets disposed	(0.1)
Consideration	(0.4)
Income statement impact of disposal	(0.5)

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

	Anglia Support Partnership contract £ m
Consideration	-
Less: Disposal costs	(0.3)
Net cash flow on disposal	(0.3)

Notes to the Financial Statements

for the Year Ended 31 December 2018

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.

	2018 *£ m*	*2017* *£ m*
Release of UK frontline clinical health contract provisions	-	(0.4)
Settlement of defined benefit pension obligations	-	(10.3)
Restructuring costs	27.7	27.4
Increase in onerous lease provision	1.8	-
Cost of Guaranteed Minimum Pension equalisation	9.3	-
Exceptional operating items	38.8	16.7

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items. There was no exceptional item in 2018.

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 2018, a charge of £27.7m (2017: £27.4m) arose in relation to the restructuring programme resulting from the Strategy Review.

In 2017 there were releases of provisions of £0.4m which were previously charged through exceptional items in relation to the exit of the UK Frontline Clinical Health contracts. This was £nil in 2018.

6 Other exceptional operating items (continued)

On 26 October 2018, the High Court handed down a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should equalise pension benefits for men and women in relation to guaranteed minimum pension ("GMP") benefits. The judgement has implications for many defined benefit schemes, including those in which Serco Limited participates.

We have worked with our actuarial advisors to understand the implications of the High Court judgement for the schemes in which the Group participates and have recorded a £9.3m pre-tax exceptional expense to reflect our best estimate of the effect on our reported pension liabilities.

The change in pension liabilities recognised in relation to GMP equalisation involves estimation uncertainty. It is expected that there will be follow-on court hearings to further clarify the application of GMP equalisation in practice. Also, it is not yet known whether Lloyds Banking Group will appeal the High Court judgement. The financial statements reflect the best estimate of the impact on pension liabilities, that estimate reflects a number of assumptions. As the outcome of future court hearings cannot be reliably predicted, it is not practical to quantify the extent of the estimation uncertainty but the best estimate reflects the information currently available. The Directors will continue to monitor any further clarifications or court hearings arising from the Lloyds case and consider the impact on pension liabilities accordingly.

The Directors have made the judgement that the estimated effect of GMP equalisation on the Groups' pension liabilities is a past service cost that should be reflected through the income statement and that any subsequent change in the estimate of that should be recognised in other comprehensive income. The judgement is based on the fact that the reported pension liabilities for the Pension Scheme as at 31 December 2017 did not include any amount in respect of GMP equalisation.

An additional charge of £1.8m has been recorded in respect of an onerous lease provision.

An exceptional charge of £9.3m (2017: nil) has been recorded in the income statement for the year ended 31 December 2018. This is to recognise the Company's obligations associated with equalising the Guaranteed Minimum Pension (GMP) payments between male and female employees for the Group's defined benefit pension schemes following a High Court ruling made in October 2018. The Serco Pension and Life Assurance Scheme (SPLAS) recorded the largest charge being £9.0m. This has been recorded as exceptional to ensure consistent treatment of all items in 2018 related to the cost of equalising the GMP payments within the Group's pension schemes. The impact of GMP equalisation is not currently estimated to have a material impact in future years.

7 Operating loss

Operating loss is stated after (crediting)/charging:

	2018 £ m	2017 £ m
Research and development costs	(0.3)	1.7
Operating lease expense - property	2.4	13.9
Operating lease expense - plant and machinery	5.7	14.9
Staff costs (note 8)	647.1	633.9
Amortisation of other intangible assets (note 14)	12.5	14.8
Impairment of other intangible assets (note 14)	0.1	2.8
Depreciation of tangible fixed assets - owned (note 15)	10.2	5.2
Depreciation of tangible fixed assets - leased (note 15)	1.2	6.7
Net profit/(loss) on disposal of operations (note 5)	0.5	(1.6)
Other exceptional operating items excluding impairment of goodwill (note 6)	38.8	16.7
Net foreign exchange loss/(gain)	1.2	(2.3)

The Committee limits the non-audit work undertaken by the External Auditor and monitors the non-audit fees paid during the year. Amounts payable to KPMG LLP and their associates by the Company in respect of non-audit services are shown within the group financial statements. Audit fees £230,000 (2017: £230,000).

8 Staff costs

The average number of persons employed by the Company (including directors) during the year was 21,795 (2017 : 21,846). The aggregate payroll costs (including directors' remuneration) were as follows:

	2018 £ m	2017 £ m
Wages and salaries	541.9	542.1
Social security costs	47.1	47.7
Staff pensions	49.6	37.5
Share-based payment expenses	8.5	6.6
	647.1	633.9

Notes to the Financial Statements
for the Year Ended 31 December 2018

8 Staff costs (continued)

The share-based payment expense for the year ended 31 December 2018 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 2018 had a weighted average contractual life of 0.37 years (2017: 0.9 years). The exercise prices for options outstanding at 31 December 2018 was £3.88 (2017: £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 £0.95 (2017: £1.17).

9 Directors' remuneration

The directors' remuneration for the year was as follows:

	2018 *£ m*	*2017* *£ m*
Remuneration	1.5	2.6

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

	2018 *No.*	*2017* *No.*
Received or were entitled to receive shares under long term incentive schemes	2	4
Exercised share options	1	2

Notes to the Financial Statements
for the Year Ended 31 December 2018

9 Directors' remuneration (continued)

In respect of the highest paid director:

	2018 £ m	2017 £ m
Remuneration	0.7	1.0
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

	2018 £ m	2017 £ m
Interest receivable from group undertakings	4.6	4.2
Bank interest receivable	-	0.1
Net interest receivable on retirement benefit assets	0.7	3.7
Other interest receivable	-	0.2
	5.3	8.2

11 Interest payable and similar charges

	2018 £ m	2017 (restated*) £ m
Other interest payable	0.4	0.6
Interest payable to group undertakings	2.0	1.3
Borrowing costs	-	0.1
Interest payable under finance leases	0.5	1.2
Movement in discount on provisions	-	0.1
	2.9	3.3

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Notes to the Financial Statements
for the Year Ended 31 December 2018

12 Income tax

Tax on ordinary activities (credited)/charged in the profit and loss account :

	2018 £ m	2017 £ m
Current taxation		
UK corporation tax	0.6	0.5
Adjustments in respect of prior years	(0.8)	-
Consortium relief	(2.1)	(2.0)
	(2.3)	(1.5)
Deferred taxation		
Current year	(11.7)	10.2
Adjustments in respect of prior years	-	(0.2)
Total deferred taxation	(11.7)	10.0
Tax (receipt)/expense in the profit and loss account	(14.0)	8.5

Notes to the Financial Statements
for the Year Ended 31 December 2018

12 Income tax (continued)

Factors affecting current tax charge for the year

The tax on profit before tax for the year is lower than the standard rate of corporation tax in the UK (2017 - higher than the standard rate of corporation tax in the UK of 19% (2017 - 19.25%.)

The differences are reconciled below:

	2018 *£ m*	*2017 (restated*)* *£ m*
Loss before tax	(49.4)	(31.4)
Corporation tax at standard rate	(9.4)	(6.0)
Expenses not deductible for tax purposes	3.0	3.4
Group relief with no consideration	3.0	-
Unrelieved tax losses	2.0	2.1
Effect of use of unrecognised tax loss	-	(0.2)
Adjustment in respect of deferred tax on pensions	(10.1)	20.5
Unprovided deferred tax	(1.8)	(8.9)
Other non taxable income	(1.4)	(0.8)
Impact of changes in statutory tax rates	1.4	(1.4)
Adjustment in respect of prior years	(0.7)	(0.2)
Total tax (credit)/charge	(14.0)	8.5

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

13 Deferred tax

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

	2018 *£ m*	*2017* *£ m*
At 1 January	17.7	9.7
Deferred tax credited/(charged) to profit and loss account	11.7	(10.1)
Deferred tax liability arising on acquisition	(2.3)	-
Items taken directly to equity - retirement benefit obligations reserve	(9.1)	18.1
At 31 December	18.0	17.7

Notes to the Financial Statements
for the Year Ended 31 December 2018

13 Deferred tax (continued)

Of the amount credited (2017 charged) to the income statement, £0.1m credit (2017: debit of £0.1m) has been taken to cost of sales in respect of the R&D Expenditure credit.

	2018 *£ m*	*2017* *£ m*
Difference between accumulated depreciation and amortisation and capital allowances	8.2	1.3
Share based payments and employee benefits	1.5	0.8
Movement in retirement benefit obligations	(11.8)	(4.3)
Other temporary differences	20.1	19.9
	18.0	17.7

Factors affecting future tax rate

In 2016 the UK Government enacted measures to reduce the current UK tax rate from 19% to 17% from April 2020. Any future current tax charge for the company will be calculated using these appropriately reduced rates.

Unprovided deferred tax

	2018 *£ m*	*2017 (restated*)* *£ m*
Temporary differences on assets/liabilities	13.7	23.0
Share based payments and employee benefits	3.5	1.1
Other temporary differences	82.1	82.7
	99.3	106.8

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Notes to the Financial Statements
for the Year Ended 31 December 2018

14 Goodwill and other intangible assets

	Goodwill £ m	*Licenses, software and development expenditure £ m*	*Total £ m*
Cost			
At 1 January 2018	232.4	122.0	354.4
Additions on internal development	-	6.3	6.3
Additions from external acquisition	6.8	13.6	20.4
Reclassification from plant, property and equipment	-	0.6	0.6
Disposals	-	(14.1)	(14.1)
Foreign exchange movements	-	0.3	0.3
At 31 December 2018	239.2	128.7	367.9
Accumulated amortisation and impairment			
At 1 January 2018	232.4	78.7	311.1
Amortisation charge	-	12.5	12.5
Disposals	-	(12.4)	(12.4)
Impairment	-	0.1	0.1
Other reclassification	-	1.2	1.2
Foreign exchange difference	-	0.2	0.2
At 31 December 2018	232.4	80.3	312.7
Carrying amount			
At 31 December 2018	6.8	48.4	55.2
At 31 December 2017	-	43.3	43.3

Included in licences, software and development expenditure is an amount of £3.6m (2017: £6.1m) in respect of leased intangibles.

Goodwill and intangible assets external additions have arisen in the year following the acquisition of Carillion plc's facilities management contracts. More detail can be found in note 27.

The net book value of internally generated intangible assets at 31 December 2018 was approximately £6.2m (2017: £10.3m) in development expenditure, £29.2m (2017: £24.4m) for software and £13.1m (2017: £nil) in customer relationships.

Notes to the Financial Statements
for the Year Ended 31 December 2018

15 Property, plant and equipment

	Freehold building £ m	*Short-leasehold assets £ m*	*Machinery, Motor vehicles, furniture and equipment £ m*	*Total £ m*
Cost				
At 1 January 2018 (restated*)	4.3	14.5	108.5	127.3
Additions	-	-	18.7	18.7
Disposals	-	(1.4)	(9.3)	(10.7)
Reclassification to other intangible assets	-	-	(0.7)	(0.7)
Foreign exchange movements	-	-	0.1	0.1
At 31 December 2018	4.3	13.1	117.3	134.7
Accumulated depreciation				
At 1 January 2018	2.5	11.5	75.6	89.6
Depreciation charge	0.2	1.0	10.2	11.4
Disposals	-	(1.2)	(6.1)	(7.3)
Impairment	-	-	0.7	0.7
Other reclassification	-	-	(1.7)	(1.7)
Foreign exchange movements	-	-	0.1	0.1
At 31 December 2018	2.7	11.3	78.8	92.8
Carrying amount				
At 31 December 2018	1.6	1.8	38.5	41.9
At 31 December 2017 (restated*)	1.8	3.0	32.9	37.7

* Results and Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The carrying amount of the Company's Machinery, motor vehicles, furniture and equipment includes an amount of £20.1m (2017: £21.8m) in respect of assets held under finance leases.

The carrying amount of the Company's Short-leasehold assets includes an amount of £0.1m (2017: £0.1m) in respect of assets held under finance leases.

Notes to the Financial Statements
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16 Investments held as fixed assets

Subsidiaries	*£ m*
At 1 January 2018	3.5
At 31 December 2018	3.5

Details of undertakings

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

Undertaking	*Activity*	*Address*	*Country of incorporation*	*Class of shares held*	*Proportion of voting rights and shares held 2018*	*2017*
Serco Geografix Limited	Design, Manufacture, sale and leasing of electronic tagging equipment	Serco House, 16, Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom	United Kingdom	Ordinary	100%	100%
Serco Environmental Services Limited	Provision of environmental cleaning services	Serco House, 16, Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom	United Kingdom	Ordinary	100%	100%

Notes to the Financial Statements
for the Year Ended 31 December 2018

16 Investments held as fixed assets (continued)

Joint ventures

Undertaking	*Activity*	*Address*	*Country of incorporation*	*Class of shares*	*Proportion of voting rights and shares held 2018*	*2017*
Viapath Group LLP	Provision of pathology services	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	United Kingdom	Partnership units	33%	33%
Viapath Analytics LLP	Provision of pathology tests	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	United Kingdom	Partnership units	33%	33%
Viapath Services LLP	Provision of laboratory facilities and pathology platforms	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom	United Kingdom	Partnership units	33%	33%

Viapath Analytics LLP and Viapath Services LLP are indirect subsidiaries of Serco Limited.

17 Stocks

	2018 *£ m*	*2017* *£ m*
Service spares	5.9	5.1
Parts awaiting installation	2.8	2.1
Work in progress	2.3	1.5
	11.0	8.7

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

Notes to the Financial Statements
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18 Debtors

a) Amounts falling due within one year

	2018 £ m	2017 (restated*) £ m
Amounts owed by group companies	19.9	131.5
Trade debtors	116.2	98.3
Other debtors	7.8	12.1
Prepayments and accrued income	26.7	28.6
Contract asset	83.8	85.1
	254.4	355.6

* Results and Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Contract asset comprise of capitalised bid costs, phase costs and accrued income. These assets represent up-front investment in contracts which are recoverable and expected to provide benefits over the life of those contracts. Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

The trade debtors balance is stated after an allowance for doubtful debts of £1.3m (2017: £0.5m). Movements on the Company's allowance for doubtful debts are as follows:

	2018 £ m	2017 £ m
At 1 January	0.5	2.0
Released to profit and loss account	2.1	(1.1)
Utilised	(1.3)	(0.4)
Exchange difference	-	-
	1.3	0.5

The Company has a receivables financing facility of £30.0m (2017: £30.0m), which was un-utilised at 31 December 2018 (2017: £nil 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 2018 included £nil (2017: £nil) of long term project-based contracts costs incurred plus recognised profits less recognised losses to date and there were £nil (2017: £nil) of progress payments. There were £nil (2017: £nil) of contract retentions held by customers.

Notes to the Financial Statements
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18 Debtors (continued)

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

	2018 £ m	2017 £ m
Amounts owed by group companies	170.9	316.6
Other debtors	4.4	6.7
	175.3	323.3

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

	2018 £ m	2017 (restated*) £ m
Debtors: amounts falling due within one year	254.4	355.6
Debtors: amounts falling due after more than one year	175.3	323.3
	429.7	678.9

* Results and Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

19 Creditors: Amounts falling due within one year

	2018 £ m	2017 (restated*) £ m
Trade creditors	39.6	42.8
Obligations under finance lease and hire purchase contracts	5.6	7.9
Amounts owed to group companies	31.1	139.3
Other taxes and social security	32.7	30.0
Other creditors	20.8	15.2
Accruals and deferred income	100.4	102.3
Contract liability	30.5	27.8
	260.7	365.3

Notes to the Financial Statements
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19 Creditors: Amounts falling due within one year (continued)

* Results and Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

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

	2018 £ m	(As restated) 2017 £ m
Obligations under finance lease and hire purchase contracts	8.9	11.2
Amounts owed to group companies	72.5	45.7
Other creditors	1.4	2.7
Deferred Income	59.2	59.5
	142.0	119.1

	2018 £ m	2017 (restated*) £ m
Creditors: amounts falling due within one year	260.7	365.3
Creditors: amounts falling due after more than one year	142.0	119.1
	402.7	484.4

* Results and Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Total creditors due in more than one year held by the Company at 31 December 2018 amount to £82.8m (2017: £59.6m).

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

Notes to the Financial Statements
for the Year Ended 31 December 2018

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

Obligations under finance leases and hire purchase contracts

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

2017	*Minimum lease payments £ m*	*Interest £ m*	*Present value £ m*
Within one year or on demand	8.3	(0.4)	7.9
Between two to five years	10.3	(0.4)	9.9
Over five years	1.4	(0.1)	1.3
	20.0	(0.9)	19.1

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.

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for the Year Ended 31 December 2018

21 Provisions

	Property *£ m*	*Contract* *£ m*	*Employee benefits* *£ m*	*Other provisions* *£ m*	*Total* *£ m*
At 1 January 2018 (restated*)	10.1	65.2	18.8	30.2	124.3
B/f reclassification	-	0.2	-	0.6	0.8
Charged to the profit and loss account - exceptional	1.8	-	-	-	1.8
Charged to the profit and loss account - other	1.3	5.1	5.8	1.7	13.9
Release to the profit and loss account - other	(1.1)	(5.0)	(4.2)	(11.6)	(21.9)
Utilised during the year	(2.0)	(28.9)	(4.9)	(9.0)	(44.8)
Exchange differences	-	-	0.7	-	0.7
At 31 December 2018	10.1	36.6	16.2	11.9	74.8
Non-current liabilities	6.9	9.1	13.9	0.1	30.0
Current liabilities	3.2	27.5	2.3	11.8	44.8

* Results and Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Total provisions held by the Company at 31 December 2018 amount to £74.8m (2017: £150.9m, 2017 restated: £124.3m) and include £74.8m (2017: £150.9m, 2017 restated: £124.3m) shown above and £nil (2017: £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 2018, additional charges have been made in respect of future losses on a number of onerous contracts totalling £5.1m, all of which related to existing OCPs.

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

21 Provisions (continued)

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

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 £17.3m (2017: £6.8m).

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 2018 the estimated actuarial deficit of SPLAS was £27.8m (2017: £33.7m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £85.8m. 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 was paid on 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).

Notes to the Financial Statements

for the Year Ended 31 December 2018

22 Pension and other schemes (continued)

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

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

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

- Investment risk. The schemes hold assets with which to discharge the future liabilities of these schemes. Any decline in the value of these investments directly impacts on the ability of the scheme to meet its commitments and could require the Company to fund this shortfall in future years. As a result of the SPLAS's investment strategy, which aims to reduce volatility risk by better matching assets to liabilities, 45% of the scheme's assets are annuity policies and 55% are Liability Driven Investments (LDIs). The annuity policies result in an insurer funding the future benefit payments to the relevant members and therefore eliminate the risk of changes in the future value of the benefits to the scheme. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays and are therefore linked to the key drivers of the scheme's liabilities. The value of these investments vary in line with gilt yields, which have decreased from 2.65% pa. to 2.53% pa. during 2018 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.

22 Pension and other schemes (continued)

- Longevity risk. The present value of the defined benefit scheme' liabilities are calculated by reference to the best estimate of the mortality of the schemes' participants both during and after their employment. An increase in the life expectancy of the schemes' participants will increase the schemes' liabilities.

- Salary risk. The present value of the defined benefit schemes' liabilities are calculated by reference to the future salaries of the schemes' participants, as such, an increase in the salary of the schemes' participants will increase the schemes' liabilities.

The defined benefit schemes are grouped together as follows:

- Contract specific. These are pre-funded defined benefit schemes. The Company has obligations to contribute variable amounts to the pension schemes over the terms of the related contracts as defined by the contract and scheme rules At rebid, any deficit or surplus would be expected to transfer to the next contractor. At the start of these relevant contracts the Company recognised the defined benefit obligation less the fair value of scheme assets with a corresponding amount recognised as an intangible asset. Subsequent actuarial gains and losses in relation to the Company's share of the pension obligations have been recognised in the SOCI. The intangible assets are amortised over the initial term of the contracts with none remaining at the current or prior year end. Where the relevant scheme has a deficit which is not required to be fully funded by the Company an adjustment is made to limit the amount recognised in the Company's balance sheet by way of a 'franchise adjustment'. Under contractual arrangements the Company makes contributions under Admitted Body status to a number of sections of the Local Government Pension Scheme for the period to the end of the relevant customer contracts. The Company will only participate in the Local Government Pension Schemes for a finite period up to the end of the contracts. The Company is required to pay regular contributions as decided by the respective Scheme Actuary and as detailed in each scheme's Schedule of Contributions. In addition, the Company may be required to pay some or all of any deficit (as determined by the respective Scheme Actuary) that is remaining at the end of the contract. In respect of this, the Company recognises a sufficient level of provision in these financial statements based on the IAS 19 valuation at the reporting date and contractual obligations.

- Non contract specific. These do not relate to any specific contract and consist of two pre-funded defined benefit schemes. The funding policy for the pre-funded schemes is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis. One of these schemes is SPLAS and the other is a non-contract specific section of the Railways Pension Scheme (RPS). There is no residual liability to fund a deficit of the RPS at the end of the franchise period and any costs are shared 60% by the employer and 40% by the members.

22 Pension and other schemes (continued)

ii) Events in the year

During the year, the Company made two one-off contributions into the SPLAS scheme. In April 2018 a payment of £1.2m was made and this was followed by a payment for £4.0m in December 2018.

Also during the year, following a ruling in the High Court, the Company has recognised a past service cost for the impact of Guaranteed Minimum Pension equalisation. The total amount recognised by the Group is £9.3m and this has been treated as an exceptional item in the Income Statement.

iii) Value recognised in total Comprehensive Income in the year

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

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

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

Notes to the Financial Statements
for the Year Ended 31 December 2018

22 Pension and other schemes (continued)

	Contract specific 2017 £m	*Non contract specific 2017 £m*	*Total 2017 £m*
Recognised in the income statement			
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)

	Contract specific 2017 £m	*Non contract specific 2017 £m*	*Total 2017 £m*
Included within the SOCI			
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)

Notes to the Financial Statements
for the Year Ended 31 December 2018

22 Pension and other schemes (continued)

iv) Balance sheet values

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

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

22 Pension and other schemes (continued)

	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

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.

Notes to the Financial Statements

for the Year Ended 31 December 2018

22 Pension and other schemes (continued)

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

	Contract specific £m	*Non contract specific £m*	*Total £m*
At 1 January 2017	-	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 settlements	-	(2.0)	(2.0)
Disposal of scheme	-	(58.6)	(58.6)
At 31 December 2017	10.4	1,340.9	1,351.3
At 1 January 2018	10.4	1,340.9	1,351.3
Current service cost - employer	0.3	4.6	4.9
Past service costs	-	9.3	9.3
Scheme participants' contributions	-	0.2	0.2
Interest cost- employer	0.3	32.6	32.9
Benefits paid	(0.2)	(80.7)	(80.9)
Effect of changes in financial assumptions	(0.6)	(74.0)	(74.6)
Effect of experience adjustments	-	30.0	30.0
At 31 December 2018	10.2	1,262.9	1,273.1

Notes to the Financial Statements
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22 Pension and other schemes (continued)

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

	Contract specific £m	*Non contract specific £m*	*Total £m*
At 1 January 2017	-	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
At 1 January 2018	10.4	1,367.7	1,378.1
Interest income on scheme assets - employer	0.3	33.3	33.6
Administrative expenses and taxes	-	(3.9)	(3.9)
Employer contributions	0.1	10.3	10.4
Contributions by employees	0.1	0.3	0.4
Benefits paid	(0.2)	(80.7)	(80.9)
Return on scheme assets less interest income	(0.5)	7.3	6.8
At 31 December 2018	10.2	1,334.3	1,344.5

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 16.1 years (2017: 17.9 years).

22 Pension and other schemes (continued)

	2018 %	2017 %
Rate of salary increases	2.80	2.70
Rate of increase in pensions in payment	2.20 (CPI) and 3.00 (RPI)	2.20 (CPI) and 3.00 (RPI)
Rate of increase in deferred pensions	2.20 (CPI) and 3.20 (RPI)	2.30 (CPI) and 3.20 (RPI)
Inflation assumption	2.30 (CPI) and 3.30 (RPI)	2.20 (CPI) and 3.20 (RPI)
Discount rate	2.90	2.50

Post retirement mortality

	2018 Years	2017 Years
Current pensioners at 65 - male	22.6	22.5
Current pensioners at 65 - female	25.1	25.1
Future pensioners at 65 - male	24.4	24.3
Future pensioners at 65 - female	27.0	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 2018 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 2018 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.

	2018 £m	2017 £m
Discount rate - 0.5% increase	(102.8)	(106.3)
Discount rate - 0.5% decrease	112.2	120.2
Inflation - 0.5% increase	66.9	81.7
Inflation - 0.5% decrease	(64.7)	(76.5)
Rate of salary increase - 0.5% increase	2.4	3.0
Rate of salary increase - 0.5% decrease	(2.3)	(2.8)
Mortality - one year age rating	39.9	41.2

Management acknowledges that the method used of presuming that all other assumptions remaining constant has inherent limitation given that it is more likely for a combination of changes, but highlights the value of each individual risk and is therefore a suitable basis for providing this analysis.

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22 Pension and other schemes (continued)

Defined contribution pension scheme

The Company paid employer contributions of £19.3m (2017: £28.0m) 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 Share capital

Allotted, called up and fully paid shares

		2018		*2017*
	No.	*£*	*No.*	*£*
Ordinary share capital of £1 each	800,776	800,776	800,776	800,776

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 £4.3m at 31 December 2018 (2017: £72.0m).

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 2018, the total facility amounts were £250m (2017: £480m) for the RCF and £242m (2017: £261m) 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 filly 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.

Notes to the Financial Statements
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25 Commitments

Capital commitments

The total amount contracted for but not provided in the financial statements was £1.1m (2017: £1.7m)

Operating leases

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

	2018 *£ m*	*2017* *£ m*
Within one year	16.6	23.3
In two to five years	11.9	29.4
In over five years	2.4	8.4
	30.9	61.1

The most significant leases are for land and building, which account for £24.7m (2017: £48.8m) of the total lease commitment.

26 Derivative financial instruments

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

	2018 Assets *£ m*	*2018 Liabilities* *£ m*	*2017 Assets* *£ m*	*2017 Liabilities* *£ m*
Forward foreign exchange contracts	0.3	-	0.2	(0.1)

	2018 Assets *£ m*	*2018 Liabilities* *£ m*	*2017 Assets* *£ m*	*2017 Liabilities* *£ m*
Analysed as:				
Non-current	0.1	-	0.1	(0.1)
Current	0.2	-	0.1	-
	0.3	-	0.2	(0.1)

26 Derivative financial instruments (continued)

The Company is exposed to foreign currency transaction risk on costs. Any material transactional exposure that does arise is hedged by the Group Treasury function using forward foreign currency contracts. Hedges on highly probable forecast transactions or commitments have been designed as cash flow hedges. All currency derivatives designated as cash flow hedges are highly effective and the fair value gain of £0.3m arising in the year (2017: £0.3m loss) has been deferred in equity.

27 Acquisitions

Serco Limited acquired Carillion plc's facilities management contracts at six major NHS hospital sites over the period from June 2018 to August 2018: 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 total annual revenue of all six contracts is expected to be around £70m and the estimated operating profit before exceptional items, including an appropriate allocation of charges for shared support services and other incremental overheads, will be approximately £4m, the aggregate consideration payable was £18.1m. The acquired contracts contributed £30.3m of revenue and an operating loss before exceptional items of £2.1m of to the Company's results during year to 31 December 2018 due to the transition costs incurred.

	Provisional fair value Carillion Health contracts £m
Goodwill	6.8
Acquisition related intangible assets	13.6
Deferred tax liability	(2.3)
Acquisition date fair value of consideration transferred	18.1
Satisfied by:	
Cash	16.1
Contingent consideration	2.0
Total consideration	18.1

The net cash outflow as a result of the acquisitions completed during the year was £18.1m made up of £16.1m consideration paid on acquisitions made during the year.

Goodwill on the Carillion Health contracts represents the premium associated with taking over contracts considered to have synergies with existing Health related contracts already being operated by the Company, and bring an established workforce able to deliver the services required under the contracts. The contracts acquired are considered to be accretive to the Company's financial performance. The contingent consideration payable on the Carillion Health contracts is contingent on the Company receiving certain indemnities in relation to the contracts acquired.

Notes to the Financial Statements
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28 Post balance sheet events

On 7 January 2019, Serco Limited signed a contract with the UK Home Office Visas and Immigration department to run two regions of the new Asylum Accommodation and Support Services Contract (AASC). Serco Limited continues to work through the anticipated financial impact that AASC will have on its results and financial position for 2019 and future years, particularly in relation to the lease of accommodation used to service the contract.

29 Parent and ultimate parent undertaking

The Company's immediate parent is Serco Holdings Limited.

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