serco
bringing service to life

# Serco Group plc

## Transition to International Financial Reporting Standards (‘IFRS’)

# Transition to International Financial Reporting Standards ('IFRS')

This announcement provides further details of Serco's transition to IFRS. Separately today, we have announced our interim results and released our Business Review. Copies of these documents are available on our website www.serco.com

## 1. Introduction

During 2002, and in order to implement a "financial reporting strategy" adopted by the European Commission in June 2000, the European Union (EU) approved an Accounting Regulation requiring all EU listed companies to follow International Financial Reporting Standards ('IFRS') in their consolidated financial statements for financial years commencing on or after 1 January 2005. In accordance with these requirements, Serco Group plc (the 'Group') will adopt IFRS in its financial statements for the year ended 31 December 2005. These financial statements will include comparatives for the year ended 31 December 2004 restated under IFRS. The Group is required to report under IFRS for the first time in the Group's interim results for the six months ended 30 June 2005, with comparatives for the six months ended 30 June 2004.

There is no change to the Group's underlying performance under IFRS and, in particular, there is no impact on the Group's cash flow.

The restatements result in:

- an increase of £6.6m (11.5%) in 2004 full year profit before tax to £64.0m, and an increase of £2.6m (9.3%) for the six months ended 30 June 2004 to £30.7m
- a decrease of £135.2m (44.4%) in net assets at 31 December 2004 to £169.2m; and £27.0m (16.0%) decrease in net assets at 1 January 2005 to £142.3m on the recognition of financial instruments (see section 9)

Restatements and changes in disclosure arise primarily as a result of:

- inclusion of a proportionate share of joint ventures' financial performance and position;
- goodwill no longer being amortised;
- reclassification of franchise assets from goodwill to intangible assets;
- recognition of all employee benefit related assets and obligations, principally defined benefit pension schemes;
- inclusion of a fair value charge in relation to share-based payment;
- dividend liability recognised when approved;
- change in recognition of deferred tax; and
- recognition of certain financial instruments at fair value at 1 January 2005.

## 2. Purpose of this report

This report explains how the Group's previously reported financial performance and position are reported under IFRS. This includes, on an IFRS basis:

- the Group's consolidated balance sheet at 1 January 2004, the Group's date of transition to IFRS;
- the Group's consolidated balance sheets at 30 June 2004, 31 December 2004 and 1 January 2005; and
- the Group's consolidated income statement for the year ended 31 December 2004 and the six months ended 30 June 2004.

The significant changes as a result of the adoption of IFRS compliant accounting policies are discussed below, and the detailed restatements of the financial results follow on pages 8 to 19. The Group's significant accounting policies under IFRS are set out in section 10.

This financial information has been prepared on the basis of financial reporting standards expected to be applicable at 31 December 2005. These are subject to ongoing review and endorsement by the European Union or possible amendment by interpretive guidance from the International Accounting Standards Board ('IASB') and the International Financial Reporting Interpretations Committee ('IFRIC') and are therefore still subject to change.

The report covers the period from 1 January 2004 to 1 January 2005. The report also includes the independent auditors' (Deloitte & Touche LLP) report to the Group in relation to the reconciliations of the consolidated balance sheets at 1 January 2004 and 31 December 2004 and the consolidated income statement for the year ended 31 December 2004 between UK GAAP and IFRS.

### 3. IFRS 1 'First-time Adoption of International Financial Reporting Standards'

IFRS 1 establishes the transitional requirements for the preparation of financial statements in accordance with IFRS for the first time. The general principle is that the IFRS effective at the first-time adoption reporting date (31 December 2005 for the Group) are to be applied retrospectively to the opening IFRS balance sheet (1 January 2004), the comparative period (2004) and the reporting period (2005).

Outlined below is the Group's position in relation to key exemptions and exceptions that are available under IFRS.

***Business combinations***

The Group has adopted the exemption not to apply IFRS 3 'Business Combinations' in respect of acquisitions occurring prior to 1 January 2004.

The Group has accounted for acquisitions prior to 1 January 2004 as follows:

- the carrying amount of goodwill recognised under UK GAAP as at 1 January 2004 has not been adjusted, other than an adjustment for the recognition of intangible assets acquired but previously not separately recognised;
- from the date of transition to IFRS (1 January 2004) goodwill is no longer amortised.
- there has been no remeasurement of original 'fair values' determined at the date of acquisition.

In February 2003, the Group acquired a 10-year franchise from the province of Ontario, Canada, relating to Ontario Driving Examination Services (DES). On transition to IFRS, the right to manage and operate the franchise has been recognised as an intangible asset, with a corresponding reduction in goodwill.

***Employee benefits***

Under IAS 19 'Employee Benefits', the Group is required to reflect its obligations or surpluses under defined benefit pension schemes on the balance sheet.

The Group has elected under IFRS 1 to recognise all cumulative actuarial gains and losses on defined benefit pension schemes at the date of transition to IFRS. 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 consolidated statement of recognised income and expense.

On transition to IFRS, the Group has recognised the full IAS 19 liability in respect of the Serco Pension and Life Assurance Scheme (SPLAS). In addition, the Group has an obligation to contribute to defined benefit pension schemes as a result of contracts and franchises that it operates and manages. The Group has recognised as a liability its share of the obligation that it will fund over the period of the contract or franchise.

***Cumulative translation differences***

The Group has adopted the exemption to set cumulative translation differences for all foreign operations to zero at 1 January 2004. The gain or loss on a subsequent disposal of any foreign operation will exclude translation differences that arose before 1 January 2004, but will include later translation differences.

***Share-based Payment***

IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that had not vested as at 1 January 2005.

Under UK GAAP, the Group's shares held in the Employee Share Ownership Plan (ESOP) trust were amortised within the ESOP reserve and charged to the profit and loss account.

Under IFRS 2, the fair value of all share and share option awards is calculated and then amortised in the income statement over the vesting period. The carrying amount of the ESOP reserve on transition to IFRS has been maintained at the carrying amount under UK GAAP at that date. On transition to IFRS, the cumulative IFRS 2 charge has been shown within a separate Share-based Payment reserve within Equity.

***Financial Instruments***

The Group has adopted IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' effective from 1 January 2005 and therefore there is no impact on the Group's balance sheet as at 1 January 2004 or 31 December 2004 on transition to IFRS. Adjustments arising from adopting IAS 39 impact the opening balance sheet at 1 January 2005 as certain financial instruments, notably interest rate swaps, are recognised at fair value. The effect of these adjustments is shown in section 9.

Movements in the fair value of these financial instruments are recognised within a separate Hedging and Translation reserve within Equity.

**Accounting for PFI contracts**

In March 2005, the International Financial Reporting Interpretations Committee ('IFRIC') issued a draft interpretation on accounting for service concession arrangements (PFI/PPP). The IFRIC is currently considering the comments received on this draft guidance, with the final guidance expected to be issued over coming months.

Until the final guidance is issued and endorsed by the EU and in the absence of specific guidance within IFRS, the Group has, from 1 January 2005, recognised the PFI debtors relating to concession arrangements held by PFI companies at amortised costs as defined by IAS 39. The effect of adopting this policy is to maintain an accounting treatment consistent with UK GAAP whilst ensuring that the accounting treatment remains consistent with existing IFRS.

The draft guidance from IFRIC, if it were issued in final form, would potentially require a number of changes to the accounting treatment of service concession arrangements. One of the more significant aspects would be the requirement to recognise the assets associated with concession arrangements at fair value. This requirement could potentially produce a significant increase in the carrying value of the Group's PFI debtors held within PFI companies.

## 4. Key IFRS adjustments and their impact on the financial statements

Key IFRS adjustments are outlined below, with summary financial details for the specific accounting periods being provided in sections 5, 6, 8 and 9.

### *IAS 31 'Interests in Joint Ventures'*

IAS 31 requires that interests in joint ventures are recognised using proportionate consolidation or the alternative equity method of accounting. This is a change from the gross equity method required under UK GAAP.

The Group has elected to recognise its interests in joint ventures using the proportionate consolidation method whereby the Group's share of each of the assets, liabilities, income and expenses of its joint ventures is combined line by line with similar items in the Group's financial statements or reported as separate line items within the Group's financial statements.

Consequently, the presentation of information on joint ventures is now comprehensive.
There is no impact on profit for the year as a result of the change.

### *IFRS 3 'Business Combinations'*

IFRS prohibits the amortisation of goodwill. The goodwill amortisation charge under UK GAAP of £15.9m for the year ended 31 December 2004 and £8.1m for the six months ended 30 June 2004 has been reversed in the IFRS restated results.

### *IAS 38 'Intangible Assets'*

Franchise assets which are identifiable non-monetary assets have been reclassified as intangible assets in accordance with IFRS requirements. The effect of this is to reclassify assets from goodwill to other intangible assets of £47.7m as at 1 January 2004, £59.0m as at 31 December 2004 and £55.8m as at 30 June 2004. Net assets are not affected by this adjustment.

The amortisation charge relating to these franchise assets was £5.4m for the year ended 31 December 2004 and £3.0m for the six months ended 30 June 2004.

In addition where the Group has recognised its share of a defined benefit pension obligation that it will fund over the period of a contract or franchise, the liability recognised on transition to IFRS or at the beginning of the contract or franchise is treated as an intangible asset representing the rights to the future economic benefits of the contract or franchise.

### *IAS 19 'Employee Benefits': Pension scheme adjustments*

In accordance with IAS19, the Group has recognised retirement benefit obligations in relation to defined benefit schemes. Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit scheme throughout the contract, and it is not virtually certain that these contributions will be recovered from the customer, the Group has recognised its proportionate share of the pension scheme obligations together with a corresponding amount as an intangible asset, representing the right to the future economic benefits of operating the contract or franchise over its life. Where it is virtually certain that pension contributions will be recovered, the Group has recognised a financial asset in trade and other receivables.

The Group has potential deferred tax assets in respect of the deficits on defined benefit pension schemes. Under IAS 12, these are recognised to the extent that it is probable that taxable profits will be available against which the deductible temporary difference can be utilised.

These changes have resulted in the following adjustments to the balance sheet:

| | As at 1 January 2004 | As at 31 December 2004 | As at 30 June 2004 |
|---|---|---|---|
| | £m | £m | £m |
| Other intangible assets | 4.1 | 15.5 | 16.3 |
| Deferred tax asset | 42.0 | 50.8 | 33.5 |
| Trade and other receivables | 12.1 | 20.0 | 1.2 |
| Deferred tax liabilities | - | (4.0) | - |
| Retirement benefit obligation | (169.9) | (204.5) | (161.2) |
| Net assets | (111.7) | (122.2) | (110.2) |

Under UK GAAP, the pension charge was included in cost of sales and administrative expenses. The IAS 19 pension charge includes a service cost which is included in cost of sales and administrative expenses, and interest on pension obligations net of the return on pension fund assets which is included in finance costs. The amortisation of intangible assets is included within other operating expenses. The net effect is to increase profit before tax by £0.4m for the year ended 31 December 2004 and to reduce profit before tax by £0.3m for the six months ended 30 June 2004.

***IAS 19 'Employee Benefits'; Employee benefit accruals and provisions***

IAS 19 requires that when employees provide a service to a company, the estimated amount that will be paid in exchange for those services should be recognised.

On transition to IFRS, the Group has recognised employee benefit accruals and provisions in respect of holiday pay, long-term disability benefits and long-term service award benefits. The adjustment on transition reflects a cumulative adjustment for the services provided by employees up to the date of transition. Following transition, the movement on these accruals and provisions reflects the current period service cost.

Arising from the recognition of these accruals and provisions, net of deferred tax, net assets have reduced by £16.0m as at 1 January 2004, £17.5m as at 31 December 2004, and £16.7m as at 30 June 2004.

***IAS 10 'Events After the Balance Sheet Date'***

Under IAS 10, dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date.

Dividends are recorded in the Group's consolidated financial statements in the period in which they are approved by the Group's shareholders.

The dividends proposed but not approved at the balance sheet date have been reversed from the financial statements. This has the effect of increasing the net assets of the Group by the amount of the proposed dividend of £7.0m as at 1 January 2004, £8.3m as at 31 December 2004 and £3.5m as at 30 June 2004.

***IFRS 2 'Share-based Payment'***

IFRS 2 'Share-based Payment' requires the recognition of an expense in relation to all share-based payments such as the Group's share and share option schemes.

The Group issues equity-settled share-based payments to certain employees and operates an Inland Revenue approved Save As You Earn share option scheme open to eligible employees which allows the purchase of shares at a discount to the market value. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest.

Fair value is measured by use of the Black Scholes, Binomial or Monte Carlo Simulation models depending on the type of scheme.

Under UK GAAP, the Group's shares held in the ESOP trust were amortised within the ESOP reserve and charged to the profit and loss account. This charge has been reversed and replaced with the IFRS 2 charge.

The IFRS 2 charge for 2004 was £4.6m and after reversing the amortisation of shares held in the ESOP reserve of £1.2m, the net effect is to reduce profit before tax by £3.4m for the year ended 31 December 2004 and £1.2m for the six months ended 30 June 2004. A related deferred tax asset of £0.5m as at 1 January 2004, £1.4m as at 31 December 2004 and £0.8m as at 30 June 2004 has been recognised and will be realised as and when share options vest and are exercised.

***IAS 12 'Income Taxes'***

The income tax adjustments required under IAS12 fall into two categories: Firstly, deferred tax that needs to be provided in respect of other IFRS restatement accounting adjustments (for example, pension scheme adjustments, employee benefits accruals, goodwill). Secondly, specific deferred tax adjustments that arise on the different recognition criteria of deferred tax balances between UK GAAP (FRS19) and IFRS (IAS12) (for example, PFI contracts and unremitted earnings from overseas subsidiaries, joint ventures and investments).

The most significant taxation adjustments for the Group relate to the deferred tax treatment of pensions and PFI contracts. The Group has accounted for deferred tax assets in respect of the pension related assets and deficits (refer to the above note regarding pension scheme adjustments under IAS19). The principles for the calculation of and recognition of deferred tax for PFI contracts under IAS12 are different to those applied under FRS19. Specifically, IAS12 requires that whenever a PFI debtor is acquired as part of a business combination, deferred tax needs to be provided upon recognition of that debtor for all future tax that will become payable as the debtor is recovered. For the Group, this has resulted in additional deferred tax liabilities being recognised at the date of transition. In addition, IAS12 further requires that whenever a PFI debtor is recognised but not by way of a business combination, deferred tax is only recognised as the debtor is recovered - no additional deferred tax is recognised in transition and this therefore leads to smaller deferred tax liabilities in early periods of the contract with an increasing effective tax rate over the project life. As a result of the change in accounting for deferred tax on PFI debtors, the tax charge has reduced by £2.5m for the year ended 31 December 2004 and £0.8m for the six months ended 30 June 2004. The additional deferred tax in the balance sheet has led to a reduction in net assets of £17.6m as at 1 January 2004, £18.7m as at 31 December 2004 and £18.0m as at 30 June 2004.

***IAS 39 'Financial Instruments: Recognition and Measurement'***

The Group adopted IAS39 'Financial Instruments: Recognition and Measurement' on 1 January 2005; the standard therefore had no effect on the Group's financial statements prior to that date. Adoption of IAS39 resulted in a £26.9m reduction in opening net assets (£37.9m net of a tax credit of £11.0m) on 1 January 2005. This represents the net effect of marking to market the interest rate swaps, cross-currency swaps and other derivatives held by the Group. The effect on opening net assets has been reflected in reserves. These derivatives are mainly held to convert the floating rate interest obligations of PFI special purpose companies into fixed rate obligations, and to hedge the Group's obligations under its long-term loan notes.

Where the Group has elected to apply hedge accounting, all hedges are "highly effective" under IAS 39 on 1 January 2005 and are expected to remain so.

## 5. 1 January 2004 – presentational changes, and equity reconciliation

### a) Impact of IAS1 'Presentation of Financial Statements' on the consolidated balance sheet as at 1 January 2004

This table highlights the presentational impact of IFRS on the consolidated balance sheet as at 1 January 2004. Assets, liabilities and shareholders' funds are stated under UK GAAP values and format and are mapped from this starting position to the line item classification required under IFRS.

| UK GAAP values and format | £m | IAS 1 Presentational changes £m | £m | UK GAAP values in IFRS format |
|---|---|---|---|---|
| **Fixed assets** | | | | **Non-current assets** |
| Intangible assets | 223.0 | (1.1) | 221.9 | Goodwill |
| | | 1.1 | 1.1 | Other intangible assets |
| Tangible assets | 77.3 | | 77.3 | Property, plant and equipment |
| Investments in joint ventures | 24.9 | | 24.9 | Investment in joint ventures |
| | | 1.7 | 1.7 | Deferred tax asset |
| | | 395.9 | 395.9 | Trade and other receivables |
| | 325.2 | 397.6 | 722.8 | |
| **Current assets** | | | | **Current assets** |
| Stocks | 39.5 | | 39.5 | Inventories |
| Debtors: Amounts due within one year | 278.9 | 20.4 | 299.3 | Trade and other receivables |
| Debtors: Amounts due after more than one year | 419.6 | (419.6) | | |
| Cash at bank and in hand | 170.9 | | 170.9 | Cash and cash equivalents |
| | 908.9 | (399.2) | 509.7 | |
| **Creditors : Amounts falling due within one year** | | | | **Current liabilities** |
| Trade creditors | (81.3) | (257.4) | (338.7) | Trade and other payables |
| | | 1.7 | 1.7 | Tax liabilities |
| | | (5.9) | (5.9) | Obligations under finance leases |
| | | (4.5) | (4.5) | Loans |
| Accruals and deferred income | (177.9) | 177.9 | | |
| Other creditors including taxation and social security | (90.9) | 90.9 | | |
| Proposed dividend | (7.0) | | (7.0) | Proposed dividend |
| | (357.1) | 2.7 | (354.4) | |
| | | | | **Non-current liabilities** |
| | | (17.5) | (17.5) | Obligations under finance leases |
| Creditors: Amounts falling due after more than one year | (539.7) | 17.5 | (522.2) | Loans |
| | | (27.9) | (27.9) | Deferred tax liabilities |
| Provisions for liabilities and charges | (56.5) | 56.5 | - | Provisions |
| | | (29.7) | (29.7) | Retirement benefit obligation |
| | (596.2) | (1.1) | (597.3) | |
| **Net assets** | 280.8 | - | 280.8 | **Net assets** |
| Called up share capital | 8.7 | | 8.7 | Share capital |
| Share premium account | 190.8 | | 190.8 | Share premium account |
| ESOP reserve | (16.9) | | (16.9) | Own shares reserve |
| Capital redemption reserve | 0.1 | | 0.1 | Capital redemption reserve |
| Profit and loss account | 98.1 | | 98.1 | Retained earnings |
| **Equity shareholders' funds** | 280.8 | - | 280.8 | **Total equity** |

## b) Reconciliation of equity at 1 January 2004

This table highlights the financial impact of the key IFRS adjustments covered in section 4 on the consolidated balance sheet as at 1 January 2004.

| | UK GAAP | IAS 31 Interest in joint ventures | IAS 38 Intangible assets | IAS19 Employee benefits -pensions | IAS19 Employee benefits -other | IAS10 Dividends | IFRS2 Share based payment | IAS12 Income taxes | Other | IFRS |
|---|---|---|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Non-current assets** | | | | | | | | | | |
| Goodwill | 221.9 | 5.2 | (47.7) | - | - | - | - | - | 0.4 | 179.8 |
| Other intangible assets | 1.1 | - | 47.7 | 4.1 | - | - | - | - | 2.4 | 55.3 |
| Property, plant and equipment | 77.3 | 15.1 | - | - | - | - | - | - | 1.7 | 94.1 |
| Investment in joint ventures | 24.9 | (24.9) | - | - | - | - | - | - | - | - |
| Deferred tax assets | 1.7 | - | - | 42.0 | 5.5 | - | 0.5 | 4.7 | 0.3 | 54.7 |
| Trade and other receivables | 395.9 | 61.2 | - | 42.7 | - | - | - | - | (2.0) | 497.8 |
| | 722.8 | 56.6 | - | 88.8 | 5.5 | - | 0.5 | 4.7 | 2.8 | 881.7 |
| **Current assets** | | | | | | | | | | |
| Inventories | 39.5 | 3.0 | - | - | - | - | - | - | - | 42.5 |
| Trade and other receivables | 299.3 | 50.2 | - | (30.6) | - | - | - | - | (1.2) | 317.7 |
| Cash and cash equivalents | 170.9 | 13.7 | - | - | - | - | - | - | | 184.6 |
| | 509.7 | 66.9 | - | (30.6) | - | - | - | - | (1.2) | 544.8 |
| **Total assets** | 1,232.5 | 123.5 | - | 58.2 | 5.5 | - | 0.5 | 4.7 | 1.6 | 1,426.5 |
| **Current liabilities** | | | | | | | | | | |
| Trade and other payables | (338.7) | (36.9) | - | - | (15.4) | - | - | - | 0.6 | (390.4) |
| Tax liabilities | 1.7 | (3.4) | - | - | - | - | - | - | - | (1.7) |
| Obligations under finance leases | (5.9) | (1.3) | - | - | - | - | - | - | (0.5) | (7.7) |
| Loans | (4.5) | (11.0) | - | - | - | - | - | - | - | (15.5) |
| Proposed dividend | (7.0) | - | - | - | - | 7.0 | - | - | - | - |
| | (354.4) | (52.6) | - | - | (15.4) | 7.0 | - | - | 0.1 | (415.3) |
| **Non-current liabilities** | | | | | | | | | | |
| Obligations under finance leases | (17.5) | (5.5) | - | - | - | - | - | - | (1.2) | (24.2) |
| Loans | (522.2) | (54.6) | - | - | - | - | - | - | - | (576.8) |
| Deferred tax liabilities | (27.9) | (8.6) | - | - | (0.1) | - | - | (22.3) | - | (58.9) |
| Provisions | - | - | - | - | (6.0) | - | - | - | - | (6.0) |
| Trade and other payables | - | - | - | - | - | - | - | - | (3.0) | (3.0) |
| Retirement benefit obligations | (29.7) | (1.6) | - | (169.9) | - | - | - | - | 2.6 | (198.6) |
| | (597.3) | (70.3) | - | (169.9) | (6.1) | - | - | (22.3) | (1.6) | (867.5) |
| **Net assets** | 280.8 | 0.6 | | (111.7) | (16.0) | 7.0 | 0.5 | (17.6) | 0.1 | 143.7 |
| **Equity** | | | | | | | | | | |
| Share capital | 8.7 | - | - | - | - | - | - | - | - | 8.7 |
| Share premium | 190.8 | - | - | - | - | - | - | - | - | 190.8 |
| Own shares reserve | (16.9) | - | - | - | - | - | - | - | - | (16.9) |
| Capital redemption reserve | 0.1 | - | - | - | - | - | - | - | - | 0.1 |
| Retained earnings | 98.1 | - | | 1.9 | (16.0) | 7.0 | (1.2) | (17.6) | (0.6) | 71.6 |
| Share-based payment reserve | - | - | - | - | - | - | 1.7 | - | - | 1.7 |
| Retirement benefit obligations reserve | - | - | - | (113.6) | - | - | - | - | - | (113.6) |
| Translation reserve | - | - | - | - | - | - | - | - | 0.7 | 0.7 |
| | 280.8 | - | - | (111.7) | (16.0) | 7.0 | 0.5 | (17.6) | 0.1 | 143.1 |
| Minority interest | - | 0.6 | - | - | - | - | - | - | - | 0.6 |
| **Total equity** | 280.8 | 0.6 | - | (111.7) | (16.0) | 7.0 | 0.5 | (17.6) | 0.1 | 143.7 |

## 6. 31 December 2004 – presentational changes, and equity and profit reconciliations

### a) Impact of IAS1 'Presentation of Financial Statements' on the consolidated profit and loss account for the year ended 31 December 2004

This table highlights the presentational impact of IFRS on the consolidated profit and loss account for the year ended 31 December 2004. Income and expense are stated under UK GAAP values and format and are mapped from this starting position to the line item classification required under IFRS.

| UK GAAP values and format<br>Profit and Loss account | £m | IAS1 Presentational changes<br>£m | £m | UK GAAP values in IFRS format<br>Income Statement |
|---|---|---|---|---|
| Turnover: Group and share of joint ventures | 1,636.9 | | 1,636.9 | |
| Less; Share of joint ventures | (255.5) | | (255.5) | |
| **Group turnover** | 1,381.4 | | 1,381.4 | **Revenue** |
| Cost of sales | (1,190.5) | | (1,190.5) | Cost of sales |
| **Gross profit** | 190.9 | | 190.9 | **Gross profit** |
| Amortisation of intangible assets | (16.5) | | (16.5) | Other operating expenses |
| Other administrative expenses | (139.7) | | (139.7) | Administrative expenses |
| **Operating profit continuing operations** | **34.7** | | **34.7** | **Profit from operations** |
| Share of operating profit in joint ventures | 25.4 | | 25.4 | Joint venture operating profit |
| Interest receivable and similar income | 35.3 | | 35.3 | Investment income |
| Interest payable and similar charges | (38.0) | | (38.0) | Finance costs |
| **Profit on ordinary activities before taxation** | 57.4 | | 57.4 | **Profit before tax** |
| Taxation on profit on ordinary activities | (20.4) | | (20.4) | Tax |
| **Profit on ordinary activities after taxation** | **37.0** | | **37.0** | **Profit for the year** |
| Share of joint venture minority interest | (0.6) | 0.6 | | |
| Minority interest | (0.4) | 0.4 | | Attributable to: |
| | | | 36.0 | Equity holders of the parent |
| | | 1.0 | 1.0 | Minority interest |
| **Profit for the financial year** | **36.0** | 1.0 | **37.0** | |
| Equity dividends | (11.8) | | | |
| **Retained profit for the financial year** | **24.2** | | | |
| Earnings per ordinary share (EPS) | | | | |
| Basic EPS | 8.37p | | 8.37p | |
| Diluted EPS | 8.27p | | 8.27p | |

serco
bringing service to life

**b) Reconciliation of the income statement for the year ended 31 December 2004**

This table highlights the financial impact of the key IFRS adjustments covered in section 4 on the consolidated income statement for the year ended 31 December 2004.

| | UK GAAP | IAS 31 Interest in joint ventures | IFRS 3 Business combinations | IAS38 Intangible assets | IAS 19 Employee Benefits -pensions | IFRS 2 Share-based payments | IAS 12 Income taxes | Other | IFRS |
|---|---|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Revenue** | 1,381.4 | 255.5 | - | - | - | - | - | - | 1,636.9 |
| Cost of sales | (1,190.5) | (207.1) | - | - | 3.9 | - | - | (0.6) | (1,394.3) |
| **Gross profit** | 190.9 | 48.4 | - | - | 3.9 | - | - | (0.6) | 242.6 |
| Other operating expenses | (16.5) | - | 15.9 | (5.4) | (1.2) | - | - | - | (7.2) |
| Administrative expenses | (139.7) | (23.0) | - | - | 0.2 | (3.4) | - | (0.3) | (166.2) |
| **Profit from operations** | 34.7 | 25.4 | 15.9 | (5.4) | 2.9 | (3.4) | - | (0.9) | 69.2 |
| Joint venture operating profit | 25.4 | (25.4) | - | - | - | - | - | - | - |
| Investment income | 35.3 | *- | - | - | - | - | - | - | 35.3 |
| Finance costs | (38.0) | *- | - | - | (2.5) | - | - | - | (40.5) |
| **Profit before tax** | 57.4 | - | 15.9 | (5.4) | 0.4 | (3.4) | - | (0.9) | 64.0 |
| Tax | (20.4) | *- | (1.5) | - | (0.2) | 0.9 | 2.5 | (0.8) | (19.5) |
| **Profit for the year** | 37.0 | - | 14.4 | (5.4) | 0.2 | (2.5) | 2.5 | (1.7) | 44.5 |
| Attributable to: | | | | | | | | | |
| Equity holders of the parent | 36.0 | - | 14.4 | (5.4) | 0.2 | (2.5) | 2.5 | (1.7) | 43.5 |
| Minority interest | 1.0 | - | - | - | - | - | - | - | 1.0 |
| | 37.0 | - | 14.4 | (5.4) | 0.2 | (2.5) | 2.5 | (1.7) | 44.5 |
| Earnings per share (EPS) | | | | | | | | | |
| Basic | 8.37p | | | | | | | | 10.11p |
| Diluted | 8.27p | | | | | | | | 9.99p |

*UK GAAP values include the Group's share of joint venture investment income, finance costs and tax.

**c) Impact of IAS1 'Presentation of Financial Statements' on the consolidated balance sheet as at 31 December 2004**

This table highlights the presentational impact of IFRS on the consolidated balance sheet as at 31 December 2004. Assets, liabilities and shareholders' funds are stated under UK GAAP values and format and are mapped from this starting position to the line item classification required under IFRS.

| UK GAAP values and format | £m | IAS1 Presentational changes £m | £m | UK GAAP values in IFRS format |
|---|---|---|---|---|
| **Fixed assets** | | | | **Non-current assets** |
| Intangible assets | 215.2 | (7.0) | 208.2 | Goodwill |
| | - | 7.0 | 7.0 | Other intangible assets |
| Tangible assets | 79.5 | - | 79.5 | Property, plant and equipment |
| Investments in joint ventures | 27.2 | - | 27.2 | Investment in joint ventures |
| Other investments | 13.7 | - | 13.7 | Other investments |
| | | 296.9 | 296.9 | Trade and other receivables |
| | 335.6 | 296.9 | 632.5 | |
| **Current assets** | | | | **Current assets** |
| Stocks | 36.2 | (13.2) | 23.0 | Inventories |
| Debtors: Amounts due within one year | 293.6 | 49.4 | 343.0 | Trade and other receivables |
| Debtors: Amounts due after more than one year | 333.6 | (333.6) | | |
| Cash at bank and in hand | 173.9 | | 173.9 | Cash and cash equivalents |
| | 837.3 | (297.4) | 539.9 | |
| **Creditors : Amounts falling due within one year** | | | | **Current liabilities** |
| Trade creditors | (76.9) | (275.3) | (352.2) | Trade and other payables |
| | | (0.4) | (0.4) | Retirement benefit obligations |
| | | (6.5) | (6.5) | Obligations under finance leases |
| | | (23.5) | (23.5) | Loans |
| Accruals and deferred income | (192.0) | 192.0 | | |
| Other creditors including taxation and social security | (114.2) | 114.2 | | |
| Proposed dividend | (8.3) | | (8.3) | Proposed dividend |
| | (391.4) | 0.5 | (390.9) | |
| | | | | **Non-current liabilities** |
| Creditors: Amounts falling due after more than one year | (415.1) | 401.5 | (13.6) | Obligations under finance leases |
| | | (401.5) | (401.5) | Loans |
| | | (32.2) | (32.2) | Deferred tax liabilities |
| | | - | - | Trade and other payables |
| Provisions for liabilities and charges | (62.0) | 62.0 | - | Provisions |
| | | (29.8) | (29.8) | Retirement benefit obligation |
| | (477.1) | - | (477.1) | |
| **Net assets** | 304.4 | - | 304.4 | **Net assets** |
| Called up share capital | 8.7 | - | 8.7 | Share capital |
| Share premium account | 191.5 | - | 191.5 | Share premium account |
| ESOP reserve | (15.8) | - | (15.8) | Own shares reserve |
| Capital redemption reserve | 0.1 | - | 0.1 | Capital redemption reserve |
| Profit and loss account | 119.9 | 2.7 | 122.6 | Retained earnings |
| | | (2.7) | (2.7) | Translation reserve |
| **Equity shareholders' funds** | 304.4 | - | 304.4 | **Total equity** |

**d) Reconciliation of equity at 31 December 2004**

This table highlights the financial impact of the key IFRS adjustments covered in section 4 on the consolidated balance sheet as at 31 December 2004.

| | UK GAAP | IAS 31 Interest in joint ventures | IFRS3 Business combin-ations | IAS 38 Intangible assets | IAS19 Employee benefits -pensions | IAS19 Employee benefits -other | IAS10 Dividends | IFRS2 Share based payment | IAS12 Income taxes | Other | IFRS |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Non-current assets** | | | | | | | | | | | |
| Goodwill | 208.2 | 11.4 | 15.9 | (59.0) | - | - | - | - | - | 0.9 | 177.4 |
| Other intangible assets | 7.0 | - | - | 53.6 | 15.5 | - | - | - | - | (1.1) | 75.0 |
| Property, plant and equipment | 79.5 | 16.0 | - | - | - | - | - | - | - | 0.7 | 96.2 |
| Investment in joint ventures | 27.2 | (27.2) | - | - | - | - | - | - | - | - | - |
| Other investments | 13.7 | - | - | - | - | - | - | - | - | - | 13.7 |
| Deferred tax assets | - | 1.3 | - | - | 50.8 | 5.4 | - | 1.4 | (12.2) | 3.4 | 50.1 |
| Trade and other receivables | 296.9 | 62.6 | - | - | 32.3 | - | - | - | - | (1.2) | 390.6 |
| | 632.5 | 64.1 | 15.9 | (5.4) | 98.6 | 5.4 | - | 1.4 | (12.2) | 2.7 | 803.0 |
| **Current assets** | | | | | | | | | | | |
| Inventories | 23.0 | 3.9 | - | - | - | - | - | - | - | - | 26.9 |
| Trade and other receivables | 343.0 | 56.7 | - | - | (12.3) | - | - | - | - | 2.7 | 390.1 |
| Cash and cash equivalents | 173.9 | 27.2 | - | - | - | - | - | - | - | (0.6) | 200.5 |
| | 539.9 | 87.8 | - | - | (12.3) | - | - | - | - | 2.1 | 617.5 |
| **Current liabilities** | | | | | | | | | | | |
| Trade and other payables | (352.2) | (47.4) | - | - | - | (16.9) | - | - | - | (0.5) | (417.0) |
| Retirement benefit obligation | (0.4) | - | - | - | 0.4 | - | - | - | - | | - |
| Tax liabilities | - | (3.9) | - | - | - | - | - | - | - | (1.9) | (5.8) |
| Obligations under finance leases | (6.5) | (1.3) | - | - | - | - | - | - | - | (0.3) | (8.1) |
| Loans | (23.5) | (22.6) | - | - | - | - | - | - | - | (0.3) | (46.4) |
| Proposed dividend | (8.3) | - | - | - | - | - | 8.3 | - | - | - | - |
| | (390.9) | (75.2) | - | - | 0.4 | (16.9) | 8.3 | - | - | (3.0) | (477.3) |
| **Non-current liabilities** | | | | | | | | | | | |
| Obligations under finance leases | (13.6) | (4.2) | - | - | - | - | - | - | - | (0.4) | (18.2) |
| Loans | (401.5) | (50.1) | - | - | - | - | - | - | - | 0.3 | (451.3) |
| Deferred tax liabilities | (32.2) | (10.4) | (1.5) | - | (4.0) | - | - | - | (6.5) | (0.4) | (55.0) |
| Trade and other payables | - | (1.1) | - | - | - | - | - | - | - | 0.5 | (0.6) |
| Provisions | - | - | - | - | - | (6.0) | - | - | - | - | (6.0) |
| Retirement benefit obligations | (29.8) | (9.2) | - | - | (204.9) | - | - | - | - | 1.0 | (242.9) |
| | (477.1) | (75.0) | - | - | (208.9) | (6.0) | - | - | (6.5) | 1.0 | (774.0) |
| **Net assets** | 304.4 | 1.7 | 14.4 | (5.4) | (122.2) | (17.5) | 8.3 | 1.4 | (18.7) | 2.8 | 169.2 |
| **Equity** | | | | | | | | | | | |
| Share capital | 8.7 | - | - | - | - | - | - | - | - | - | 8.7 |
| Share premium | 191.5 | - | - | - | - | - | - | - | - | - | 191.5 |
| Own shares reserve | (15.8) | - | - | - | - | - | - | (0.6) | - | - | (16.4) |
| Capital redemption reserve | 0.1 | - | - | - | - | - | - | - | - | - | 0.1 |
| Retained earnings | 122.6 | - | 14.4 | (5.4) | 2.2 | (17.5) | 8.3 | (4.2) | (18.7) | 2.7 | 104.4 |
| Share-based payment reserve | - | - | - | - | - | - | - | 6.2 | - | - | 6.2 |
| Retirement benefit obligations reserve | - | - | - | - | (124.4) | - | - | - | - | - | (124.4) |
| Translation reserve | (2.7) | - | - | - | - | - | - | - | - | 0.1 | (2.6) |
| | 304.4 | - | 14.4 | (5.4) | (122.2) | (17.5) | 8.3 | 1.4 | (18.7) | 2.8 | 167.5 |
| Minority interest | - | 1.7 | - | - | - | - | - | - | - | - | 1.7 |
| **Total equity** | 304.4 | 1.7 | 14.4 | (5.4) | (122.2) | (17.5) | 8.3 | 1.4 | (18.7) | 2.8 | 169.2 |

## 7. Independent Auditors' Report To The Board Of Directors Of Serco Group Plc On The 2004 Reconciliations

We have audited the reconciliations of the consolidated balance sheet at 1 January 2004 and 31 December 2004 and consolidated income statement for the year ended 31 December 2004 between UK GAAP and International Financial Reporting Standards ('IFRS'), (together "the 2004 Reconciliations").

This report is made solely to the Board of Directors, in accordance with our engagement letter dated 30 August 2005 and solely for the purpose of assisting with the transition to IFRS. Our audit work has been undertaken so that we might state to the Company's board of directors those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we will not accept or assume responsibility to anyone other than the company for our audit work, for our report, or for the opinions we have formed.

**Respective responsibilities of directors and auditors**

The Company's directors are responsible for ensuring that the Company and the Group maintains proper accounting records and for the preparation of the 2004 Reconciliations on the basis set out in section 10, which describes how IFRS will be applied under IFRS 1, including the assumptions the directors have made about the standards and interpretations expected to be effective, and the policies expected to be adopted, when the company prepares its first complete set of IFRS financial statements as at 31 December 2005. Our responsibility is to audit the 2004 Reconciliations in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards and report to you our opinion as to whether the 2004 Reconciliations are prepared, in all material respects, on the basis set out in section 10.

**Basis of audit opinion**

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the 2004 Reconciliations. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the 2004 Reconciliations and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the 2004 Reconciliations are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the 2004 Reconciliations.

Without qualifying our opinion, we draw attention to section 10 which explains why there is a possibility that the 2004 Reconciliations may require adjustment before constituting the final 2004 Reconciliations. Moreover, we draw attention to the fact that, under IFRS, only a complete set of financial statements comprising a balance sheet, income statement, statement of changes in equity, cash flow statement, together with comparative financial information and explanatory notes, can provide a fair presentation of the Group's financial position, results of operations and cash flows in accordance with IFRS.

**Opinion**

In our opinion the 2004 Reconciliations are prepared, in all material respects, on the basis set out in section 10 which describes how IFRS will be applied under IFRS 1, including the assumptions the directors have made about the standards and interpretations expected to be effective, and the policies expected to be adopted, when the company prepares its first complete set of IFRS financial statements as at 31 December 2005.

**Deloitte & Touche LLP**

Chartered Accountants
London

31 August 2005

## 8. 30 June 2004 - presentational changes, and equity and profit reconciliations

### a) Impact of IAS1 'Presentation of Financial Statements' on the consolidated profit and loss account for the six months ended 30 June 2004

This table highlights the presentational impact of IFRS on the consolidated profit and loss account for the six months ended 30 June 2004. Income and expense are stated under UK GAAP values and format and are mapped from this starting position to the line item classification required under IFRS.

| **UK GAAP values and format** | | **IAS1 Presentational changes** | **UK GAAP values in IFRS format** | |
|---|---|---|---|---|
| **Profit and Loss account** | **£m** | **£m** | **£m** | **Income Statement** |
| Turnover: Group and share of joint venture | 804.5 | | 804.5 | |
| Less: Share of joint ventures | (120.4) | | (120.4) | |
| **Group turnover** | 684.1 | | 684.1 | **Revenue** |
| Cost of sales | (589.5) | | (589.5) | Cost of sales |
| **Gross profit** | 94.6 | | 94.6 | **Gross profit** |
| Amortisation of intangible assets | (8.4) | | (8.4) | Other operating expenses |
| Other administrative expenses | (68.9) | | (68.9) | Administrative expenses |
| **Operating profit continuing operations** | **17.3** | | **17.3** | **Profit from operations** |
| Share of operating profit in joint ventures | 11.8 | | 11.8 | Joint venture operating profit |
| | | 17.5 | 17.5 | Investment income |
| | | (18.5) | (18.5) | Finance costs |
| Net interest and similar income | (1.0) | 1.0 | | |
| **Profit on ordinary activities before taxation** | 28.1 | - | 28.1 | **Profit before tax** |
| Taxation on profit on ordinary activities | (10.1) | | (10.1) | Tax |
| **Profit on ordinary activities after taxation** | **18.0** | | **18.0** | **Profit for the year** |
| Share of joint venture minority interest | (0.1) | 0.1 | | Attributable to: |
| Minority interest | (0.1) | 0.1 | | |
| | | | 17.8 | Equity holders of the parent |
| | | 0.2 | 0.2 | Minority interest |
| **Profit for the financial year** | **17.8** | **0.2** | **18.0** | |
| Equity dividends | (3.5) | | | |
| **Retained profit for the financial year** | **14.3** | | | |
| Earnings per ordinary share (EPS) | | | | |
| Basic EPS | 4.14p | | 4.14p | |
| Diluted EPS | 4.09p | | 4.09p | |

**b) Reconciliation of the income statement for the six months ended 30 June 2004**

This table highlights the financial impact of the key IFRS adjustments covered in section 4 on the consolidated income statement for the six months ended 30 June 2004.

| | UK GAAP | IAS 31 Interest in joint ventures | IFRS3 Business combinations | IAS38 Intangible assets | IAS19 Employee Benefits - pensions | IFRS2 Share-based payments | IAS12 Income taxes | Other | IFRS |
|---|---|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Revenue** | 684.1 | 120.4 | - | - | - | - | - | - | 804.5 |
| Cost of sales | (589.5) | (99.4) | - | - | 1.3 | - | - | (0.3) | (687.9) |
| **Gross profit** | 94.6 | 21.0 | - | - | 1.3 | - | - | (0.3) | 116.6 |
| Other operating expenses | (8.4) | - | 8.1 | (3.0) | (0.4) | - | - | - | (3.7) |
| Administrative expenses | (68.9) | (9.2) | - | - | - | (1.2) | - | (0.7) | (80.0) |
| **Profit from operations** | 17.3 | 11.8 | 8.1 | (3.0) | 0.9 | (1.2) | - | (1.0) | 32.9 |
| Joint venture operating profit | 11.8 | (11.8) | - | - | - | - | - | - | - |
| Investment income | 17.5 | *- | - | - | - | - | - | - | 17.5 |
| Finance costs | (18.5) | *- | - | - | (1.2) | - | - | - | (19.7) |
| **Profit before tax** | 28.1 | - | 8.1 | (3.0) | (0.3) | (1.2) | - | (1.0) | 30.7 |
| Tax | (10.1) | *- | (0.9) | - | 0.1 | 0.3 | 0.8 | 0.1 | (9.7) |
| **Profit for the year** | 18.0 | - | 7.2 | (3.0) | (0.2) | (0.9) | 0.8 | (0.9) | 21.0 |
| Attributable to: | | | | | | | | | |
| Equity holders of the parent | 17.8 | - | 7.2 | (3.0) | (0.2) | (0.9) | 0.8 | (0.9) | 20.8 |
| Minority interest | 0.2 | - | - | - | - | - | - | - | 0.2 |
| | 18.0 | - | 7.2 | (3.0) | (0.2) | (0.9) | 0.8 | (0.9) | 21.0 |
| Earnings per share (EPS) | | | | | | | | | |
| Basic EPS | 4.14p | | | | | | | | 4.84p |
| Diluted EPS | 4.09p | | | | | | | | 4.78p |

*UK GAAP values include the Group's share of joint venture investment income, finance costs and tax.

serco
bringing service to life

**c) Impact of IAS1 'Presentation of Financial Statements' on the consolidated balance sheet as at 30 June 2004**
This table highlights the presentational impact of IFRS on the consolidated balance sheet as at 30 June 2004. Assets, liabilities and shareholders' funds are stated under UK GAAP values and format and are mapped from this starting position to the line item classification required under IFRS.

| UK GAAP values and format | £m | IAS1 Presentational changes £m | £m | UK GAAP values in IFRS format |
|---|---|---|---|---|
| **Fixed assets** | | | | **Non-current assets** |
| Intangible assets | 215.1 | (1.1) | 214.0 | Goodwill |
| | | 1.0 | 1.0 | Other intangible assets |
| Tangible assets | 72.0 | | 72.0 | Property, plant and equipment |
| Investments in joint ventures | 27.5 | | 27.5 | Investment in joint ventures |
| | | 378.0 | 378.0 | Trade and other receivables |
| | 314.6 | 377.9 | 692.5 | |
| **Current assets** | | | | **Current assets** |
| Stocks | 41.0 | (13.3) | 27.7 | Inventories |
| Debtors: Amounts due within one year | 276.2 | 45.7 | 321.9 | Trade and other receivables |
| Debtors: Amounts due after more than one year | 410.4 | (410.4) | | |
| Cash at bank and in hand | 168.3 | - | 168.3 | Cash and cash equivalents |
| | 895.9 | (378.0) | 517.9 | |
| **Creditors : Amounts falling due within one year** | | | | **Current liabilities** |
| Trade creditors | (70.7) | (247.5) | (318.2) | Trade and other payables |
| | | (6.8) | (6.8) | Tax liabilities |
| | | (5.7) | (5.7) | Obligations under finance leases |
| | | (0.6) | (0.6) | Loans |
| Accruals and deferred income | (174.5) | 174.5 | | |
| Other creditors including taxation and social security | (86.1) | 86.1 | | |
| Proposed dividend | (3.5) | | (3.5) | Proposed dividend |
| | (334.8) | - | (334.8) | |
| | | | | **Non-current liabilities** |
| | | (15.5) | (15.5) | Obligations under finance leases |
| Creditors: Amounts falling due after more than one year | (526.0) | 15.6 | (510.4) | Loans |
| | | (27.7) | (27.7) | Deferred tax liabilities |
| Provisions for liabilities and charges | (56.2) | 56.2 | - | Provisions |
| | | (28.5) | (28.5) | Retirement benefit obligation |
| | (582.2) | 0.1 | (582.1) | |
| **Net assets** | 293.5 | - | 293.5 | **Net assets** |
| Called up share capital | 8.7 | | 8.7 | Share capital |
| Share premium account | 190.9 | | 190.9 | Share premium account |
| ESOP reserve | (16.2) | | (16.2) | Own shares reserve |
| Capital redemption reserve | 0.1 | | 0.1 | Capital redemption reserve |
| Profit and loss account | 110.0 | | 110.0 | Retained earnings |
| **Equity shareholders' funds** | 293.5 | - | 293.5 | **Total equity** |

## d) Reconciliation of equity at 30 June 2004

This table highlights the financial impact of the key IFRS adjustments covered in section 4 on the consolidated balance sheet as at 30 June 2004.

| | UK GAAP | IAS 31 Interest in joint ventures | IFRS3 Business combina-tions | IAS 38 Intangible assets | IAS19 Employee Benefits -pensions | IAS19 Employee Benefits -other | IAS10 Dividends | IFRS2 Share based payment | IAS12 Income taxes | Other | IFRS |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Non-current assets** | | | | | | | | | | | |
| Goodwill | 214.0 | 5.1 | 8.1 | (55.8) | - | - | - | - | - | (4.6) | 166.8 |
| Other intangible assets | 1.0 | - | - | 52.8 | 16.3 | - | - | - | - | 0.8 | 70.9 |
| Property, plant and equipment | 72.0 | 13.7 | - | - | - | - | - | - | - | 1.2 | 86.9 |
| Investment in joint ventures | 27.5 | (27.5) | - | - | - | - | - | - | - | - | - |
| Deferred tax assets | - | 0.9 | - | - | 33.5 | 5.5 | - | 0.8 | (3.7) | 1.7 | 38.7 |
| Trade and other receivables | 378.0 | 61.6 | - | - | 1.2 | - | - | - | - | (1.7) | 439.1 |
| | 692.5 | 53.8 | 8.1 | (3.0) | 51.0 | 5.5 | - | 0.8 | (3.7) | (2.6) | 802.4 |
| **Current assets** | | | | | | | | | | | |
| Inventories | 27.7 | 2.3 | - | - | - | - | - | - | - | - | 30.0 |
| Trade and other receivables | 321.9 | 52.5 | - | - | - | - | - | - | - | 0.4 | 374.8 |
| Cash and cash equivalents | 168.3 | 15.8 | - | - | - | - | - | - | - | - | 184.1 |
| | 517.9 | 70.6 | - | - | - | - | - | - | - | 0.4 | 588.9 |
| **Current liabilities** | | | | | | | | | | | |
| Trade and other payables | (318.2) | (33.9) | - | - | - | (16.2) | - | - | - | - | (368.3) |
| Tax liabilities | (6.8) | (4.0) | - | - | - | - | - | - | - | - | (10.8) |
| Obligations under finance leases | (5.7) | (1.4) | - | - | - | - | - | - | - | (0.4) | (7.5) |
| Loans | (0.6) | (16.2) | - | - | - | - | - | - | - | (0.1) | (16.9) |
| Proposed dividend | (3.5) | - | - | - | - | - | 3.5 | - | - | - | |
| | (334.8) | (55.5) | - | - | - | (16.2) | 3.5 | - | - | (0.5) | (403.5) |
| **Non-current liabilities** | | | | | | | | | | | |
| Obligations under finance leases | (15.5) | (4.7) | - | - | - | - | - | - | - | (0.6) | (20.8) |
| Loans | (510.4) | (51.3) | - | - | - | - | - | - | - | - | (561.7) |
| Deferred tax liabilities | (27.7) | (7.8) | (0.9) | - | - | - | - | - | (14.3) | - | (50.7) |
| Provisions | - | - | - | - | - | (6.0) | - | - | - | - | (6.0) |
| Trade and other payables | - | (4.3) | - | - | - | - | - | - | - | - | (4.3) |
| Retirement benefit obligations | (28.5) | - | - | - | (161.2) | - | - | - | - | - | (189.7) |
| | (582.1) | (68.1) | (0.9) | - | (161.2) | (6.0) | - | - | (14.3) | (0.6) | (833.2) |
| **Net assets** | 293.5 | 0.8 | 7.2 | (3.0) | (110.2) | (16.7) | 3.5 | 0.8 | (18.0) | (3.3) | 154.6 |
| **Equity** | | | | | | | | | | | |
| Share capital | 8.7 | - | - | - | - | - | - | - | - | - | 8.7 |
| Share premium | 190.9 | - | - | - | - | - | - | - | - | - | 190.9 |
| Own shares reserve | (16.2) | - | - | - | - | - | - | (0.7) | - | - | (16.9) |
| Capital redemption reserve | 0.1 | - | - | - | - | - | - | - | - | - | 0.1 |
| Retained earnings | 112.4 | - | 7.2 | (3.0) | 1.1 | (16.7) | 3.5 | (2.0) | (18.0) | 0.9 | 85.4 |
| Share-based payment reserve | | - | - | - | - | - | - | 3.5 | - | - | 3.5 |
| Retirement benefit obligations reserve | - | - | - | - | (111.3) | - | - | - | - | - | (111.3) |
| Translation reserve | (2.4) | - | - | - | - | - | - | - | - | (4.2) | (6.6) |
| | 293.5 | - | 7.2 | (3.0) | (110.2) | (16.7) | 3.5 | 0.8 | (18.0) | (3.3) | 153.8 |
| Minority interest | - | 0.8 | - | - | - | - | - | - | - | - | 0.8 |
| **Total equity** | 293.5 | 0.8 | 7.2 | (3.0) | (110.2) | (16.7) | 3.5 | 0.8 | (18.0) | (3.3) | 154.6 |

## 9. Reconciliation of equity at 1 January 2005 as a result of adopting IAS 32 and IAS 39

| | As at 31 December 2004 Restated under IFRS £m | IAS 32 and IAS 39 Financial instruments £m | As at 1 January 2005 Restated under IFRS £m |
|---|---|---|---|
| Non-current assets | 803.0 | 11.0 | 814.0 |
| Current assets | 617.5 | - | 617.5 |
| Current liabilities | (477.3) | (4.3) | (481.6) |
| Non-current liabilities | (774.0) | (33.6) | (807.6) |
| Net assets | 169.2 | (26.9) | 142.3 |

## 10. Significant accounting policies

The financial information has been prepared on the basis of financial reporting standards expected to be applicable at 31 December 2005. These are subject to ongoing review and endorsement by the European Union or possible amendment by interpretive guidance from the International Accounting Standards Board ('IASB') and the International Financial Reporting Interpretations Committee ('IFRIC') and are therefore still subject to change.

The financial information has been prepared on the historical cost basis. The principal accounting policies adopted are set out below.

**Presentation of financial information**
The primary statements within the financial information contained in this document have been presented substantially in accordance with IAS 1 'Presentation of Financial Statements'. However, this format and presentation may require modification in the event that further guidance is issued and as practice develops.

**Basis of consolidation**
The consolidated financial statements incorporate the financial statements of the Company, entities controlled by the Company (its subsidiaries) and entities jointly controlled by the Company (its joint ventures) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identified net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the profit and loss account in the period of acquisition.

The results of subsidiaries and joint ventures acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries and joint ventures to bring accounting policies used into line with those used by the Group.

All intragroup transactions, balances, income and expenses are eliminated on consolidation.

**Investments in joint ventures**
The Group's investments in joint ventures are reported in the financial statements using the proportionate consolidation method, whereby the Group's share of each of the assets, liabilities, income and expenses of its joint ventures is combined line by line with similar items in the Group's financial statements or reported as separate line items within the Group's financial statements.

**Goodwill**
Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable net assets and liabilities of a subsidiary, or jointly-controlled entity at the date of acquisition.

Goodwill is recognised as an asset. Goodwill is not amortised and is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary or jointly-controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated.

**Revenue recognition**
Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes.

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

Revenue from long-term project-based contracts is recognised in accordance with the Group's accounting policy below.

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

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

**Segmental information**
Segmental information is based on two segment formats: the primary format reflects the Group's management structure, whereas the secondary format is geographically-orientated.

Unallocated items comprise mainly corporate expenses. Specific corporate expenses are allocated to the corresponding segments. Segment assets comprise goodwill, other intangible assets, property, plant and equipment, other debtors and prepayments, inventories, and trade and other receivables (excluding corporation tax recoverable). Liabilities comprise trade and other payables, retirement benefit obligations, and other creditors. Eliminations represent inter-company balances between the different segments.

**Long-term project-based contracts**
The Group has a number of long-term contracts for the provision of complex, project-based services. Where the outcome of such long-term project-based contracts can be measured reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a long-term project-based contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs that it is probable will be recovered. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

All bid costs are expensed through the income statement up to the point where contract award (or full recovery of costs) is virtually certain. Bid costs incurred after this point are then capitalised within trade and other receivables. On contract award these bid costs are amortised through the income statement over the contract period by reference to the stage of completion of the contract activity at the balance sheet date.

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

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

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

**Foreign currencies**
Transactions in currencies other than pounds 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. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the date when the fair value was determined. 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.

On consolidation, the assets and liabilities of the Group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

**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 in profit or loss in the period in which they are incurred.

**Profit from operations**
Profit from operations is stated after charging restructuring costs and before investment income and finance costs.

**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 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 consolidated statement of recognised income and expense.

Past service cost is recognised immediately to the extent that the benefits are already vested, and is amortised on a straight-line basis over the average period until the benefit becomes vested.

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

***Defined benefit obligations arising from contractual obligations***

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract and it is not virtually certain that the contributions will be recovered from the customer, 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 assets which reflects the Group's right to manage and operate the contract, is amortised over the contract period. Subsequent actuarial gains and losses in relation to the Group's share of pension obligation are recognised outside the income statement and are presented in the consolidated statement of recognised income and expense.

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract and it is virtually certain that the contributions will be recovered from the customer, the Group's share of the defined benefit obligation less its share of the pension scheme assets are recognised as a liability at the start of the contract with a corresponding amount being recognised as a financial asset at fair value, being the fair value of the reimburseable rights. In the consolidated income statement, the expense relating to the defined benefit plan is presented net of the amount recognised for reimbursement. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised outside the income statement and are presented in the consolidated statement of recognised income and expense. The change in fair value of the reimburseable right that is not presented in the income statement is reported in the consolidated statement of recognised income and expense.

***Multi-employer pension schemes***

Multi- employer pension schemes are classified as a defined contribution pension scheme or a defined benefit scheme under the terms of the scheme.

When sufficient information is not available to use defined benefit accounting for a multi-employer defined benefit pension scheme, the Group accounts for the scheme as if it were a defined contribution scheme.

**Taxation**

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

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

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

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

Such 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 that is not 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 and joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited to 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.

**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.

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

The principal annual rates used are:

| | |
|---|---|
| Freehold buildings | 2.5% |
| Short-leasehold building improvements | The higher of 10% or the rate produced by lease term |
| Machinery | 15% - 20% |
| Motor vehicles | 18% - 50% |
| Furniture | 10% |
| Office equipment | 20% - 33% |
| Leased equipment | The higher of the rate produced by 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 income.

**Other intangible assets**
Development expenditure relating to software is capitalised as an intangible asset only if all of the following conditions are met:

- An asset is created that can be identified
- It is probable that the asset created will generate future economic benefits
- The development cost of the asset can be measured reliably

Development expenditure is amortised over the period in which the Group is expected to benefit. This period is between three to five years, or the length of the contract if longer. Provision is also made for impairment. All other development expenditure is written off as incurred.

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

Franchises represent bid costs relating to costs incurred in obtaining franchise rights, and franchise goodwill arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the franchise.

**Impairment of tangible and intangible assets excluding goodwill**
At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is 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 using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) 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 had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately.

Impairment losses and reversals are included within administrative expenses within the income consolidated statement.

**Inventories**
Inventories are stated at the lower of cost and net realisable value. Where applicable, cost includes an appropriate proportion of direct material and labour.

**Share-based payment**
The Group has applied the requirements of IFRS 2 ‘Share-based Payment’. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005.

The Group issues equity-settled share-based payments to certain employees and operates an Inland Revenue approved Save As You Earn share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group’s estimate of shares that will eventually vest.

Fair value is measured by use of the Black Scholes, Binomial or Monte Carlo Simulation models depending on the type of scheme. 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.

**Accounting for PFI contracts**
Within Public Private Partnership (PPP) projects (including Private Finance Initiative (PFI) projects), where the concession agreement transfers limited risks and rewards associated with ownership to the contractors, during the period of initial asset construction costs incurred as a direct consequence of financing, designing and constructing the asset are shown as “PFI assets in the course of construction” within trade and other receivables. On completion of the asset construction phase the asset is transferred within trade and other receivables to a “PFI debtor.”

Revenues received from the customer are apportioned between capital repayments and operating revenue. The ‘finance income’ element of the capital repayment is shown as notional interest receivable within investment income.

The Group has fully owned Special Purpose Companies (SPC) which are used for the purpose of running the PFI business. All other SPCs are joint ventures and accounted for using the proportionate consolidation method.

**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. This definition is also used for the consolidated cash flow statement.

**Dividends**
Dividends are recorded in the Group’s consolidated financial statements in the period in which they are approved by the Group’s shareholders.

**Debt**
Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting period and reduced by payments made in the period.

Debt of certain Special Purpose Companies and joint ventures is described as non recourse debt. Debt is described as non recourse debt only if the debt funds the construction or ownership of a specific asset and the security granted to the relevant lenders is limited to the shares in the borrowing company and the assets and cash flows of the borrowing company.

**Derivative financial instruments and hedging activities**
The Group has adopted IAS39 'Financial Instruments: Recognition and Measurement' with effect from 1 January 2005. Derivatives are initially accounted and measured at fair value on the date a derivative contract is entered into and subsequently measured at fair value. The gain or loss on re-measurement is taken to the income statement except where the derivative is a designated cash flow hedging instrument. The accounting treatment of derivatives classified as hedges depends on their designation, which occurs on the date that the derivative contract is committed to. The Group designates derivatives as:

- A hedge of the fair value of an asset or liability ('fair value hedge').
- A hedge of the income/cost of a highly probable forecast transaction or commitment ('cash flow hedge').
- A hedge of net investment in a foreign entity.

Gains or losses on fair value hedges that are regarded as highly effective are recorded in the income statement with the gain or loss on the hedged item attributable to the hedged risk.

Gains or losses on cash flow hedges that are regarded as highly effective are recognised in equity. Where the forecast transaction results in a financial asset or liability only gains or losses previously recognised in equity are reclassified to profit or loss in the same period as the asset or liability affects profit or loss. Where the forecast transaction or commitment results in a non-financial asset or a liability, then any gains or losses previously deferred in equity are included in the cost of the related asset or liability. If the forecast transaction or commitment results in future income or expenditure, gains or losses deferred in equity are transferred to the income statement in the same period as the underlying income or expenditure. The ineffective portion of the gain or loss on the hedging instrument is recognised in profit or loss.

For the portion of hedges deemed ineffective or transactions that do not qualify for hedge accounting under IAS 39, any change in assets or liabilities is recognised immediately in the income statement. Where a hedge no longer meets the effectiveness criteria, any gains or losses deferred in equity are only transferred to the income statement when the committed or forecast transaction is recognised in the income statement. However, where cash flow hedge accounting has been applied for a forecast or committed transaction that is no longer expected to occur, then the cumulative gain or loss that has been recorded in equity is transferred to the income statement. When a hedging instrument expires or is sold, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement.

Where the group hedges net investments in foreign entities through currency borrowings, the gains or losses on the translation of the borrowings are recognised in equity. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.