

The Board of Serco Group plc (the “Company”) is committed to achieving high standards of corporate governance, integrity and business ethics for all its activities around the world. The Company supports the Principles of Good Governance and Code of Best Practice as appended to the Listing Rules of the Financial Services Authority (the “Combined Code”). The Company has achieved full compliance with the code provisions set out in section 1 of the July 2003 FRC Combined Code on corporate governance during 2004.

#### THE BOARD AND ITS DIRECTORS

The Board currently comprises seven Directors, Kevin Beeston, Margaret Ford, Ralph Hodge, Christopher Hyman, Andrew Jenner, DeAnne Julius and David Richardson. Excluding the Executive Chairman, the Board comprises four Non-Executive Directors and two other Executive Directors.

Since the Group has been listed it has been run with a structure consisting of both an Executive Chairman and a Chief Executive with distinct and complementary roles. The Group has also maintained a position of Senior Independent Director throughout this time. During 2004, following Rhidian Jones’ retirement, DeAnne Julius was appointed as the Group’s Senior Independent Director.

The Board continues to believe in the need for a full time Executive Chairman who is responsible for the effective operation of the Board, oversight of corporate governance and assurance activities, and the Company’s relationship with the City and key business stakeholders. This role is distinct from that of the Chief Executive who focuses on the formation and implementation of the Group strategy, chairing and managing the Global Management Board and delivery of all aspects of the business. Job specifications are in place for both the Executive Chairman and the Chief Executive defining their roles and responsibilities. The Board have reviewed and re-approved the individual roles and responsibilities of both the Chairman and the Chief Executive during the year. The Directors’ profiles are set out on pages 69 and 70.

The Board believes that all the Non-Executive Directors are independent of management and free from any business or other relationship, which could materially interfere with the exercise of their independent judgment. They bring a wide range of experience to the Board including international business operations, strategy, human resources, finance and economics. The Senior Independent Director is DeAnne Julius, who took over from Rhidian Jones in April 2004 following Rhidian’s retirement from the Board. David Richardson replaced Rhidian Jones as Chairman of the Audit Committee in April 2004. As Finance Director of a FTSE 100 Company, the Board believes that David has the relevant financial experience to chair this Committee as recommended by the Combined Code. The Non-Executive Directors have met on an informal basis during the year without the presence of the Executive Directors. The Non-Executive Directors are initially appointed for a three-year term, which may be extended for a further period of three years.

During the year the Board met on four occasions for two days at a time, at varying locations, and took the opportunity to combine the formal business of the Group with site visits and divisional presentations and discussions. In addition, three other meetings took place during the year to discuss the proposed acquisitions of ITNET and RCI. Apologies were received from Christopher Hyman who could not attend the May 2004 Board meeting, due to his attendance at a key customer meeting.

There is a formal schedule of matters reserved for the Board including the responsibility for leading and directing the affairs of the Group. This schedule together with the terms of reference for each of the Board Committees were reviewed and revised by the Board in November 2003 following publication of the revised Combined Code. Terms of reference of the Committees are available on the Company’s website [www.serco.com](http://www.serco.com). Membership of the Committees was revised following the changes to the Board in May 2004.

**Board evaluation** – During the year each Director has participated in a comprehensive Board and Committee evaluation process, comprising 1:1 meetings with the Chairman, completion of a detailed Board Evaluation Questionnaire, and discussion of a summary of the findings with the Board. As part of this review the effectiveness and independence of both the internal and external auditors was assessed. Following discussions had with other Board members, the Senior Independent Director met with the Chairman to discuss the evaluation of his performance.

All Directors have access to the Company Secretary and independent professional advice at the Company’s expense. The Company Secretary has the responsibility for ensuring that the Board procedures are followed and for advising on governance matters. The appointment and removal of the Company Secretary is one of the matters reserved for the Board. The Company Secretary is also Secretary to all the Board Committees and responsible for operation of the Group’s “whistle-blowing” procedure. The information provided to the Board is reviewed by the Chairman and the Company Secretary on a regular basis, to ensure that it remains appropriate, timely and adequate and enables the Directors to discharge their duties. The information provided to the Board was assessed as part of the Board evaluation process.

In accordance with the Company’s Articles of Association, a Director must retire at the Annual General Meeting (but is eligible for re-appointment) if he or she has held office for more than 30 months (as at the date of the notice convening the meeting) since he or she was appointed or last re-appointed.

THE BOARD AND ITS DIRECTORS (continued)

**Other Directorships** – The Board believes that it is in the customer's best interests for Executive Directors to gain additional experience through limited, but carefully selected, Non-Executive appointments. During the year Christopher Hyman was appointed Non-Executive Director of United Business Media plc for which he received £17,051 in remuneration and 815 shares during the year, and also Non-Executive Director of the Prince of Wales' charity In Kind Direct which is a non-fee earning role. Kevin Beeston is a Non-Executive Director of Ipswich Town Football Club plc and a member of the Board of Companions of the Chartered Management Institute. Both roles are non-fee earning. The Board is fully supportive of the external roles undertaken by Kevin and Christopher and consider that the time commitment required will not significantly impact their positions in the Company.

BOARD COMMITTEES

The Board has delegated authority to a number of committees to deal with matters in accordance with written terms of reference. The terms of reference were reviewed and revised in November 2003 to take account of the changes to the Combined Code. The Chairmen of the Board Committees attend the Annual General Meeting to answer questions from shareholders.

The terms of reference for the Board Committees and matters reserved for the Board are displayed on the Company's website [www.serco.com](http://www.serco.com).

THE AUDIT COMMITTEE

The Audit Committee is chaired by David Richardson, who was appointed in April 2004 following the retirement of Rhidian Jones. Margaret Ford and DeAnne Julius, Non-Executive Directors, are also members of the Committee. Apologies were received from Margaret Ford and DeAnne Julius who could not attend the meeting held in February 2004. In accordance with best practice the Committee has produced a report on its activities during the year, which can be found below:

REPORT OF THE AUDIT COMMITTEE

The Audit Committee met three times during the year. At the meetings, attended by the internal and external auditors and, by invitation, the Finance Director, matters relating to the integrity of the financial statements of the Company, the accounting policies adopted, significant financial reporting judgements made and the role of the internal auditors were discussed. During the year the Committee held discussions regarding the business risk auditing activities undertaken by the Company's internal audit providers, Grant Thornton. Members of the Committee have received updates on accounting standards and generally accepted accounting principles on a quarterly basis as part of the Finance Director's report to the Board, and also on a half-yearly basis from the external auditors. The Committee has also received a presentation and update reports on the impact of the International Financial Reporting Standards on the Company and the Group. During the year the Company has complied with the policy set by the Committee in respect of the provision of audit and non-audit services by Deloitte & Touche LLP ("Deloitte"). The Committee reviewed adherence to the policy during the year. Where appropriate non audit services have been provided by companies other than Deloitte. The Committee considered and recommended approval of the annual audit fee for Deloitte, which was subsequently approved by the Board.

The independence, objectivity and effectiveness of the external auditors has been examined by the Committee and discussions were held regarding their terms of engagement, remuneration and proposal for partner rotation. The Committee has met with both the internal and external auditors without the presence of the Executive Directors.

In accordance with the Combined Code, the Committee approved a formal "whistle-blowing" policy and procedure for implementation throughout the Group. This has been fully implemented during 2004 and responsibility for the operation of this policy has been delegated to the Company Secretary.

The Committee recommended to the Board that Deloitte be proposed for re-appointment at the forthcoming Annual General Meeting. This recommendation has been accepted and will be proposed to shareholders.

#### THE NOMINATION COMMITTEE

The Nomination Committee comprises the Executive Chairman, who chairs the Committee, and the four independent Non-Executive Directors. The Committee met twice during the year and all Committee members attended both meetings. Matters considered included succession planning and crisis management planning for the Board and the change of the Company Secretary.

#### THE REMUNERATION COMMITTEE

The Remuneration Committee is chaired by Ralph Hodge, with the other three Non-Executive Directors being the remainder of the Committee. The Committee met four times during the year to deal with matters relating to remuneration policy and individual remuneration for Executive Directors. All meetings were attended by each of the Committee members. The Remuneration Report is set out on pages 72 to 80. The Committee also considered the policy and framework of remuneration for senior executives within the Group. The individual remuneration of these executives is considered and approved by the Remuneration Committee of the Global Management Board (GMB), which comprises the Executive Team of the Global Management Board and is advised by the Human Resources (HR) Director.

There are three further committees of the Board, details of which are below:

#### THE APPROVALS AND ALLOTMENT COMMITTEE

This Committee meets on an as required basis and comprises the Executive Directors and the Company Secretary. Forty meetings were held during the year. The business of the Committee is varied and ranges from bid and contract approval to the releasing of share options. The Committee also considers matters requiring formal approval following discussion by the GMB. The Committee forms a key part of the Group's internal controls and acts to facilitate and authorise the operations of the business on a day-to-day basis. The level of authority delegated to this Committee is reviewed on an annual basis.

#### THE GLOBAL MANAGEMENT BOARD (GMB)

The Board has delegated responsibility for the day-to-day management of the business to the GMB. The GMB comprises a number of senior managers within the business and includes all three of the Executive Directors. The GMB meets formally three times a year to review Company activities and discuss operational issues. Other meetings are scheduled where required. Representatives from across the Serco businesses are often invited to the meetings to discuss aspects of their business or give presentations on specific topics. By bringing together senior managers from across the Group, the GMB is able to take a broad view of the business. Matters discussed by the GMB, which require formal approval are submitted to the Board or the Approvals and Allotment Committee, details of which are provided above.

#### THE TRAINING AND DEVELOPMENT COMMITTEE

The Training and Development Committee comprises Margaret Ford, Christopher Hyman, Ralph Hodge and is chaired by Kevin Beeston. The Committee met twice during the year to consider the training needs of all Directors and the Company Secretary, ensuring the appropriateness of the induction process for new Directors in providing a comprehensive familiarisation programme including the role of the Board and its Committees, the corporate governance framework and latest financial statements, together with site visits and meetings with senior management around the Group. In addition the Committee reviewed the leadership development programme being implemented across the Group. This programme of activities has been shaped to focus on the leadership attributes that will underpin delivery of the Group's strategic aspirations and, as well as addressing development of the existing leadership population, also targets those who have the greatest potential to undertake leadership roles in the future.

All Board members are encouraged to attend training courses at the Company's expense.

#### THE COMPANY AND ITS SHAREHOLDERS

The Board remains committed to ongoing dialogue with its institutional and private shareholders. This year has seen the continuation of the Company's programme of site visits and strategy presentations attended by institutional investors and analysts designed to facilitate a greater understanding of the Group.

THE COMPANY AND ITS SHAREHOLDERS (continued)

Formal presentations are made to institutional investors and brokers' analysts after the release of the interim and preliminary results. As part of her induction programme as Senior Independent Director, and in accordance with best practice, DeAnne Julius attended meetings with a number of shareholders following the interim results. She also attended three introductory meetings with the heads of corporate governance at leading institutions. Further requests for individual meetings are always welcomed by the Company.

An Investor Relations report is presented to the Board on a quarterly basis, which covers the dynamics of the market during the period including share price movements, market valuation, share register movements, key investor related activities of the Company, and analyst recommendations thereby ensuring that the Directors have a clear understanding of the Company's performance in the Investor Relations arena.

During the year the Company continued its online communication with a webcast of the interim and preliminary results presentations, an online radio broadcast for staff and a number of conference calls were held during the year. In addition to the interim and preliminary results announcements, the Company made two further regular trading updates during the year, together with a number of announcements covering key business events.

The principal methods of communication with private investors remain the News Announcements, Interim Report, the Annual Review and Accounts, the Annual Review and Summary Financial Statement, the Annual General Meeting and the Company's website [www.serco.com](http://www.serco.com).

The Company's website [www.serco.com](http://www.serco.com) includes an area specifically tailored for investors including information such as the terms of reference for all the Board Committees and information on voting at the 2004 Annual General Meeting and the Extraordinary General Meeting held on 12 January 2005. It also has a link directly to our Registrars to enable shareholders to view their shareholding online. This online facility has also been extended to allow shareholders to vote on the notice of the 2005 Annual General Meeting.

INTERNAL CONTROL AND RISK MANAGEMENT

The Group has a well-established and embedded system of internal control, including financial, operational and compliance controls and risk management designed to safeguard shareholders' investments and the Group's assets and reputation. Whilst the Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness, it is the role of management to implement the policies on risk and control. The Group's risk management process identifies the key risks facing each business and reports to the Board on how those risks are being managed. The Board confirms that this process has been in place for the year under review and up to the date of approval of the Annual Review and Accounts. These processes are reviewed regularly by the Board and conform to the requirements of the Combined Code. Such a system, however, can only be designed to mitigate, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable, and not absolute assurance, against misstatement or loss.

The Serco Management System (SMS), provides the framework within which the business divisions, operating companies and contracts have implemented processes and procedures in ways that are appropriate to the type of business being undertaken. Divisional Chief Executives and business unit managers have the responsibility and authority to implement the system and monitor its operation within their businesses. The SMS defines the Group's vision and strategy; the core values that define the context within which the business operates, a set of business principles that define the corporate behaviour of the organisation, the operating structure and roles and responsibilities of the principal elements of the organisation and the core processes of the business.

As part of the SMS, a set of policy statements have been authorised by the Board and supporting standards, guidance and training material has also been produced.

An ethical standard defines the following principles that apply to all business activities undertaken by the Group:

- We will comply with the laws of the country in which business is being transacted
- We will respect the rights of the individual
- We will respect the traditions and culture of communities and protect the environment within which we operate
- We will undertake our business activities in accordance with the highest standards of professionalism, integrity and honesty.

## INTERNAL CONTROL AND RISK MANAGEMENT (continued)

These broad principles are further interpreted in respect of individual and corporate behaviours. A separate standard defines the corporate responsibility programme that is implemented throughout the Group.

A risk management standard defines the processes that are required at each level in the organisation in order to manage and mitigate the threats to the achievement of our business objectives. Risk registers are maintained at a contract, business unit, divisional and Group level and are reviewed at least quarterly and more frequently as required. The risk registers identify the key risks, the probability of those risks occurring, their potential impact on the business and the actions being taken to reduce and mitigate the risks. Risks are prioritised using a consistent scoring system across the business. Guidance on the risk appetite of the Group has been issued to managers which defines the appetite/tolerance levels both for individual risks and for projects or business units where multiple risks may be present.

The Group risk register identifies the key principle risks facing the business including risks that are managed directly at a Group level. The risks identified in the Group risk register could arise as a result of internal or external events or decisions and could affect the Group's short or long term value, its reputation, the safety of its staff or third parties or compliance with statutory obligations. The risk management process specifically identifies the interests not only of shareholders but also of other stakeholders that are likely, directly or indirectly, to influence the performance of the business and its value. These include, but are not limited to, customers, suppliers, staff, trade unions, government, regulators, banks and insurers. The interests of the wider community in areas such as social, environmental and ethical impact are recognised in the Group's corporate responsibility programme.

The Group risk register is updated regularly, reviewed six monthly by the Risk Oversight Group and discussed at quarterly Board meetings; active risks are ranked into five categories of importance based on the risk score and grouped under the following six headings:

- Business strategy – covering threats to the long-term deliverability of the Group's strategy. Principle risks of the Group include loss of competitive position, and strategic risks associated with recent acquisitions
- Financial/commercial performance – covering threats to the short term performance of the Group's existing business. Principle risks of the Group include the loss of key contracts, the failure to meet financial business plans, pension fund liabilities and delays or cost over-runs in major transition programmes
- Compliance – covering compliance with all relevant legislation and regulations. Principle risks of the Group include legal action resulting from compliance failures, the introduction of the International Financial Reporting Standards (IFRS) and unethical behaviour by Directors or members of staff
- Safety – covering threats to the safety of staff, sub-contractors, members of the public and the environment. Risks of the Group include the responsibility of a major accident or incident where public safety is concerned, environmental pollution and assaults on staff in the course of their duties
- Business continuity – covering threats to the continuity of business operations in the event of adverse events. Principle risks of the Group include the failure of information systems, loss of key infrastructure and the recruitment and retention of key staff
- Hostile actions – covering threats posed by the deliberate actions of individuals and organisations against the interests of the Group. Principle risks of the Group include crime and fraud, pressure group action, terrorism and industrial action.

Additionally, risks relating to the reputation of the Group are assessed by Corporate Communications and the Board on an ongoing basis.

For the Group, the most significant risks relate to the strategy and safety areas; social, environmental and ethical issues, while recognised within a number of the Group's risks, do not represent significant threats to the achievement of the Group's strategy at present. All risks and potential threats are kept under regular review and the Board informed of changes as they occur.

Each risk is assigned an owner at Board or senior management level and specific risk reduction and risk mitigation actions are identified. The Board may ask for additional information in respect of risk reduction or mitigation actions from risk owners or request that a specific audit is undertaken to provide additional assurance in respect of the risk controls. Risk management techniques used by Sercos include appropriate systems, staff, internal controls, public and media relations and business continuity planning. These techniques are designed with clarity of accountability and responsibility and with certain formal policies covering areas such as compliance, safety and environmental protection. Sercos's business units build and maintain an understanding of their operational risk profiles and are expected to fully understand the likelihood and potential impact of any operational incidents, at the same time making appropriate and informed decisions that balance the risks against the potential returns and opportunities.

INTERNAL CONTROL AND RISK MANAGEMENT (continued)

While operational risk can never be eliminated, the Group endeavours to minimise the impact by ensuring that appropriate infrastructure, controls, systems, staff and processes are in place. Some of the key management and control techniques are set out below:

- The principles of clear delegation of authority and segregation of duties are fully reflected in the Group's operating processes
- Comprehensive business review processes ensure that our services and products meet customer expectations, performance criteria, operational effectiveness, regulatory requirements investment returns and profitability
- An Investment Committee meets on a monthly basis to consider new or developing projects against a defined set of criteria. Projects can then be submitted to the GMB for consideration as a Group key target and allocation of appropriate resources
- There is a formal review and approval process for all proposals and business acquisitions including delegated authority for sign-off based on the financial value and capital requirement of the transaction and the assessed risk of the project
- Sound project management and change implementation disciplines are applied to all major development projects including new contract phase-ins, acquisitions, new technology applications, change programmes and other major initiatives
- The commitment and capability of staff is critical for the effective management of operational risk. Ongoing training and career development constantly improves the skills of our workforce. Selective recruitment, succession planning and other human resource policies and practices are in place to ensure that staff skills are aligned with the needs of the organisation
- Safety management systems in the Group's aviation, rail, defence, nuclear and marine businesses have been addressed by the appointment of safety specialists for each area who report directly to the Board and are charged with maintaining and further developing the very high standards of safety expected in these industries
- The Group's approach to health, safety and environmental protection is described in the Directors' Report. Qualified and experienced staff in each business unit, provide advice and support on health, safety and environmental issues and undertake regular audits
- The Company Secretary is responsible for the review of ethical issues that may arise from the Group's activities and for managing the confidential reporting service (whistle-blowing), to which staff can report illegal, dangerous, dishonest or unethical activities.
- A programme of internal audits confirms the extent to which key controls are in place and are being applied across the Group's business activities. Audit priorities are established on the basis of risk assessments, regulatory requirements and business imperatives
- The operational risk framework tracks key risk indicators. These include analysis of business performance and variances from plan, customer satisfaction and retention data, staff turnover and satisfaction levels, occupational health and safety incidents, and error and exception reporting
- The Group maintains insurance policies to provide protection from losses arising from circumstances such as damage or destruction of physical assets, theft and legal liability for third party loss. The adequacy of the insurance cover is reviewed at regular intervals.

The Corporate Assurance Group (CAG) has the responsibility to oversee and review the internal control and risk policies, procedures and management framework within the Group and to develop guidance, training material and management training to ensure the current and future needs of the business are met. The Board recognises not only its responsibilities to shareholders but also to the wider community where social, environmental and ethical issues are becoming increasingly important. CAG is responsible for developing and overseeing the corporate responsibility activities within the Group. The corporate responsibility model is described in the separate Corporate Responsibility Report and encompasses four elements:

- Safety – recognising the Group's legal responsibility for the safety of our staff and the general public for whom we have a duty of care
- People – addressing the Group's legal and moral responsibility for its employees
- Community – addressing the Group's social responsibility for the communities within which we operate
- Environment – recognising the Group's legal and moral responsibility to protect the environment from damage as a direct result of its operations and to promote activities to protect and sustain the wider environment.

The Corporate Responsibility Report includes performance measures against key objectives within these four areas.

CAG reports formally to the Executive Chairman and to the Board on a quarterly basis providing analyses of performance against previously established assurance targets and also advises the Board regarding policy and future activities to enhance best practice around the organisation. CAG has undertaken a number of reviews of internal controls during 2004 including risk management, health, safety and environmental management. As a result of these reviews, a number of activities have been included in CAG's programme for 2005 to strengthen the Group's performance in these areas.

## INTERNAL CONTROL AND RISK MANAGEMENT (continued)

CAG sponsors five specialist Groups:

- An Assurance Network Group, chaired by the Assurance Director, and comprising senior assurance representatives from across the Group. During the year, this group met four times to review policy and procedures, and the development, integration and dissemination of the SMS that defines how the Group operates
- A Risk Oversight Group, chaired by the Risk Director, comprising assurance representatives from across the Group, met twice during the year to review the Group risk register and key risk controls. This group provides additional assurance in relation to the system of internal control and risk management and enhances the Board's ability to discharge its responsibilities in relation to internal control
- An Aviation Safety Oversight Group, chaired by the Aviation Safety Director and comprising the aviation safety representatives from across the Group met twice during the year. This group has been responsible for the implementation of the aviation safety management system across the Group and for transferring best practice between Serco's aviation operating companies
- A Rail Safety Oversight Group, chaired by the Rail Technical Director of the Integrated Transport division and comprising the rail safety representatives from across the Group was established in 2003 to oversee safety management systems within Serco's rail businesses in the United Kingdom, Denmark and Australia
- A Corporate Responsibility Steering Group, chaired by the Executive Chairman, provides direction on projects that address the social and environmental issues affecting our staff and the communities within which we work.

During 2004, Grant Thornton has continued to provide an internal audit function within the Group, in addition to that provided by internal peer review and CAG. Their programme is complementary to the Group's broader programme and has been designed to address internal control and risk management processes and the recommendations of the Combined Code. Grant Thornton reported to the Audit Committee twice during the year. There were no material weaknesses identified as a result of the audits undertaken and corrective action has been taken where deficiencies were found.

In addition to contracts held in Serco's name, the Group has material investments in a number of joint ventures and associated companies. Where these investments are not wholly owned by Serco, the Group can influence, but not control, management practices. Serco representatives within these companies ensure that the processes and procedures for identifying and managing risk are appropriate for the business and that internal controls exist and are regularly monitored. Employees from the Company's joint ventures participate in the Assurance network and the Risk Oversight and Rail Safety Oversight Groups.

## GOING CONCERN

The Directors confirm that they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future and therefore continue to adopt the going concern basis in preparing the Annual Review and Accounts.

## COMPLIANCE DURING 2004

The Company has achieved full compliance with the code provisions set out in section 1 of the July 2003 FRC Combined Code on corporate governance during 2004.

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



Joanne Roberts  
Secretary

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