



serco

bringing service to life

Serco Group plc
interim report 2005

on board the ghan train, on its inaugural journey from adelaide to darwin, frank birch is served a tomato juice. there's no celery. half an hour later he orders another. this time, celery. a crew member had phoned her mother up the line to put a bunch on board.

around the world people are experiencing a quality of service that makes a difference to their lives. expectations are met and often surpassed because Serco enables those delivering the service to give their best.

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business highlights

strong organic growth

- revenue before acquisitions and disposals up 20.8%
- profit before tax, amortisation and acquisitions up 14.5%
- continued win rates of over 90% on rebids and over 50% on new bids
- contracts signed valued at £0.7bn in the period, appointed preferred bidder on contracts worth a further £1.5bn

continuing focus on cash generation

- Group EBITDA to cash conversion of 70% (2004 – 58%) contributing to Group free cash flow of £19.4m (2004 – £23.5m)

Note: Group EBITDA is earnings from subsidiaries before interest, tax, depreciation and intangible amortisation. Group free cash flow is from subsidiaries and is reconciled in Section 4 of the finance review

acquisitions' performance on target

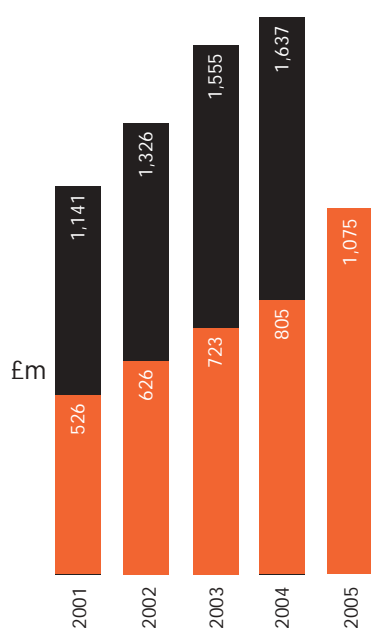
- completed purchase of ITNET in February and RCI in March
- acquisitions added £134.4m of revenue and £9.3m (£4.3m after funding costs) of profit before tax and amortisation
- management reorganisations complete, integration proceeding well and customers responding positively

high visibility of future revenues

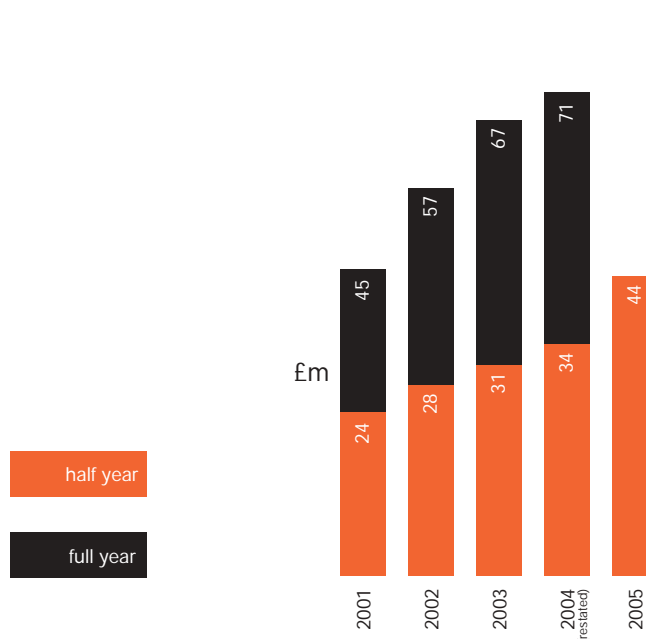
- forward order book of £12.9bn at 30 June 2005
- 99% of 2005 planned revenue secured, 85% for 2006 and 74% for 2007
- bids worth £4.5bn submitted and under evaluation, including £1.7bn at preferred bidder
- in excess of £18bn of further opportunities identified

financial highlights

revenue including joint ventures



profit before tax and amortisation



	6 months to 30 June 2005	6 months to 30 June 2004	
Revenue	£1,074.9m	£804.5m	up 33.6%
Profit before tax and amortisation	£43.7m	£34.4m	up 27.0%
Earnings per share before amortisation	6.78p	5.53p	up 22.6%
Profit before tax	£37.3m	£30.7m	up 21.5%
Earnings per share	5.61p	4.84p	up 15.9%
Dividend per share	0.91p	0.81p	up 12.3%

Note: 2004 restated under IFRS



Andrew Jenner
Finance Director

Kevin Beeston
Executive Chairman

Christopher Hyman
Chief Executive

“Serco’s growth is being fuelled by the continuing shift towards private provision of public services in our chosen markets, combined with our ability to deliver customers’ desired outcomes.”

Serco Group plc ("Serco") has had an excellent first half, achieving significant growth both organically and from our recent acquisitions. A strong operating performance saw profits before tax and amortisation rise by 27.0% on revenue that rose 33.6%. Our cash performance remains robust, with Group EBITDA to cash conversion of 70% (2004 – 58%) contributing to a Group free cash flow of £19.4m in the first half.

Business summary

Serco's growth is being fuelled by the continuing shift towards private provision of public services in our chosen markets, combined with our ability to deliver customers' desired outcomes. This ability has helped us develop long term relationships with clients and build trust and credibility with the people who ultimately use our services.

Excellent service delivery is key to driving the organic growth that remains the cornerstone of our strategy. Our track record does more than position us to retain business. It also gives our clients the confidence to enable us to expand the scope and scale of our services to them, leveraging our expertise across national borders and industry sectors.

During the six months, organic revenue growth was 20.8%. On rebids, our success rate was maintained at over 90%, while we continued to win more than 50% of new bids.

Our two recent acquisitions, ITNET and RCI, had the anticipated positive impact, adding £134.4m to revenue and £9.3m (£4.3m after funding costs) to profit before tax and amortisation.

We have maintained the high visibility of our future revenue. At 30 June 2005, our forward order book stood at £12.9bn, nearly eight times 2004's revenue. To date, we have secured 99% of planned revenue for 2005, 85% for 2006 and 74% for 2007. In addition, at the half year we had a further £1.7bn of contracts at preferred bidder stage and another £2.8bn of bids – where we are down to the last two or three bidders – are under evaluation by customers. We have also identified a pipeline of opportunities exceeding £18bn.

Organic growth

During the first half, we signed contracts and extensions valued at £0.7bn and were appointed preferred bidder on contracts worth a further £1.5bn.

Early in the year, we secured one of our most significant defence wins, the 23-year, £400m Defence Academy Campus Integrator contract to deliver a world-class academic centre of excellence for senior commanders and staff from the Ministry of Defence ("MoD").

In March, our joint venture with SNC-Lavalin was appointed preferred bidder to operate a rapid rail transit link in Vancouver, Canada – a project worth C\$16-20m per annum to Serco, over 30 years.

Our joint venture with Equion, a division of John Laing plc, was appointed preferred bidder for a 35-year agreement worth around £1.2bn to support three Leicester hospitals as part of the city's Pathway private finance initiative.

Serco was also successful in winning or extending more than 100 smaller and medium-sized contracts during the first half such as the Dubai Airport air traffic services rebid, the contract to supply the MoD's Integrated Sensor Management System, and the contract to support the Mechanical and Electrical Engineering Departments of the European Space Agency.

Meanwhile, Northern Rail, our largest-ever contract, delivered strong operational performance in its first few months under our joint venture's management. Northern has consistently exceeded service performance targets, delivering real improvements for the thousands of passengers who use the network daily. As the consolidation of the two previous franchises into Northern continues on schedule, we expect to achieve further performance enhancements while maximising efficiencies.

We have also continued to expand our consulting business. As well as contributing to our profits, consulting helps us to shape our markets through the provision of advice to existing and potential clients at a senior level. In conjunction with the Serco Institute, this helps to position us as thought leaders in our field.

Since the start of the second half, our joint venture with BNFL and Lockheed Martin has signed a contract that significantly increases the scale of our work for the MoD at the Atomic Weapons Establishment. The organic growth from this contract is valued at over £350m to Serco over the next three years.

Serco has also been appointed preferred bidder on important contracts in the early part of the second half. These include a strategic partnership with the Defence Science and Technology Laboratory ("Dstl"), which will be worth around £400m to us. Serco will manage the design and build of new facilities for Dstl, the migration of 1,600 scientists to these facilities, and provide support services ranging from laboratory set-up to travel management across the entire Dstl estate for 15 years.

We are also close to securing more than £180m of opportunities across homeland security and offender management.

"Our track record does more than position us to retain business. It also gives our clients the confidence to enable us to expand the scope and scale of our services to them."

chairman's statement

More detail on our first half wins and operating performance can be found in the business review on pages 14 to 27.

Acquisitions

The business case underpinning the acquisitions of ITNET and RCI remains compelling. The efficiency of their integration testifies to the strength of the compatibility between the acquisitions and the rest of our business. It also demonstrates our ability to integrate organisations successfully into the Group.

ITNET, now renamed Serco Solutions, is a leading supplier of IT services, business process management, consulting and e-services to UK local authorities and private sector organisations. It has performed in line with our forecasts since its February acquisition, contributing £83.9m in revenue and £6.1m in profit from operations.

Although, as anticipated, its first half revenue was below the corresponding period last year, Serco Solutions continues to receive positive feedback from customers as opportunities for organic growth increase. In June, Serco Solutions announced its selection by IBM as sub-contractor to manage key IT platforms and services for Bradford Council. The award is part of a wider business transformation programme led by IBM, with a contract valued at £158m to the consortium. By the end of the first half, Serco Solutions had also secured important contract extensions and additional work with several clients in the local government sector, including Coventry City Council and the London boroughs of Ealing, Enfield, Richmond and Southwark. It also renewed its contract with Cadbury Schweppes plc and won an extension to its work for Wales & West Utilities.

Serco Solutions has begun to establish itself as the Group's centre of IT excellence. It is working closely with other parts of Serco – notably in home affairs, health and education – and has been shortlisted for a contract worth up to £80m over four years in a joint bid with our science business.

RCI – now renamed Serco Inc. – supplies business process management, IT services, supply chain management, systems engineering and strategic consulting to the US Federal Government, primarily in defence. It has a particularly strong reputation in human resources management programmes for the army and navy. Since the acquisition was completed in March, Serco Inc. has contributed £50.5m in revenue and £3.2m in profit from operations.

Under Serco's ownership, Serco Inc. has maintained its strong position on the US Army's HR Solutions Program through a series of multi-award contracts used by the US Army to acquire personnel-related IT and business process services, studies and analysis, and recruitment and retention support for uniformed staff worldwide. The combined value of the program to Serco is expected to exceed \$300m over the next five years.

In addition, Serco Inc. recently retained its position as provider of the US Army's transition services through the award of the Army Career and Alumni Program task order valued at \$15m annually. Serco was awarded a new contract with the Army to provide services aimed at preventing sexual assault and harassment.

“The business case underpinning the acquisitions of ITNET and RCI remains compelling. The efficiency of their integration testifies to the strength of the compatibility between the acquisitions and the rest of our business.”

financial performance

Results

Total revenue during the period increased by 33.6% to £1,074.9m. Of this increase, £161m came from organic growth, and acquisitions contributed £135m. The effect of last year's contract disposals was to reduce revenue by £26m, thereby resulting in underlying revenue growth of 20.8%.

In the six months to June 2005, profit before tax and amortisation grew 27.0% to £43.7m. Profit before tax, amortisation and acquisitions increased by 14.5%. Earnings per share before intangible amortisation grew 22.6% to 6.78p.

Profit before tax after amortisation grew 21.5% to £37.3m and earnings per share after intangible amortisation grew by 15.9% to 5.61p.

Free cash generation remains a high priority for Serco. During the half year Group free cash flow totalled £19.4m, (2004 – £23.5m), down largely due to one-off tax benefits in the previous year. Group EBITDA to cash conversion was 70% (2004 – 58%). This was a consistent performance and working capital management remains strong.

Dividend

We have increased the interim dividend by 12.3% to 0.91p per ordinary share, from 0.81p in 2004. It will be paid on 19 October 2005 to shareholders on the register at close of business on 9 September 2005.

International Financial Reporting Standards ("IFRS")

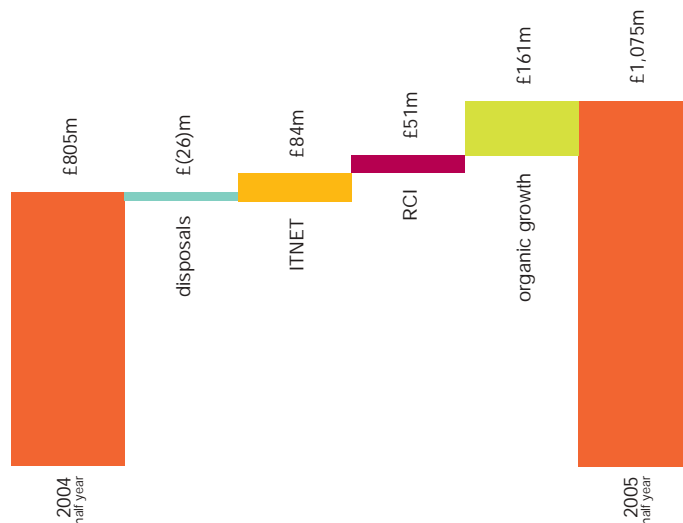
This half year is the first period Serco has reported under IFRS. The main areas of impact are covered in the finance review, with further details in the Transition to IFRS report on pages 38 to 60.

Market development – a global vision

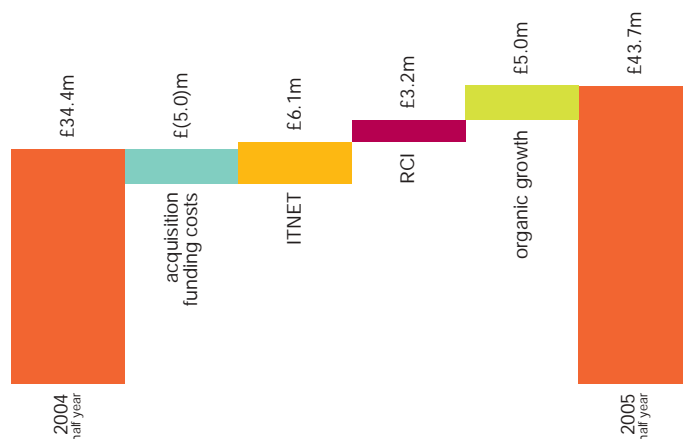
Our global outlook – based on our conviction that a balanced and international portfolio will, over time, become essential for sustaining long term growth – distinguishes us from our competitors. Our ability to transfer our business model and management system across national borders, as well as industry sectors, means that we are able to capitalise on international opportunities as they emerge.

These opportunities are created by two principal factors: the necessity for central and local governments to control their spending; and their need to respond to social pressures for improved public services.

revenue



profit before tax and amortisation



Note: 2004 restated under IFRS.

As more governments recognise the value of private sector partnership in the delivery of essential public services, we will continue to establish and grow our presence in the countries with the greatest potential. The climate in the UK, US and parts of Europe is working strongly in our favour. We also see longer term potential in selected countries in the Middle East and Asia Pacific.

In the UK, the Labour Government's election manifesto endorsed the private sector's role in delivering public services. Post-election, issues such as transforming homeland security, offender management, transport systems, health and education, are high on the political agenda and offer substantial opportunities for Serco.

Group EBITDA to cash conversion was 70% (2004 – 58%). This was a consistent performance and working capital management remains strong.

chairman's statement

The home affairs market – homeland security, law enforcement, offender management and immigration control – is driven by the change in government focus from implementing initiatives to the delivery of outcomes – reducing crime and the fear of crime. At the same time, homeland and border security are critical issues. We are bidding on a number of identified programmes and see others emerging as the market evolves.

New opportunities are also arising in science, with the formation of the Nuclear Decommissioning Agency, a market worth around £2bn per year, with 13 of the 20 nuclear sites being competed by 2008. We have established positions in health and education, which are among the largest and fastest growing areas of government spending.

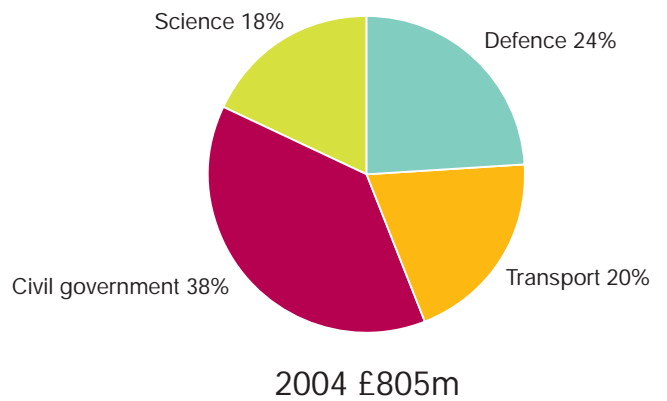
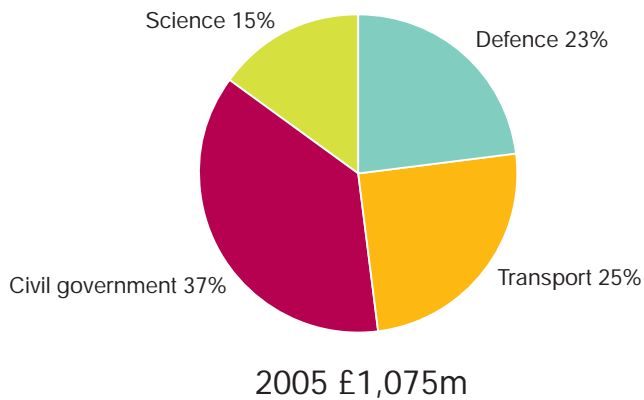
The UK Government will spend some £89bn on health in 2005/6, up 9% on the previous year and education expenditure, at £70bn, will be up 8% resulting in many opportunities within our addressable markets. Other areas of government, in contrast, are seeing budget pressure and in response are changing the way they work. This plays to our strengths.

In UK defence, for example, we expect our addressable market to double to £8bn by 2010, as the MoD focuses resources and seeks cost savings.

With the political framework in place where efficiency, choice, competition and diversity are all important factors, we are confident that the drive to improve the UK's public services will continue.

A similar pattern is emerging in North America, the largest services market in the world. The market is estimated at \$2,000bn, of which around one third is at the Federal level and the remainder with state and local governments. The US defence budget is nearly \$400bn and rising, while homeland security spending will be in excess of \$30bn this year. Some market segments, such as transportation, are looking at private sector service provision for the first time and we are bidding in the traffic management arena. More established markets are moving to more sophisticated, performance-based contracting, as the emphasis shifts from lowest cost to best value, a trend which plays to Serco's strengths.

market sector analysis of first half revenue



Note: 2005 private sector revenue of £94m (2004 - £52m)
2004 restated under IFRS.

In the US, the Bush Administration is pressing forward with Agency scorecards designed to ensure the use of competitive sourcing for the provision of public service across the US Federal government. The global war on terrorism is also accelerating the shift towards private sector involvement, resulting in long-lasting changes that are moving uniformed military personnel from administrative support functions into more direct roles. By leveraging our worldwide defence expertise, we expect to make a long term contribution in helping to support the US's homeland defence capability. Other important factors expanding our markets include the US Federal deficit and an ageing civilian workforce. Given the strength of these drivers, we anticipate a strong flow of opportunities.

In March 2005, we established Serco Europe as a stand-alone division to harness emerging opportunities in two potentially profitable areas: the European scientific agency network and the German public sector.

In Germany, economic conditions are accelerating the trend towards public-private partnerships. There is a widening gap between the supply of public funds and demand for investment in the country's essential infrastructure. These pressures are felt at federal, state and local government levels, resulting in a broad range of opportunities emerging for Serco. Our primary focus is in the defence and justice markets, with transport also likely to provide exciting opportunities. Although a general election is scheduled for September, the economic pressures are unlikely to change. As a result, we are confident that the shift towards a growing role for the private sector in Germany will continue.

A further milestone this year was the opening of our new office in Shanghai in May. From there, we are exploring how we can assist the regional government to meet its ambitious public service objectives. As China's growth continues, we are confident that Serco can have a role in unlocking the country's massive potential.

People

As a service organisation, we know that our people will always be the key factor in providing customers with great value and making Serco a great place to work. And our people have demonstrated a strong public service ethos in a number of major events so far this year.

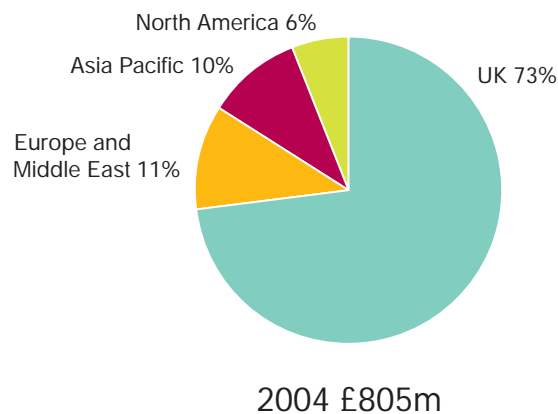
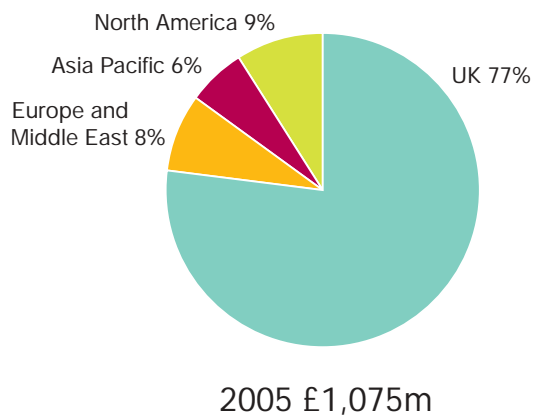
This was so clearly demonstrated during the London bombings, which tragically claimed the life of one of our colleagues. Our hearts go out to his wife and family.

And our thanks go out to all those remarkable Serco people who were directly involved in supporting the emergency services in the series of major incidents that took place in London.

Teams working on the Docklands Light Railway, the London Heliport and the Helicopter Emergency Medical Service played a vital part in the city's calm, prompt and courageous response to these attacks.

Serco people were also involved in managing demonstrations surrounding the G8 Conference in Scotland, and, in more positive circumstances, in the ceremonial review of the Royal Navy commemorating the 200th anniversary of the Battle of Trafalgar.

geographical analysis of first half revenue



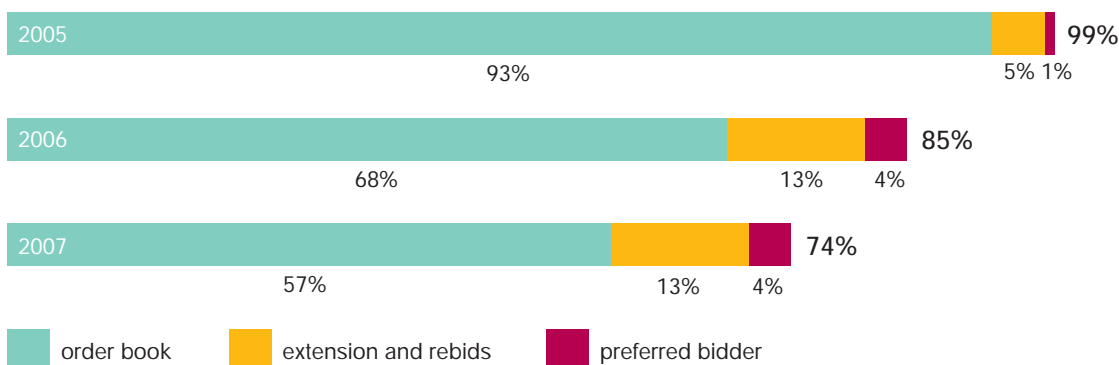
Note: 2004 restated under IFRS.

This year, we introduced a new brand positioning statement for Serco – 'bringing service to life'. This statement links our vision to our daily work. Our people make this statement a reality, every day. I would like to thank each one of them for their commitment, energy and professionalism.

To ensure we have the capability to maintain our growth, we have reinforced the breadth and depth of our management. As well as expanding our executive team, we continue to invest in identifying and developing leadership talent at every level of our business.

Earlier this year, another 12 of our leaders were awarded the Institute of Directors' prestigious Certificate in Company Direction, while two other leaders attained the high-ranking Diploma. At present, 77 Serco leaders have received the certificate and another 30 hold the diploma – a record that demonstrates our commitment to nurturing strong and capable leaders.

high visibility of earnings
percentage of planned revenue secured



We are committed to developing excellence at every level of our business. Serco's "Skills for You" programme, for example, offers our employees essential skills training alongside work-based learning. In July 2005, the programme won the Rentokil Initial Skills For Life Award at the annual Business in the Community awards in London.

It is inspiring to see that "Skills for You" is helping to enrich life beyond work, as more participants take their positive learning experiences back to their homes and communities.

Corporate responsibility

A highly developed sense of corporate responsibility characterises everything that Serco does. We strive to foster a productive dialogue with stakeholders and communities wherever we operate. With an uncompromising emphasis on safety, we seek to have a positive impact on the public and the environment.

Our employees' wholehearted response to last December's tsunami disaster exemplifies this philosophy in practice. With the challenge to match the £100,000 donated by Serco, employee fundraising initiatives exceeded £120,000 within six weeks of the disaster. Serco also provided support to enable 70 employees from businesses in the UK, the Middle East, Europe and the Ascension Islands to travel to Sri Lanka with the charity Habitat for Humanity to help rebuild homes for local people. Another 15 employees from other worldwide Serco locations will be undertaking the same project in November. Meanwhile, and equally importantly, we continue to demonstrate our commitment to safety and the environment, and, as in the past, have received a number of awards recognising our achievements.

Outlook

Serco's culture is infused with the spirit of public service, an ethos that is vital to our growth. By delivering the social outcomes desired by our customers, we encourage them to build long term relationships with us, and to increase the scale and scope of the work we do for them. Our ethos is helping to expand our addressable markets, as governments consider how to extend the role of the private sector in public services.

Market conditions, including social, political and economic factors, remain strongly in our favour. We see numerous opportunities to grow in the UK and internationally.

In recent years we have put in place the building blocks that will allow us to achieve our vision: to be the leading service company in our chosen markets. We have developed Serco's leadership, ensuring we have the capability to drive the Group forward. We have focused on operational efficiency, withdrawing from areas that do not meet our growth and return criteria, and streamlining our structure. Our two recent acquisitions have given us critical mass in North America and a fuller suite of products. We will continue to drive synergies from the acquisitions, with the aim of turning promising leads into new business wins and reducing the debt associated with the transactions.

Our actions to develop leadership, streamline our structure and improve efficiency will contribute to growth and enhance our profitability, resulting in increasing margins over time.

With the breadth of opportunities available to the Group, we look forward to further strong performance in the second half and are confident of achieving double digit growth for the foreseeable future.

finance review

1. Introduction

The Group presents its consolidated results for the first time under International Financial Reporting Standards ("IFRS").

Further explanation of the impact of the transition from previous UK Generally Accepted Accounting Principles ("UK GAAP") to IFRS is covered in the Transition to IFRS report on pages 38 to 60. All comparatives throughout the finance review (on pages 9 to 13) and the interim financial statements included on pages 29 to 36 have been restated under IFRS.

2. Financial performance

The performance in the first six months of the year shows continued strong organic growth, together with the contribution from the acquisitions of ITNET plc ("ITNET") and RCI Holding Corp ("RCI"), which were completed in the period.

Analysis of the Group's financial performance in the six months to 30 June 2005, including our joint ventures on a proportionate consolidation basis, is shown in Figure 1.

Figure 1: Income statement

Six months to 30 June	2005 £m	2004 £m	Increase
Revenue	1,074.9	804.5	33.6%
Gross profit	153.5	116.6	31.6%
Administrative expenses	(101.6)	(80.0)	27.0%
Investment income and finance costs	(8.2)	(2.2)	
Profit before intangible amortisation and tax	43.7	34.4	27.0%
Intangible amortisation	(6.4)	(3.7)	
Profit before tax	37.3	30.7	21.5%
Tax	(11.4)	(9.7)	
Profit for the period	25.9	21.0	
Minority interest	(0.5)	(0.2)	
Retained earnings	25.4	20.8	
Effective tax rate	30.5%	31.6%	
Earnings per share before intangible amortisation	6.78p	5.53p	22.6%
Earnings per share after intangible amortisation	5.61p	4.84p	15.9%
Dividend per share	0.91p	0.81p	12.3%

2.1 Revenue

Total revenue in the six months to 30 June 2005 increased by 33.6% to £1,074.9m. Excluding the impact of acquisitions in the period (see 7 Acquisitions) and disposals in the previous period, revenue increased by 20.8%.

Joint venture revenue increased by 111.4% to £254.5m reflecting the full period impact of the Northern Rail franchise which became operational in December 2004 and the continued strong performances of our Merseyrail and AWE joint ventures.

Gross margin on total revenue, representing the average contract margin across the portfolio, is 14.3%.

2.2 Investment income and finance costs

Investment income and finance costs of £8.2m (2004 – £2.2m) have increased principally due to the interest on debt funding for the acquisitions. Also included in investment income and finance costs is the net impact of interest relating to the assets and liabilities of the defined benefit pension schemes (see 6. Pensions).

2.3 Intangible amortisation

Intangible amortisation of £6.4m (2004 – £3.7m) primarily arises from separately identifiable intangible assets acquired as part of the acquisition of ITNET and RCI (see 7. Acquisitions), and the rights to manage and operate contracts and franchises (see 6 Pensions).

2.4 Profit before intangible amortisation and tax

Profit before intangible amortisation and tax increased 27% to £43.7m (2004 – £34.4m), representing a net margin of 4.1% (2004 – 4.3%). Profit before intangible amortisation and the impact of acquisitions and their funding increased by 14.5%.

2.5 Profit before tax

Profit before tax increased by 21.5% to £37.3m.

finance review

2.6 Tax

The tax charge of £11.4m (2004 – £9.7m) represents an effective rate of 30.5% (2004 – 31.6%). The decrease is primarily due to changes in the geographical mix of profits.

2.7 Earnings per share (“EPS”)

EPS before intangible amortisation increased by 22.6% to 6.78p. EPS after intangible amortisation increased by 15.9% to 5.61p. EPS is calculated on an average share base of 452.7m, which increased during the period primarily due to the issue of 30.4m shares in settlement of the share-for-share element of the acquisition of ITNET.

EPS before intangible amortisation and the effect of acquisitions increased by 16.9% to 6.46p, and on a post-amortisation basis increased by 11.9% to 5.42p.

3. Dividends

The proposed interim dividend of 0.91p per share is a 12.3% increase on 2004.

4. Cash flow

Cash flow is analysed consistently with previous periods to show the true operating cash flow of the Group and its use, excluding the proportionate consolidation of joint ventures. Free cash flow is defined as cash generated by the operation of the business, including joint venture dividends. Cash movements on non recourse balances, financing, acquisitions and disposals are accounted for in reconciling Group free cash flow to the movement in Group cash. The adjustment line shown in Figure 2 reconciles this to the cash flow included on page 32, taking account of joint venture cash balances.

Further analysis of the cash flow for the period is shown in Figure 2.

Figure 2: Cash flow

Six months to 30 June	2005 £m	2004 £m
Group profit from operations	29.4	21.7
Non-cash items	22.9	16.6
Group EBITDA	52.3	38.3
Working capital movement	(15.5)	(16.0)
Group operating cash flow	36.8	22.3
Interest	(7.7)	(1.0)
Taxation	(3.2)	4.0
Expenditure on tangible and intangible assets	(12.1)	(8.0)
Dividends from joint ventures	7.7	6.2
Other items	(2.1)	-
Group free cash flow	19.4	23.5
(Acquisitions)/disposals	(282.5)	3.6
Other financing	254.4	(10.0)
Dividends paid	(8.3)	(7.0)
Non recourse debt financed assets	(9.2)	(12.7)
Group net decrease in cash and cash equivalents	(26.2)	(2.6)
Adjustment to include joint venture cash impacts	29.3	2.1
Net increase/(decrease) in cash and cash equivalents	3.1	(0.5)

Note: Group EBITDA is earnings from subsidiaries before interest, tax, depreciation and intangible amortisation.
Group free cash flow is from subsidiaries.

4.1 Group operating cash flow

There was a net Group operating cash inflow for the period of £36.8m (2004 – £22.3m), an increase of 65.0%. This represents a conversion of 70.4% (2004 – 58.2%) of Group EBITDA into cash. The working capital movement reflects the strong level of organic growth shown by the Group in the period and continues to reflect the trend of increasing by approximately one month's incremental revenue.

4.2 Interest

Net cash interest paid is £7.7m (2004 – £1.0m). The increase reflects the draw down of funds to finance the acquisitions of ITNET and RCI.

4.3 Taxation

Tax paid in the period was £3.2m. The same period last year benefited from a net tax refund of £4.0m arising from the ability to relieve tax losses of subsidiaries which were previously joint ventures.

4.4 Expenditure on tangible and intangible assets

Expenditure on tangible and intangible assets of £12.1m (2004 – £8.0m) represents around 1.5% of Group revenue, a level broadly similar to that of previous periods.

4.5 Dividends from joint ventures

Dividends received from joint ventures during the first half of 2005 of £7.7m (2004 – £6.2m) represents 61% (2004 – 71%) of profit after tax and management charges of joint ventures. This anticipated reduction in conversion on the same period last year is primarily due to a low dividend from Northern Rail as the cash generated has been used to repay shareholder loans. We anticipate a further dividend in the second half of the year.

4.6 Acquisitions in the period

The cash outflow in the period of £282.5m primarily relates to the acquisitions of ITNET and RCI (see 7 Acquisitions).

4.7 Other financing

Other financing of £254.4m primarily relates to the draw down of loans to fund the acquisition of ITNET and RCI (see 9 Treasury).

4.8 Group non recourse debt financed assets

The £9.2m outflow relates to the net movement on expenditure on PFI assets under construction, non recourse loans and other PFI balance movements. Further analysis is provided in Figure 3.

Figure 3: Group non recourse debt financed assets

As at	30 June 2005 £m	30 June 2004 £m
<i>Change in PFI balances</i>		
PFI debtor	4.3	6.0
Assets in the course of construction	(3.0)	(9.1)
Non recourse debt	(7.9)	(7.6)
	(6.6)	(10.7)
<i>Change in other balances</i>		
Non recourse debt: Ontario Driver Examination Services	(2.6)	(2.0)
Group non recourse debt financed assets	(9.2)	(12.7)

The movements on the PFI balances are the result of timing differences between loan repayment/draw-down and asset spend/recovery. Over the lifetime of each PFI contract, we expect these movements to offset each other.

5. Net debt

At the end of June 2005, Group recourse net debt was £315.2m (31 December 2004 – £15.3m). Further analysis is provided in Figure 4.

Figure 4: Net debt

As at	30 June 2005 £m	31 December 2004 £m
Group – cash and cash equivalents	148.4	173.9
Group – other loans	(440.0)	(168.4)
Group – obligations under finance leases	(23.6)	(20.8)
Group recourse net debt	(315.2)	(15.3)
Joint venture recourse net cash/(debt)	22.3	(4.6)
Total recourse net debt	(292.9)	(19.9)
Group non recourse debt	(248.5)	(256.5)
Joint venture non recourse debt	(45.1)	(47.1)
Total non recourse debt	(293.6)	(303.6)
Total net debt	(586.5)	(323.5)

Within Group recourse net debt, the increase in other loans reflects the draw down required to fund the acquisition of ITNET and RCI. These loans contain covenants consistent with our private placements and allow sufficient headroom to fund known commitments and working capital movements.

finance review

Non recourse debt (see 8 PFIs) represents long term loans funding the construction or ownership of a specific asset secured on the contracts of PFI and other concessions, and not any other assets of the Group. The loans are excluded from all of our credit agreements and other covenants calculations, therefore having no impact on the Group's ability to borrow. Group non recourse debt, utilised to fund PFI assets and the acquisition of the DES franchise, reduced during the period to £248.5m (31 December 2004 – £256.5m) due to scheduled repayments of debt across all non recourse debt funded asset projects.

6. Pensions

To provide assistance in understanding the complex impact of accounting for pension schemes under IFRS an overview is provided below, with further detail explained in the Transition to IFRS report on pages 38 to 60. Total pension cost included within profit before tax and amortisation for the period is £20.9m (2004 – £16.8m). The net amount included in the balance sheet arising from the Group's obligations in respect of defined benefit pension schemes is £157.8m (31 December 2004 – £124.8m). Further analysis is provided in Figure 5.

Figure 5: Defined benefit pension schemes

As at	30 June 2005 £m	31 December 2004 £m
Group scheme	(145.8)	(122.3)
Other schemes	(72.9)	(54.4)
Joint venture schemes	(72.8)	(66.2)
Retirement benefit liabilities	(291.5)	(242.9)
Intangible assets arising from rights to operate franchises and contracts	20.0	21.1
Reimbursable rights debtor	61.7	56.0
Deferred tax assets	52.0	41.0
Net balance sheet position	(157.8)	(124.8)

Across our business we have three main types of pension scheme which are accounted for as defined benefit pension schemes under IFRS, each with their own accounting treatment in accordance with IAS 19 "Employee Benefits":

- non-contract specific schemes, where the actuarial gain or loss for the period is charged to the consolidated statement of recognised income and expense (the "Sorje") but no asset is created
- schemes relating to franchises and specific contracts, where the actuarial gain or loss for the period is charged to the Sorje, but a recoverable intangible asset is recognised on the balance sheet and amortised to the income statement
- a contract where there is a right of cost reimbursement, where the deficit is included in both assets and liabilities on the balance sheet

The increase in net liabilities as at 30 June 2005 principally relates to the reduction in the AA bond rate in the period, increasing the liabilities on all defined benefit pensions. These increases, together with the related deferred tax movement, have been reflected in the Sorje in the period.

7. Acquisitions

The acquisition of ITNET was completed on 3 February 2005 for consideration of £245.5m, comprising £171.3m of cash and the issue of shares worth £74.2m. The share-for-share option was fully subscribed, requiring the issue of 30.4m shares. The acquisition gave rise to goodwill of £262.3m, including fair value adjustments and acquisition costs of £26.4m. Intangible assets arising on the acquisition have initially been recognised at £20.0m and will be amortised on a straight-line basis over their expected life of eight years. From the date of ownership ITNET contributed £83.9m to revenue and £6.1m to profit before tax and amortisation.

The acquisition of RCI was completed on 21 March 2005 for consideration of £116.3m. The acquisition gave rise to goodwill of £93.0m, including fair value adjustments and acquisition costs of £6.3m. Intangible assets arising on the acquisition have initially been recognised at £2.2m and will be amortised on a straight-line basis over their expected life of five years. From the date of ownership RCI contributed £50.5m to revenue and £3.2m to profit before tax and amortisation.

8. PFIs

8.1 PFI portfolio

The current portfolio of PFIs consists of 11 PFI projects, with 10 equity investments and 11 operating contracts. Seven of the PFI stakes are 100% owned. JSCSC, a 50% joint venture, is now included in our primary statements under proportionate consolidation. During October 2004, we ceased accounting for Laser (the National Physical Laboratory PFI SPC) as a subsidiary due to the transfer of control of the PFI asset to the DTI. This has removed the non recourse debt and corresponding PFI debtor from the balance sheet.

8.2 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 cost as defined by IAS 39. The effect of adopting this policy is to maintain an accounting treatment consistent with UK GAAP while 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.

9. Treasury

9.1 Credit facilities and liquidity management

The £420m bank credit facility raised during December 2004 to provide funding for the acquisitions together with the two existing private placements provide liquidity for the Group. The first private placement for £43.2m was taken out in 1997 and matures in 2007. The second for £117m was taken out in 2003 and amortises from 2011 to 2015.

The Group borrowed £282.3m under the bank credit facility to fund the acquisitions of ITNET and RCI and to cover the costs of acquisition. The loan attracts interest at a rate of 50bp over LIBOR, is unsecured, with covenants and obligations typical of these types of arrangement and expires in December 2009.

9.2 Impact of IAS 39

The Group adopted IAS 39 "Financial Instruments: Recognition and Measurement" from 1 January 2005 with a £26.9m reduction in opening net assets. This principally represents a fair value loss from marking to market the interest rate swaps used by the Group to hedge the interest obligations of PFI special purpose companies into fixed rate obligations, and the cross-currency swaps used to hedge long term loan notes. The Group has obtained hedge accounting for all designated hedges and, as a result, the impact on the income statement for the period was immaterial. Fair value gains of £0.7m have been recognised in the Sorie during the period. The effect of IAS 39 adoption is further explained in the Transition to IFRS report on pages 38 to 60.

10. Transition to IFRS

A dedicated report on the Transition to IFRS is included on pages 38 to 60. The report incorporates:

- the impact of IAS 1 "Presentation of Financial Statements" on the financial statements
- the accounting policies adopted and the optional elections made under IFRS 1 "First-time Adoption of International Financial Reporting Standards"
- the financial impact on the consolidated balance sheet as at 1 January 2004, being the date of transition to IFRS
- the financial impact on the consolidated balance sheet as at 30 June 2004 and 31 December 2004, being the comparatives presented in this report
- the financial impact on the income statement for the six months ended 30 June 2004 and the year ended 31 December 2004, being the comparatives presented in this report
- the financial impact on the consolidated balance sheet as at 1 January 2005 as a result of adopting IAS 32 and IAS 39, both relating to "Financial Instruments", being the opening balance sheet position for the six months ended 30 June 2005
- explanations for key movements included above

“Quality service delivery is the foundation of our growth and in the first half we saw a strong operational performance across the businesses.”

overview

Serco's vision is to be the leading service company in its chosen markets. The Group's strategy is to build a balanced, international contract portfolio through organic growth, achieved by delivering great service and building long term relationships.

That focus on long term relationships, where we can help clients achieve their ambitions through continuous improvement, organisational change and assured service delivery, is reflected in our strong first half performance in delivering growth across markets, notable business wins and high levels of service.

In the period to 30 June, we signed new contracts valued at more than £700m and were appointed preferred bidder on contracts valued at a further £1.5bn.

The first few weeks of the second half have seen further strong performance.

So far this year, we have signed, or been appointed preferred bidder, for significant contracts valued at more than £1.15bn with the UK Ministry of Defence (“MoD”) – Serco's longest standing client.

Our health services business became preferred bidder for a £1.2bn Private Finance Initiative (“PFI”) contract to improve services at three hospitals in Leicester, UK, and our transport division was appointed preferred bidder to operate and maintain a rapid rail transit link in Canada, valued at up to C\$600m to Serco.

In addition, Serco won or extended more than 100 small and medium sized contracts during the first half, including business process management and IT services valued at over £100m.

The first half of 2005 also saw the acquisitions of ITNET plc (“ITNET”) and RCI Holding Corp (“RCI”) completed and the integration processes begun. Both organisations have been reorganised and renamed, and they are increasingly working with colleagues across the group in developing opportunities and improving performance.

Quality service delivery is the foundation of our growth and in the first half we saw a strong operational performance across the businesses, particularly in rail where our management of the UK's Northern Rail, Docklands Light Railway and Merseyrail has improved train punctuality and availability. In Australia, the Ghan train service has further increased passenger numbers and is looking to increase the frequency of this iconic train journey through the heart of the country.

In the US, employees of our federal air traffic control teams once again received a prestigious national award for their services.

Government inspectors found that our education teams in Bradford, UK, had made significant progress in improving the opportunities for children through better delivery of the education service. Inspectors also recommended that further public sector investment would be needed in Bradford to sustain these levels of improvement.

Our environmental service teams serving the people of Woking, UK, have achieved their highest ever satisfaction ratings.

All around the world, people are experiencing a quality of service that makes a difference to their lives. Expectations are met and often surpassed because Serco's public service ethos encourages our people in bringing service to life – which in turn develops our long term relationships and increases the scope and scale of the work we do.

civil government

The civil government sector remains our largest market. Revenue grew by 31% in the first half, representing 37% of our Group revenue.

Home affairs

UK

Serco's remit in home affairs covers four segments: homeland security, law enforcement, offender management and immigration control. Our contract base ranges from managing prisons and operating electronic monitoring programmes to developing IT systems for the police and criminal intelligence agencies.

We support the UK Home Office and its associated agencies in their search for integrated, cost-effective and innovative solutions. These customers are spending significant sums. The Home Office and its associated agencies are budgeted to spend over £12bn in 2005/6. During this period, the Home Office will spend more than £600m on crime reduction and community safety. The National Offender Management Service has a central budget of almost £300m and is responsible for prison and probation budgets of over £2.4bn and £900m respectively, while immigration control and management costs the UK around £1.7bn annually.

The combination of our Premier Custodial Group and Justice divisions into one business – Serco Home Affairs – offers customers the unique combination of a strong service ethic underpinned by a depth of technology capability. The creation of this business gives us the scale and breadth of capability we need to compete for the major opportunities we see ahead of us. At the end of the first half, there were several significant contracts in the pipeline, notably in the areas of border control and homeland security, where our technology and security capabilities give us a significant advantage. We are confident of positive news on bids which would be valued at over £180m to us.

Electronic monitoring is established as an integral part of the UK justice system as an effective means of monitoring curfew compliance. In April, having been successful at rebid, we began two key electronic monitoring contracts with the Home Office, covering Greater London and East Anglia, and West Midlands and Wales. The contracts are for five years each with the possibility of extensions of up to a further two years and together are valued at approximately £18m per annum.

We are also currently participating in the use of voice verification and satellite tracking initiatives and interest has been shown by other government departments such as the Immigration and Nationality Directorate ("IND") and the police.

The Government's decision to defer market testing of three publicly run prisons on the Isle of Sheppey was a less encouraging development. Instead, the public sector has been invited to submit proposals on how it would manage the prisons. Separately, the Government is expected to announce how it plans to progress its prison contestability agenda. A forum to be chaired by the Home Secretary will be held in October and we remain confident of further opportunities in this area.

Our reputation in immigration control has been reinforced by the opening of the 334-bed Colnbrook Immigration Removal Centre and Short-term Holding Centre in August 2004. The Home Office has publicly commended Serco's "high level of commitment and motivation". We anticipate further opportunities in this area.

Serco's relationship with the National Crime Squad ("NCS") continues to thrive, with several enabling projects nearing completion as preparations for the launch of the Serious Organised Crime Agency, in April 2006, continue on schedule. This new body will be formed through the merger of NCS and the National Criminal Intelligence Service, along with elements of HM Revenue & Customs ("HMRC") and the IND. We are confident that our track record with these departments will open up new opportunities in this area.

Elsewhere, Serco continues to foster strong links with law enforcement agencies across the UK, engaging new audiences in the debate over the value of private sector provision of essential support services.

Mainland Europe

Last year, Serco won Germany's first major prison contract at Hünfeld in Hessen. Preparations for this contract are progressing on schedule. Serco will provide all non-custodial services within the prison, including psychological, medical and educational care of the prisoners. Serco will also provide industrial work for approximately 220 prisoners. German law requires the state to retain control of custodial services.

North America

Developments in local and civic government are creating an increasingly robust pipeline of opportunities. We see emerging opportunities for homeland security projects across virtually all of our chosen state and local markets including analytical, technical and training services. For example, we are bidding for contracts to help local authorities develop, coordinate and conduct emergency preparedness training. Such work includes the development and conduct of bioterrorism table-top and full scale exercises for hospitals. Participants will include hospital staff, Regional Counter Terrorism Task Forces, emergency medical services, emergency management agencies and local first responders. Additionally, Serco is looking to provide further systems engineering support for the Customs and Border patrol in California.

Education

Education is one of the largest and fastest growing areas of government spending in the UK. In 2005/6, the cost to the public sector is expected to be £70bn, an increase of 8% on the previous year. We estimate our current addressable market at around £4bn. Market growth drivers include the pressure to increase children's educational achievement, the need for improved efficiency following the Gershon Review, and investment in infrastructure – in particular under the Building Schools for the Future ("BSF") programme. There are also emerging opportunities in children's services.

Serco has established a sound track record in the UK education sector, and the improvements our management teams have achieved in the schools of Walsall and Bradford have been significant. Earlier this year, the Office for Standards in Education ("Ofsted") declared the performance of Bradford's schools "satisfactory". Once among the UK's poorest performing local education authorities, it is now among the most improved in the country. Meanwhile, the children of Walsall continue to benefit from the passionate commitment of our school management professionals.

We remain actively involved with the UK Government's BSF programme. Over the next 15 years, this programme will deliver around £40bn of capital investment to rebuild or refurbish 3,500 schools. We are working in partnership with IBM to provide a complete information and communication technology ("ICT") solution to several consortia preparing BSF bids. We are also providing educational advice and guidance to a number of other bid leaders.

Our schools' software continues to penetrate the education sector, attracting praise from a growing number of schools. Facility – our innovative information management solution – is also providing vital support to teachers at other schools across the country, reducing their administrative workload and enabling them to focus on their work with pupils.

Meanwhile, we continue to raise our profile in the children's services market, where the number of opportunities is rising. This follows Government moves to align education and other child support services more closely, focusing them around schools. This is likely to provide a range of opportunities including the integration of ICT databases and systems, working with the newly formed Children's Services Directorates to help them integrate their services and cultures, as well as helping to improve poorly performing elements within these more widely based organisations.

“Throughout the first half, we continued to explore new opportunities across the health sector, diversifying into new areas such as the management of chronic diseases.”

Health

Total health spending by the UK Government is expected to be nearly £90bn in 2005/6, some 9% higher than the previous year. Of this, we estimate that around £10bn is accessible to Serco. Market drivers include the need to reduce waiting lists, investment in new facilities – including through PFI – and payment by results.

In March, our joint venture with Equion Ltd, a division of John Laing plc, was named preferred bidder on the Leicester Pathway PFI project. This programme involves the extensive modernisation and refurbishment of three hospitals for the University Hospitals of Leicester NHS Trust. Financial close is expected in 2006.

Serco will support the new facilities and manage the transition process. When the five-year development phase is finished, we will provide support services to the Trust for a further three decades. In total, the operating contract is valued at around £1.2bn to Serco over the 35 years. This contract builds on the facilities management contract that Serco has managed at Leicester Royal Infirmary (“LRI”) since August 1996. For the past four years, the Serco team has enabled the LRI to achieve green star rating, the highest rating in the Patient Environment Action Team evaluation. This covers areas such as cleaning, catering and the environment.

We will continue to bid selectively for hospital PFIs that allow us to secure attractive long term operating contracts, with near term opportunities arising at the Forth Valley Primary Care NHS Trust and Nottingham City Hospital NHS Trust.

Serco has consistently delivered strong results at the Norfolk and Norwich University Hospital, frequently achieving satisfaction levels over 92%. The quality of our performance recently helped the hospital to improve its NHS star rating from one star to two stars in the national scheme. Our contract at Wishaw General Hospital continues to deliver strong performance, increasing the use and integration of technology to support and improve service delivery. Our performance at Wishaw positions us well for emerging health contracts in Scotland.

Our specialist health consultancy provides strategic advice to all levels of the NHS. In the first half it achieved sustained growth, after a strong 2004. Its clinical focus and expertise, client access and market knowledge ensure our health strategy is appropriately targeted. Throughout the first half, we continued to explore new opportunities across the health sector, diversifying into new areas such as the management of chronic diseases.

Regional and local government services

We finished the half with a number of important wins under our belt, as we built on our strong reputation among UK local authorities for IT services and business process management. Among other agreements with local authorities, we signed a two-year, £11m contract extension with Southwark. Our existing contracts with Ealing and Richmond grew organically by more than £3m in total.

Towards the end of the half, we announced our selection by IBM as sub-contractor to manage key IT platforms and services for Bradford Council. This contract covers helpdesks, network management, desktop services, application management and server management. The award is part of a wider business transformation programme led by IBM, with a total contract valued at almost £160m to the consortium.

“Demand for our services within the local government market remains strong, with councils pursuing a wide range of strategic partnership opportunities.”

In April, our streetscene and environmental services partnership with Breckland District Council commenced. The partnership is valued at £3m a year over 20 years, and a number of high-profile clean-up initiatives are already delivering real improvements to the local environment.

Demand for our services within the local government market remains strong, with councils pursuing a wide range of strategic partnership opportunities in environmental services, housing repairs and improvements, and streetscene. Our current pipeline for these services is over £500m over the next 12 months, based on bids in progress.

Consulting

Serco Consulting aims to raise awareness of and enhance Serco's reputation with potential and existing customers by providing high-value advisory services. It is also an attractive and profitable business in its own right, which will generate revenue of around £16m this year and employs around 80 consultants.

Our consulting capabilities have been enhanced by specialist management and technology business French Thornton, which was formerly owned by ITNET and which provides services to the government and private sector. Its addition has widened the scope of our opportunities while enhancing the quality of our consulting bids.

During the first half of 2005, Consulting recorded a number of business wins including assignments at the BBC associated with TV licensing and property, and a programme management assignment in the commercial directorate of the Department of Health, as well as new projects at the Financial Services Authority, HBOS plc and Arla Foods UK. Continuing long term assignments include the Office of the Deputy Prime Minister and HMRC.

In North America, Serco employs numerous consultants who are engaged in workforce planning and business process reengineering projects with several US Federal agencies.

Other government services

Middle East

As Gulf states such as the United Arab Emirates ("UAE"), Bahrain and Qatar continue to boom, our Dubai-based businesses are strongly positioned to capitalise on the unprecedented proliferation of opportunities in the region, most notably in the construction sector.

Serco is already emerging as the Gulf's leading facilities management specialist, providing strategic consultancy support on two iconic construction projects in Dubai: Palm Island and the Burj Dubai Tower.

In January, we signed an agreement with Mubadala Development Company to form a joint venture to provide facilities management services for the proposed new 19,000-student UAE University at Al Ain, which will be completed in 2010. Our consultancy team is already very much involved in the design of the new complex. The first buildings come on stream in 2006 and the contract is for a period of 14 years.

Mubadala is an investment arm of the Abu Dhabi Government and this contract indicates an increasing interest in partnering between the public and private sectors within the region.

Asia Pacific

In February, our New Zealand joint venture Serco Project Engineering Ltd delivered the first four of seven fire-fighting trucks to the Australian Capital Territory ("ACT") Government. These vehicles – built as part of a contract worth NZ\$2.4m – carry state-of-the-art compressed air foam systems. They are designed to strengthen the ACT's defences against the bush fires that are prevalent across Australia.

transport

Transport revenue grew by 61% in the first half, representing 25% of our Group revenue.

Rail

UK

Serco has achieved strong growth in the UK rail market since we began operating our first franchise – Merseyrail – in 2003. We see good opportunities in this area as franchises are remapped, reducing the number from 21 to 16. The proposed break-up of the Central franchise may benefit us, and we anticipate being given the opportunity to tender for services that border our Northern Rail franchise. We will also consider bidding for other franchises as they come up for renewal in the next few years. Our experience further positions us well to take our proposition overseas, in particular to Germany, the market most advanced in tendering after the UK.

Northern Rail – which started in December 2004 as a joint venture with NedRailways – is our largest contract to date. Over eight years and nine months, it will be worth around £2bn to Serco. During the first half, we consistently exceeded service performance targets, delivering real improvements for the thousands of passengers who use the network daily. As the consolidation of the old North East and North West franchises into the new Northern organisation continues on schedule, we expect to achieve further performance and customer service enhancements while delivering efficiencies.

Our Merseyrail network runs a greater proportion of trains on time than any other UK rail network. While the national punctuality level averages 86.2%, Merseyrail's management and staff achieved a score of 94.7% in the first quarter of 2005. Passenger numbers have risen by 5.5% in the past year.

Merseytravel was the first local transport authority to assume responsibility for a network from the Strategic Rail Authority. Merseytravel now wishes to extend its responsibility to include the infrastructure currently managed by Network Rail. This is currently planned for transfer to Merseytravel in 2006 and we would then be responsible for all infrastructure maintenance and operations on the Merseyrail network.

Asia Pacific

Following the success of the Ghan train's weekly return service between Adelaide and Darwin, our Great Southern Railways business launched a second weekly service for the three-month peak tourist season. This additional capacity has been fully sold. In July 2005, the Ghan carried 10,000 passengers in a single month on its legendary two-day transcontinental journey between Adelaide and Darwin. This is twice the volume carried in the same period in 2003 on this service, which previously operated on the shorter route between Adelaide and Alice Springs. Plans for a further expansion of services in 2006 are at an advanced stage.

Urban transportation

In the UK and other developed economies, policy is increasingly shifting towards integration of different modes of transport as governments battle with increasing congestion and its social and economic costs. In the UK, for example, there is a trend towards the development of integrated transport plans to support investment in major projects.

In response to these trends, we have combined our light rail and road operations to position us as an urban transportation integrator. Our capabilities cover the broad range of transport operation and technology services required by major conurbations, including light rail, passenger information systems, bus lane design and traffic control centres. The breadth and depth of our experience allows us to integrate one or more of these services into a client's existing framework. We believe this puts us in a very strong position to capitalise on growth in these markets.

UK

Serco is the UK's largest light railway operator, carrying 45% of the country's light railway passengers when measured by passenger kilometres.

In the first quarter of the year, the Serco-operated Docklands Light Railway continued its highly successful record of service reliability by equalling its best ever performance of 97.3%. During the half, we submitted a rebid to maintain and operate this record-breaking service for a further seven or nine years, to be determined by the client. We are pleased to have been shortlisted to the final two bidders. The contract award decision is expected towards the end of this year.

While we were disappointed at the cancellation of the Lorry Road User Charge project, for which we had been shortlisted, the UK Government has stated its intention to introduce general road pricing and has made funding available for local charging schemes. We believe that there is still significant potential in the UK market.

Serco is a leading supplier of traffic management systems and services and has a strong track record in Stockholm, Sydney, London and Hong Kong.

In England, we also operate the National Traffic Control Centre which is helping travellers plan and complete their journeys by providing real-time traffic information, including alternative routing advice, direct to the media and the public via a website and interactive phone service, as well as on roadside variable message signs. Achieving full implementation has taken longer than envisaged and we are working with our client, the Highways Agency, to complete the implementation phase.

Our expertise in the area of traffic management information has led to further opportunities overseas.

North America

Serco has established an office to enter the North American integrated transportation market. The primary focus will include technical and service-based solutions for transportation agencies. Technological solutions which are well established within the UK will be positioned for US market entry. With the recent passing of the US highway appropriation bill, this market will see an increasing focus on private sector involvement in new initiatives. This is a large and exciting market, where we can leverage many of our existing relationships. Initial studies have revealed a robust pipeline of short, medium and long term opportunities.

We are currently bidding for the operation and management of Hampton Roads Smart Traffic Center, Virginia. We have identified a number of traffic management centre opportunities throughout the major metropolitan areas of North America. State and local transportation agencies are increasingly looking to private sector solutions.

In addition, Serco is actively developing the market in several large US cities for the deployment of the smart meter parking management system, which we have successfully installed in San Francisco.

In March, Serco was appointed preferred bidder for its first ever rail operation contract in North America. Its joint venture with SNC-Lavalin was commissioned to provide a fully automated, driverless train system connecting Vancouver, Richmond and Vancouver International Airport. Construction is planned to commence in August 2005 with completion scheduled in time for the 2010 Winter Olympics. After the five-year construction period, the joint venture will operate and maintain the line under a 30-year agreement, worth between C\$16m and C\$20m per annum to Serco.

“The construction boom across the Middle East is driving growth in other areas of the region’s economy, notably aviation, where we are building on our outstanding track record.”

Asia Pacific

In June, we signed a contract with the Roads and Traffic Authority (“RTA”) of New South Wales to deliver a system that will monitor bus punctuality and provide traffic signal priority. The contract requires Serco to work closely with RTA staff to develop and maintain the client’s existing bus management and priority system while delivering design improvements. The contract is valued at AUS\$6.7m over three years, which includes a system trial on 270 buses. Depending on the trial’s success, Serco will have an opportunity to participate in the expansion of the system, which is planned to cover a further 5,000 buses.

Air

Middle East

The construction boom across the Middle East is driving growth in other areas of the region’s economy, notably aviation, where we are building on our outstanding track record. In April, we signed yet another extension to our air traffic control (“ATC”) contract with Dubai Civil Aviation, which has been a Serco client for the last 45 years. The latest two-year agreement is worth around £12m in total.

We also signed a one-year extension worth £2m to our ATC contract at Bahrain Airport, which is planning a major expansion in response to massive growth in aircraft and passenger numbers.

North America

During the half, Serco was awarded the prestigious Willie F Card Federal Aviation Administration Federal Contract Tower Service Award for the third successive time since its inauguration three years ago. Given public concerns over air traffic control issues since 9/11, this achievement is significant and acknowledges Serco’s excellent safety and service record there.

“Our success in winning new business with the MoD reflects our skill as an integrator capable of delivering bespoke solutions based on innovation and flexibility.”

defence

Our defence business grew by 29% in the first half of 2005 and accounted for 23% of our Group revenue.

UK

The MoD is recognised as leading the world in the use of the private sector to support its vision. With new threats materialising, new methodologies requiring new support arrangements and little increase in UK defence spending, the MoD is focusing resources and seeking cost savings. This presents Serco with opportunities for growth. We expect our addressable market in the UK to double to £8bn by 2010.

Our success in winning new business with the MoD reflects our skill as an integrator capable of delivering bespoke solutions based on innovation and flexibility. This integration capability is demonstrated by the award of one of our most significant defence contracts, the £400m Defence Academy Campus Integrator (“DACI”) at Shrivenham, Wiltshire. For the next 23 years, we will deliver support services to this world-class academic centre of excellence for senior MoD commanders and staff.

The DACI contract builds upon the long term relationship and spirit of partnership we have established with the MoD. The agreement followed our success at designing, building and managing the MoD’s Joint Services Command and Staff College (“JSCSC”), an achievement that has been praised by the National Audit Office as “a textbook PFI”. In turn, the JSCSC contract was instrumental to Serco winning the Middle East’s first PFI, to build a joint technical training college for Oman’s Ministry of Defence, currently at preferred bidder status.

Similarly, our expertise in developing and managing science facilities has contributed to Serco being appointed preferred bidder for a strategic partnership with the Defence Science and Technology Laboratory (“Dstl”). Valued at around £400m to us over 15 years, this contract will see us manage the design and build of new facilities for Dstl, the migration of 1,600 scientists to these facilities, and provide support services ranging from laboratory set-up to travel management across the entire Dstl estate.

Over the last six months, stronger links with the Royal Navy, one of our key customers, have helped us secure several significant contracts, including the Waterfront Training and Education Centres (“WTEC”) contract.

The strategically significant WTEC contract involves delivering a wide range of e-learning, web-based learning and computer-based training at Her Majesty’s Naval Bases at Devonport, Faslane and Portsmouth. The centres are being set up as part of the Royal Navy’s Rebalancing Life initiative which has driven the development of training provision at the waterfront to enable Navy personnel to balance operational commitments and family life. Scheduled to start in August 2005, the WTEC service follows a successful pilot at Devonport in 2004.

Our respect for the Royal Navy’s heritage, our understanding of the MoD’s values and our dedication to bringing service to life proved instrumental to the success of the celebrations that marked the 200th anniversary of the Battle of Trafalgar on 29 June. Among other essential marine services, Serco personnel handled 1,000 ship movements in 12 days on behalf of the Royal Navy. Without their contribution, it would not have been possible to re-enact the battle or complete the naval review.

Skynet 5, one of the largest-ever defence PFI contracts, is designed to guarantee Britain's armed forces with secure communications whenever and wherever required. Since February, this service now enables the MoD to receive more imported information services on platforms such as ships with IP data services. Skynet 5 – worth £220m to Serco in a contract extending to 2018 – is also on target for the next milestone in early 2007. By then, the first Skynet 5 spacecraft will have been launched to provide the MoD with a new generation of satellite communication.

Middle East

Serco and its joint venture partner Bahwan Group were chosen in 2004 as the preferred bidder for a 30-year, \$1.4bn PFI contract to design, build and operate a joint technical training college for Oman's Ministry of Defence. Contract negotiations are proceeding. The college will eventually accommodate up to 2,000 students, both military and civilian.

North America

The acquisition of RCI was completed in March and has been well received by our clients, demonstrated by the continuing flow of task orders arising from the various multi-award contract vehicles in the portfolio. The most significant indicator was our successful rebid for the US Army's Career and Alumni Program, which helps retiring US Army soldiers, civilian family members and their families transition successfully from federal service. This win will extend our unbroken support to this important program to more than 17 years – an exceptional achievement in US defence contracting. We have also been selected as one of the successful contractors on a multi-award basis for the support of the Pentagon's information management centre. In total, we are in line to bid for 200-300 employee work years under this agreement.

The US Department of Defense recently announced it was realigning and closing a number of bases and reassigning troops around the world. These initiatives create substantial near term and long term opportunities for Serco based on our involvement in supporting soldier activities affected by reassignment to other bases. Serco is also well positioned to benefit from changing base support and infrastructure requirements driven by these changes.

Our ability to win new business with the US military has been greatly enhanced by the success of our Price Fighter contract with the US Department of Defense. Under this agreement, we provide the engineering and analytical expertise that the department needs to measure whether it is paying an appropriate price to third-party suppliers and contractors.

Following the completion of the RCI acquisition, Serco has been nominated for a prestigious Federal Contractor of the Year award in the medium business category.

Over the coming months, we hope to explore innovative ways of leveraging the expertise and experience we have gained in the US defence sector to further strengthen our relationship with defence authorities elsewhere, notably in the UK.

Asia Pacific

In May, Serco Sodexho Defence – our joint venture with Sodexho – was named preferred bidder to provide the Australian Department of Defence with garrison support services in the Sydney West South region of New South Wales. Partly a new bid and partly a re-tender, this contract, signed in August, is substantially larger than the original contract, valued at around AUS\$200m to Serco over a term of up to nine years.

Also in May, Defence Maritime Services – our joint venture with P&O Maritime – delivered the first of 12 Armidale-class patrol boats to the Australian Navy. After successful sea trials, HMAS Armidale was officially commissioned in June in its new home port of Darwin. In the half, Defence Maritime Services also signed a contract with Australian Customs Services, valued at AUS\$36m over six years, to maintain eight patrol boats.

“We are positioning ourselves to win a significant share of the UK’s emerging £2bn per annum nuclear clean up market.”

science

Serco’s science sector revenue grew by 13% in the first half, representing 15% of our Group revenue.

UK

Science and technology remain at the top of the UK political agenda as drivers of wealth creation and improvements in healthcare and the environment. Serco is now an established part of the UK’s technical community, creating public-private partnerships to maximise the impact of science and turn government policy into results.

Serco, together with our joint venture partners BNFL and Lockheed Martin, has signed an amendment significantly increasing the scale of our contract with the MoD to operate the Atomic Weapons Establishment (“AWE”). The increased Government investment is valued at £350m to Serco over the next three years. We will deliver a programme of investment in key skills and facilities at AWE. Our experience at AWE and our capabilities elsewhere within our science business – such as the provision of safety advice to nuclear power generators and the Royal Navy’s nuclear submarine fleet – have positioned us as a key player in the nuclear industry. We have secured a contract to develop safety case scenarios and environmental impact assessments for Urenco’s nuclear enrichment plant at Capenhurst, near Chester. This one-year contract – critical in terms of health and environmental protection – is worth £400,000.

Serco also continues to play an important role in national security. In May, Serco successfully bid for a £5m contract under the MoD’s nuclear propulsion critical technology research programme, applying our unique knowledge of materials performance and applied physics.

Serco has also secured a £13m contract to supply the MoD’s Integrated Sensor Management System, an intelligent network of sensors designed to detect chemical, biological or nuclear attacks on field installations. Ultimately, we plan to transfer the leading-edge technology developed on this project to harness new opportunities in the civil sector.

Drawing on our nuclear expertise and Serco’s market leadership in applying the Government Owned Contractor Operated model, we are positioning ourselves to win a significant share of the UK’s emerging £2bn per annum nuclear clean-up market, following the establishment of the Nuclear Decommissioning Authority in April 2005. The first competition for management of a UK site is expected in early 2006.

Our Science division operates the UK’s National Physical Laboratory (“NPL”), which continues to win funding for new programmes. Towards the end of the half, the Department of Trade and Industry (“DTI”) awarded NPL contracts valued at £4m to develop innovative services in micro-nanotechnology (technology measured in millionths and billionths of a metre) working in partnership with, amongst others, QinetiQ, Taylor Hobson, Imperial College and University College London. NPL also won a contract valued at £1.2m to provide online support to DTI’s new Technology Networks.

Applying this knowledge base to environmental challenges, NPL won a research contract with the Department for Food, Environment and Rural Affairs to assess nano-particulates in the atmosphere. It could improve life for millions of people by helping to improve the way that the UK’s air quality is monitored and managed.

Increasingly, innovation support is being delivered on a regional basis. Regional Development Agencies and devolved administrations around the UK are investing in innovation and technology centres and Serco has established a portfolio of contracts and opportunities in this market. We have teamed up with the University of Wales to manage the Centre for Advanced Software Technology, under an £8m programme to develop a cluster of innovative software businesses in North Wales.

We are closely engaged in projects that will transform the way society benefits from global positioning technology. NPL has won a prestigious three-year contract to provide the time for Europe's ambitious Galileo constellation of 30 global navigation satellites. Galileo is due to start operating from 2008 and will provide a guaranteed global positioning service under civilian control, with accuracy to within a metre on the ground.

NPL is part of a core consortium of nine European organisations developing the Galileo Time Service Provider. This will support a range of time-dependent applications such as telephone networks, digital broadcasting and the Internet, as well as giving everyone access to a reliable source of time for everyday needs.

Mainland Europe

Elsewhere, Serco successfully rebid a contract in Italy worth €14m over three years to provide services to the European Space Agency's ("ESA") Earth observation programme. The service makes remote-sensing data available to scientific users once it is captured by satellite. This contract is part of a larger agreement worth €41m over three years to a Serco-led consortium of 24 companies. This involves completing a comprehensive cost reduction programme while harmonising the delivery of services across all of ESA's Earth observation activities.

We also successfully rebid our contract for engineering support at ESA's technology centre ("ESTEC"), in the Netherlands. The roots of this support work can be traced back over 30 years and include spacecraft design, laboratory maintenance and operation, mission simulation and scientific research. The contract is worth over €4m per annum and has an anticipated duration of five years.

private sector

Serco has traditionally approached the private sector on an opportunistic basis, building up a portfolio of blue-chip clients, such as Microsoft, GlaxoSmithKline, Airbus and The Boots Company. The acquisition of ITNET has increased our presence in this sector and it is now a strategic focus for us. With commercial clients increasingly concentrating on core activities and facing strong international competition, they are moving from single service providers, to fully integrated providers, such as Serco. This allows us to grow organically by selectively bidding for new contracts and expanding the range of services we provide to each client.

We are focusing on those areas within the private sector which will benefit from the provision of a widescale, single supplier approach for support services and information services. This approach builds upon our traditional focus of manufacturing, transport, utilities, financial services and hospitality.

UK and Europe

We have continued to build our relationships with key customers in food and drinks manufacturing. At Coca Cola Enterprises Ltd, our IT services have been extended for a further three years. Cadbury Schweppes has implemented an enterprise resource planning solution within the UK which is hosted within our dual data centres in Birmingham. Food services provider 3663 chose Serco Solutions to introduce a new service regime which will provide a common IT delivery platform within each of the company's 43 sites and will help it increase the efficiency of distribution.

At Wales & West Utilities, Serco helped to implement a 20-week business process reorganisation and SAP implementation for the regional gas distribution network. Despite very tight deadlines, the project went live successfully on 1 June, and the relationship with Wales & West Utilities continued to strengthen. The overall project was managed by Macquarie Bank, with whom Serco is developing an ongoing relationship.

Our focus on and knowledge of our customers is providing us with the opportunity to expand our services in the information technology sector into wider support services that embrace the full end-to-end capability of Serco.

Our relationship with Microsoft has developed from providing traditional facilities management services to the provision of multi-activity integrated services. We now operate Microsoft's Global Shared Services from its European Operations Centre in Dublin, processing some 300,000 invoices every year from Microsoft suppliers in 17 European countries. In addition, we provide licensing, processing, documentation control, revenue and rebate recognition services and in February, we were awarded a prestigious contract for the provision of administration and personal assistant services to Microsoft senior management and directors.

We renewed our contract with Airbus UK for the provision of integrated services to its manufacturing facility in Filton, UK, valued at £25m over a further five-year period. Serco already provides a fire and rescue service to Airbus, and in April we were awarded the "Top Airport Fire Service Award" by the Civil Aviation Authority.

“With commercial clients increasingly concentrating on core activities and facing strong international competition, they are moving from single service providers to fully integrated providers, such as Serco.”

Starwood Group Hotels & Resorts Worldwide Inc is one of the leading hotel and leisure companies in the world. Our relationship with them is developing. In 2004, we commenced with the provision of engineering and security services to their 5* Westin Hotel in Dublin. In February of this year, due to the success in Dublin, we were awarded a contract for the provision of maintenance and property-related services to the Westin Turnberry resort in Ayrshire and Sheraton Grand Hotel and Spa in Edinburgh.

In May, we were awarded a contract to provide facilities management services to the Bank of Ireland's property portfolio in Northern Ireland. This covers its branch network of 44 properties and five administration properties, including its prestigious new Northern Ireland Head Office in Belfast.

North America

Serco continues to grow its fleet and power distribution business with US utilities such as Dayton Power & Light, Exelon Energy and various other smaller utilities.

At PECO Energy, a natural gas and electric utility in Pennsylvania, we have completed the first year of contract operations where we provide fleet management services to support over 10 sites, involving some 1500 vehicles. At the end of the first year, Serco exceeded contract performance requirements while delivering a 20% reduction in cost of services to PECO. This is the first contract arising from our appointment as preferred supplier of fleet management services to Exelon, PECO's parent group and one of the largest US electricity generators and energy distributors.

We continue to win work to provide computer-aided facilities management services in the commercial sector to add to our existing portfolio of Fannie Mae, a lending institution; Capital One, a financial services company; and the University of Maryland.

independent review report to Serco Group plc

Introduction

We have been instructed by the Company to review the financial information for the six months ended 30 June 2005 which comprises the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash flow statement and related notes 1 to 8, set out on pages 29 to 36. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the Company in accordance with Bulletin 1999/4 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures are consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

International Financial Reporting Standards ("IFRS")

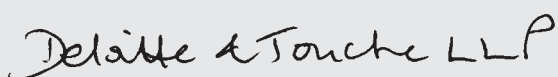
As disclosed in Note 1, the next annual financial statements of the Group will be prepared in accordance with IFRS as adopted for use in the EU. Accordingly, the interim report has been prepared in accordance with the recognition and measurement criteria of IFRS and the disclosure requirements of the Listing Rules. The accounting policies are consistent with those that the directors intend to use in the annual financial statements. There is, however, a possibility that the directors may determine that some changes to these policies are necessary when preparing the full annual financial statements for the first time in accordance with IFRS as adopted for use in the EU.

Review work performed

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of Group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with International Standards on Auditing (UK and Ireland) and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2005.



Deloitte & Touche LLP

Chartered Accountants

London

31 August 2005

interim financial statements

The interim financial statements have been prepared for the first time in accordance with the recognition and measurement criteria of International Financial Reporting Standards ("IFRS"), which have been adopted from 1 January 2004 with comparative figures restated accordingly. As permitted by IFRS 1 "First-time Adoption of IFRS", the Group has adopted IAS 32 and IAS 39 "Financial Instruments" prospectively from 1 January 2005, and comparative figures have not been restated.

consolidated income statement

for the six months ended 30 June 2005

	Note	6 months to 30 June 2005 £m (unaudited)	6 months to 30 June 2004 £m (unaudited)	Year to 31 December 2004 £m (audited)
Continuing operations				
Revenue		1,074.9	804.5	1,636.9
Cost of sales		(921.4)	(687.9)	(1,394.3)
Gross profit		153.5	116.6	242.6
Administrative expenses		(101.6)	(80.0)	(166.2)
Other operating expenses		(6.4)	(3.7)	(7.2)
Profit from operations		45.5	32.9	69.2
Investment income	2	16.2	18.6	35.3
Finance costs	2	(24.4)	(20.8)	(40.5)
Profit before taxation		37.3	30.7	64.0
Taxation		(11.4)	(9.7)	(19.5)
Profit for the financial period		25.9	21.0	44.5
Attributable to:				
Equity holders of the parent		25.4	20.8	43.5
Minority interest		0.5	0.2	1.0
Earnings per Ordinary share (EPS)				
Basic EPS	3	5.61	4.84	10.11
Diluted EPS	3	5.51	4.78	9.99

consolidated statement of recognised income and expense

for the six months ended 30 June 2005

	Note	6 months to 30 June 2005 £m (unaudited)	6 months to 30 June 2004 £m (unaudited)	Year to 31 December 2004 £m (audited)
Net actuarial (loss)/gain on defined benefit pension schemes	7	(33.9)	21.2	(29.4)
Fair value gain/(loss) on reimbursable rights	7	4.0	(10.7)	13.0
Goodwill previously written off, released on sale of subsidiary		-	-	0.2
Expense in relation to share-based payment	7	2.7	1.8	4.5
Net exchange gain/(loss) on translation of foreign operations	7	2.8	(7.3)	(3.3)
Fair value loss on cash flow hedges on transition to IAS 39 on 1 January 2005	7	(37.9)	-	-
Fair value gain on cash flow hedges during the financial period	7	0.7	-	-
Tax credit/(charge) on items taken directly to equity		20.3	(3.6)	5.6
Net (expense)/income recognised directly in equity		(41.3)	1.4	(9.4)
Profit for the financial period		25.9	21.0	44.5
Total recognised (expense)/income for the financial period		(15.4)	22.4	35.1
Attributable to:				
Equity holders of the parent		(15.9)	22.2	34.1
Minority interest		0.5	0.2	1.0

consolidated balance sheet

as at 30 June 2005

	Note	As at 30 June 2005 £m (unaudited)	As at 30 June 2004 £m (unaudited)	As at 31 December 2004 £m (audited)
Non-current assets				
Goodwill		539.3	166.8	177.4
Other intangible assets		95.2	70.9	75.0
Property, plant and equipment		104.1	86.9	96.2
Investments		-	-	13.7
Trade and other receivables		388.5	439.1	390.6
Deferred tax assets		93.8	38.7	50.1
		1,220.9	802.4	803.0
Current assets				
Inventories		33.6	30.0	26.9
Trade and other receivables		481.4	374.8	390.1
Cash and cash equivalents	6	204.1	184.1	200.5
		719.1	588.9	617.5
Total assets		1,940.0	1,391.3	1,420.5
Current liabilities				
Trade and other payables		(495.4)	(368.3)	(417.0)
Current tax liabilities		(12.9)	(10.8)	(5.8)
Obligations under finance leases	6	(8.3)	(7.5)	(8.1)
Loans		(50.1)	(16.9)	(46.4)
Financial instruments		(4.2)	-	-
		(570.9)	(403.5)	(477.3)
Non-current liabilities				
Trade and other payables		(1.8)	(4.3)	(0.6)
Obligations under finance leases	6	(21.1)	(20.8)	(18.2)
Loans		(711.1)	(561.7)	(451.3)
Financial instruments		(32.1)	-	-
Retirement benefit obligations		(291.5)	(189.7)	(242.9)
Provisions		(26.4)	(6.0)	(6.0)
Deferred tax liabilities		(64.0)	(50.7)	(55.0)
		(1,148.0)	(833.2)	(774.0)
Total liabilities		(1,718.9)	(1,236.7)	(1,251.3)
Net assets		221.1	154.6	169.2
Equity				
Share capital	7	9.3	8.7	8.7
Share premium account	7	266.5	190.9	191.5
Capital redemption reserve	7	0.1	0.1	0.1
Retained earnings	7	118.7	85.4	104.4
Retirement benefit obligations reserve	7	(145.0)	(111.3)	(124.4)
Share-based payment reserve	7	8.9	3.5	6.2
Own shares reserve	7	(16.4)	(16.9)	(16.4)
Hedging and translation reserve	7	(23.2)	(6.6)	(2.6)
Equity attributable to equity holders of the parent		218.9	153.8	167.5
Minority interest		2.2	0.8	1.7
Total equity		221.1	154.6	169.2

consolidated cash flow statement

for six months ended 30 June 2005

	Note	6 months to 30 June 2005 £m (unaudited)	6 months to 30 June 2004 £m (unaudited)	Year to 31 December 2004 £m (audited)
Net cash inflow from operating activities	5	67.5	29.0	87.6
Investing activities				
Interest paid		(23.1)	(19.5)	(39.4)
Interest received		15.4	18.6	35.0
Proceeds from reduction in investment in joint ventures		-	1.2	1.8
Disposal of subsidiary and business undertakings		-	3.6	3.2
Proceeds from disposal of property, plant and equipment		0.4	0.1	0.4
Purchase of property, plant and equipment		(11.3)	(8.3)	(21.9)
Increase in development expenditure		(2.4)	-	(4.1)
Acquisition of a franchise		-	-	(4.1)
Acquisition of subsidiaries		(280.9)	-	(13.7)
Net cash outflow from investing activities		(301.9)	(4.3)	(42.8)
Financing activities				
Dividends paid		(8.3)	(7.0)	(10.4)
Decrease in other loans		-	(4.7)	(0.8)
Increase in other loans		260.2	3.7	10.2
Capital element of finance lease repayments		(3.4)	(5.7)	(9.0)
Proceeds from issue of share capital		1.4	0.1	0.7
Decrease in non recourse loans		(12.4)	(11.6)	(19.2)
Net cash inflow/(outflow) from financing activities		237.5	(25.2)	(28.5)
Net increase/(decrease) in cash and cash equivalents		3.1	(0.5)	16.3
Cash and cash equivalents at start of period		200.5	184.6	184.6
Net exchange gain/(loss)		0.5	-	(0.4)
Cash and cash equivalents at end of period		204.1	184.1	200.5

notes to the accounts

1. General information

The basis of preparation and accounting policies are set out in the Transition to IFRS report on pages 38 to 60.

The accounting policies used in the interim financial statements are consistent with those that the directors intend to use in the annual financial statements, but some changes to these policies may be necessary as a result of the IFRIC's proposed interpretations on service concessions or those standards yet to be endorsed by the European Commission.

The interim financial statements are unaudited and do not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985. The statutory accounts for the year ended 31 December 2004, which were prepared under UK GAAP, have been delivered to the Registrar of Companies. The auditor's opinion on these accounts was unqualified and did not contain a statement made under Section 237(2) or Section 237(3) of the Companies Act 1985. The interim financial statements for both 2005 and 2004 are unaudited, but have been reviewed by the auditors and their report to the Company is set out on page 28.

2. Investment income and finance costs

	6 months to 30 June 2005 £m (unaudited)	6 months to 30 June 2004 £m (unaudited)	Year to 31 December 2004 £m (audited)
Interest receivable by PFI companies	13.3	16.4	31.8
Interest receivable on other loans and deposits	2.9	2.2	3.5
Investment income	16.2	18.6	35.3
Interest payable on non recourse loans	(11.2)	(14.3)	(32.9)
Interest payable on other loans	(10.7)	(4.9)	(4.5)
Other – finance leases and net interest on retirement benefit obligations	(2.5)	(1.6)	(3.1)
Finance costs	(24.4)	(20.8)	(40.5)

3. Earnings per share

Basic and diluted earnings per ordinary share have been calculated in accordance with IAS 33 "Earnings Per Share". Earnings per share ("EPS") is shown both before and after amortisation of intangible assets to assist in the understanding of the impact of IAS 38 "Intangible Assets" on the Group financial statements.

The calculation of the basic and diluted EPS is based on the following data:

Number of shares

	6 months to 30 June 2005 millions (unaudited)	6 months to 30 June 2004 millions (unaudited)	Year to 31 December 2004 millions (audited)
Weighted average number of ordinary shares for the purpose of basic EPS	452.7	429.9	430.1
Effect of dilutive potential ordinary shares: share options	8.3	4.8	5.3
Weighted average number of ordinary shares for the purpose of diluted EPS	461.0	434.7	435.4

Earnings

	6 months to 30 June 2005		6 months to 30 June 2004		Year to 31 December 2004	
	Earnings £m (unaudited)	Per share amount pence (unaudited)	Earnings £m (unaudited)	Per share amount pence (unaudited)	Earnings £m (audited)	Per share amount pence (audited)
Earnings for the purposes of basic EPS being net profit attributable to the equity holders of Serco Group plc	25.4	5.61	20.8	4.84	43.5	10.11
Add back:						
Amortisation of intangible assets, net of tax	5.3	1.17	3.0	0.69	5.8	1.35
Basic earnings before amortisation of intangible assets	30.7	6.78	23.8	5.53	49.3	11.46
Earnings for the purposes of diluted EPS	25.4	5.51	20.8	4.78	43.5	9.99
Diluted earnings before amortisation of intangible assets	30.7	6.65	23.8	5.47	49.3	11.32

notes to the accounts

4. Acquisitions

a) Acquisition of ITNET plc ("ITNET")

On 3 February 2005, the Group acquired ITNET for consideration of £245.5 million comprising cash and the issue of shares. This transaction has been accounted for in accordance with IFRS 3 "Business Combinations".

	Book value £m	Fair value adjustments £m	Fair value £m
Goodwill	12.8	(12.8)	-
Other intangible assets	-	20.0	20.0
Property, plant and equipment	10.0	(1.4)	8.6
Deferred tax assets	7.7	3.2	10.9
Inventories	6.3	(0.3)	6.0
Trade and other receivables	44.7	(5.2)	39.5
Overdraft	(1.0)	-	(1.0)
Trade and other payables	(42.5)	(4.8)	(47.3)
Current tax liabilities	(0.4)	(1.0)	(1.4)
Provisions	(3.9)	(18.8)	(22.7)
Loans	(3.0)	-	(3.0)
Retirement benefit obligations	(15.3)	-	(15.3)
Obligations under finance leases	(5.8)	-	(5.8)
Net liabilities acquired	9.6	(21.1)	(11.5)
Goodwill			262.3
Total consideration			<u>250.8</u>
Satisfied by:			
Issue of Serco Group plc ordinary shares			74.2
Cash			171.3
Purchase consideration			<u>245.5</u>
Directly attributable costs			5.3
Total consideration			<u>250.8</u>
Net cash outflow arising on acquisition:			
Cash consideration paid in 2004			13.7
Cash consideration paid in 2005			162.8
			<u>176.5</u>

b) Acquisition of RCI Holding Corp ("RCI")

On 21 March 2005, the Group acquired all of the issued share capital of RCI for cash consideration of £116.3 million. This transaction has been accounted for in accordance with IFRS 3 "Business Combinations".

	Book value £m	Fair value adjustments £m	Fair value £m
Goodwill	4.3	(4.3)	-
Other intangible assets	0.1	2.1	2.2
Property, plant and equipment	1.9	-	1.9
Deferred tax assets	1.0	0.1	1.1
Inventories	0.6	-	0.6
Trade and other receivables	35.4	-	35.4
Trade and other payables	(13.7)	(2.3)	(16.0)
Net assets acquired	29.6	(4.4)	25.2
Goodwill			93.0
Total consideration			<u>118.2</u>
Satisfied by:			
Cash			116.3
Directly attributable costs			1.9
Total consideration			<u>118.2</u>
Net cash outflow arising on acquisition			<u>118.2</u>

5. Reconciliation of profit from operations to net cash from operating activities

	6 months to 30 June 2005 £m (unaudited)	6 months to 30 June 2004 £m (unaudited)	Year to 31 December 2004 £m (audited)
Profit from operations	45.5	32.9	69.2
Adjustments for:			
Share-based payments	2.7	1.8	4.5
Depreciation of property, plant and equipment	15.2	11.5	22.2
Amortisation of intangible assets	6.4	3.7	7.2
Loss on disposal of property, plant and equipment	0.4	-	0.8
Loss on sale of subsidiary undertakings	-	0.4	0.1
Operating cash inflows before movements in working capital	70.2	50.3	104.0
Decrease/(increase) in inventories	0.2	(1.4)	2.3
(Increase)/decrease in receivables	(19.5)	2.3	(34.4)
Increase/(decrease) in payables	20.0	(19.4)	31.7
Decrease in provisions	(0.8)	-	-
Cash generated by operations before PFI asset expenditure	70.1	31.8	103.6
Movement in PFI debtor	4.7	6.3	7.6
Expenditure on PFI assets in the course of construction	(3.0)	(9.2)	(16.3)
Cash generated by operations after PFI asset expenditure	71.8	28.9	94.9
Income taxes (paid)/received	(4.3)	0.1	(7.3)
Net cash inflow from operating activities	67.5	29.0	87.6

6. Analysis of total net debt

	As at 30 June 2005 £m (unaudited)	As at 30 June 2004 £m (unaudited)	As at 31 December 2004 £m (audited)
Cash and cash equivalents	204.1	184.1	200.5
Other loans – current liabilities	(23.5)	(13.2)	(20.0)
Other loans – non-current liabilities	(444.1)	(170.4)	(174.1)
Obligations under finance leases – current liabilities	(8.3)	(7.5)	(8.1)
Obligations under finance leases – non-current liabilities	(21.1)	(20.8)	(18.2)
Recourse net debt	(292.9)	(27.8)	(19.9)
Non recourse loans – current liabilities	(26.6)	(3.7)	(26.4)
Non recourse loans – non-current liabilities	(267.0)	(391.3)	(277.2)
Non recourse net debt	(293.6)	(395.0)	(303.6)
Total net debt	(586.5)	(422.8)	(323.5)

notes to the accounts

7. Reserves

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Retirement benefit obligations reserve £m	Share-based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total £m
As at 31 December 2004 (audited)	8.7	191.5	0.1	104.4	(124.4)	6.2	(16.4)	(2.6)	167.5
Shares issued	0.6	-	-	-	-	-	-	-	0.6
Premium on shares issued	-	75.0	-	-	-	-	-	-	75.0
Profit for the period attributable to equity holders of the parent	-	-	-	25.4	-	-	-	-	25.4
Dividends paid	-	-	-	(8.3)	-	-	-	-	(8.3)
Net actuarial loss on defined benefit pension schemes	-	-	-	-	(33.9)	-	-	-	(33.9)
Fair value gain on reimbursable rights	-	-	-	-	4.0	-	-	-	4.0
Expense in relation to share-based payment	-	-	-	-	-	2.7	-	-	2.7
Fair value loss on cash flow hedges on transition to IAS 39	-	-	-	(3.5)	-	-	-	(34.4)	(37.9)
Fair value gain on cash flow hedges during the period	-	-	-	-	-	-	-	0.7	0.7
Net exchange gain on translation of foreign operations	-	-	-	-	-	-	-	2.8	2.8
Tax credit on items taken directly to equity	-	-	-	0.7	9.3	-	-	10.3	20.3
As at 30 June 2005 (unaudited)	9.3	266.5	0.1	118.7	(145.0)	8.9	(16.4)	(23.2)	218.9

8. Joint ventures

The Group's interests in joint ventures are reported in the consolidated financial statements using the proportionate consolidation method. The effect of the Group's joint ventures on the consolidated income statement is as follows:

Income statement

	6 months to 30 June 2005 £m (unaudited)	6 months to 30 June 2004 £m (unaudited)	Year to 31 December 2004 £m (audited)
Revenue	254.5	120.4	255.5
Profit from operations	16.1	11.2	25.7
Profit before taxation	16.3	11.2	25.2
Taxation	(3.6)	(2.6)	(6.3)
Profit for the financial period	12.7	8.6	18.9
Minority interest	(0.4)	(0.1)	(0.6)
Attributable to the parent	12.3	8.5	18.3

Included in the above income statement for the six months to 30 June 2005 is a charge of £4.4m to joint ventures from the Group for management services.

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transition to IFRS report

This report provides further details of Serco's transition to IFRS.

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 a £26.9m (15.9%) 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
- 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
- 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 43 to 54. 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.

transition to IFRS report

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 IFRIC issued a draft interpretation on accounting for service concession arrangements including Public Private Partnerships ("PPP") projects and Private Finance Initiative ("PFI") projects. 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 cost as defined by IAS 39. The effect of adopting this policy is to maintain an accounting treatment consistent with UK GAAP while 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 IAS 19, 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 £m	As at 31 December 2004 £m	As at 30 June 2004 £m
Other intangible assets	4.1	15.5	16.3
Deferred tax assets	42.0	50.8	33.5
Trade and other receivables	12.1	20.0	1.2
Deferred tax liabilities	-	(4.0)	-
Retirement benefit obligations	(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.

transition to IFRS report

IFRS 2 "Share-based Payment"

IFRS 2 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 IAS 12 fall into two categories: First, deferred tax that needs to be provided in respect of other IFRS restatement accounting adjustments (for example, pension scheme adjustments, employee benefits accruals, goodwill). Second, specific deferred tax adjustments that arise on the different recognition criteria of deferred tax balances between UK GAAP (FRS 19) and IFRS (IAS 12) (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 IAS 19). The principles for the calculation of and recognition of deferred tax for PFI contracts under IAS 12 are different to those applied under FRS 19. Specifically, IAS 12 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, IAS 12 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 IAS 39 on 1 January 2005; the standard therefore had no effect on the Group's financial statements prior to that date. Adoption of IAS 39 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 IAS 1 “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 assets
		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)	
		(17.5)	(17.5)	Non-current liabilities
Creditors: Amounts falling due after more than one year	(539.7)	17.5	(522.2)	Obligations under finance leases
		(27.9)	(27.9)	Loans
Provisions for liabilities and charges	(56.5)	56.5	-	Deferred tax liabilities
		(29.7)	(29.7)	Provisions
	(596.2)	(1.1)	(597.3)	Retirement benefit obligations
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

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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	IAS 19 Employee benefits – pensions	IAS 19 Employee benefits – other	IAS 10 Dividends	IFRS 2 Share-based payment	IAS 12 Income taxes	Other £m	IFRS £m
	£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
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 account	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 IAS 1 “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 Profit and Loss account	£m	IAS 1 Presentational changes £m	£m	UK GAAP values in IFRS format 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		Attributable to: Equity holders of the parent Minority interest
Minority interest	(0.4)	0.4	36.0	
		1.0	1.0	
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	

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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	IAS 38 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 EPS	8.37p								10.11p
Diluted EPS	8.27p								9.99p

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

c) Impact of IAS 1 "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	IAS 1 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)	
Creditors: Amounts falling due after more than one year				Non-current liabilities
	(415.1)	401.5	(13.6)	Obligations under finance leases
		(401.5)	(401.5)	Loans
		(32.2)	(32.2)	Deferred tax liabilities
Provisions for liabilities and charges	(62.0)	62.0	-	Provisions
		(29.8)	(29.8)	Retirement benefit obligations
	(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

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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 £m	IAS 31 Interest in joint ventures £m	IFRS 3 Business comb -inations £m	IAS 38 Intangible assets £m	IAS 19 Employee benefits - pensions £m	IAS 19 Employee benefits - other £m	IAS 10 Dividends £m	IFRS 2 Share- based payment £m	IAS 12 Income taxes £m	Other £m	IFRS £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)	-	-	-	-	-	-	-	-	-
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 obligations	(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)	(1.5)	-	(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 account	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	(a5.4)	(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") set out on pages 43 to 48.

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 and 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

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

a) Impact of IAS 1 “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 Profit and Loss account	£m	IAS 1 Presentational changes £m	£m	UK GAAP values in IFRS format Income statement
Turnover: Group and share of joint ventures	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
		18.6	18.6	Investment income
		(19.6)	(19.6)	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	IFRS 3 Business combinations	IAS 38 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	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	18.6	*-	-	-	-	-	-	-	18.6
Finance costs	(19.6)	*-	-	-	(1.2)	-	-	-	(20.8)
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
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.

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c) Impact of IAS 1 "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	IAS 1 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)	
		(15.5)	(15.5)	Non-current liabilities
Creditors: Amounts falling due after more than one year	(526.0)	15.6	(510.4)	Obligations under finance leases
		(27.7)	(27.7)	Loans
Provisions for liabilities and charges	(56.2)	56.2	-	Deferred tax liabilities
		(28.5)	(28.5)	Provisions
	(582.2)	0.1	(582.1)	Retirement benefit obligations
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	2.4	112.4	Retained earnings
		(2.4)	(2.4)	Translation reserve
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 £m	IAS 31 Interest in joint ventures £m	IFRS 3 Business comb- inations £m	IAS 38 Intangible assets £m	IAS 19 Employee benefits - pensions £m	IAS 19 Employee benefits - other £m	IAS 10 Dividends £m	IFRS 2 Share- based payment £m	IAS 12 Income taxes £m	Other £m	IFRS £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 account	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

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

	At 31 December 2004 Restated under IFRS £m	IAS 32 and IAS 39 Financial instruments £m	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 IASB and the IFRIC and are therefore still subject to change.

The financial information has been prepared on the historical cost basis, except for the revaluation of derivative financial instruments. 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 consolidated income statement 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 intra-Group 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.

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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 at 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 at 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 asset, 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 obligations 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.

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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 sale 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 and five years, or the length of the contract if longer. Provision is also made for impairment if required. 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 (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 consolidated income 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 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 SPCs 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 secured on the contracts of PFI and other concessions, and not any other assets of the Group.

Derivative financial instruments and hedging activities

The Group has adopted IAS 39 "Financial Instruments: Recognition and Measurement" with effect from 1 January 2005. Derivatives are initially accounted for 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.

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Derivative financial instruments and hedging activities (cont.)

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 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.

on board the ghan train, on its inaugural journey from adelaide to darwin, frank birch is served a tomato juice. there's no celery. half an hour later he orders another. this time, celery. a crew member had phoned her mother up the line to put a bunch on board.

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