OUR STRATEGY
To find out more about our business strategy go to page 10

OUR PERFORMANCE
For an in-depth analysis of how we performed in 2010 go to page 15

OUR IMPACT ON SOCIETY
For an explanation of our approach to corporate responsibility go to page 38

# open to learn

PEARSON ANNUAL REPORT AND ACCOUNTS 2010

## Always learning

# Pearson is the world's leading learning company. We have 36,000 people in more than 70 countries, helping people of all ages to make progress in their lives through all kinds of learning.

## Learn more at www.pearson.com

- Browse, download or print our interactive online annual report at www.pearson.com/investor/ar2010
- View our 2010 results presentation at: www.pearson.com/pearson-2010-results/

## Notes

### Reliance on this document

Our Business Review on pages 10 to 47 has been prepared in accordance with the Directors' Report Business Review Requirements of section 417 of the Companies Act 2006. It also incorporates much of the guidance set out in the Accounting Standards Board's Reporting Statement on the Operating and Financial Review.

The intention of this document is to provide information to shareholders and is not designed to be relied upon by any other party or for any other purpose.

### Forward-looking statements

This document contains forward-looking statements which are made by the directors in good faith based on information available to them at the time of approval of this report. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing, anticipated costs savings and synergies and the execution of Pearson's strategy, are forward-looking statements. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that will occur in the future. There are a number of factors which could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including a number of factors outside Pearson's control. Any forward-looking statements speak only as of the date they are made, and Pearson gives no undertaking to update forward-looking statements to reflect any changes in its expectations with regard thereto or any changes to events, conditions or circumstances on which any such statement is based.

# What's inside this report?

Directors' report

Business review

## 1 Introduction

A summary of who we are and what we do, including highlights of the operating and financial performance for the year.



## 2 Our strategy

An analysis of our business strategy and the key areas of investment and focus.



## 3 Our performance

An in-depth analysis of how we performed in 2010. Also looks at the outlook for 2011 and the principal risks and uncertainties affecting our businesses.



## 4 Our impact on society

Explains Pearson's approach to corporate responsibility, giving a summary of our work in 2010 and our plans for 2011.



## 5 Governance

Provides details of the board, its policies and procedures and the report on directors' remuneration.



## 6 Financial statements

Detailed financial statements for both the Group and the parent company, including an analysis of the key measures used by the Group in its management of the business.

# Pearson at a glance

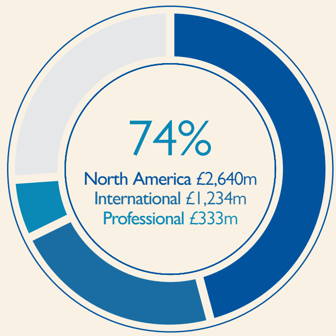
Overview | People | Proportion of Pearson revenue

## Education

We provide learning materials, technologies, assessments and services to teachers and students of all ages and in more than 70 countries.

**29,200**

US 16,000
UK 3,600
RoW 9,600

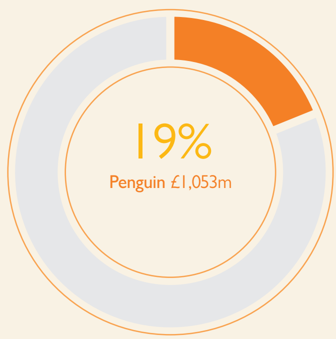



## Consumer publishing

Penguin publishes more than 4,000 fiction and non-fiction books each year – on paper, on screens and in audio formats – for readers of all ages. It is one of the world's leading consumer publishing businesses and an iconic global brand.

**3,450**

US 1,800
UK 750
RoW 900

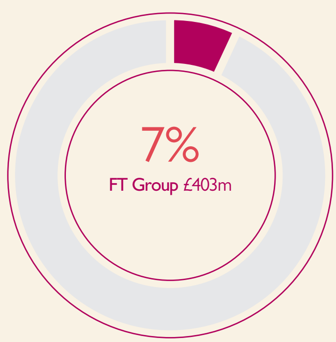



## Business information

The FT Group provides news, data, comment and analysis to the international business community. It is known around the world for its independent and authoritative information.

**2,600**

US 500
UK 1,600
RoW 500




FT

## Business

We are a leading provider of educational materials and learning technologies. We provide test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. We publish across the curriculum and provide a range of education services including teacher development, educational software and system-wide solutions.

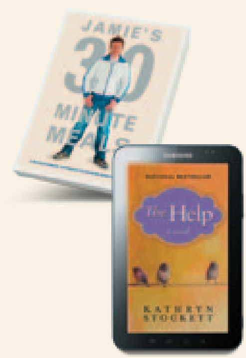
## Markets

For some years, Pearson has been a leader in education, with leading positions in large developed markets and local publishing centres in more than 30 countries. More recently we have significantly accelerated our international expansion, investing in countries including China, Brazil, India and South Africa.


› See more on page 18 and at pearsoned.com

Penguin operates around the world through a series of connected national publishing houses. It publishes under a number of well-known imprints including Putnam, Viking, Allen Lane, Hamish Hamilton, Berkley, the Penguin Press, Puffin and Dorling Kindersley.

Penguin combines a longstanding commitment to local publishing with a determination to benefit from its worldwide scale, a globally recognised brand and growing demand for books in emerging markets. Its largest businesses are in the US, the UK, Australia, Canada, Ireland, India and South Africa.

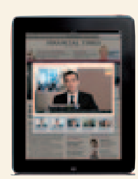



› See more on page 28 and at penguin.com

The FT Group includes: the *Financial Times* and FT.com, a range of specialist financial magazines and online services, and Mergermarket.

The FT Group also has a stake in a number of joint ventures, including those with FTSE International, Vedomosti in Russia, BDFM in South Africa and a 50% stake in The Economist Group.

The *Financial Times* has a network of approximately 600 journalists in 47 countries and a unique model of producing distinctive newspaper editions for Europe, the UK, the US, Asia and the Middle East. FT.com, with 10.6 million monthly unique users and 3.2 million registered users around the world, makes the FT even more widely available.




› See more on page 26 and at ft.com

# Financial highlights

In financial terms, Pearson's goal is to achieve sustainable growth on three key financial goals – earnings, cash and return on invested capital – and reliable cash returns to our investors through healthy and growing dividends. Over the past five years we have produced, on average, 16% growth in earnings and cash flow. And we have sustained our growth even in the face of very tough economic and market conditions in recent years.

| | 2010 £m | 2009 £m | Headline growth | CER growth | Underlying growth |
|---|---|---|---|---|---|
| **Business performance** | | | | | |
| Sales | 5,663 | 5,140 | 10% | 8% | 5% |
| Adjusted operating profit | 857 | 710 | 21% | 15% | 14% |
| Adjusted profit before tax | 853 | 761 | 12% | | |
| Adjusted earnings per share | 77.5p | 65.4p | 19% | | |
| Operating cash flow | 1,057 | 913 | 16% | | |
| Total free cash flow | 904 | 723 | 25% | | |
| Total free cash flow per share | 112.8p | 90.5p | 25% | | |
| Return on invested capital | 10.3% | 8.9% | 1.4%pts | | |
| Net debt | (430) | (1,092) | 61% | | |
| **Statutory results** | | | | | |
| Operating profit | 743 | 619 | 20% | | |
| Profit before tax | 670 | 523 | 28% | | |
| Basic earnings per share | 161.9p | 53.2p | 204% | | |
| Cash generated from operations | 1,169 | 1,012 | 16% | | |
| Dividend per share | 38.7p | 35.5p | 9% | | |

Notes

Throughout this document:

a) Growth rates are stated on a constant exchange rate (CER) basis unless otherwise stated. Where quoted, underlying growth rates exclude both currency movements and portfolio changes.

b) Interactive Data is treated as a discontinued business and sales and operating profit are stated on a continuing business basis, excluding Interactive Data from both 2009 and 2010. Until its sale on 29 July 2010, Interactive Data contributed revenues of £296m (full year 2009: £484m) and adjusted operating profit of £81m (2009: £148m).

c) The 'business performance' measures are non-GAAP measures and reconciliations to the equivalent statutory heading under IFRS are included in notes 2, 8 and 31 to the annual report.

## 2010 Sales

£5.7bn

+8%

## 2010 Adjusted operating profit

£857m

+15%

## Our record

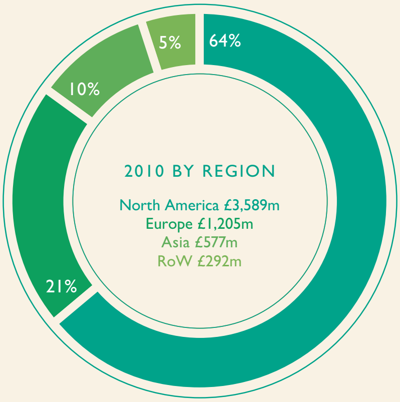
Average annual growth in headline terms, 2006–2010

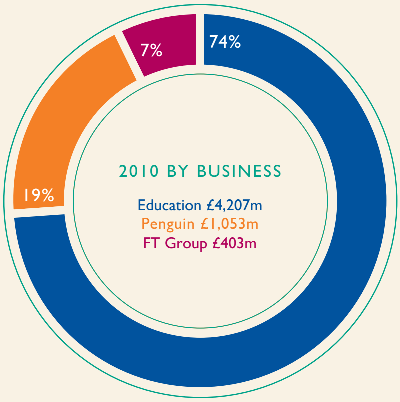
ADJUSTED EARNINGS PER SHARE

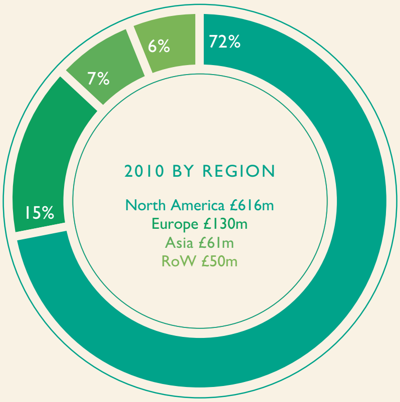
+16%

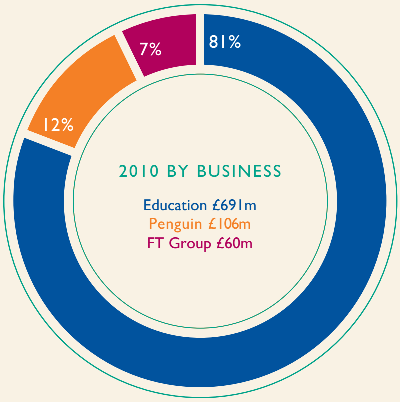
OPERATING CASH FLOW

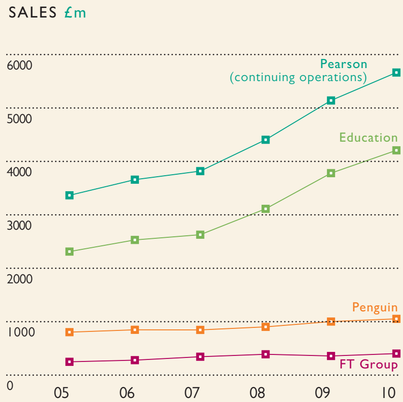
+16%

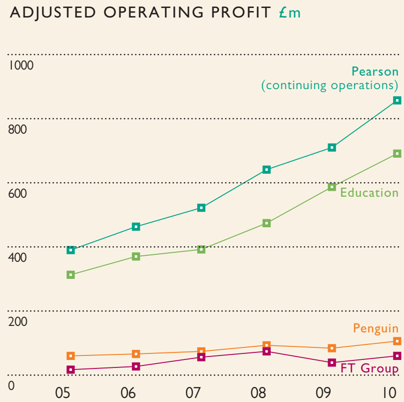

2010 BY REGION
North America £3,589m
Europe £1,205m
Asia £577m
RoW £292m
64%
21%
10%
5%


2010 BY BUSINESS
Education £4,207m
Penguin £1,053m
FT Group £403m
74%
19%
7%


2010 BY REGION
North America £616m
Europe £130m
Asia £61m
RoW £50m
72%
15%
7%
6%


2010 BY BUSINESS
Education £691m
Penguin £106m
FT Group £60m
81%
12%
7%


SALES £m
6000
5000
4000
3000
2000
1000
0
05
06
07
08
09
10
Pearson
(continuing operations)
Education
Penguin
FT Group


ADJUSTED OPERATING PROFIT £m
1000
800
600
400
200
0
05
06
07
08
09
10
Pearson
(continuing operations)
Education
Penguin
FT Group

# Chairman's statement

## We have a clear strategy, a talented team and a proud record of performance. Once again, that was rewarded with good returns for shareholders.

Glen Moreno Chairman

Dear shareholder,

Welcome to our report to you for 2010.

It was another challenging year for your company. The global economy did begin to crawl out of recession, but governments, businesses and consumers continued to suffer the aftershocks of the financial crisis. Confidence was in short supply, and my own guess is that it's likely to remain that way for some time.

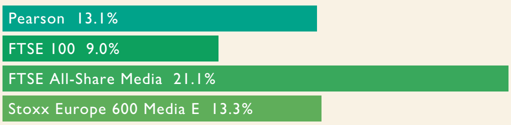
But once again, Pearson rose to the challenge. As you'll have seen, your company posted operating profit and earnings growth of 15% and 19% respectively. Beneath those numbers for all of Pearson stand excellent results in all parts – Penguin, the Financial Times Group and our education company. For that, all our talented people deserve every credit.

On two especially important performance measures – operating cash flow and return on capital – we hit all-time highs of £1.06bn and 10.3% respectively. And much more important than any single year, this continues a trend of consistent, reliable growth through good times and bad. Over the past five years, our profits, earnings per share and free cash flow have all doubled.

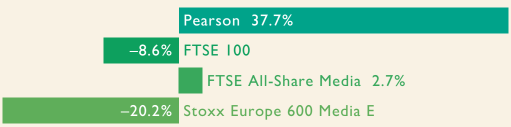
Once again, that strong operational performance was rewarded with good returns for shareholders. After a substantial increase of almost 40% in 2009 our shares began 2010 at 891p. They ended the year 13% higher, just above ten pounds. That growth was a little faster than the overall market (the FTSE 100 was up 9%) but a little slower than our sector as advertising-funded companies that had been hit hard during the recession enjoyed a sharp recovery (the DJ Stoxx 600 Media index was up 13% and the FTSE All-Share Media index 21%).

The second element of our return to shareholders – the dividend – was further increased in 2010. So our total shareholder return (which combines both the share price movement and dividends paid) was up 17% for the year – this coming on top of a gain of close to 50% in 2009. Again, this was ahead of the FTSE 100 (up 13%), but behind the DJ Stoxx 600 Media (up 18%) and the FTSE media sector (up 25%).

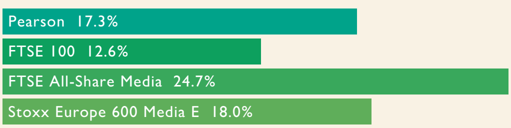
SHARE PRICE PERFORMANCE – 1 YEAR % CHANGE
01.01.10 – 31.12.10



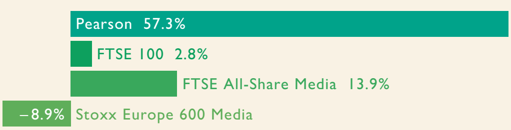

SHARE PRICE PERFORMANCE – 3 YEAR % CHANGE
01.01.08 – 31.12.10




TOTAL SHAREHOLDER RETURN – 1 YEAR % CHANGE
01.01.10 – 31.12.10




TOTAL SHAREHOLDER RETURN – 3 YEAR % CHANGE
01.01.08 – 31.12.10




Source: Datastream as at 31 December 2010

So, there is much to be proud of and I convey my thanks and congratulations to everyone at Pearson. But we cannot look back: our markets are filled with change and we have much to be cautious about.

The economic recovery is not assured and in many parts of the world debt – both public and private – remains a heavy burden. At the same time, the disruptive transformations that have been reshaping Pearson for some time – slower growth in our traditional markets set against rapid expansion in the so-called 'developing' world; and the revolutionary impact of connected digital technologies on the way we all read, learn and communicate – are snowballing. These twin forces – technology and globalisation – have been the dominant trends throughout my business career and Pearson's strategies, opportunities and risks are to a very great extent shaped by them. As reliable as our growth has been, we cannot take it for granted; as Marjorie writes in her strategy review, we have to keep on investing and changing.

These are the strategic matters that consume the attention of our people and the board. Your board believes it can contribute most to Pearson's success by focusing on four key themes: governance, strategy, business performance and people. Our annual board cycle and meeting agendas are formally structured around these things.

## Governance

As a board, our belief is that good governance supports the long-term development of strategy and good performance. We are determined not to second-guess a highly experienced and effective executive management team; but we do believe that robust, open board debate brings a discipline to important decisions and adds a valuable and diverse set of external perspectives.

We're fortunate to have a varied group of non-executive directors drawn from successful businesses and education institutions with deep experience of global corporate strategy, education, consumer marketing and technology. Terry Burns's decision to depart from the board last year, soon followed by the untimely death of CK Prahalad, left us with an unexpected imbalance between executive and non-executive directors. We have addressed this with the recent appointment of Josh Lewis as a non-executive director. We believe Josh will make an excellent addition to our board. We are currently looking to make one further non-executive director appointment.

# Chairman's statement continued

## Strategy

At each board meeting your board reviews the detailed strategy and long-term plans for one or more of our businesses. Once a year, at a specific two-day meeting, the board considers Pearson's overall strategy. We analyse in detail the market conditions and trends facing us, and consider the long-term goals and plans of all parts of Pearson. We have an open and robust debate over major strategic issues such as the shape of the company, the potential value to be created by further acquisitions and disposals, and the priorities for capital allocation and organic investment. Marjorie's letter to shareholders, which begins on page 10, is as always an excellent summary of our strategic direction.

As I wrote in my letter to shareholders last year, Pearson is a company that has totally transformed itself over the past decade. Yet even by our standards, 2010 was a year of dramatic change. As a board we debated and approved Pearson's largest disposal ever: the $2.0bn sale of our stake in Interactive Data to Silver Lake and Warburg Pincus. We looked at all the acquisitions that the company made during the year – including significant investments to expand our position in fast-growing developing markets such as Brazil, India and Africa. And we also, as a matter of routine, revisited acquisitions made in prior years to assess their performance against the plans originally laid out for them. In 2010, in addition to reviewing returns and lessons learned from capital allocation decisions over the past seven or so years, we conducted detailed post-acquisition reviews of acquisitions completed during 2008.

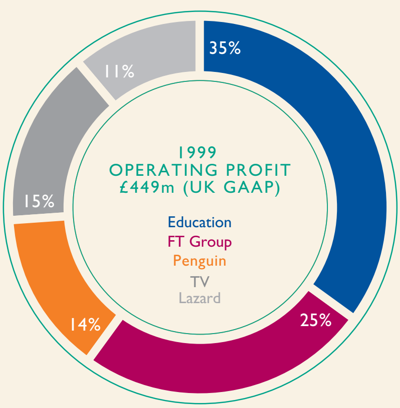
I am convinced that this steady reallocation of resources into learning companies that are heavily oriented towards developing markets and new technologies is an excellent strategy for Pearson to pursue. Our return on capital from all acquired companies from 2002–2010 is 12%, well above our average cost of capital.

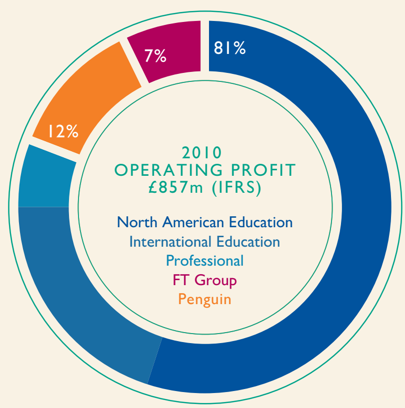
## Business performance

At the start of each year, in addition to reviewing long-term strategic plans, the board debates and agrees a stretching-but-realistic one-year operating plan. It focuses on a balanced mix of financial goals – sales growth, margins, earnings, cash and working capital reduction – which are intended to contribute to the long-term financial goals of the company, to align executive compensation with shareholders' interests and to avoid an excessive focus on any single financial measure. These targets in turn form the basis of our expectations for the year and for executive compensation. At every board meeting, we hear from the company's chief financial officer and executive directors on the company's business performance relative to plan.

This past year, in monitoring business performance the board has paid particularly close attention to risk management. You can read our full discussion of the material risks affecting the company from page 35; they are dominated by risks related to a prolonged period of low economic growth and the transformational shift towards digital delivery and business models.

CHANGE AT PEARSON
OPERATING PROFIT



## People

Your board is keenly aware that a creative business like Pearson is acutely dependent on its internal talent – not just of a small group of senior directors, but of a wide pool of writers, editors, educators, publishers, technologists, marketers and sales experts.

Each year we devote one full board meeting to talent, succession planning and organisational structure. We look in detail at the 20 most senior jobs in Pearson, ensuring that there are several credible candidates for each role, that they are well known by the board and that we have development plans in place to round out their experience and skills and to give them every possible chance of progressing their careers at Pearson.

In addition, in 2010 the board reviewed the goals and plans of Pearson's new director for people, Robin Baliszewski. And the remuneration committee, as always, played the pivotal role in setting overall compensation policy, senior executive reward and incentive targets across the company aligned to our strategy and performance. You can read the full report of our remuneration committee from page 63.

In 2010, in addition to my Pearson responsibilities, I took on a new role as deputy chairman of the Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting. In that capacity I have become even more aware of the desire of shareholders, large and small, to understand how boards are spending their time and how they are ensuring that key decisions around investment, performance and compensation are closely connected to strategy.

I do hope that this report helps provide you with that understanding in relation to Pearson. We have a clear strategy, a focused board, a talented team and a proud record of performance. We will be straining every sinew to continue to build on all those strengths in 2011.

If you have any questions, I invite you to send them to us via our website at www.pearson.com; or to join us in person at our annual shareholders' meeting.

**Glen Moreno** Chairman

# Pearson's strategy: Marjorie Scardino, chief executive

## As we report on 2010, we look back on another successful result for our work and for our shareholders.

Marjorie Scardino Chief executive

Our world remained unsettled through the year we've just left. In much of the developed world it was marked by deep budget deficits, severe public spending cuts and harsh unemployment. Though 'official statistics' about economic progress started to look promising enough to deserve the term 'recovery' toward the end of the year, it doesn't yet feel like much of a rising tide to businesses or families now facing cuts in public services, lower property values, higher taxes and demanding debts.

We were fortunate in Pearson, though. As we look back on that year, we look back on another successful result for our work and for our shareholders. We showed once again that we're collectively capable of swimming against the current, of being a company that has the people and purpose and agility to reach our goals even when the economic flow is against us. And we turned in another set of exceptional results.

It was also, once again, a very good year for every single part of Pearson. Every one of our companies has grown well, pulled further ahead of its competitors and made progress on the long-term shift to the digital and international expansion that we've been pushing for. I don't need to rehearse the figures; you can read all about them on these pages and elsewhere in this report.

### ADJUSTED EARNINGS PER SHARE PENCE +19%

| | |
|---|---|
| 10 | 77.5p |
| 09 | 65.4p |
| 08 | 57.7p |
| 07 | 46.7p |
| 06 | 43.1p |

### OPERATING CASH FLOW £m +16%

| | |
|---|---|
| 10 | £1,057m |
| 09 | £913m |
| 08 | £796m |
| 07 | £684m |
| 06 | £575m |

### ADJUSTED OPERATING PROFIT £m +15%

| | |
|---|---|
| 10 | £857m |
| 09 | £710m |
| 08 | £641m |
| 07 | £522m |
| 06 | £463m |

### RETURN ON INVESTED CAPITAL % +1.4%pts

| | |
|---|---|
| 10 | 10.3% |
| 09 | 8.9% |
| 08 | 9.2% |
| 07 | 8.9% |
| 06 | 8.1% |

One number, though, is especially important to me (and it might be to you as you think about our future prospects): while we were producing record profits, earnings and cash, we were also making our biggest-ever *investment* in Pearson's future. We invested $0.8bn in new companies and a further $1.4bn organically in new education programmes, new forms of journalism, new authors and writers and most of all new technologies to make learning more personal and more effective.

As we've said many times, our goal as a company reaches much further than those financial measures. Our profits sustain us in our larger aim: to make an impact on people's lives and on society through education and information. This past year we began to talk about that fundamental goal in a new way: we now say that we, like our customers, are '*always learning*'.

*So what have we learned in the past 12 months?*
Here's my list:

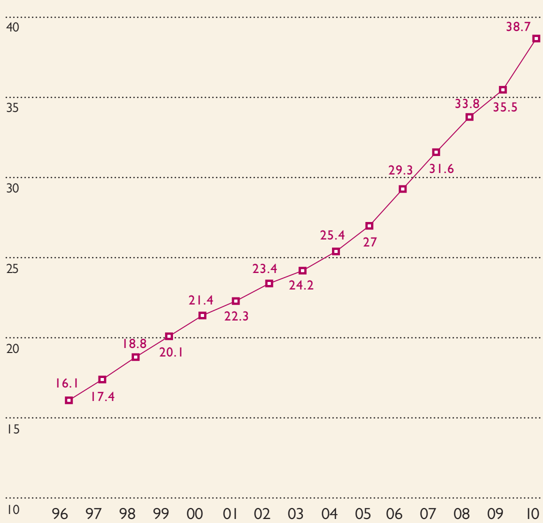
## 1. The world is changing shape

In 2010, China overtook Japan to become the world's second largest economy (behind America). In 2011, they're about to overtake the US as the world's largest manufacturer, though India may soon leapfrog China in the category of fastest economic growth.

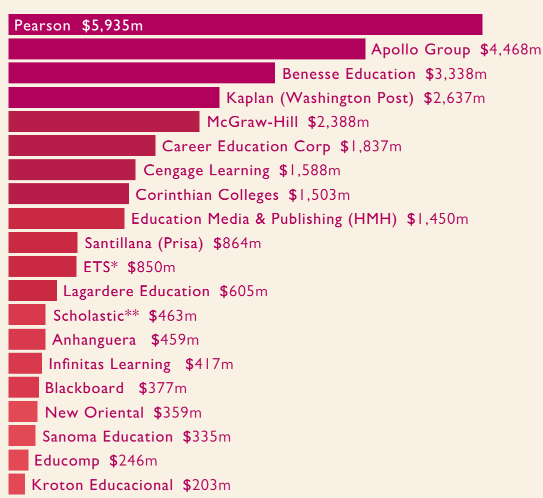
We're witnessing an historic shift in economic power from developed to developing economies. This year we'll also once again face a stark contrast between a rich world struggling with a weak and jobless recovery and an emerging world growing perhaps four times as fast. At the same time, in both worlds, we'll likely still see a widening gap between the richest and the poorest, a gap that has a profound effect on everything from health to education to economic progress, and has to concern us in our work.

Pearson today has an important presence in many of these fast-growing markets: language schools in China; *Sistemas* and Penguins in Brazil; universities in South Africa; online tutoring in India, to name just four examples. We won't slight our strong developed world businesses, but you can expect to see us investing and

DIVIDEND PER SHARE PAID IN FISCAL YEAR PENCE




THE WORLD'S LEADING EDUCATION COMPANIES
EDUCATION REVENUES $m




* 2008 data ** Year to February 2010 2009 data

# Pearson's strategy: Marjorie Scardino, chief executive continued

picking up speed in these newer places. And you can figure out that to do that we'll need to get better and faster at moving our intellectual talent all around the world, not just from West to East, and North to South, not just to the next step on the ladder, but to build a new ladder entirely.

## 2. The age of digital readers has dawned. At last

Though ebooks have been around for more than two decades, I suspect publishers of all kinds will look back on 2010 as the 'lift-off' for digital reading. Apple with its iPad sparked a lot of the buzz. But the real phenomenon was the quick emergence of a symbiotic community of multi-purpose devices, ebook formats and sales channels. There's now genuine consumer demand for high-quality digital reading (and learning) experiences, and we're beginning to deliver them in earnest.

At Penguin, for example, ebook sales almost trebled over the course of 2010 (having increased four-fold in 2009) and now represent more than $1 in every $20 of Penguin's total global sales (and much more in the US). At the FT, another example, digital subscribers topped 200,000 as the year ended, and also brought in more print subscribers. And in our education companies, demand for our combination of ebooks and our digital learning platforms – eCollege, MyLabs, to name only two – has been growing fast, but this past year that pace exploded.

In fact across Pearson, just as we see developing economies growing several times faster than those in the developed world, so we see a similar contrast between our digital services and our more traditional, print-only products.

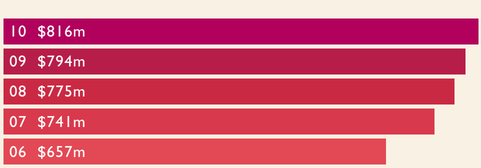
## OUR STRATEGY

### 1

### Long-term organic investment in content

Over the past five years, we have invested £4.0bn in our business: new education programmes; new and established authors for Penguin; the FT Group journalism. In 2010, that investment reached an all-time high of approximately £0.9bn. We believe that this constant investment is critical to the quality and effectiveness of our products and that it has helped us gain share in many of our markets.

EDUCATION AND PENGUIN PRE-PUBLICATION EXPENDITURE AND AUTHOR'S ADVANCES $m

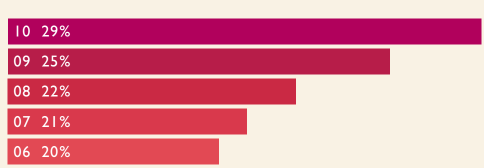



### 2

### Digital products and services businesses

Our strategy is to add services to our content, usually enabled by technology, to make the content more useful, more personal and more valuable. These digital products and services businesses give us access to new, bigger and faster-growing markets. In 2010, our digital revenues were £1.6bn or 29% of Pearson's total sales. Our worldwide educational testing businesses have increased their revenues almost 70% over the past five years to $1.7bn.

PEARSON'S DIGITAL REVENUES % OF SALES



### 3. Information wants to be valuable

For a few years now, the idea that 'information wants to be free' – that consumers won't pay for content in a hyper-connected digital world – has echoed 'round the ether'. We resisted that movement, believing rather unfashionably that high quality content costs real money to create and should be worth paying for if that money is well-spent. The pendulum swung back in our direction last year, as other media companies began to experiment with paid-for online services and as the app economy helped stimulate the market for digital reading.

I'm proud that we held our ground and proved that, if the content and the experience is good enough, users *are* willing to pay. But we can't say that we've won the argument on all counts. In some parts of the world, we face potential changes to copyright and intellectual property laws that might weaken the ability of authors and publishers to generate a return from their creative endeavours, and in turn weaken incentives to invest.

And in some cases, what we publish *is* a commodity or so generally important that we *ought* to find a way to make it available more widely and easily, and take a different account of its value.

All of that means that we have to keep an open mind about the terms under which we create and sell our content and services. And we have to make our piece of this digital and mobile world easy for people to access and connected to what else they do and who they do it with.

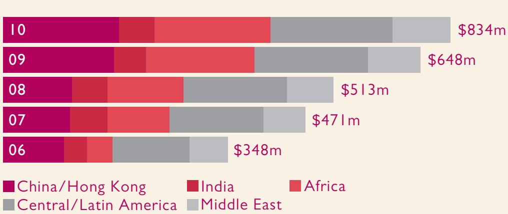
We also have to work to educate people on the value of intellectual property in an economy based on brain-power. The first step, of course, is to respect intellectual property ourselves (which reminds me to give due credit to the FT's media editor, who wrote that headline above – '*Information wants to be valuable*').

## 3

### International expansion

We are already present in more than 70 countries and we are investing to become a much larger global company, with particular emphasis on fast-growing markets in China, India, Africa and Latin America. Over the past five years, our international education business has grown headline sales at an average annual rate of 18% through strong organic growth and acquisitions, generating more than £1.2bn of revenues in 2010.

RAPID GROWTH IN EMERGING MARKETS
PEARSON REVENUES $m

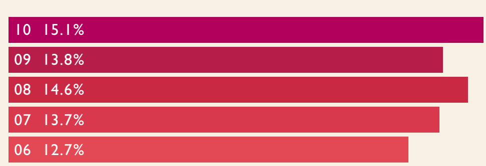



## 4

### Efficiency

Our investments in content, services and new geographic markets are fuelled by steady efficiency gains. Since 2006, our operating profit margins have increased from 12.7% to 15.1% and our ratio of average working capital to sales has improved from 26.3% to 20.1%.

PEARSON MARGINS %



# Pearson's strategy: Marjorie Scardino, chief executive continued

### 4. Trust is precious

Part of the fall-out from the global financial crisis was a scepticism of the motives of large corporations – not just banks, but companies like ours. As the year went on, that rumbling scepticism became more than a rumble, as several companies that made headlines can attest.

Though the nature of Pearson's business is very different from those companies, we're arguably more dependent on the public's trust than most. Readers of the FT trust its editorial integrity and independence; customers of Penguin trust it to be a mark of exceptional quality; teachers and students trust our learning programmes (on paper or screens) to be effective and engaging and our testing, qualifications and services to be reliable, rigorously accurate and helpful.

What we all understand is that trust can never be taken for granted: it's something that all of us – every single one of us – have to go out and earn every day.

Those are four of the lessons I think 2010 taught us (some probably for the second or third time).

None of those lessons is new; we've been tracking those trends and shaping our strategy around them for some time. So we were pretty well-prepared to stare down those changes and to use them to fuel our growth.

That strategy (which I've been writing to you about for so many years you're probably tired of hearing it) is pretty simple:

1. We develop an idea, a story, a lesson, a premise (quality content), determined that it should be both unique and respected;

2. We add services, generally enabled and delivered by technology, to make that content more useful and more valuable;

3. We work in markets around the world, with an increasing emphasis on those in the developing world;

4. Those first three priorities all require consistent investment. We make room for that investment through efficiency gains, measured in margin and working capital improvements.

Because I've written about this strategy every year for the past 12, you may be lulled into a sense that everything is stable; but that would be a false sense. That same strategy is not a description of business-as-usual. It's a manifesto for disruption, for constant change, and for the kind of radical corporate reinvention that's required in a world that's changing before our eyes (and often, too fast for us to perceive the change).

So we know we'll need to reinvent ourselves again in 2011. We've already witnessed events that congealed our conviction that we can't rest our hopes for the future on doing what we did or how we did it in the past. We have to keep on learning new lessons; to keep learning and changing before we really think we need to.

That kind of change is a lot to ask against the backdrop of a world economy that remains at best 'uncertain' and at times 'troubling'. But our success over the past six years has been based on bucking the tide, doing new things. We don't for a minute take that success for granted; but we are as determined as ever that it will continue. And we thank all shareholders – large and small, institutional and private, Pearson employees, former employees and pensioners – for your continued commitment to the company. We're very focused on ensuring your commitment is rewarded; and we never forget that it is your investment that makes it possible for us to pursue the goals and the change that we are hell-bent on achieving.

Marjorie Scardino Chief executive

# Our performance: 2010 financial overview

In 2010, Pearson's sales increased by 10% in headline terms to £5.7bn and adjusted operating profit by 21% to £857m. The headline growth rates include a benefit from currency movements and acquisitions. Currency movements added £128m to sales and £39m to operating profit. This was the result of the strengthening of the US dollar and other currencies against sterling: we generated approximately 60% of our sales and profits in US dollars and the average exchange rate strengthened from £1:$1.57 in 2009 to £1:$1.54 in 2010. At constant exchange rates (ie stripping out the benefit of those currency movements), our sales and operating profit grew 8% and 15% respectively.

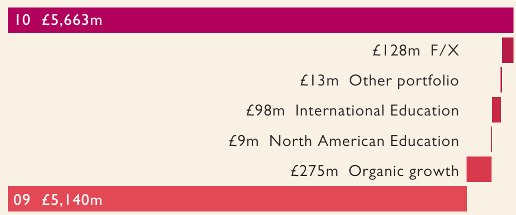
Acquisitions, primarily in our education company, contributed £120m to sales and £5m to operating profits. This includes integration costs and investments related to our newly-acquired companies, which we expense.

Our underlying revenue and operating profit (ie stripping out the benefit of both portfolio changes and currency movements) grew 5% and 14% respectively.

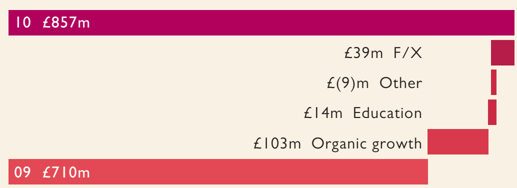
The disposal of Interactive Data was completed on 29 July 2010. Interactive Data therefore contributed seven months of profit in 2010, compared to a full twelve months in 2009. Pearson's total operating profit increased 9% in headline terms to £938m, reflecting this part-year contribution from Interactive Data in 2010.

Our tax rate in 2010 was 25.2%, a little lower than in 2009. We increased adjusted earnings per share by 19% in headline terms to 77.5p.

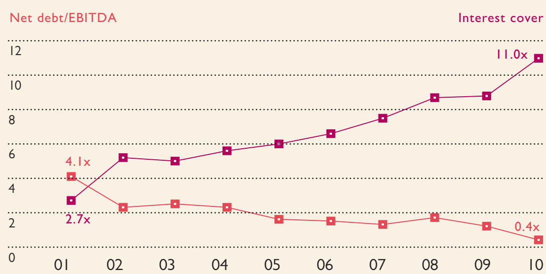
SALES GROWTH £m +8%



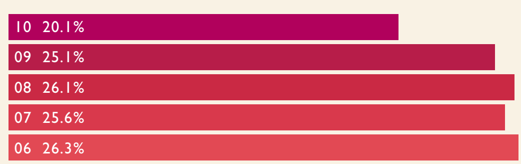

PROFIT GROWTH £m +15%




BALANCE SHEET STRENGTH




AVERAGE WORKING CAPITAL/SALES %



# Our performance: 2010 financial overview continued

## Cash generation

We increased operating cash flow by £144m to £1,057m (headline growth of 16%) and free cash flow by £181m to £904m, or 112.8p per share (headline growth of 25%). We converted 113% of operating profit into cash, with our average working capital: sales ratio improving by a further five percentage points to 20.1% as we benefited from the rapid growth in our digital businesses and continued efficiency improvements.

## Return on invested capital

We improved our return on average invested capital by 1.4 percentage points to 10.3%, benefiting from strong profit growth and tight control of working capital as well as the part year contribution from Interactive Data.

## Statutory results

Our statutory results show an increase of £124m in operating profit to £743m (£619m in 2009). Basic earnings per share were 161.9p in 2010, up from 53.2p in 2009, helped by the profit on disposal of Interactive Data.

## Balance sheet

We significantly reduced our net debt by £662m to £430m (£1,092m in 2009). We benefited from the proceeds from the sale of Interactive Data and strong cash generation, partly offset by acquisition investment of £535m and sustained investment in our businesses. Since 2000, Pearson's net debt/EBITDA ratio has fallen from 3.9x to 0.4x and our interest cover has increased from 3.1x to 11.0x.

## Dividend

The board is proposing a dividend increase of 9% to 38.7p, subject to shareholder approval. 2010 will be Pearson's 19th straight year of increasing our dividend above the rate of inflation and our fastest rate of growth in a decade. Over the past ten years we have increased our dividend at a compound annual rate of 6%, returning more than £2.3bn to shareholders. We have a progressive dividend policy of sustaining our dividend cover at around 2.0x over the long term while moving our dividend growth more in line with earnings growth.

# Outlook: 2011

Over the past five years Pearson has produced, on average, 16% growth in earnings and cash flow. We sustained our growth even in the face of very tough economic and market conditions in recent years. We are planning for some of our markets to remain weak in 2011, particularly those that depend on government spending and traditional print publishing business models. In addition, we face tough comparatives (especially in the first half of the year) after our particularly strong competitive and financial performance in 2010.

Even so, we have built a series of competitive advantages which should help us deliver another good year in 2011. These advantages include our sustained investment, digital leadership, educational effectiveness, positions in fast-growing economies and operating efficiency.

## Education

In education, we expect to achieve continued growth in 2011. In North America, we see growth in higher education (despite slower enrolment rates) and assessment more than offsetting a slower year for the school publishing industry (the result of the lower new adoption opportunity and pressure on state budgets). Our International education business will benefit from its rapidly-growing position in services, technology and developing economies, enabling it to grow again despite the weak public spending environment in some markets.

## FT Group

At the FT Group, we are rapidly shifting our business model towards digital and subscription revenues. Advertising revenues remain unpredictable, but we see healthy demand for the FT's premium content, especially in digital formats, and a recovery in business conditions for Mergermarket.

## Penguin

Penguin will face another year of fast-changing industry conditions, driven by the rapid growth of both digital sales channels and digital books, and by the resulting pressures on physical bookstores. After particularly strong competitive performance and financial results in 2010, we expect Penguin to perform in line with the overall consumer publishing industry this year, while we continue to adapt the business to these industry changes.

## Interest and tax

In 2011, our lower net debt level and pension finance charge will result in a lower interest charge to adjusted earnings than in 2010. We expect our P&L tax charge against adjusted earnings to be in the 24–26% range and our cash tax rate to be in the 15–20% range.

## Exchange rates

Pearson generates approximately 60% of its sales in the US. A five cent move in the average £:$ exchange rate for the full year (which in 2010 was £1:$1.54) has an impact of approximately 1.3p on adjusted earnings per share.

# North American Education

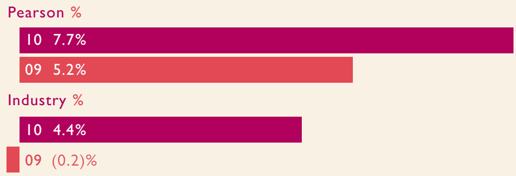
## North American Education is Pearson's largest business, with 2010 sales of £2.6bn and operating profit of £469m.

Building on our roots as a leading publisher of educational materials and provider of assessment services, we have made significant investments and change to transform Pearson into a world-leading provider of learning technologies for students and enterprise technologies for educational institutions. These technology services – including eCollege, PowerSchool, the MyLabs and Edustructures – are the backbone of our strategy to help educators raise student performance and institutions to become more effective.

### KEY PERFORMANCE INDICATORS

| £ millions | 2010 | 2009 | Headline growth | CER growth | Underlying growth |
|---|---|---|---|---|---|
| Sales | 2,640 | 2,470 | 7% | 5% | 4% |
| Adjusted operating profit | 469 | 403 | 16% | 14% | 12% |

### US EDUCATION PUBLISHING SCHOOL AND COLLEGE SALES GROWTH VS INDUSTRY




Pearson's total year-on-year sales growth in school and college education publishing products in the US versus the year-on-year sales growth of the total US industry.

### SCHOOL PUBLISHING ADOPTION CYCLE WIN RATES


Pearson's market share by value of new business in the US adoption states. Market share is quoted as a percentage of the total value of adoptions that we participated in.

### ASSESSMENT AND INFORMATION TESTING CONTRACT WIN RATES

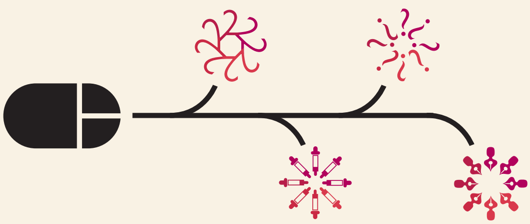

The lifetime value of US testing contracts won by Pearson this year as a percentage of the total lifetime value of competitive contracts bid for this year.

### ONLINE LEARNING USERS


The number of registrations by students to access one of our US online learning programmes.

**Higher Education highlights in 2010 include:**

- The US Higher Education publishing market grew 7.3% in 2010, according to the Association of American Publishers, with the industry seeing healthy enrolment growth and good demand for instructional materials. Pearson gained share, benefiting from its lead in technology and customisation, and has now grown faster than the US higher education industry for 12 consecutive years.



- Pearson's pioneering 'MyLab' digital learning, homework and assessment programmes grew strongly with student registrations up 32% to more than 7.3 million. Evaluation studies show that the use of MyLab programmes can significantly improve student test scores and institutional efficiency http://bit.ly/fWPic0
- We launched LearningStudio, a broad suite of learning management technologies including eCollege and Fronter. We increased fully-online student enrolments by 54% to 8.3 million in North America. Renewal rates remain high at approximately 90% by value.

**Assessment and Information highlights in 2010 include:**

- Revenues at our Assessment and Information division were broadly level with 2009. State funding pressures made market conditions tough for our state assessment and teacher testing businesses; these were offset by good growth in diagnostic and clinical assessments. Assessment and Information achieved good profit growth, benefiting from a shift to premium products and further efficiencies generated from the integration of the Harcourt Assessment business.

AMERICA'S CHOICE

## Partners in education

We acquired America's Choice to boost Pearson's services in school reform, a major focus of the US education department. America's Choice brings together instruction, assessment, leadership development, professional development, coaching and ongoing consulting services.

To learn more about America's Choice, watch our film at www.pearson.com/films

## North American Education continued

- We renewed two important contracts, extending our long-standing relationships with the College Board to administer the SATs and with the Texas Education Agency to administer state-wide student assessments.
- We continue to achieve strong growth in secure online testing, delivering 13.3 million online tests in 2010, up 41% over 2009.
- Our market-leading student information systems business in the US continued to achieve rapid organic growth further boosted by the acquisition of Administrative Assistants Limited in 2010. We now support almost 16 million US students, an increase of 49% over 2009.
- We achieved strong growth with AIMSWEB, our progress monitoring service which enables early intervention and remediation for struggling students. AIMSWEB now supports almost four million students, an increase of more than 20%.

School Curriculum highlights in 2010 include:

- The US School publishing market grew 3.2% in 2010, according to the Association of American Publishers. State budgets continue to be under pressure but the industry returned to growth, benefiting from the stronger new adoption opportunity this year (total opportunity of $800m in 2010 against $500m in 2009).
- Pearson gained share with a strong performance from enVisionMATH, Pearson's pioneering digital math curriculum. A two-year study in elementary schools concluded that students using enVisionMath demonstrated significantly greater improvement in math computation, math problem-solving and math communication compared to students using other math programs. In computation they jumped the equivalent of five grade levels in two years.


- Successnet, our online learning platform for teachers and students which supports Pearson's digital instruction, assessment and remediation programmes, grew strongly. It generated almost six million registrations in 2010, up 33% on 2009, with the number of assessments taken through the system increasing 53% to more than eight million.

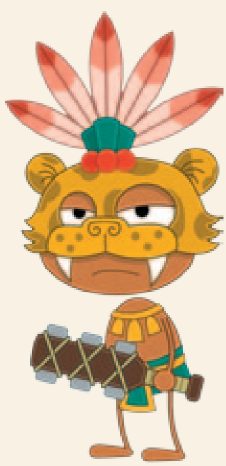
- We continue to develop digital programmes, platforms and mobile apps to boost achievement and to increase access and affordability. We successfully launched three major new school programmes:

  *digits* (right)

  *Writing Coach* www.phwritingcoach.com a blended print and online programme that helps middle and high school students in writing and grammar with personalised assignments and grading. Studies of classes using the technology behind Writing Coach show significant gains in writing proficiency as measured by district and state assessments;

  *Online Learning Exchange*, an open education resource that allows teachers to create personalised digital learning programmes using standards-based Pearson content as well as teacher-generated material.

- Poptropica www.poptropica.com is the largest virtual world for young children in the US with average monthly unique visitors growing by 40% to 8.1 million from more than 100 countries and speaking more than 70 languages. Poptropica launched seven new islands and was the fifth most searched-for video game on Google.com in 2010.



DIGITS

## Twice as much time for teaching

*digits,* our digital middle school maths programme, provides powerful services for teachers including embedded assessment, differentation of students and automation of administrative tasks. In field tests and pilots, digits helped to make teachers more efficient, doubling the amount of time they had to devote to instruction. http://bit.ly/i9NcId

# International Education

## Our International Education company, the world leader by revenues, is active in more than 70 countries.

It is a major focus of our strategy, and sales and profits have doubled since 2006. Our strategy is to combine educational content, assessment, technologies and related services to help educational institutions become more effective and their students more successful. We expect to benefit from a series of powerful long-term global trends: increasing public and private spending on education (despite current pressures on public spending in developed markets); growing participation rates in elementary, secondary and higher education; the demand for assessment to provide measures of achievement; the growing technology infrastructure in educational institutions; and the rise of English as a global language.

Our International Education business has significant exposure to a wide range of currencies including the US dollar and the euro. In 2010, currency movements boosted revenues by £38m and adjusted operating profits by £15m compared to 2009.

### KEY PERFORMANCE INDICATORS

| £ millions | 2010 | 2009 | Headline growth | CER growth | Underlying growth |
|---|---|---|---|---|---|
| Sales | 1,234 | 1,035 | 19% | 16% | 6% |
| Adjusted operating profit | 171 | 141 | 21% | 10% | 8% |

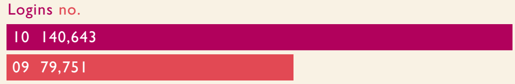
### ONLINE LEARNING USERS

**MyLab Registrations** no.


The number of registrations by students and professors to access one of our International Education online learning programmes.

### ONLINE RESULTS LOGINS

**Logins** no.




Number of logins by users of International Education's online results service.

### Global highlights in 2010 include:

- We acquired Wall Street Institute (WSI), which provides premium spoken English training for adults, for $101m in cash. WSI has about 340 franchised learning centres in 25 territories in Asia, Europe, the Middle East and Africa.
- More than 670,000 students used our MyLab digital learning, homework and assessment programmes, an increase of more than 40%. They included 150,000 users of our online English-language products MyEnglishLabs and MyNorthStarLab, a 170% increase.
- Our eCollege learning management system won new contracts in Malaysia and Colombia. Our Fronter learning management system continued to grow strongly with unique registration rising more than 20% to 1.1 million students in more than 8,700 schools, colleges and universities around the world.

› Pearson Learning Solutions, which combines products and services from across Pearson to deliver a systematic approach to improving student performance, won new contracts in South Africa, Malta, Vietnam and the UK.

## UK highlights in 2010 include:

› BTEC, our flagship vocational qualification, attracted more than 1.4 million student registrations, up 28% on 2009. Research suggests that a BTEC National qualification can increase an individual's lifetime earnings by up to £92,000. Registrations for our NVQ work-based learning qualification grew 45% to more than 165,000, and we introduced the BTEC Apprenticeship to serve the work-based learning market.

› We marked more than 5.4 million A/AS Level and GCSE and Diploma scripts in the 2009–2010 academic year, with 90% now marked on screen. Pearson marked and delivered 3.4 million tests in six weeks for the National Curriculum Tests at Key Stage 2.

› Pearson announced plans to create a vocational degree, to boost student access to higher education in the UK and around the world. The first phase of degree programmes will be developed in business, engineering, IT and health and social care.

› We established a new school improvement business in the UK, which will work with schools to help them train teachers, improve strategic planning and structure teaching methods.

## Continental Europe highlights in 2010 include:

› In Italy, adoption of our Linx digital secondary science programme increased three-fold, helping Pearson to grow strongly and become joint market leader for combined lower and upper secondary education. Linx is built around content from our North American science programmes customised for the Italian market. We began to develop a broader range and depth of digital products and services, including teacher training, to personalise learning and increase educational effectiveness.

› In the Netherlands, we launched iPockets, the first fully digital Early English course for 4-8 year-olds in primary education. The course is 100% digital and subscription based and customised for the Dutch market.

WALL STREET ENGLISH

# Starting a global conversation

Student enrolments at our Wall Street English schools increased by 27%. We announced plans to open 50 new English language centres in China adding to the 66 centres and schools already operating under the Wall Street English and Longman English brands. We also acquired Wall Street Institute (WSI), which provides premium spoken English training for adults, for $101m in cash. WSI has about 340 franchised learning centres in 25 territories in Asia, Europe, the Middle East and Africa.

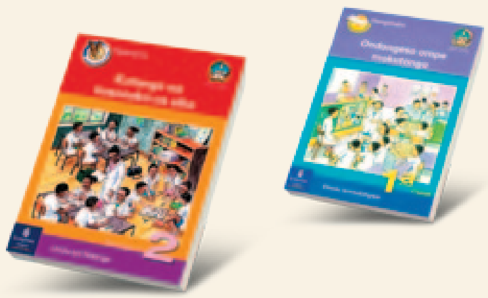
To learn more about Wall Street English, watch our film at www.pearson.com/films

# International Education continued

### Africa and the Middle East highlights in 2010 include:

- In South Africa's Western Cape province, we won a three-year contract to prepare, administer and report all Grade 9 student assessments. The tests focus on both individual student results and the systemic performance of schools and districts.

- Pearson won new national contracts in Ethiopia, to supply 2.9m Biology and Physics learning materials for Senior Secondary Grades 9 to 12. In Zimbabwe, we were awarded a contract by UNICEF to deliver 13.5 million textbooks to children in Grades 1–7 in mathematics, environmental science, English, Shona and Ndebele.



- Pearson announced its intention to acquire a 75% stake in CTI Education Group of South Africa, one of South Africa's leading private higher education institutions, for £31 million in cash. CTI serves more than 9,000 students on 12 campuses.

To learn more about CTI Education Group, watch our film at www.pearson.com/films

- We generated strong growth in the Gulf region in higher education with integrated technology products in Business & Economics and Science.

### Asia highlights in 2010 include:

- Wall Street English (see previous page).

- In January 2011, Pearson agreed to increase its shareholding in Indian education company TutorVista to a controlling 76% stake for a consideration of $127m. TutorVista supplies digital content and technology platforms, online tutoring and services to K-12 schools.

To learn more about TutorVista, watch our film at www.pearson.com/films

### Latin America highlights in 2010 include:

- Our School curriculum business grew strongly, particularly in Mexico, Colombia, Chile and Peru, as we continued to build our locally developed materials as well as Spanish language adaptations of US school programmes.

- Strong growth of English Language Teaching materials across Latin America underpinned by performance in Brazil, Colombia, Argentina, Chile, Dominican Republic and Peru.

SISTEMA EDUCACIONAL BRASILEIRO

## Learning: a systemic approach

Pearson agreed a strategic partnership with Sistema Educacional Brasileiro (SEB) in Brazil to provide services to its educational institutions and to acquire its school learning systems ('sistema') business for $517m. SEB's serves more than 450,000 students across both private and public schools.

To learn more about SEB, watch our film at www.pearson.com/films

# Professional Education

## Our Professional business is focused on publishing, training, testing and certification for professionals.

Over the past five years, we have increased operating profit from £17m in 2006 to £51m in 2010. We expect these businesses to benefit from rising demand for work-related skills and qualifications in both developed and developing markets and from close connections with professional content and customers in other parts of Pearson.

**Professional testing highlights in 2010 include:**

- We continued to see good growth at Pearson VUE, with test volumes up 3% on 2009 to approximately 8 million. Average revenues per test are increasing as we develop a broader range of services and enhance our systems and assessments to meet our customers' current and future needs.
- Pearson VUE renewed a number of major contracts including the Driving Standards Agency (DSA) of Great Britain and the Driver & Vehicle Agency (DVA) of Northern Ireland; Cisco; and Colorado Department of Regulatory Agencies. On 11 January 2011, we announced a 12-year extension of our relationship with the Graduate Management Admission Council to administer the Graduate Management Admission Test.
- We also won a number of new contracts to deliver computer-based tests in the US, UK and the Middle East, covering the real estate, accountancy, legal, healthcare, skills and finance sectors.

**Professional publishing highlights in 2010 include:**

- Our Professional publishing business was level in 2010 with steady margins as strong growth in digital products and services offset continued challenging trading conditions in the retail market and international markets, as well as a planned reduction in the number of print titles published.

### KEY PERFORMANCE INDICATORS

| £ millions | 2010 | 2009 | Headline growth | CER growth | Underlying growth |
|---|---|---|---|---|---|
| Sales | 333 | 275 | 21% | 20% | 6% |
| Adjusted operating profit | 51 | 43 | 19% | 16% | 5% |

- We launched online learning products with customisable content, assessment and personalised study paths and also delivered 450 hours of technical training through online subscriptions for the IT certification market.
- We developed applications for social networks and mobile devices to extend the reach and accessibility of our content and videos available within our Safari Books Online platform.

**Professional training highlights in 2010 include:**

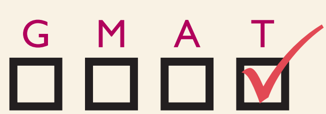
- We acquired Melorio plc, one of the UK's leading vocational training groups, for £98m, supporting our vocational education strategy by combining Melorio's training delivery skills with our existing complementary strengths in educational publishing, technology and assessments. Melorio traded well in the second half of the year securing a number of large key contracts for training delivery, and successfully graduating and placing the largest IT graduate cohort in the history of the business. Our investment in systems, streamlining the course offering and training centres and back office integration are all on track.

To learn more about Melorio, watch our film at www.pearson.com/films

### GMAT RETAINED

## A testing decade

At the start of 2011, our largest professional testing contract with the Graduate Management Admission Council to administer the GMAT test was renewed until 2022.




INTRODUCTION
OUR STRATEGY
OUR PERFORMANCE
OUR IMPACT ON SOCIETY
GOVERNANCE
FINANCIAL STATEMENTS

# Business Information: FT Group

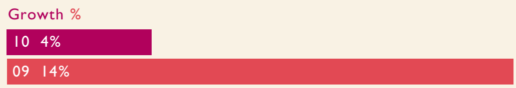
## The FT Group is a leading provider of essential information in attractive niches of the global business information market.

These include insight, news and analysis and indices provided through a growing number of print, digital and mobile channels. In recent years, The FT Group has significantly shifted its business towards digital, subscription and content revenues and has continued to invest in talent and in services in faster growing emerging markets. In 2010, digital services accounted for 40% of FT Group revenues, up from 14% in 2006. Content revenues comprised 55% of total revenues, up from 33% in 2006, while advertising accounted for 45% of FT Group revenues, down from 67% in 2006.

### KEY PERFORMANCE INDICATORS

| £ millions | 2010 | 2009 | Headline growth | CER growth | Underlying growth |
|---|---|---|---|---|---|
| Sales | 403 | 358 | 13% | 12% | 9% |
| Adjusted operating profit | 60 | 39 | 54% | 54% | 49% |

### FT CIRCULATION REVENUE GROWTH

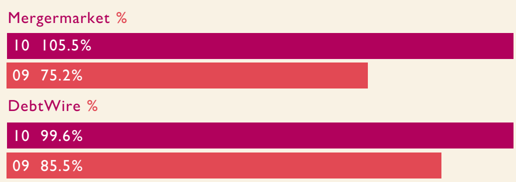



The FT newspaper's year-on-year growth in circulation revenue.

### FT.COM AVERAGE MONTHLY UNIQUE USERS FOR THE YEAR


The average monthly number of unique users of FT.com for the year.

### MERGERMARKET RENEWAL RATES




The current year value of sales to existing customers as a percentage of their spend in the previous year.

### Financial Times highlights in 2010 include:

- The FT's combined paid print and digital circulation reached 597,000 in the fourth quarter of 2010.
- After weak advertising markets in 2009, we saw good advertising growth in 2010 although the visibility for advertising revenues is poor.
- We extended the breadth and depth of the FT's premium subscription services through the launch of FT Tilt, focused on emerging markets; the launch of MandateWire US, extending the reach of this successful European brand into new markets; and the acquisition of Medley Global Advisors, a premier provider of macro policy intelligence.

To learn more about Medley Global Advisors, watch our film at www.pearson.com/films

### Mergermarket highlights in 2010 include:

- The Mergermarket Group benefited from improving market conditions and its flexibility in adapting to new client investment strategies, which supported stronger renewal rates and new business revenues. An increase in global M&A activity benefited mergermarket and dealReporter; continued volatility in debt markets helped sustain the strong performance of DebtWire.

- Strong growth in developing markets supported by new product launches including our first local language version of mergermarket in China.
- In March 2010 we acquired Xtract research, which provides bond covenant data to help investors understand the impact of covenants on valuation.

### Joint ventures highlights in 2010 include:

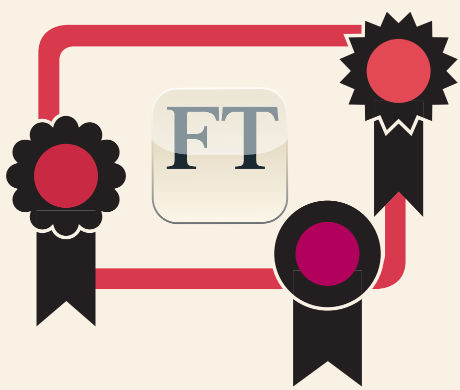
- ***The Economist,*** in which Pearson owns a 50% stake, increased global weekly circulation by 3.7% to 1.47 million (for the July–December 2010 ABC period); total annual online visits increased to 118 million, up 21% on 2009.


- **FTSE,** our 50%-owned joint venture with the London Stock Exchange, increased revenues by 20% and acquired the remaining 50% of FXI, FTSE's JV with Xinhua Finance in China.
- **Business Day and Financial Mail (BDFM),** our 50% owned joint-venture in South Africa with Avusa, returned to profitability with revenue increasing by 5%. The business benefited from a recovery in advertising and the closure of non-profitable operations.

FT ONLINE

## Award-winning app, Award-winning content

The FT provided strong and accelerating growth in its digital readership with digital subscriptions up over 50% to 207,000, more than 1,000 direct corporate customers and registered users up 79% to more than three million. It generated over 900,000 downloads of FT apps on mobile phones and tablet devices and scooped a prestigious Apple Design Award for its iPad app.



# Consumer Publishing: Penguin

## Penguin is one of the most famous brands in book publishing, known around the world for the quality of its publishing and its consistent record of innovation.

Over the past five years, Penguin's profits have increased at an annual average rate of 8%.

In 2010 Penguin achieved record sales and profits in a challenging and rapidly-changing industry environment. Penguin's profits were struck after making additional provisions for a number of credit exposures in the book retailing sector, including in relation to Borders in the US. Our market share gains and improved profitability were the result of three factors in particular:

1. An outstanding US publishing performance included a record number of bestsellers, an increase in market share and rapid expansion in emerging digital platforms and formats;

2. Penguin in the UK celebrated the best year in its history, leading the bestseller lists and increasing its market share by 2 percentage points to 10%;

3. DK captured the benefits of its 2009 reorganisation, with sales of Lego Star Wars titles boosting revenue and the transfer of cost centres to India enhancing its margin.

### KEY PERFORMANCE INDICATORS

| £ millions | 2010 | 2009 | Headline growth | CER growth | Underlying growth |
|---|---|---|---|---|---|
| Sales | 1,053 | 1,002 | 5% | 2% | 6% |
| Adjusted operating profit | 106 | 84 | 26% | 10% | 26% |

### US BESTSELLERS


The number of Penguin books entering the Top Ten bestseller lists in the US (New York Times).

### UK BESTSELLERS


The number of Penguin books entering the Top Ten bestseller lists in the UK (Nielsen BookScan Top Ten).

### E-BOOK SALES


Penguin global e-book sales as a percentage of Penguin Group net sales.

### Global highlights in 2010 include:

- A strong and consistent publishing performance across imprints and territories produced market share gains in the US, UK and Australia, our three largest markets.
- Strong growth in developing markets was boosted by the launch of new imprints and the increasing breadth and depth of our local publishing programmes in India, China and South Africa.
- Continued investment in global publishing with the launch of Penguin's Classics in Portuguese and Arabic, joining existing Mandarin and Korean editions; the launch in India of a new imprint in partnership with bestselling author and superstar Shobhaa De; and the continued international roll-out of our non-fiction imprint Allen Lane in Canada.

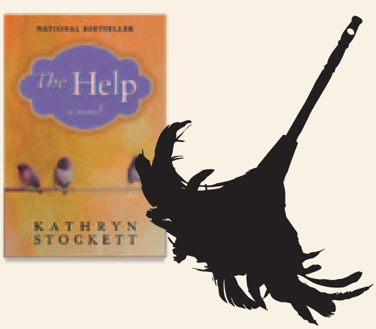
**Digital highlights in 2010 include:**

- eBook sales were up 182% on the previous year and now account for 6% of Penguin revenues worldwide.
- We accelerated our investment in digital products and innovation with new app releases in the children's market including Spot, Peppa Pig, The Little Engine That Could, Ladybird's Babytouch and the Mad Libs app, which was named one of the best apps at the 2010 E-Book Summit. For adults, we launched the groundbreaking myFry app, published the amplified ebook of Ken Follett's international bestselling novel *The Pillars of the Earth*, featuring video, art and music from the original TV series; and we introduced ten DK Eyewitness Top Ten Travel Guides apps with more to follow in 2011.
- Penguin continued to invest to transform its internal publishing processes onto Pearson-wide digital platforms, enabling faster product development and more efficient creation and re-use of content.

**Publishing performance highlights in 2010 include:**

- Penguin performed strongly in the US with a broad range of number one bestsellers from repeat authors such as Charlaine Harris, Nora Roberts, Tom Clancy, Ken Follett and Patricia Cornwell.

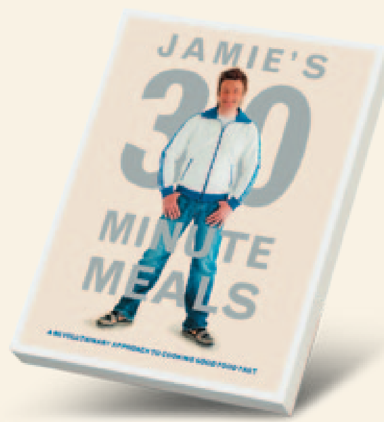

- Kathryn Stockett's *The Help* stayed on the *New York Times* bestseller list for the whole of 2010 and has sold more than three million copies to date.




JAMIE OLIVER

## The UK's biggest selling non-fiction title of the last decade

Jamie Oliver's *30 Minute Meals* sold 1.2 million copies to become the UK's biggest selling hardback non-fiction title of the last decade.



# Consumer Publishing: Penguin continued

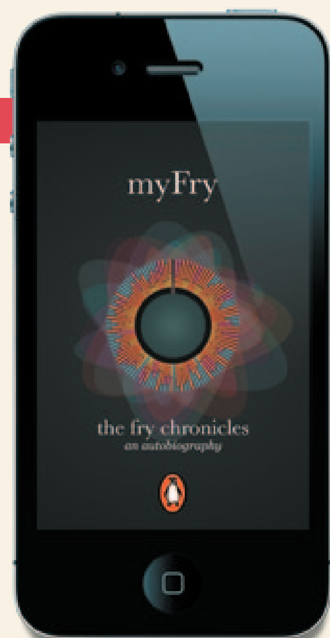
**Publishing performance highlights continued:**

- Our outstanding performance in the UK, resulting in our market share rising two percentage points to 10%, was led by Jamie Oliver's *30 Minute Meals*. It sold 1.2 million copies to become the UK's biggest selling non-fiction title of the last decade. Major bestsellers included Stephen Fry's *The Fry Chronicles*, Kathryn Stockett's *The Help*, and *The History of the World in 100 Objects* (published in partnership with the BBC and the British Museum), as well as the Percy Jackson and *Diary of a Wimpy Kid* series.
- DK produced a very good year thanks in part to its top-performing franchise LEGO (*Lego Star Wars Visual Dictionary* was on the *New York Times* bestseller list for the whole of 2010 with 18 weeks at number one). Other bestselling titles included *The Masterchef Cookbook, Complete Human Body* and *Natural History*. DK continues to benefit from the organisation changes made in 2009 as well as the ongoing development of its publishing centre in India.
- Penguin Children's had an excellent year in the US, with Penguin Young Readers Group achieving a record 39 *New York Times* bestsellers, and in the UK, where we reclaimed our position as the number one children's publisher with significant market share gains.
- In 2011, we will publish books from some of our leading authors including, in the US, Patricia Cornwell, Sue Grafton, Charlaine Harris, Nora Roberts, Henry Kissinger, Betty White, Richelle Mead, John Grisham and Eric Carle; and, in the UK, Jamie Oliver, Stephen Fry, Rob Brydon, Jeff Kinney, Rick Riordan and David Almond.

THE FRY CHRONICLES

## Number one in five categories

Stephen Fry's *The Fry Chronicles* made publishing history as the first title to hit number one in five categories: hardback, eBook, enhanced eBook with videos featuring the author, audio book and an innovative app that allows readers to delve in and out of the book by topic.



# Other financial information

## Net finance costs

| £ millions | 2010 | 2009 |
|---|---|---|
| Net interest payable | (73) | (86) |
| Finance costs in respect of retirement benefit plans | (12) | (12) |
| Net finance costs reflected in adjusted earnings | (85) | (98) |
| Other net finance income | 12 | 2 |
| Total net finance costs | (73) | (96) |

Net finance costs reported in our adjusted earnings comprise net interest payable and net finance costs relating to retirement benefit plans.

After excluding discontinued businesses, net interest payable in 2010 was £73m, down from £86m in 2009. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from a fall in average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) fell by 0.3% to 0.4%. This reduction in floating market interest rates drove the Group's lower interest charge. However, the low rates on deposited funds coupled with the impact on the calculation of significantly lower net debt, created an increase in the Group's average net interest payable of 5.3% to 7.9%. The Group's average net debt fell by £681m, reflecting the impact of the Interactive Data disposal.

Finance charges relating to post-retirement plans were £12m in both 2010 and 2009. Also included in the statutory definition of net finance costs are foreign exchange and other gains and losses. These are excluded from adjusted earnings as they represent short-term fluctuations in market value and are subject to significant volatility. These other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity. In 2010 the total of these items excluded from adjusted earnings was a profit of £12m compared to a profit of £2m in 2009.

## Funding position and liquid resources

The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer-term loans from banks and capital markets. Our objective is to secure continuity of funding at a reasonable cost from diverse sources and with varying maturities. The Group does not use off-balance sheet special purpose entities as a source of liquidity or for any other financing purposes.

The net debt position of the Group is set out below.

| £ millions | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | 1,736 | 750 |
| Marketable securities | 12 | 63 |
| Net derivative assets | 134 | 103 |
| Bonds | (2,226) | (1,923) |
| Bank loans and overdrafts | (73) | (70) |
| Finance leases | (13) | (15) |
| Net debt | (430) | (1,092) |

The main contributor to the change in the Group's net debt is the increase in cash balances due primarily to the Interactive Data disposal in July 2010 and strong cash collection at the end of 2010. Reflecting the geographical and currency split of our business, a large proportion of our debt is denominated in US dollars (see note 19 for our policy). The weakening of sterling against the US dollar during 2010 (from $1.61 to $1.57:£1) slightly increased our reported net debt.

The Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term.

In May 2010, the Group accessed the capital markets, raising $350m through the sale of notes maturing in 2016 and bearing interest at 4%. Of the $350m issued, $300m was swapped to floating rate to conform with the policy described in note 19. The proceeds were used to fund the Group's working capital requirements.

# Other financial information continued

In November 2010, the Group negotiated a new $1,750m committed revolving credit facility which matures in November 2015. At 31 December 2010 this facility was undrawn. The facility is intended to be used for short-term drawings and providing refinancing capabilities, including acting as a back-up for our US commercial paper programme. This programme is primarily used to finance our US working capital requirements, in particular our US educational businesses which have a peak borrowing requirement in July. At 31 December 2010, no commercial paper was outstanding.

The Group also maintains other committed and uncommitted facilities to finance short-term working capital requirements in the ordinary course of business.

Further details of the Group's approach to the management of financial risks are set out in note 19 to the financial statements.

## Taxation

The effective tax rate on adjusted earnings in 2010 was 25.2% which compares to an effective rate of 25.5% for 2009. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than the UK corporation tax rate (which had an effective statutory rate of 28% in 2010 and in 2009). These higher tax rates were offset by amortisation-related tax deductions and the utilisation of previously unrecognised operating tax losses and credits.

The reported tax charge on a statutory basis was £146m (21.8%) compared to a charge of £146m (27.9%) in 2009. The reduction in the statutory rate is largely due to the recognition of tax losses and credits in the year including pre-acquisition and capital losses that were utilised in connection with the Interactive Data sale. The tax charge relating to that sale in July 2010 is included in the loss on discontinued businesses. Tax paid in 2010 was £335m compared to £103m in 2009 and includes £250m relating to the Interactive Data sale.

## Discontinued operations

On 29 July 2010, Pearson's 61% share in Interactive Data Corporation was sold to Silver Lake and Warburg Pincus for $2bn. The results of Interactive Data have been included as discontinued operations in these financial statements. Interactive Data's adjusted operating profit for the seven months to the date of sale was £81m compared to a full year contribution in 2009 of £148m. Also included in discontinued operations in 2010 is the gain on sale of Interactive Data of £1,037m and the attributable tax charge of £306m. The total profit from discontinued operations after taking account of the above items, intangible amortisation, interest and related tax was £776m in 2010 compared to £85m in 2009.

## Segmental analysis

During the course of 2010, a number of minor changes to management responsibilities in certain countries were made which have affected reported 2010 segmental numbers in Penguin, North American Education and International Education. The amounts concerned have no impact on the Group as a whole and have been treated as portfolio changes in 2010 for the purposes of calculating growth rates. The 2009 figures have not been restated as the amounts are not considered to be significant. The effect of these changes in the 2010 financial statements has been to reduce the sales and profits at Penguin by £41m and £12m respectively, to increase sales and profits at International Education by £52m and £3m respectively and to reduce sales by £11m and increase profits by £9m in the North American Education segment.

## Non-controlling interest

The non-controlling interest in the income statement comprises mainly the publicly-held share of Interactive Data for the period to disposal in July 2010. There are also non-controlling interests in the Group's businesses in South Africa, Nigeria, China and India although none of these are material to the Group numbers. The non-controlling interest in the Group's newly acquired Brazilian business, Sistema Educacional Brasileiro (SEB), is expected to be bought out in the first half of 2011.

## Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The gain on translation of £173m in 2010 compares to a loss in 2009 of £388m and is principally due to movements in the US dollar. A significant proportion of the Group's operations are based in the US and the US dollar weakened in 2009 from an opening rate of £1:$1.44 to a closing rate at the end of that year of £1:$1.61. At the end of 2010 the US dollar had strengthened slightly in comparison to the opening rate moving from £1:$1.61 to £1:$1.57.

Also included in other comprehensive income in 2010 is an actuarial gain of £71m in relation to post retirement plans. This gain largely arises from improved asset returns for the UK Group pension plan and compares to an actuarial loss in 2009 of £302m. The 2009 loss arose as the assumptions relating to inflation, mortality and the discount rate used in the actuarial valuation all contributed to an increase in the value of liabilities.

## Dividends

The dividend accounted for in our 2010 financial statements totalling £292m represents the final dividend in respect of 2009 (23.3p) and the interim dividend for 2010 (13.0p). We are proposing a final dividend for 2010 of 25.7p, bringing the total paid and payable in respect of 2010 to 38.7p, a 9.0% increase on 2009. This final 2010 dividend was approved by the board in February 2011, is subject to approval at the forthcoming AGM and will be charged against 2011 profits. For 2010 the dividend is covered 2.0 times by adjusted earnings.

We seek to maintain a balance between the requirements of our shareholders for a rising stream of dividend income and the reinvestment opportunities which we identify around the Group and through acquisitions. The board expects to raise the dividend above inflation, more in line with earnings growth, thereby maintaining dividend cover at around two times earnings in the long term.

## Pensions

Pearson operates a variety of pension plans. Our UK Group plan has by far the largest defined benefit section. We have some smaller defined benefit sections in the US and Canada but, outside the UK, most of our companies operate defined contribution plans.

The income statement expense for defined benefit plans is determined using annually derived assumptions as to discount rates, investment returns and salary inflation, based on prevailing conditions at the start of the year. The assumptions for 2010 are disclosed in note 25 to our accounts, along with the year-end surpluses and deficits in our defined benefit plans.

The charge to profit in respect of worldwide pensions and post-retirement benefits for continuing operations amounted to £102m in 2010 (2009: £90m) of which a charge of £90m (2009: £78m) was reported in operating profit and the net finance cost of £12m (2009: £12m) was reported against net finance costs.

The overall deficit on the UK Group plan of £189m at the end of 2009 has become a deficit of £5m at 31 December 2010. This decrease is principally due to an increased level of contributions in the year together with improved asset performance. In total our worldwide deficit in respect of pensions and post retirement benefits fell from a deficit of £339m in 2009 to a deficit of £148m at the end of 2010.

## Acquisitions

On 17 June 2010 the Group acquired Melorio plc, one of the UK's leading vocational training groups for £98m.

On 22 July 2010 the Group announced that it had entered into an agreement to purchase the learning systems business of Sistema Educacional Brasileiro (SEB) one of Brazil's leading education companies for approximately $517m. The agreement provided for the acquisition of the business in two tranches – the first of these tranches representing 69% of the business was acquired on 1 September 2010 for $357m and the remaining tranche is expected to be acquired in the first half of 2011.

# Other financial information continued

On 19 August 2010 the Group completed the acquisition of Wall Street Institute Education S.a.r.l. (WSI) for $101m. WSI provides spoken English training for adults through a combination of web-based content, classroom instruction and digital and printed materials.

The acquisition of America's Choice, a provider of educational solutions for states and school districts in the US, was completed on 7 September 2010 for $101m.

The Group also completed the acquisition of Medley Global Advisors LLC and various other smaller acquisitions in the year. Although the Group has announced the acquisition of CTI Education Group and the increased stake in TutorVista, these transactions did not complete until 2011.

Net cash consideration for all acquisitions made in the year ended 31 December 2010 was £535m and provisional goodwill recognised was £288m.

In total, acquisitions completed in the year contributed an additional £84m of sales and £6m of operating profit.

## Return on invested capital (ROIC)

Our ROIC is calculated as total adjusted operating profit less cash tax, expressed as a percentage of average gross invested capital. ROIC increased by 1.4 percentage points from 8.9% in 2009 to 10.3% in 2010. Improved profit performance and a reduction in working capital were the main drivers behind the increase. Although cash tax rates were low in 2010 we expect an increase in tax payments in 2011 as US tax losses are now fully utilised.

## Capital expenditure

Net capital expenditure in the year on property, plant equipment and software amounted to £144m. The analysis of capital expenditure and details of capital commitments are shown in notes 10, 11 and 33 of the financial statements.

## Related party transactions

Transactions with related parties are shown in note 34 of the financial statements.

## Post balance sheet events

On 22 November 2010, the Group announced the proposed acquisition of a 75% stake in CTI Education Group, a leading South African education company for £31m. As at the end of December 2010 this acquisition had not been completed but is expected to complete in the first half of 2011.

On 18 January 2011, the Group announced that it had agreed to increase its shareholding in TutorVista, the Bangalore based tutoring services company, to a controlling 76% stake for a consideration of $127m.

On 7 March 2011, the Group and Education Development International plc (EDI) announced that they had reached agreement on the terms of a recommended cash offer to be made by Pearson for the entire issued share capital of EDI. The offer values EDI at approximately £112.7m. EDI is a leading provider of education and training qualifications and assessment services, with a strong reputation for the use of information technology to administer learning programmes and deliver on-screen assessments.

## Supplier payment policy

Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. These supplier payment terms vary by operating company reflecting the different industries and countries in which they operate. It is company policy that suppliers are aware of such terms of payment and that payments to them are made in accordance with these, provided that the supplier is also complying with all the relevant terms and conditions. Group trade creditors at 31 December 2010 were equivalent to approximately 30 days of purchases during the year ended on that date. The company does not have any significant trade creditors and therefore is unable to disclose average supplier payment terms.

# Principal risks and uncertainties

Our principal risks and uncertainties are outlined below. These are the most significant risks that may adversely affect our business strategy, financial position or future performance. The risk assessment process evaluates the probability of the risk materialising and the financial or strategic impact of the risk. Those risks which have a strong probability and significant impact on strategy, reputation or operations or a financial impact greater than £40 million are identified as principal risks. The risk assessment and reporting criteria are designed to provide the board with a consistent, Group-wide perspective of the key risks. The reports to the board, which are submitted every six months, include an assessment of the probability and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness.

We conduct regular risk reviews to identify risk factors which may affect our business and financial performance and to assist management in prioritising their response to those risks. Our Group internal audit function facilitates risk reviews with each business, shared service operations and corporate functions, identifying measures and controls to mitigate these risks. These reviews are designed so that the different businesses are able to tailor and adapt their risk management processes to suit their specific circumstances. Management is responsible for considering and executing the appropriate action to mitigate these risks whenever possible. It is not possible to identify every risk that could affect our businesses, and the actions taken to mitigate the risks described below cannot provide absolute assurance that a risk will not materialise and/or adversely affect our business or financial performance.

In addition to the principal risks described here, further information on other risks and how they are addressed can be found on pages 172 and 173.

# Principal risks and uncertainties continued

| Principal risks | Mitigating factors |
|---|---|
| Our education, business information and book publishing businesses will be impacted by the rate of and state of technological change, including the digital evolution and other disruptive technologies. | We are transforming our products and services for the digital environment along with managing our print inventories. Our content is being adapted to new technologies across our businesses and is priced to drive demand. We develop new distribution channels by adapting our product offering and investing in new formats. We are actively monitoring contraction in the consumer book market to minimise the downturn of bankruptcy. |
| Investment returns outside our traditional core US and UK markets may be lower than anticipated. | We draw on our experience of developing businesses outside our core markets and our existing international infrastructure to manage specific country risks. We have strengthened our financial control and managerial resources in these markets to manage expansion. The diversification of our international portfolio, and relative size of 'emerging markets' in relation to the Group, further minimises the effect any one territory could have on the overall Group results. |
| Our US educational solutions and assessment businesses may be adversely affected by changes in state and local educational funding resulting from either general economic conditions, changes in government educational funding, programs, policy decisions, legislation at both at the federal and state level and/or changes in the state procurement processes. | We actively monitor changes through participation in advisory boards and representation on standard setting committees. Our customer relationship teams have detailed knowledge of each state market. We are investing in new and innovative ways to expand and combine our product and services to provide a superior customer offering when compared to our competitors, thereby reducing our reliance on any particular funding stream in the US market. We work through our own government relations team and our industry trade associations including the Association of American Publishers. We are also monitoring municipal funding and the impact on our education receivables. |

| Principal risks | Mitigating factors |
|---|---|
| A control breakdown or service failure in our school assessment businesses could result in financial loss and reputational damage. | We seek to minimise the risk of a breakdown in our student marking with the use of robust quality assurance procedures and controls and oversight of contract performance, combined with our investment in technology, project management and skills development of our people. |
| Our reported earnings and cash flows may be adversely affected by changes in our pension costs and funding requirements. | We review our funding arrangements every three years and will take steps to ensure pension funding plans are sufficient to meet future liabilities without unduly affecting the development of the company. |
| Our intellectual property and proprietary rights may not be adequately protected under current laws in some jurisdictions and that may adversely affect our results and our ability to grow. | We seek to mitigate this type of risk through general vigilance, co-operation with other publishers and trade associations, advances in technology, as well as recourse to law as necessary. Data rights management standards and monitoring programmes have been developed. We have established a piracy task force to identify weaknesses and remediate breaches. We monitor activities and regulations in each market and take legal action where necessary. |
| A major data privacy breach may cause reputational damage to our brands and financial loss. | Through our global security office under the direction of our Chief Security Officer, we have established various data privacy and security programmes. We constantly test and re-evaluate our data security procedures and controls across all our businesses with the aim of ensuring personal data is secured and we comply with relevant legislation and contractual requirements. We regularly monitor regulation changes to assess impact on existing processes and programmes. |
| Operational disruption to our business caused by our third party providers, a major disaster and/or external threats could restrict our ability to supply products and services to our customers. | We have developed business continuity arrangements, including IT disaster recovery plans and back-up delivery systems, to minimise any business disruption in the event of a major disaster. The governance structure, overseen by a global coordinator, provides the capability to centrally monitor all related activities. Full contingency plans have been completed for all high and medium risk locations and are updated on a regular basis. Insurance coverage may minimise any losses in certain circumstances. |

# Our impact on society

## Our premise is that being responsible is fundamental to our success as a company.

Robin Freestone Chief financial officer

Pearson is a company with a strong sense of purpose. As Marjorie sets out in her strategy review, it is to help people get on in their lives through learning. (We are 'Always learning', as the tagline says.)

That's a social purpose. It sets the stage for our approach to responsible business – and shines a spotlight on the deep connection between strategy and responsibility.

Our premise is that being responsible is fundamental to our success as a company. There's nothing new about that: our heritage draws on Weetman Pearson, who more than a century ago had a reputation as one of the most enlightened employers of his time.

Building and maintaining trust remains essential to our business; we recognise that many people – our shareholders, customers, employees, suppliers and communities – have high expectations of us. We welcome those expectations, and intend to live up to them. By being clear about our strategy, setting objectives and targets, we build and sustain that trust.

This past year, we've made some important progress in the way that we manage our responsibility to the communities we work in. We've formed a corporate responsibility steering group, bringing together senior business leaders to oversee the development of our strategy and the implementation of our plans. We have for the first time appointed a senior executive to lead that work across the company. And we've begun to develop a clear framework to articulate our goals and guide our activities. We intend to use this framework as the basis for our reporting, so it's worth setting out the major elements:

1. We start with our corporate strategy and purpose: to be the world's leading learning company and to help people make progress in their lives.

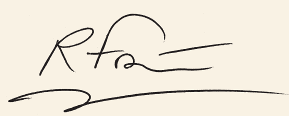
2. We focus on three key issues of social and economic importance, where we believe Pearson has a unique role to play. These are literacy, efficacy and competitiveness.

3. In addition to those key Pearson-specific issues, we have a wide agenda for responsible business activities that covers a range of disciplines from environmental sustainability to supply chain management to diversity policies to the work of the Pearson Foundation.

4. And we recognise that any definition of 'responsible business' is built on and contributes to our company culture, values and behaviour.

In addition to refining our overall approach, I'm pleased to report that we have continued to expand the reach and impact of the many activities that fall under our broad definition of 'responsible business'. We summarise a sample of them in this report; we hope that you enjoy reading about them as much as we enjoy and value being actively engaged in them.

We've been honoured this year to receive many awards for our approach to responsibility. But we want to do more, and better. So we always welcome comments, observations and suggestions about this aspect of Pearson – just as we do about all the company's activities. So please feel free to contact me at robin.freestone@pearson.com or Peter Hughes, our new head of corporate responsibility, at peter.hughes@pearson.com



Robin Freestone Chief financial officer
(and Board member responsible for corporate responsibility)

## Overview

As thinking develops about what 'responsible businesses' do, Pearson is constantly assessing and reassessing the opportunities and challenges of responsible business practice. Public and private sector customers regularly seek information from us about how we go about our business, while many consumers and employees want to understand our approach to sustainability. Socially responsible investors and non-governmental organisations look at issues such as supply chain standards and ethics. Our approach is informed by the priorities and views of our many stakeholders.

Wherever we operate in the world, our businesses and people pursue a common purpose: to help people of all ages to progress through their lives through learning. Our financial and commercial success sustains us, providing the means to invest and innovate to deliver on that goal.

Although our purpose is deliberately broad and we contribute to learning in many forms, we are focusing much of our activity and reporting on three priority issues.

### OUR THREE PRIORITY ISSUES

1 Raising literacy levels, the foundation both for learning and reading for pleasure.

2 Improving learning outcomes, for learners, teachers, their education institutions and for policymakers. We aim to create education programmes that have a demonstrable impact on student learning and institutional effectiveness. We believe that will be a source both of educational and competitive advantage.

3 Contributing to competitiveness, supporting both personal success and wider economic growth.

In pursuing these goals, there are several key aspects of our business strategy that influence our approach and priorities for corporate responsibility.
They include:

- International As detailed elsewhere in this report, we are making significant investments to build Pearson's business in new markets, particularly in the developing world.
- Digital Our strategy includes a deliberate and significant shift from print to digital media. Over time, that changes the environmental footprint of our business and offers opportunities to enhance accessibility to our content and services.
- Partnership We aim to extend our reach and impact by working with partners in the public, private and not-for-profit sectors, through our operating companies and, most notably, through the Pearson Foundation.

### 1 RAISING LITERACY LEVELS

Through our products and partnerships, we aim to play a part in raising literacy levels, helping people to learn to read and to enjoy reading.

One in five adults – or nearly 800 million people – cannot read. But that gift of reading has a profound influence on modern life: from how we perform at school to the kind of job we can find to our participation in society and our local community. All depend, to a very large degree, on literacy.

For a business built on the premise that people want to read, learn and enjoy doing it, we have a keen interest in doing all we can to nurture enthusiastic readers.

## Our approach

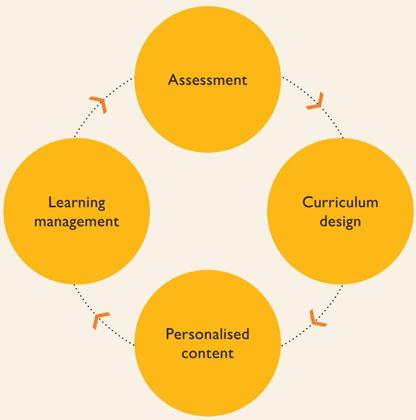
We play a part in three main ways:

- For many, the first story that they read or that is read aloud to them will be one of our titles.
- Our reading programmes – both print and digital – are found in classrooms the world over.
- We run projects and campaigns, often through the Pearson Foundation, that encourage reading and promote literacy.

# Our impact on society continued

## Reading in the classroom

We have a full suite of print and digital services designed to help students to learn to read. These reflect our belief in a virtuous circle of learning where digital technology empowers teachers to assess students, identify their learning needs, develop methods for personalised learning, and constantly monitor progress.




### Case study: Reading Street

Reading Street is on the front line of improving student reading skills in thousands of schools in every state in the United States. As part of our commitment to independent research, recent findings by Gatti Evaluation showed that kindergarten and first-grade students using Reading Street gained between 46 and 48 percentiles in reading skills, including significant gains in comprehension and vocabulary. Reading Street, available as a print, blended or fully digital programme, combines instruction and embedded assessment with videos, animation, activities, songs and audio. It is designed to allow teachers to personalise instruction for every child. www.readingstreet.com

Reading STREET

Sometimes students need extra help. We have developed research-based programmes proven to lead to greater student success for those falling behind.

### Case study: SuccessMaker

SuccessMaker is a digitally driven set of courses tailored to the needs of the individual learner that supplements regular classroom reading and mathematics instruction. It combines one-on-one instruction, fun ways to engage and involve students and progress reporting for the teacher to aid timely intervention. From its initial development 30 years ago, through to ongoing improvement of the product usability and efficacy testing, the research that went into SuccessMaker constitutes the biggest ongoing research effort to date for any of our digital products. www.successmaker.com

## Reading in the home

Children need access to quality and fun ways to read. Our Penguin Young Readers – Puffin, Frederick Warne and Ladybird books – all provide plenty of options.

### Case study: Ladybird Books

For millions of people the world over, Ladybird books are known and loved. As the most recognisable brand in children's books, they play an essential role in helping kids to learn to read and to discover the magic of books. Ladybird today offers its widest ever range of formats and styles from birth to eight years old. Ladybird's award-winning baby range is informed by the latest research relating to how babies learn and respond. The toddler list uses rhyme, stories and songs in interactive formats to give children a head start in learning.

### Partnering with others to encourage reading

When parents read aloud to their children, they can have a significant impact on their vocabulary and language development. We work with others to encourage that kind of shared reading. For example, Jumpstart's Read for the Record™, our flagship nationwide campaign to promote reading in the United States run with the Pearson Foundation, again set a new world record for the largest shared reading experience on a single day, involving over two million people. For the first time, we were able to provide the opportunity to help people set the record online for free at www.wegivebooks.org. Created by Penguin and the Pearson Foundation, We Give Books is a digital reading initiative that allows anyone who reads a free book online to donate a book to a literacy project of their choice. In conjunction with this year's Read for the Record campaign, We Give Books also donated more than 200,000 copies of *The Snowy Day* to young people.

## 2 IMPROVING LEARNING OUTCOMES

Pearson's transition from textbook publisher to education technology and service provider is a major strategic opportunity. Where we once sold products to education institutions, we now also provide services to help them and their students succeed. That means we are becoming more directly involved in the process of learning, and more accountable for outcomes.

We are devoting significant resources to improving student success and institutional effectiveness by:

- Ensuring that our own education programmes are developed and assessed for quality, efficacy and usability. Our usability lab allows Pearson's instructional design teams and researchers to develop and improve our programmes. Building on this approach, we opened the Pearson iDEA Innovation Centre, a digital laboratory focused on user-centred design, software usability testing, and efficacy research for use by the business globally.

### Case study: Pearson North America

A distinguishing characteristic for us is our ongoing significant investment in research and efficacy. We are the only educational instruction provider to consistently employ randomised control trials – the gold standard in research – to determine the effectiveness of our curricula in the classroom and to evaluate the impact on student learning. We commission independent third-party research firms to work with school districts across the US to conduct these efficacy studies that use the same rigorous scientific model that the Department of Education's What Works Clearinghouse requires.

### Case study: MyLabs

The MyLabs – our digital learning, homework and assessment programmes – grew by 33% to eight million students registered in 2010. Evaluation studies show the efficacy of the model. For MyMathLab, institutions across the United States are reporting pass-rate increases of 30% to 40% and at less cost to the institution than traditional courses.

# Our impact on society continued

› Helping close achievement gaps for individual learners and schools. Pearson is investing in new models of education to help turn around failing schools and districts by helping make fundamental changes and sustain improvements for the long term. We draw on Pearson's research base and proven resources – including curriculum, assessment, technology, and teacher professional development products and services.

### Case study: America's Choice

Building on our existing school improvement service in the United States, the acquisition of America's Choice significantly extends our reach. The America's Choice system – instruction, professional development, assessment, leadership development, coaching and ongoing consulting services – is designed to help transform whole schools where students are having difficulty meeting state standards across multiple subjects. Our services are applied in more than 2,000 schools in 38 states. For example, after one year of working with the lowest-performing elementary schools in Arkansas, students from America's Choice schools outpaced state gains in proficiency in both literacy and mathematics.

AMERICA'S CHOICE

› Supporting teacher education and development. We work with teachers to improve teaching effectiveness with content and services that shape teachers from their earliest undergraduate experiences up to and throughout their teaching careers.

### Case study: Great Colombian Teachers

The Great Colombian Teachers initiative aims to provide academic support and recognition to English language teachers in Colombia. The initiative is based on open-source content management software, providing the means for teachers to contribute and share their thoughts and ideas.

› Helping share what works between education policymakers. Active in education in more than 70 countries, Pearson helps to bring together education leaders to share experiences and best practice. One example is Strong Performers and Successful Reformers in Education, a Pearson Foundation partnership with the Organisation for Economic Co-operation and Development (OECD). We commissioned an investigative video series documenting policies and programmes that local education leaders credit with improving student achievement.
www.pearsonfoundation.org.oecd/

## 3 CONTRIBUTING TO COMPETITIVENESS

The connection between education and long-term economic growth is well-documented and increasingly well understood.

› Helping individuals get ready for work. Securing a professional or vocational qualification is an important factor in getting a job. We create and administer millions of admissions tests, certifications, vocational assessments and general qualifications including:

*BTEC,* the vocational qualification recognised by schools, colleges, universities, employers and professional bodies across the United Kingdom and in over 100 countries worldwide.

*Graduate Management Admission Test (GMAT),* the leading test for entrance to business schools and management programmes worldwide.

*NCLEX Nursing examination,* required to obtain a licence necessary to apply for work as a nurse in the United States.

*CTI Education Group,* one of the leading private higher education groups in South Africa, serving more than 9,000 students.

### Case study: BTEC increasing earning potential

London Economics research commissioned by Pearson found that achieving a BTEC National can increase the lifetime earnings of an individual by up to £92,000, while a BTEC First can increase lifetime earnings by up to £42,000.

**Doing informed business.** The FT Group is the leading provider of essential information, insight and analysis to the global business and opinion-forming community. Access to trusted and informed information is the basis on which businesses make effective decisions. The FT plays a unique global role in providing that information.

### Case study: FT Tilt

*The Financial Times* has launched FT Tilt, a premium online financial news and analysis service focused exclusively on the emerging world. It serves finance professionals who have a direct interest in Latin America, Africa, the Middle East, South and East Asia, Russia and Eastern Europe and business professionals who need a deeper understanding of these fast-growing regions.

## RESPONSIBLE BUSINESS PRACTICE

We believe Pearson has a unique opportunity to make a positive impact in those three focus areas – literacy, efficacy and competitiveness.

In addition, we adopt a broad and holistic definition of 'responsible business' that captures a series of priorities that are common across many industries and individual companies. These include commitments to:

- deliver against stakeholder expectations on the key area of climate change and to seek to make better use of resources;
- extend our principles on labour standards, human rights and environmental responsibility to include our suppliers and business partners;
- ensure that our products and services are appropriate in content to the age and location of the student and are safe to use;
- provide a safe, healthy workplace, where our employees are able to realise their own individual potential and aspirations and where there is respect for their privacy, dignity and life outside work;
- provide opportunities for Pearson people to be good citizens and to get involved in their local communities.

Responsible business practice cuts across all aspects of our company and our focus is to integrate this into the way we manage our businesses.

Highlights of our activities in 2010 include:

### Environment: A focus on climate change

A particular focus for us is climate change, as one of the most serious issues facing the planet. Minimising our own environmental impact is not only the right thing to do; it is fundamental to our future as a sustainable business.

Our climate neutral commitment has helped us to achieve three times the level of carbon reduction we were previously reporting. It has also helped us do new things, such as to start to invest in renewable energy generation – both wind and solar – at our sites.

- Pearson was named as a 2010 Green Power Leadership Award winner by the US Environmental Protection Agency. We offset 100% of the energy we use in North America by purchasing wind power credits.

## Our impact on society continued

- Pearson businesses in the UK achieved Carbon Trust Standard accreditation, which recognises organisations for real carbon reduction.
- Work started on our second solar energy project at our Distribution Centre in New Jersey. It is among the largest company-owned single roof solar installations in the world.
- We established the Pearson/FT Rainforest in Costa Rica to offset emissions we could not eliminate through other means.
- $CO_2$ emissions relating to our US Sales car fleet were reduced by 20% since 2007 by moving to more efficient vehicles and introducing over 200 hybrids.
- Penguin was recognised in the Forest Stewardship Council (FSC) Global Partner Awards for outstanding achievement in promoting the FSC brand worldwide.
- *The Financial Times* has reduced the volume of newsprint it uses by 25% over the past two years, primarily by reducing the base weight of paper used.
- As part of a three-year environmental plan, the production department of Pearson International surveyed all printers and binders whose turnover with Pearson exceeded £100k.

### Our customers, our people and our communities

Highlights in 2010 include:

- The Pearson Foundation launched The Million Voice project to improve education by listening to students. With the support of thousands of schools and communities from across the US, the project aims to capture the perspectives of one million students in grades 6–12.
- Pearson continued with its programme of Student Advisory Boards in the US and the UK. Members of the Boards provide input to Pearson in return for mentoring and internships.
- Pearson hosted a debate on what represents good corporate citizenship in a 21st century media organisation. The event was run in partnership with JustMeans, the online social media platform, and made available to its 70,000 members.
- Our first site in the UK has been accredited against ISO 18001, the international health and safety management standard.
- Pearson was again named joint winner of the FTSE Executive Women Award by Opportunity Now.
- Pearson in the US was named one of the top 100 employers by *Working Mother* magazine and by The Human Rights Campaign, which campaigns for equal rights for lesbian, gay, bisexual and transgender citizens.
- *The Financial Times* seasonal appeal raised $1.6 million on behalf of Action Against Hunger/ACF International, to help fight child malnutrition and its causes.
- Pearson VUE helped to bring over 550 Insurance Jobs to Twin Falls, Idaho. To secure the jobs, Pearson VUE helped to deliver nearly 900 insurance licensure exams and follow up background checks in less than 30 days.
- Penguin Group held its second global walk involving more than 1,000 employees. Walkers raised funds for a national charity of their choice including the Nature Conservancy's Plant a Billion Trees campaign in the US and Save the Kiwi in New Zealand.
- A new partnership between the Global Fund and Penguin saw 50% of the profits from the new (Penguin Classics)RED series go towards the fight to eliminate AIDS in Africa.

Each of these areas is underpinned by measures of performance.

## Indicators of responsible business performance

| Our responsible business priorities | Aim | Progress 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Environment | Maintain percentage of electricity we use from renewable sources at over 75% of total (measured in Mwh) | Yes 170,700[1] | Yes 170,229 | N/A 3,255 | N/A 2,594 |
| | Maintain commitment to climate neutrality –% of remaining emissions offset | 100 | 100 | 0 | 0 |
| Suppliers | Ensure our suppliers share our commitment to responsible business practice: | | | | |
| | Number of significant global suppliers with material spend advised of Pearson commitment to UN Global Compact social responsibility principles | 1,882 | N/A[2] | 1,702 | 750 |
| External benchmarks | Maintain our position in key indices of social responsibility: | | | | |
| | Dow Jones Sustainability Indexes | Global Sector Leader | Global Sector Leader | Global Sector Leader | Global Sector Leader |
| | BITC Corporate Responsibility Index | Platinum (Retained) | Platinum (Retained) | Platinum (Sector Leader) | Platinum (Joint Sector Leader) |
| | Inclusion in FTSE4Good | Yes | Yes | Yes | Yes |
| Community | Grow our total community investment and maintain at 1% or more of operating profit | £13.1m (1.6%) | £10.5m (1.4%) | £7.7m (1.1%) | £7.2m (1.3%) |

1. Final number subject to confirmation by separate environmental audit.
2. 2009 focus was on business continuity planning.

### Values, principles, behaviour and governance

The bedrock of corporate responsibility is the culture of the company. We are defined by our values – in everything we do, we aspire to be brave, imaginative and decent.

In turn, our approach is underpinned by our code of conduct that covers, among other things, the environment, employees, individual conduct, community and society.

We make sure everyone is aware of and understands the code. Once a year, everyone working for Pearson gets a copy, either electronically or on paper, and is asked to read it; to confirm to the Pearson CEO that they have read it and understood it; and in doing so, to provide a check that the company complies with it. The code forms part of induction and an online training module is available. If anyone has concerns, these can be raised with a line manager or through a free, confidential telephone line/website.

We are committed to making sure our people understand how we are doing as a company, including how world trends might affect both them and the businesses. This means providing comprehensive relevant information in a variety of ways – including regular presentations from senior executives – and consulting where appropriate so that we can learn and take into account the views of our people. We will always aim to seek the best candidate for a role: career progression will be without regard for race, gender, age, physical ability, religion or sexual orientation; and we will continue to monitor and benchmark our progress on diversity and inclusion, as well as providing opportunities for our people to benefit from our performance, such as through our WorldWide Save for Shares plan.

# Our impact on society continued

## Progress and plans

In 2009, we set out a series of plans for 2010 in the Annual Report covering our responsible business practice priorities. We report here on our progress against those plans.

| Plan 2010 | Progress | Plan 2011 |
|---|---|---|
| Continue the Pearson summit at an event in London in 2010 to include a focus on ICT in education, a key concern for educators in the classroom and for administrators hoping to improve academic systems, assessments and reporting. | Achieved The third International Conference on Education was held in London in June 2010 welcoming education experts from around the world. The conference theme was how to learn from UK experience in adopting and applying digital technologies in support of teaching and student learning. | Continue to help local education leaders from countries around the world to explore and apply what distinguishes strong performing educational systems through our ongoing support of the OECD and programmes such as the Pearson/CCSSO International Education Summit. |
| Continue to provide professional development for educators and administrators in Southern Africa and to integrate this programming with educational programming that is based on the Bridge*it* model first introduced in Tanzania in 2009. | Achieved Pearson Southern Africa and the Pearson Foundation continued to develop and expand their innovative early-childhood professional development programme focusing on partnering local education bodies to deliver training in literacy, numeracy and childhood development for teachers in Kenya, Nigeria, South Africa as well as Tanzania. | Expand our use of the latest mobile and digital technologies as we provide professional development for classroom teachers and administrators in local communities around the world through programmes such as Bridge*it* and the Mobile Learning Institute. |
| Continue to develop our emerging leaders through international experience and support Pearson's needs in our developing markets. | Ongoing A third of participants in our various future leader and talent management programmes came from businesses outside of the US and the UK. A focus this year was on developing talent in Asia. | 2010 also saw the development and launch of a training module on ethical conduct. Our plan for 2011 is to further develop this through additional material, a train the trainers pack and an e-learning module. |
| Continue to show evidence of progress in retention of people with diverse backgrounds for both entry level and management positions by tracking the success of women, people from minority ethnic backgrounds and those with a disability within Pearson. Continue to develop programmes and relationships to attract talented people from the above groups into our business. | Ongoing 27% of Pearson top managers are female. Pearson was awarded the Opportunity Now FTSE Executive Women Award 2010 for employing the most female executives. Pearson in the US was recognised for the 10th time as one of 100 Best Employers for Working Mothers. The Pearson Diversity Summer Internship was recognised as a finalist in the 'Best Diversity within Work Experience Awards at the National Placement & Internship Awards 2011'. Pearson was included in the Human Rights Campaign Best Places to Work for lesbian, gay, bisexual and transgender employees. | Continue to develop programmes and relationships that help attract and retain talented diverse people into our business and track our progress. Activities planned for 2011 include a contribution to the 'It Gets Better' video campaign launched by Penguin author Dan Savage. |
| Continue to develop our capacity to combine training opportunities for our staff with opportunities to partner with schools, colleges and not-for-profits. | Achieved We ran a company-wide award scheme to identify and celebrate exemplary commitments made by Pearson people getting involved in their local communities. For the first time, we took steps to formally invite our people to participate in specific projects managed by the Pearson Foundation. | We aim to review how we approach, recognise and support our people when they volunteer in their local communities with a particular focus on schools and colleges |

Target ongoing

Target achieved

| Plan 2010 | Progress | Plan 2011 |
|---|---|---|
| Continue to expand and consolidate our network of environmental teams across our businesses. | Achieved We now have 40 green teams involving over 300 people around the world. | Continue to develop and support our network of environmental teams across our businesses including launching a global award scheme to recognise the work of our environmental champions from across the business. |
| Maintain and extend our commitment to being a climate neutral company. | Achieved Pearson extended its climate neutrality to cover existing businesses as at the end of 2009. We continue to invest in reducing our carbon footprint and to offset what we cannot eliminate by other means. | To maintain our commitment to being a climate neutral company in 2011. |
| Further development of the Planet Pearson website by Pearson staff. | Ongoing New website developed; designed and piloted with its contents shaped by a global employee survey on environmental responsibility. | Launch new Planet Pearson website globally as part of a wider commitment to encouraging global collaboration. |
| Continuation of our programme to make our key buildings energy efficient. | Achieved Our dedicated green capital funds invested in projects ranging from renewable energy generation from solar panels to lighting upgrades. | Continuation of our programme to make our key buildings energy efficient with a particular focus on on-site renewable energy generation. |
| Completing the ISO 14001 environmental management system for our business in Australia. | Ongoing Good progress made towards preparing for accreditation. | Complete ISO 14001 certification in Australia and identify additional businesses to start the process in 2011. |
| Continue to work with industry partners to establish a methodology to assess the carbon footprint of a textbook.<br><br>Establish a total carbon footprint identification initiative for our company. | Ongoing As part of an industry group, we are supporting the development of a web tool to assess the carbon footprint of a book. We have also assessed the emissions relating to the paper purchased from suppliers in North America. | As part of an initiative to build a comprehensive global vendor relationship management system comprising a suite of online portals and data-marts, we will incorporate corporate responsibility metrics in vendor selection where appropriate. |
| Establish FSC chain of custody certification for our paper use in our North American businesses. | Ongoing Process seeking accreditation started in 2010. | Complete FSC chain of custody certification for our paper use in our North American businesses. |
| Increase the impact on children and adults reached through literacy campaigns, focusing Booktime funds more strategically and rolling out Jumpstart's Read for the Record programme further internationally. | Achieved Over one million free books were donated to schools and libraries under the Booktime programme, supported by materials for use by parents, teachers and in libraries. Through We Give Books – the international digital initiative launched in 2010 by the Penguin Group and the Pearson Foundation – we extended the reach of Read for the Record internationally. | Increase support for exemplary early-learning and literacy organisations and for the young people they serve through community campaigns such as Booktime and Read for the Record, and via We Give Books. |
| Increase the number of interventions we make to facilitate constructive debate on key contemporary issues. | Achieved Two examples featured in this section are the London Economics research into the impact of BTEC qualifications on earning potential and the Pearson Foundation partnership with the OECD. | Continue to increase the number of interventions we make to facilitate constructive debate on key contemporary issues. |
| Launch the Pearson Prize in the US, identifying students currently in a two – or four-year college/university who are working on specific projects that support their institution and/or local communities, and providing a package of financial and in-kind support to help these students finish their college careers. | Achieved Over 10,000 college students applied for the inaugural Pearson Prize. The 70 winners were selected based on their record of contributing to enriching college life. | Extend our support of young leaders making a difference inside and outside the classroom by continuing programmes such as the Pearson Prize and the international Pearson Fellowship for Social Innovation. |

# Board of directors

## Chairman

**Glen Moreno, †• chairman,** aged 67, was appointed chairman of Pearson on 1 October 2005 and is chairman of the nomination committee. He was appointed deputy chairman of The Financial Reporting Council Limited in November 2010. He is also the senior independent director of Lloyds Banking Group plc as well as a non-executive director of Fidelity International Limited. He was previously the senior independent director of Man Group plc and acting chairman of UK Financial Investments Limited, the company set up by HM Treasury to manage the government's shareholdings in UK banks.

## Executive directors

**Marjorie Scardino, • chief executive,** aged 64, joined the Pearson board in January 1997. She trained and practised as a lawyer, and was chief executive of The Economist Group from 1993 until joining Pearson. She is also vice chairman of Nokia Corporation and on the boards of several charitable organisations. In 2010 she was named a fellow of the American Academy of Arts and Sciences.

**Will Ethridge, chief executive, Pearson North American Education,** aged 59, joined the Pearson board in May 2008, having held a number of senior positions within Pearson Education, including CEO of the International and Higher Education divisions. He is chairman of CourseSmart, a publishers' digital retail consortium and chairman of the Association of American Publishers.

## Non-executive directors

**David Arculus, *†•** aged 64, is a non-executive director of Telefónica S.A. He is also chairman of Numis Corporation plc and in October 2010 was appointed chairman of Aldermore Bank plc. His previous roles include chairman of $O_2$ plc, Severn Trent plc and IPC Group, chief operating officer of United Business Media plc and group managing director of EMAP plc. He became a non-executive director of Pearson in February 2006 and is chairman of the remuneration committee.

**Patrick Cescau, *†•** aged 62, is the senior independent director of Tesco plc and a director of INSEAD, the Business School for the World. In September 2010, he joined the board of IAG, the International Consolidated Airlines Group, S.A. He was previously group chief executive of Unilever. He became a non-executive director of Pearson in April 2002 and senior independent director in April 2010.

**Susan Fuhrman, *•** aged 66, is president of Teachers College at Columbia University, America's oldest and largest graduate school of education and president of the National Academy of Education. She was previously dean of the Graduate School of Education at the University of Pennsylvania and on the board of trustees of the Carnegie Foundation for the Advancement of Teaching. She became a non-executive director of Pearson in July 2004.

**Rona Fairhead, chairman and chief executive of The Financial Times Group,** aged 49, joined the Pearson board in June 2002 as chief financial officer. She was appointed chief executive of The Financial Times Group in June 2006 and became responsible for Pearson VUE in March 2008. From 1996 until 2001, she served as executive vice president, group control and strategy at ICI. She is also a non-executive director of HSBC Holdings plc and chairs the HSBC audit and risk committees. In December 2010 she was appointed as a non-executive director of The Cabinet Office.

**Robin Freestone, chief financial officer,** aged 52, joined Pearson in 2004 as deputy chief financial officer and became chief financial officer in June 2006, when he also joined the Pearson board. He was previously group financial controller of Amersham plc (now part of GE). He qualified as a chartered accountant with Touche Ross (now Deloitte). He is also a non-executive director and founder shareholder of eChem Limited.

**John Makinson, chairman and chief executive of The Penguin Group,** aged 56, joined the Pearson board in March 1996 and was finance director until June 2002. He was appointed chairman of The Penguin Group in May 2001. He is also chairman of The Royal National Theatre and trustee of the Institute for Public Policy Research.

**Ken Hydon, *†•** aged 66, is a non-executive director of Reckitt Benckiser Group plc, Royal Berkshire NHS Foundation Trust and Tesco plc. He was previously financial director of Vodafone Group plc and of subsidiaries of Racal Electronics. He became a non-executive director of Pearson in February 2006 and is chairman of the audit committee.

* A member of the audit committee.

† A member of the remuneration committee.

• A member of the nomination committee.

The members of the board as at 31 December 2010, together with their biographical details, are shown on these pages.

As a matter of board policy, Pearson shareholders have the opportunity to re-elect all board directors each year at the company's Annual General Meeting (this year, on 28 April 2011). The chairman believes that the contribution and performance of each of the directors continues to be valuable and effective and it is appropriate for them to continue to serve as directors of the company.

Details of directors' remuneration, interests and dealings in ordinary shares and options of the company are contained in the report on directors' remuneration on pages 63 to 86. Details of directors' service agreements can be found on pages 74 and 75.

# Board governance

## Corporate governance

### Introduction

The Pearson board believes that good corporate governance supports good performance and the long-term development of strategy. It believes that robust, open board debate over major business issues brings a discipline to important decisions and adds a valuable and diverse set of external perspectives. The board believes that during 2010 the company was in full compliance with section 1 of the Combined Code 2008 (the Code) with the exception of its ratio of independent non-executive directors to executive directors. Following the resignation of Terry Burns and the untimely death of CK Prahalad in April last year, there was an imbalance of executive and non-executive directors on the board for a short period of time. However, effective 1 March 2011, Joshua Lewis was appointed to the board as an independent non-executive director and upon appointment joined the nomination committee and audit committee. The board embraces the Code's underlying principles with regard to board balance and the nomination committee, led by the chairman, is actively seeking an additional suitable candidate who possesses the right mix of knowledge, skills and experience to enhance debate and decision-making. A detailed account of the provisions of the Code can be found on the company website at www.pearson.com/investors/shareholder-information/governance

### Composition of the board

The board currently consists of the chairman, Glen Moreno, five executive directors including the chief executive, Marjorie Scardino, and five independent non-executive directors.

### Chairman

As stated in his biography, the chairman was appointed as deputy chairman of the Financial Reporting Council Limited on 18 November 2010. Both the chairman and the board are confident that he can fulfil this new role without reducing his time commitment to Pearson.

### Senior independent director

Patrick Cescau was appointed senior independent director last year following the retirement of Terry Burns. The board believes that Patrick's extensive knowledge of Pearson together with his broad commercial experience, make him highly suitable for this appointment. Although he is approaching nine years of service, the board continues to consider him to be independent.

His role includes being available to shareholders if they should have concerns that have not been addressed through the normal channels, and attending meetings with shareholders in order to gain a balanced understanding of any concerns that they might have. The senior independent director also meets with the non-executive directors at least once a year in order to appraise the performance of the chairman, and would be expected to chair the nomination committee in the event that it was considering succession to the role of chairman of the board.

### Independence of directors

The board reviews the independence of each of the non-executive directors annually. This includes reviewing their external appointments and any potential conflicts of interest as well as assessing their individual circumstances.

All of the non-executive directors were considered by the board to be independent for the purposes of the Code during the year ended 31 December 2010.

### Conflicts of interest

Since October 2008, directors have had a statutory duty under the Companies Act 2006 (the Act) to avoid conflicts of interest with the company. As permitted by the Act, the company adopted new Articles of Association at its AGM in 2008 to allow the directors to authorise conflicts of interest. The company has established a procedure to identify actual and potential conflicts of interest, including all directorships or other appointments to companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Such conflicts are then considered for authorisation by the board. The relevant director cannot vote on an authorisation resolution, or be counted in the quorum, in relation to the resolution relating to his/her conflict or potential conflict. The board reviews any authorisations granted on an annual basis.

## Board meetings

The board meets six times a year, each meeting taking place over two days, and at other times as appropriate. In recent years, we have developed our board meeting agenda to ensure that board discussion and debate is centred on the key strategic issues facing the company. Over the course of 2010 the major items covered by the board included:

BUSINESS PERFORMANCE: 25 AND 26 FEBRUARY 2010, LONDON

- 2009 Report and Accounts
- 2010 Operating plan
- Risk
- Annual review of authorised conflicts
- Disposal of Interactive Data Corporation

GOVERNANCE: 29 AND 30 APRIL 2010, LONDON

- Feedback on Annual Report
- Report on shareholders' views
- Board effectiveness review
- Acquisition of Melorio plc
- Disposal of Interactive Data Corporation

STRATEGY: 10 AND 11 JUNE 2010, UPPER SADDLE RIVER, NEW JERSEY

- Strategy discussions (Communications; Corporate responsibility; People; Shared Services; Digital)
- Acquisition of Sistema Educacional Brasiliero
- Review of non-executive directors' fees

BUSINESS PERFORMANCE: 22 AND 23 JULY 2010, LONDON

- Interim results
- Post-acquisition reviews
- Acquisition of Wall Street Institute
- Acquisition of America's Choice

STRATEGY: 7 AND 8 OCTOBER 2010, AUSTIN, TEXAS

- Strategic plan 2011 to 2013
- Review of Assessment and Information business
- Acquisition of CTI Education Group
- Review of audit, remuneration and nomination committee terms of reference

PEOPLE AND STRATEGIC PLAN: 9 AND 10 DECEMBER 2010, LONDON

- Acquisition of TutorVista
- Review of standing committee terms of reference
- People and business strategies
- Risk

The following table sets out the attendance of the company's directors at board and committee meetings during 2010:

| | Board meetings (maximum 6) | Audit committee meetings (maximum 4) | Remuneration committee meetings (maximum 4) | Nomination committee meetings (maximum 3) |
|---|---|---|---|---|
| **Chairman** | | | | |
| Glen Moreno | 6 | | 4 | 3 |
| **Executive directors** | | | | |
| Marjorie Scardino | 6 | | | 3 |
| Will Ethridge | 6 | | | |
| Rona Fairhead* | 4 | | | |
| Robin Freestone | 6 | | | |
| John Makinson | 5 | | | |
| **Non-executive directors** | | | | |
| David Arculus | 6 | 3 | 4 | 3 |
| Terry Burns** | 2 | | 2 | 1 |
| Patrick Cescau*** | 6 | 4 | 2 | 3 |
| Susan Fuhrman | 6 | 4 | | 3 |
| Ken Hydon | 5 | 4 | 3 | 3 |
| CK Prahalad**** | 1 | | | 1 |

* took a temporary leave of absence due to illness.
** resigned 30 April 2010.
*** appointed to the remuneration committee effective 30 April 2010.
**** deceased 16 April 2010.

The board values the insight it receives from witnessing first hand how our businesses are run and meeting the operating teams who run them. It held its June board meeting in New Jersey and its October meeting in Texas, to review and discuss the business and strategy for its operating companies located there.

# Board governance continued

## The role and business of the board

The formal matters reserved for the board's decision and approval include:

- Determining the company's strategy in consultation with management and reviewing performance against it;
- Any decision to cease to operate all or any material part of the company's business;
- Major changes to the company's corporate structure, management and control structure or its status as a public limited company;
- Approval of all shareholder circulars, resolutions and corresponding documentation and press releases concerning matters decided by the board;
- Acquisitions, disposals and capital projects above £15m per transaction or project;
- All guarantees over £10m;
- Treasury policies;
- Setting interim dividends, recommending final dividends to shareholders and approving financial statements;
- Borrowing powers;
- Appointment of directors;
- Appointment and removal of the company secretary;
- Ensuring adequate succession planning for the board and senior management;
- Determining the remuneration of the non-executive directors, subject to the Articles of Association and shareholder approval as appropriate;
- Approving the written division of responsibilities between the chairman and the chief executive and approval of the terms of reference of board committees; and
- Reviewing the Group's overall corporate governance arrangements, including the performance of the board, its committees and individual directors and determining the independence of directors.

The board receives timely, regular and necessary financial, management and other information to fulfil its duties. Directors can obtain independent professional advice, at the company's expense, in the performance of their duties as directors. All directors have access to the advice and services of the company secretary.

We endeavour to give non-executive directors access to the senior managers of the business via involvement at both formal and informal meetings. In this way we hope that the experience and expertise of the non-executive directors can be utilised for the benefit of the company. At the same time, this practice enables the non-executive directors to develop an understanding of the abilities of senior management which will help them judge the company's prospects and plans for succession.

## Board evaluation

The board conducts an annual review of its effectiveness. For the review of 2010, the board has appointed an external adviser to conduct detailed interviews with all directors to ensure the board is effectively focused on its agreed priorities: governance; strategy; business performance and people. The outcome and recommendations of this review will be discussed at the April 2011 board meeting.

During the year, we have made progress in a number of areas which came out of the 2009 board effectiveness review. In particular, board meetings have been lengthened to take place over two days, including an informal dinner to give further opportunity for constructive debate and discussion of issues raised in the board meetings.

During the course of the year the executive directors were evaluated by the chief executive on their performance against personal objectives under the company's standard appraisal mechanism. The chairman leads the assessment of the chief executive and the senior independent director conducts a review of the chairman's performance.

## Directors' training

Directors receive a significant bespoke induction programme and a range of information about Pearson when they join the board. This includes background information on Pearson and details of board procedures, directors' responsibilities and various governance-related issues, including procedures for dealing in Pearson shares and their legal obligations as directors. The induction also includes a series of meetings with members of the board, presentations regarding the business from senior executives and a briefing on Pearson's investor relations programme.

We supplement the existing directors' training programme through continuing presentations at board meetings about the company's operations, by holding board meetings at the locations of operating companies and by encouraging the directors to visit operating companies and local management as and when their schedule allows. Directors can also make use of external courses.

## Directors' indemnities

In accordance with section 232 of the Companies Act 2006 (the Act), the company grants an indemnity to all of its directors. The indemnity relates to costs incurred by them in defending any civil or criminal proceedings and in connection with an application for relief under sections 661(3) and (4) or sections 1157(1)-(3) of the Act, so long as it is repaid not later than when the outcome becomes final if: (i) they are convicted in the proceedings; (ii) judgement is given against them; or (iii) the court refuses to grant the relief sought.

The company has purchased and maintains directors' and officers' insurance cover against certain legal liabilities and costs for claims in connection with any act or omission by such directors and officers in the execution of their duties.

## Dialogue with institutional shareholders

We have an extensive programme for the chairman, chief executive, executive directors and senior managers to meet with institutional shareholders. The chief executive and chief financial officer present trading updates five times a year and attend regular meetings throughout the year with investors both in the UK and around the world. The chairman meets with our principal investors and our advisers throughout the year and keeps the board informed of their views on strategy and corporate governance. The chairman and senior independent director also make themselves available to meet any significant shareholder as required. The non-executive directors meet informally with shareholders both before and after the AGM and respond to shareholder queries and requests as necessary.

Every year the board receives a detailed report on the views of major institutional shareholders, provided either by our corporate brokers or our independent investor relations advisers, Makinson Cowell. At every meeting, the directors also receive an analysis of the shareholder register highlighting any significant movements in ownership or the share price.

## Board committees

The board has established three committees: the nomination committee, the remuneration committee and the audit committee. The chairmen and members of these committees are appointed by the board on the recommendation (where appropriate) of the nomination committee and in consultation with each relevant committee chairman.

### NOMINATION COMMITTEE

**Chairman** Glen Moreno

**Members** Glen Moreno, Marjorie Scardino, David Arculus, Patrick Cescau, Susan Fuhrman, Ken Hydon and Joshua Lewis

The nomination committee meets as and when required. The committee primarily monitors the composition and balance of the board and its committees, and identifies and recommends to the board the appointment of new directors and/or committee members.

When considering the appointment of a new director the committee reviews the current balance of skills and experience of the board.

Whilst the chairman of the board chairs this committee, he is not permitted to chair meetings when the appointment of his successor is being considered or during a discussion regarding his performance.

During 2010 the committee met to consider the appointment of additional independent non-executive directors and to review succession planning for non-executive and executive board positions, as well as board committee assignments.

The committee has written terms of reference which clearly set out its authority and duties. These can be found on the company website at www.pearson.com/investors/shareholder-information/governance

# Board governance continued

## REMUNERATION COMMITTEE

**Chairman** David Arculus

**Members** David Arculus, Patrick Cescau, Ken Hydon and Glen Moreno

The remuneration committee has responsibility for determining the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the management committee, as well as recommending the chairman's remuneration to the board for its decision.

The committee takes independent advice from consultants when required. No director takes part in any discussion or decision concerning their own remuneration. The committee reports to the full board and its report on directors' remuneration, which has been considered and adopted by the board, is set out on pages 63 to 86.

The committee met four times during the year, and has written terms of reference which clearly set out its authority and duties. These can be found on the company website at www.pearson.com/investors/shareholder-information/governance

During the year, Terry Burns retired from the board and was replaced on the remuneration committee by Patrick Cescau.

## AUDIT COMMITTEE

**Chairman** Ken Hydon

**Members** Ken Hydon, David Arculus, Patrick Cescau, Susan Fuhrman and Joshua Lewis

### Members

All of the audit committee members are independent non-executive directors and have financial and/or related business experience due to the senior positions they hold or held in other listed or publicly traded companies and/or similar public organisations. Ken Hydon, chairman of the committee, is the company's designated financial expert. He is a fellow of the Chartered Institute of Management Accountants, the Association of Chartered Certified Accountants and the Association of Corporate Treasurers. He also serves as audit committee chairman for Tesco plc, Reckitt Benckiser Group plc and Royal Berkshire NHS Foundation Trust.

The qualifications and experience of the other committee members are detailed on pages 48 and 49.

### Role and responsibilities

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website at www.pearson.com/investors/shareholder-information/governance

The committee has been established by the board primarily for the purpose of overseeing the accounting, financial reporting, internal control and risk management processes of the company and the audit of the financial statements of the company.

The committee is responsible for assisting the board's oversight of the quality and integrity of the company's external financial reporting and statements and the company's accounting policies and practices. The Group's internal and external auditors have direct access to the committee to raise any matter of concern and to report on the results of work directed by the committee. The committee reports to the full board on a regular basis but no less frequently than at every board meeting immediately following a committee meeting. It also reviews the independence of the external auditors, including the provision of non-audit services (further details of which can be found on page 58), and ensures that there is an appropriate audit relationship.

### External audit

Based on management's recommendations, the committee reviews the proposal to reappoint the external auditors. The committee reviewed the effectiveness and independence of the external auditors during 2010 and remains satisfied that the auditors provide effective independent challenge to management. The committee will continue to review the performance of the external auditors on an annual basis and will consider their independence and objectivity, taking account of all appropriate guidelines. There are no contractual obligations restricting the committee's choice of external auditors. In any event, the external auditors are required to rotate the audit partner responsible for the Group audit every five years. The current lead audit partner has been in place for three years.

During the year, the committee discussed the planning, conduct and conclusions of the external audit as it proceeded.

At the July 2010 audit committee meeting, the committee discussed and approved the auditors' group audit plan, in which they identified the following key risks of misstatement of the Group's financial statements:

- Revenue recognition, specifically in relation to long-term contract accounting and increasingly to digital revenue streams where management assumptions and estimates are necessary;
- Accounting for acquisitions and disposals in light of material transactions in 2010, in particular, valuation of acquired intangibles which involves significant judgement;
- Key balance sheet judgements, since small changes in provisioning judgements or methodology can have notable impacts on the Group's balance sheet and income statement; and
- Assessment of goodwill and intangible assets for impairment in the context of current market conditions, recognising that management judgement is required.

The committee also discussed with the auditors the risks of fraud in the Group and the programme of work they planned to undertake to address the risks they had identified to ensure that they did not lead to a material misstatement of the financial statements. This work included the evaluation and testing of the Group's own internal controls. The auditors explained where they planned to obtain direct external evidence.

The committee discussed these issues with the auditors at the time of their review of the half year interim financial statements in July 2010 and again at the conclusion of their audit of the financial statements for the year in February 2011. In December 2010, the committee discussed with the auditors the status of their work, focusing on their work in relation to internal controls. As the auditors concluded their audit, they explained to the committee:

- The work they had conducted over revenue, which included targeted procedures at businesses which were considered to have more complex revenue recognition, such as the assessment and testing businesses;
- The results of their review of acquisition accounting for all significant acquisitions, encompassing assessment of management's valuations of intangible assets as well as other purchase price adjustments;
- The work they had done to test management's assumptions and estimates in relation to balance sheet judgements (encompassing provisions for bad and doubtful debts and inventory, recoverability of pre-publication assets and authors' advances, estimates of tax and pension liabilities) and how they had satisfied themselves that these were reasonable;
- The results of their review of the impairment model, including a consideration of key assumptions such as discount rates and perpetuity rates and sensitivities, which indicated that all cash-generating units had ample headroom; and
- The outputs of their controls testing for Sarbanes-Oxley, section 404 reporting purposes and in support of their financial statements audit.

The auditors also reported to the committee the misstatements that they had found in the course of their work and the committee confirmed that there were no such material items remaining unadjusted in these financial statements.

### Training

The committee receives regular technical updates as well as specific or personal training as required. In addition to the committee's regular technical updates, a training session was held in June 2010 at which PwC updated the committee on a number of relevant accounting matters and provided a briefing on the UK Bribery Act and changes to UK corporate governance practice.

### Meetings

The committee met four times during the year with the chief financial officer, head of group internal audit, members of the senior management team and the external auditors in attendance. The committee also met regularly in private with the external auditors and the head of group internal audit. The committee members attended site visits to our businesses in New Jersey and Texas during the year and met with senior financial management based there in order to better understand how Group policies are embedded in operations.

At every meeting, the committee considered reports on the activities of the internal audit function, including the results of internal audits, risk reviews, project assurance reviews, and fraud and whistleblowing reports. The committee also monitored the company's financial reporting, internal controls and risk management procedures and considered any significant legal claims and regulatory issues in the context of their impact on financial reporting.

Specifically, the committee considered the following matters during the course of the year:

- The annual report and accounts: preliminary announcement and trading update;
- The Group accounting policies;

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- Compliance with the Combined Code;
- The Form 20-F and related disclosures including the annual Sarbanes-Oxley Act 404 attestation of financial reporting internal controls;
- Receipt of an external auditors' report on the Form 20-F and on the year end audit;
- Assessment of the effectiveness of the company's internal control environment;
- Reappointment, remuneration and engagement letter of the external auditors;
- Triennial review of external auditors benchmarking;
- Review of the interim management statements;
- Review of the effectiveness of the audit committee and a review of both the internal and external auditors;
- Annual approval of the internal audit mandate;
- Compliance with SEC & NYSE requirements including Sarbanes-Oxley;
- Review of interim financial statements and announcement;
- Approval of external audit policy;
- Review of the committee's terms of reference;
- Annual internal audit plan including resourcing of the internal audit function;
- Review of company risk returns including Social, Ethical and Environmental (SEE) risks; and
- Annual review of treasury policy.

## Internal control and risk management

The board of directors has overall responsibility for Pearson's system of internal control, which is designed to manage, rather than eliminate, the risks facing the Group, safeguard assets and provide reasonable, but not absolute, assurance against material financial misstatement or loss.

In accordance with the provisions of the Code, the directors confirm that they have reviewed the effectiveness of the Group's internal control and risk management systems.

They also confirm that there is an ongoing process allowing for the identification, evaluation and management of significant business risks. This ongoing process accords with the revised Turnbull Guidance 'Internal control: Revised Guidance for Directors on the Combined Code', and was in place throughout 2010 and up to the date of approval of this annual report.

The Group's internal control framework covers financial, operational and compliance risks. Its main features are described below:

### Board

The board of directors exercises its control through an organisational structure with clearly defined levels of responsibility and authority and appropriate reporting procedures. To maintain effective control over strategic, financial, operational and compliance matters the board meets regularly, and has a formal schedule of matters that is brought to it, or its duly authorised committees, for attention. Responsibility for monitoring financial management and reporting, internal control and risk management systems has been delegated to the audit committee by the board. At each meeting, the audit committee considers reports from management, internal audit and the external auditors, with the aim of reviewing the effectiveness of the internal financial and operating control environment of the Group.

### Operating company controls

The identification and mitigation of major business risks is the responsibility of Group senior management and operating company management. Each operating company, including the corporate centre, maintains internal controls and procedures appropriate to its structure and business environment, whilst complying with Group policies, standards and guidelines. These controls include those over external financial reporting which are documented and tested in accordance with the requirements of section 404 of the Sarbanes-Oxley Act, which is relevant to our US listing.

### Financial reporting

There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the board of directors. Monthly financial information, including trading results, balance sheets, cash flow statements and indebtedness, is reported against the corresponding figures for the plan and prior years, with corrective action outlined by the appropriate senior executive. Group senior management meet, on a quarterly basis, with operating company management to review their business and financial performance against plan and forecast. Major business risks relevant to each operating company as well as performance against the stated financial and strategic objectives are reviewed in these meetings.

In particular, with regard to preparing consolidated accounts, the group financial reporting team operates a rigorous process. This includes up-to-date Group financial policies, formal requirements for business unit finance functions, Group consolidation reviews and analysis of material variances, group finance technical reviews, including the use of technical specialists, and review and sign-off by senior finance managers. These controls are monitored and assessed during the year by the group internal audit and group compliance functions.

In addition, the chief executive prepares a report for the board, 11 times a year, on key developments, performance and issues in the business.

### Risk management

Operating companies undertake formal, semi-annual risk reviews to identify new or potentially under-managed risks. Throughout the year, risk sessions facilitated by the head of group internal audit are held with operating company management to identify the key risks the company faces in achieving its objectives, to assess the probability and impact of those risks and to document the actions being taken to manage those risks. The Pearson management committee reviews the output of these sessions, focusing on the significant risks facing the business. Management has the responsibility to consider and execute appropriate action to mitigate these risks whenever possible. The results of these reviews are summarised twice a year by group internal audit for evaluation and onward reporting to the board, in summary, and in more detail via the audit committee.

### Group internal audit

The group internal audit function is responsible for providing independent assurance to management on the design and effectiveness of internal controls to mitigate financial and operational risks. The annual internal audit plan, derived from a risk-based approach, is approved by the audit committee. Recommendations to improve internal controls and to mitigate risks, or both, are agreed with operating company management after each audit. Formal follow-up procedures allow Group internal audit to monitor operating companies' progress in implementing its recommendations and to resolve any control deficiencies. The group internal audit function also has a remit to monitor significant Group projects, in conjunction with the central project management office and to provide assurance that appropriate project governance and risk management strategies are in place. Regular reports on the work of group internal audit are provided to executive management and, via the audit committee, to the board.

The head of group internal audit is jointly responsible with the group legal counsel for monitoring compliance with our Code of Conduct, and investigating any reported incidents including fraud allegations.

### Treasury management

The treasury department operates within policies approved by the board and its procedures are reviewed regularly by the audit committee. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the chief financial officer and regular reports are prepared for the audit committee and the board.

### Insurance

Insurance is provided through Pearson's insurance subsidiary or externally, depending on the scale of the risk and the availability of cover in the external market, with the objective of achieving the most cost-effective balance between insured and uninsured risks.

## Going concern

Having reviewed the Group's liquid resources and borrowing facilities and the Group's 2011 and 2012 cash flow forecasts, the directors believe that the Group has adequate resources to continue as a going concern. For this reason, the financial statements have, as usual, been prepared on that basis. Information regarding the Group's borrowing liabilities and financial risk management can be found in notes 18 and 19 on pages 129 to 137.

## Shareholder communication

Pearson has an extensive programme of communication with all of its shareholders – large and small, institutional and private.

We also make a particular effort to communicate regularly with our employees, a large majority of whom are shareholders in the company.
We post all company announcements on our website, www.pearson.com, as soon as they are released, and major shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes

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information about all of our businesses, links to their websites and details of our corporate responsibility policies and activities.

We have an established programme of educational seminars for our institutional shareholders focusing on individual parts of Pearson. These seminars are available to all shareholders via webcast on www.pearson.com

Our AGM – which will be held on 28 April this year – is an opportunity to meet the company's managers, hear presentations about Pearson's businesses and the previous year's results as well as to conduct general AGM business.

## Share capital

Details of share issues are given in note 27 to the accounts on page 149. The company has a single class of shares which is divided into ordinary shares of 25p each. The ordinary shares are in registered form. As at 31 December 2010, 812,677,377 ordinary shares were in issue. At the AGM held on 30 April 2010, the company was authorised, subject to certain conditions, to acquire up to 80 million of its ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 28 April 2011.

Information provided to the company pursuant to the Financial Services Authority's Disclosure and Transparency Rules is published on a Regulatory Information Service and on the company's website. As at 25 February 2011, the company had been notified under DTR5 of the following significant voting rights in its shares.

| | Number of shares | Percentage |
|---|---|---|
| Legal & General Group plc | 32,300,784 | 3.98% |
| Libyan Investment Authority | 24,431,000 | 3.01% |

## Annual General Meeting (AGM)

The notice convening the AGM to be held at 3 pm on Thursday, 28 April 2011 at The Institution of Engineering and Technology, 2 Savoy Place, London WC2R 0BL is contained in a circular to shareholders to be dated 24 March 2011.

## Registered auditors

In accordance with section 489 of the Companies Act 2006 a resolution proposing the reappointment of PricewaterhouseCoopers LLP (PwC) as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the directors.

## Auditors' independence

In line with best practice, our relationship with PwC is governed by our external auditors policy, which is reviewed and approved annually by the audit committee. The policy establishes procedures to ensure the auditors' independence is not compromised as well as defining those non-audit services that PwC may or may not provide to Pearson. These allowable services are in accordance with relevant UK and US legislation.

The audit committee approves all audit and non-audit services provided by PwC. Certain categories of allowable non-audit services have been pre-approved by the audit committee subject to the authorities below:

- Pre-approved non-audit services can be authorised by the chief financial officer up to £100,000 per project, subject to a cumulative limit of £500,000 per annum;
- Acquisition due diligence services up to £100,000 per transaction;
- Tax compliance and related activities up to the greater of £1,000,000 per annum or 50% of the external audit fee; and
- For forward-looking tax planning services we use the most appropriate adviser, usually after a tender process. Where we decide to use our independent auditors, authority, up to £100,000 per project subject to a cumulative limit of £500,000 per annum, has been delegated by the audit committee to management.

Services provided by PwC above these limits and all other allowable non-audit services, irrespective of value, must be approved by the audit committee. Where appropriate, services will be tendered prior to awarding work to the auditors.

In 2007, Interactive Data appointed Ernst & Young LLP (Ernst & Young) as its independent auditors. Until July 2010, Interactive Data was part of the Group and therefore, in order to maintain Ernst & Young's independence we have restricted the services that Ernst & Young can provide to Pearson and its subsidiaries, in a similar way to which we restrict the services that PwC can provide to the company.

The audit committee receives regular reports summarising the amount of fees paid to the auditors.

A full statement of the fees for audit and services is provided in note 4 to the accounts on page 109.

## Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and the Group and of the profit or loss of the Group for that period.

In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and accounting estimates that are reasonable and prudent;
- State that the financial statements comply with IFRSs as adopted by the European Union or disclose and explain any material departures from those IFRSs; and
- Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company and/or the Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the Group. This enables them to ensure that the financial statements and the report on directors' remuneration comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the directors, whose names and functions are listed on pages 48 and 49, confirm that to the best of their knowledge and belief:

- The Group financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and company; and
- The directors' report contained in the annual report includes a fair review of the development and performance of the business and the position of the company and Group, together with a description of the principal risks and uncertainties that they face.

The directors also confirm that, for all directors in office at the date of this report:

a) so far as the directors are aware, there is no relevant audit information of which the company's auditors are unaware; and

b) they have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Approved by the board on 7 March 2011 and signed on its behalf by

**Philip Hoffman** Secretary

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## Additional information for shareholders

### Amendment to Articles of Association

Any amendments to the Articles of Association (the Articles) of the company may be made in accordance with the provisions of the Companies Act 2006 (the Act) by way of a special resolution.

### Rights attaching to shares

The rights attaching to the ordinary shares are defined in the company's Articles. A shareholder whose name appears on the company's register of members can choose whether his/her shares are evidenced by share certificates (i.e. in certificated form) or held electronically (i.e. uncertificated form) in CREST (the electronic settlement system in the UK).

Subject to any restrictions below, shareholders may attend any general meeting of the company and, on a show of hands, every shareholder (or his/her representative) who is present at a general meeting has one vote on each resolution for every ordinary share of which they are the registered holder. A resolution put to the vote at a general meeting is decided on a show of hands unless before, or on the declaration of the result of, a vote on a show of hands, a poll is demanded. A poll can be demanded by the chairman of the meeting, or by at least three shareholders (or their representatives) present in person and having the right to vote, or by any shareholders (or their representatives) present in person having at least 10% of the total voting rights of all shareholders, or by any shareholders (or their representatives) present in person holding ordinary shares on which an aggregate sum has been paid up of at least 10% of the total sum paid up on all ordinary shares.

At this year's AGM voting will be conducted on a poll.

Shareholders can declare a final dividend by passing an ordinary resolution but the amount of the dividend cannot exceed the amount recommended by the board. The board can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide, provided the distributable profits of the company justify such payment. The board may, if authorised by an ordinary resolution of the shareholders, offer any shareholder the right to elect to receive new ordinary shares, which will be credited as fully paid, instead of their cash dividend.

Any dividend which has not been claimed for 12 years after it became due for payment will be forfeited and will then belong to the company, unless the directors decide otherwise.

If the company is wound up, the liquidator can, with the sanction of a special resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the company and he/she can value assets and determine how the division shall be carried out as between the members or different classes of members. The liquidator can also transfer the whole or any part of the assets to trustees upon any trusts for the benefit of the members.

### Voting at general meetings

Any form of proxy sent by the company to shareholders in relation to any general meeting must be delivered to the company, whether in written or electronic form, not less than 48 hours before the time appointed for holding the meeting or adjourned meeting at which the person named in the appointment proposes to vote.

No shareholder is, unless the board decides otherwise, entitled to attend or vote either personally or by proxy at a general meeting or to exercise any other right conferred by being a shareholder if he/she or any person with an interest in shares has been sent a notice under section 793 of the Act (which confers upon public companies the power to require information with respect to interests in their voting shares) and he/she or any interested person failed to supply the company with the information requested within 14 days after delivery of that notice. The board may also decide, where the relevant shareholding comprises at least 0.25% of the nominal value of the issued shares of that class, that no dividend is payable in respect of those default shares and that no transfer of any default shares shall be registered.

Pearson operates two employee benefit trusts to hold shares, pending employees becoming entitled to them under the company's employee share plans. There were 14,008,555 shares so held as at 31 December 2010. Each trust has an independent trustee which has full discretion in relation to the voting of such shares. A dividend waiver operates on the shares held in these trusts.

Pearson also operates a nominee shareholding arrangement known as Sharestore which holds shares on behalf of employees. There were 2,027,976 shares so held as at 31 December 2010. The trustees holding these shares seek voting instructions from the employee as beneficial owner, and voting rights are not exercised if no instructions are given.

## Transfer of shares

The board may refuse to register a transfer of a certificated share which is not fully paid, provided that the refusal does not prevent dealings in shares in the company from taking place on an open and proper basis. The board may also refuse to register a transfer of a certificated share unless (i) the instrument of transfer is lodged, duly stamped (if stampable), at the registered office of the company or any other place decided by the board, and is accompanied by the certificate for the share to which it relates and such other evidence as the board may reasonably require to show the right of the transferor to make the transfer; (ii) it is in respect of only one class of shares; and (iii) it is in favour of not more than four transferees.

Transfers of uncertificated shares must be carried out using CREST and the board can refuse to register a transfer of an uncertificated share in accordance with the regulations governing the operation of CREST.

## Variation of rights

If at any time the capital of the company is divided into different classes of shares, the special rights attaching to any class may be varied or revoked either:

(i) with the written consent of the holders of at least 75% in nominal value of the issued shares of the relevant class; or

(ii) with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of the relevant class.

Without guidance to any special rights previously conferred on the holders of any existing shares or class of shares, any share may be issued with such preferred, deferred, or other special rights, or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the company may from time to time by ordinary resolution determine.

## Appointment and replacement of directors

The Articles contain the following provisions in relation to directors:

Directors shall number no less than two. Directors may be appointed by the company by ordinary resolution or by the board. A director appointed by the board shall hold office only until the next AGM and shall then be eligible for reappointment, but shall not be taken into account in determining the directors or the number of directors who are to retire by rotation at that meeting. The board may from time to time appoint one or more directors to hold executive office with the company for such period (subject to the provisions of the Act) and upon such terms as the board may decide and may revoke or terminate any appointment so made.

At every AGM of the company, one-third of the directors shall retire by rotation (or, if their number is not a multiple of three, the number nearest to one-third). The first directors to retire by rotation shall be those who wish to retire and not offer themselves for re-election. Any further directors so to retire shall be those of the other directors subject to retirement by rotation who have been longest in office since they were last re-elected but, as between persons who became or were last re-elected on the same day, those to retire shall (unless they otherwise agree among themselves) be determined by lot. In addition, any director who would not otherwise be required to retire shall retire by rotation at the third AGM after they were last re-elected.

However, although not required by the Articles, the board has resolved that for this year, and in future years, all directors should offer themselves for re-election annually, in accordance with good corporate governance.

The company may by ordinary resolution remove any director before the expiration of his/her term of office. In addition, the board may terminate an agreement or arrangement with any director for the provision of his/her services to the company.

# Board governance continued

## Powers of the directors

Subject to the company's Articles, the Act and any directions given by special resolution, the business of the company will be managed by the board who may exercise all the powers of the company, including powers relating to the issue and/or buying back of shares by the company (subject to any statutory restrictions or restrictions imposed by shareholders in general meeting).

## Significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the company:

Under the $1,750,000,000 revolving credit facility agreement dated November 2010 which matures in November 2015 between, amongst others, the company, HSBC Bank plc (as facility agent) and the banks and financial institutions named therein as lenders (together, the Facilities), any such bank may, upon a change of control, require its outstanding advances, together with accrued interest and any other amounts payable in respect of such Facilities, and its commitments, to be cancelled, each within 60 days of notification to the banks by the facility agent. For these purposes, a 'change of control' occurs if the company becomes a subsidiary of any other company or one or more persons acting either individually or in concert, obtains control (as defined in section 1124 of the Corporation Tax Act 2010) of the company.

Shares acquired through the company's employee share plans rank *pari passu* with shares in issue and have no special rights. For legal and practical reasons, the rules of these plans set out the consequences of a change of control of the company.

# Report on directors' remuneration

The board presents its report on directors' remuneration to shareholders. This report complies with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and was approved by the board of directors on 7 March 2011.

The committee believes that the company has complied with the provisions regarding remuneration matters contained within the UK Corporate Governance Code.

We will put a resolution to shareholders at the Annual General Meeting (AGM) on 28 April 2011 inviting them to consider and approve this report.

## The remuneration committee

David Arculus chaired the remuneration committee for the year 2010; the other members were Patrick Cescau, Ken Hydon and Glen Moreno. David Arculus, Patrick Cescau and Ken Hydon are independent non-executive directors. Terry Burns stepped down from his membership of the committee and his role as a non-executive director on 30 April 2010. Glen Moreno, chairman of the board, is a member of the committee as permitted under the UK Corporate Governance Code.

Marjorie Scardino, chief executive, Robin Baliszewski, director for people, Robert Head, compensation and benefits director, and Stephen Jones, head of company secretarial, provided material assistance to the committee during the year. They attended meetings of the committee, although no director was involved in any decisions relating to his or her own remuneration.

To ensure that it receives independent advice, the committee has appointed Towers Watson to supply survey data and to advise on market trends, long-term incentives and other general remuneration matters. Towers Watson also advised the company on health and welfare benefits in the US and provided consulting advice directly to certain Pearson operating companies.

The committee's principal duty is to determine and regularly review, having regard to the UK Corporate Governance Code and on the advice of the chief executive, the remuneration policy and the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee who report directly to the chief executive. This includes base salary, annual and long-term incentive entitlements and awards, and pension arrangements.

The committee's terms of reference are available on the company's website.

The committee met four times during 2010. The matters discussed and actions taken were as follows:

19 AND 26 FEBRUARY 2010

- Reviewed and approved 2009 annual incentive plan payouts
- Reviewed and approved 2007 long-term incentive plan payouts and release of shares
- Approved vesting of 2005 and 2007 annual bonus share matching awards and release of shares
- Reviewed and approved 2010 base salary increases for the Pearson Management Committee
- Reviewed and approved 2010 Pearson and operating company annual incentive plan targets
- Reviewed and approved 2010 individual annual incentive opportunities for the Pearson Management Committee
- Reviewed and approved 2010 long-term incentive awards and associated performance conditions for the Pearson Management Committee
- Discussed policy on service agreements for executive directors
- Reviewed and approved 2009 report on directors' remuneration
- Noted company's use of equity for employee share plans
- Reviewed and approved the remuneration package for the chief executive

23 JULY 2010

- Approved 2010 long-term incentive awards for executives and managers
- Considered the strategy and timetable for the 2011 renewal of the long-term incentive plan
- Reviewed committee's charter and terms of reference
- Approved changes to the remuneration packages for two members of the Pearson Management Committee

# Report on directors' remuneration continued

8 DECEMBER 2010

- Considered Towers Watson's report on remuneration for the Pearson Management Committee for 2011
- Reviewed status of outstanding long-term incentive awards
- Discussed 2011 renewal of long-term incentive plan
- Considered the approach to 2011 long-term incentive plan awards for the Pearson Management Committee
- Reviewed 2011 annual incentive plan metrics
- Reviewed the chairman's remuneration

## Summary of policy changes in 2010

As described in the report on directors' remuneration for 2009, in light of market data and practice elsewhere in the company, we increased the maximum annual incentive for the chief executive from 150% to 180% of base salary. In addition, for the other members of the Pearson Management Committee we adopted a structure of relating individual incentive opportunities to base salary taking into account their membership of that committee and the contribution of their respective businesses or role to Pearson's overall financial goals. Further details are set out on page 67.

## Remuneration policy

This report sets out the company's policy on directors' remuneration that applies to executive directors for 2011 and, so far as practicable, for subsequent years. The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the company's business environment and in remuneration practice. Future reports, which will continue to be subject to shareholder approval, will describe any changes in this policy.

Our goal as a company is to make an impact on people's lives and on society through education and information. Our strategy to achieve that goal is pursued by all Pearson's businesses in some shape or form and has four parts: investment in quality content; adding services to this content; working in markets around the world, particularly in the developing world; and efficiency.

An important measure of our strategy is, of course, financial performance. Here, our goal is to achieve sustainable growth in three key financial measures – earnings, cash and return on invested capital – and reliable cash returns to our investors through healthy and growing dividends. We believe those are, in concert, good indicators that we are building the long-term value of Pearson. So those measures (or others that contribute to them, such as operating margins and working capital) form the basis of our annual budgets and plans, and the basis for bonuses and long-term incentives.

We determine whether or not targets have been met under the company's various performance-related annual or long-term incentive plans based on relevant internal information and input from external advisers.

In light of the prevailing economic conditions and the impact of these on the company's objectives and strategy, we continue to keep our remuneration policy under review particularly with regard to its approach to annual and long-term incentives.

Our starting point continues to be that total remuneration (base compensation plus annual and long-term incentives) should reward both short- and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional company performance.

The performance conditions that we select for the company's various performance-related annual or long-term incentive plans are linked to the company's strategic objectives set out above and aligned with the interests of shareholders.

Generally speaking, we have concluded that no fundamental changes are required to the performance measures used in the company's annual and long-term incentive plans.

We will however continue to give careful consideration to the selection and weighting of these measures and the targets that apply taking into account the company's short- and longer term strategy and risk and the impact on the sustainability and future development of the company.

In accordance with the UK Corporate Governance Code, the committee has considered the company's powers to reclaim variable remuneration in exceptional circumstances of misstatement or misconduct. The company will follow its legal rights and reclaim rewards gained in the event of proven wrong doing which led to misstatement of the company's accounts.

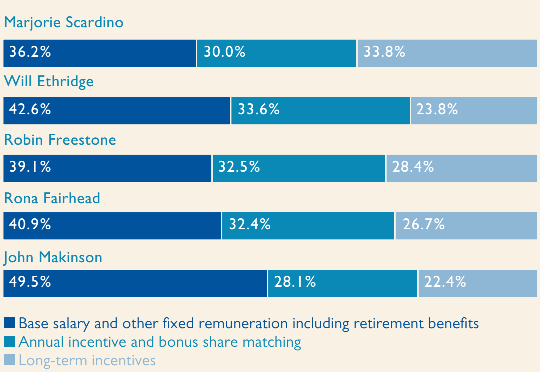
## Main elements of remuneration

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives.

| Element | Objective | Performance period | Performance conditions |
|---|---|---|---|
| Base salary (see page 66) | Reflects competitive market level, role and individual contribution | Not applicable | Normally reviewed annually taking into account general economic conditions and the wider pay scene, the level of increases applicable to employees across the company as a whole, the remuneration of directors and executives in comparable companies and individual performance |
| Annual incentives (see page 66) | Motivates achievement of annual strategic goals | One year | Subject to achievement of targets for sales, earnings per share or profit, working capital, cash flow and personal objectives |
| Bonus share matching (see page 68) | Encourages executive directors and other senior executives to acquire and hold Pearson shares. Aligns executives' and shareholders' interests | Three years | Subject to achievement of target for earnings per share growth |
| Long-term incentives (see page 70) | Drives long-term earnings and share price growth and value creation. Aligns executives' and shareholders' interests | Three years | Subject to achievement of targets for relative total shareholder return, return on invested capital and earnings per share growth |

Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual incentives, bonus share matching and long-term incentives. Our assessment of the relative importance of fixed and performance-related remuneration for each of the directors based on our policy and the data set out in this report is as follows:

PROPORTION OF TOTAL COMPENSATION




Note The method for valuing the different elements of remuneration is summarised in the table on page 66.

We will continue to review the mix of fixed and performance-linked remuneration on an annual basis, consistent with our overall philosophy.

## Benchmarking

The committee wants our executive directors' remuneration to be competitive with those of directors and executives in similar positions in comparable companies.

For benchmarking purposes, we review remuneration by reference to the UK and US market depending on the relevant market or markets for particular jobs.

We look separately at three comparator groups. First, we use a select peer group of FTSE 100 companies with very substantial overseas operations. These companies are of a range of sizes around Pearson, but the method our independent advisers use to make comparisons on remuneration takes this variation in size into account. Secondly, for the US, we use a broad media industry group. And thirdly, we look at the FTSE 20-50, excluding financial services.

# Report on directors' remuneration continued

We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

Market assessments against the three groups take account of those factors which Towers Watson's research shows differentiate remuneration for jobs of a similar nature, such as financial size, board membership, reporting relationships and international activities.

For benchmarking purposes, comparison with practice in other organisations and consistency with survey data, the main elements of remuneration are valued as follows:

| Element of remuneration | Valuation |
|---|---|
| Base salary | Actual base salary |
| Annual incentive | Target level of annual incentive |
| Bonus share matching | Expected value of matching award based on 50% of target level of annual incentive |
| Long-term incentive | Expected value of long-term incentive award |
| Pension and benefits | Cost to company of providing pension and other benefits |
| Total remuneration | Sum of all elements of remuneration |

Note Expected value means our independent advisers' assessment of the awards' net present value taking into account the vesting schedule, risk of forfeiture and their view of the likelihood that any performance target will be met.

## Base salary

The committee's normal policy is to review the base salaries of the executive directors and other members of the Pearson Management Committee taking into account general economic conditions and the wider pay scene, the level of increases applicable to employees across the company as a whole, the remuneration of directors and executives in comparable companies and individual performance.

Before the base salaries and remuneration packages for the Pearson Management Committee are set for the coming year, the committee considers a report from the chief executive and director for people on general pay trends and pay increases across the company and an assessment by the Committee's independent advisers of remuneration relative to the market.

For 2011, the company has reviewed or is reviewing salaries for employees taking into account the location and economic conditions of each business as it did for 2010. For executive directors and other members of the Pearson Management Committee, we have reviewed base salaries consistent with the policy and process set out above. Full details of the executive directors' remuneration for 2011 will be set out in the report on directors' remuneration for 2011.

For 2010, with the exception of one slightly higher increase, the executive directors and other members of the Pearson Management Committee received increases of broadly 2% in line with the general level of increases elsewhere across the company. Full details of the executive directors' 2010 remuneration are set out in table 1 on page 79.

## Allowances and benefits

The company's policy is that benefit programmes should be competitive in the context of the local labour market, but as an international company we require executives to operate worldwide and recognise that recruitment also operates worldwide.

## Annual incentives

The committee establishes the annual incentive plans for the executive directors and the chief executives of the company's principal operating companies, including performance measures and targets. These plans then become the basis of the annual incentive plans below the level of the principal operating companies, particularly with regard to the performance measures used and the relationship between the relevant business unit operating plans, and the incentive targets.

We will continue to review the annual incentive plans each year and to revise the performance measures, targets and individual incentive opportunities in light of current conditions. We will continue to disclose details of the operation of the annual incentive plans in the report on directors' remuneration each year.

Annual incentive payments do not form part of pensionable earnings.

### Performance measures

The financial performance measures relate to the company's main drivers of business performance at both the corporate, operating company and business unit level. Performance is measured separately for each item. For each performance measure, the committee establishes threshold, target and maximum levels of performance for different levels of payout.

A proportion (which for 2011 may be up to 30%) of the total annual incentive opportunity for the executive directors and other members of the Pearson Management Committee is based on performance against personal objectives as agreed with the chief executive (or, in the case of the chief executive, the chairman). These comprise functional, operational, strategic and non-financial objectives relevant to the executives' specific areas of responsibility and *inter alia* may include objectives relating to environmental, social and governance issues.

For 2011, the principal financial performance measures are: sales; operating profit (for the operating companies) and growth in underlying earnings per share for continuing operations at constant exchange rates (for Pearson plc); average working capital as a ratio to sales; and operating cash flow. The selection and weighting of performance measures takes into account the strategic objectives and the business priorities relevant to each operating company and to Pearson overall each year.

### Incentive opportunities

In each year's report on directors' remuneration, we describe any changes to target and maximum incentive opportunities for the chief executive and the other executive directors for the year ahead.

For 2011, there are no changes to the target and maximum annual incentive opportunities for the chief executive which remain at 100% and 180% respectively, of base salary (as in 2010).

For the other members of the Pearson Management Committee, individual incentive opportunities take into account their membership of that committee and the contribution of their respective businesses or role to Pearson's overall financial goals. In the case of the executive directors, the target individual incentive opportunity for 2011 is in a range from 80% to 87.5% of base salary (as in 2010). The maximum opportunity remains at twice target (as in 2010).

The annual incentive plans are discretionary and the committee reserves the right to make adjustments to payouts up or down if it believes exceptional factors warrant doing so.

The committee may also award individual discretionary incentive payments.

For 2010, total annual incentive opportunities were based on Pearson plc and operating company financial performance and performance against personal objectives as follows:

| Name | Pearson plc | Operating company/ companies | Personal objectives |
|---|---|---|---|
| Marjorie Scardino | 90% | – | 10% |
| Will Ethridge | 30% | 60% | 10% |
| Rona Fairhead | 30% | 60% | 10% |
| Robin Freestone | 80% | – | 20% |
| John Makinson | 30% | 60% | 10% |

# Report on directors' remuneration continued

## 2010 performance

Performance in 2010 against the relevant incentive plans was as follows:

| Incentive plan | Performance measure | Performance against incentive plan: Below threshold | Between threshold and target | Between target and maximum | Above maximum |
|---|---|---|---|---|---|
| Pearson plc | Sales | | | ✓ | |
| | Underlying growth in adjusted earnings per share at constant exchange rates | | | | ✓ |
| | Average working capital to sales ratio | | | | ✓ |
| | Operating cash flow | | | | ✓ |
| Pearson Education North America | Sales | | | ✓ | |
| | Operating profit | | | ✓ | |
| | Average working capital to sales ratio | | | | ✓ |
| | Operating cash flow | | | | ✓ |
| FT Publishing | Sales | | | | ✓ |
| | Operating profit | | | | ✓ |
| | Operating cash flow | | | | ✓ |
| Pearson VUE | Sales | | | ✓ | |
| | Operating profit | | | | ✓ |
| | Average working capital to sales ratio | | | | ✓ |
| | Operating cash flow | | | | ✓ |
| Penguin Group | Sales | | | ✓ | |
| | Operating profit | | | | ✓ |
| | Operating margin | | | | ✓ |
| | Average working capital to sales ratio | | | | ✓ |
| | Operating cash flow | | | ✓ | |

Details of actual payouts for 2010 are set out in table 1 on page 79.

## Bonus share matching

In 2008, shareholders approved the renewal of the annual bonus share matching plan first approved by shareholders in 1998.

### Invested and matching shares

The plan permits executive directors and senior executives around the company to invest up to 50% of any after-tax annual bonus in Pearson shares.

If the participant's invested shares are held, they are matched subject to earnings per share growth over the three-year performance period on a gross basis i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares.

50% of the maximum matching award is released if the company's adjusted earnings per share increase in real terms by 3% per annum compound over the three-year performance period. 100% of the maximum matching award is released if the company's adjusted earnings per share increase in real terms by 5% per annum compound over the same period.

For real growth in adjusted earnings per share of between 3% and 5% per annum compound, the rate at which the matching award is released is calculated according to a straight-line sliding scale.

| Real earnings per share growth per annum | Proportion of maximum matching award released |
|---|---|
| Less than 3% | 0% |
| 3% | 50% |
| Between 3% and 5% | Sliding scale between 50% and 100% |
| 5% or more | 100% |

## Performance condition

Earnings per share growth is calculated using the point-to-point method. This method compares the adjusted earnings per share in the company's accounts for the financial year ended prior to the grant date with the adjusted earnings per share for the financial year ending three years later and calculates the implicit compound annual growth rate over the period.

Real growth is calculated by reference to the UK Government's Retail Prices Index (All Items).

## Dividend shares

Where matching shares vest in accordance with the plan, participants also receive additional shares representing the gross value of dividends that would have been paid on the matching shares during the performance period and reinvested.

## Outstanding awards

Details of awards made, outstanding, held or released under the annual bonus share matching plan are as follows (subject to audit):

| Date of award | Share price on date of award | Vesting | Status of award |
|---|---|---|---|
| 21 April 2010 | 1,024.1p | 21 April 2013 | Outstanding subject to 2009 to 2012 performance |
| 16 April 2009 | 670.0p | 16 April 2012 | Outstanding subject to 2008 to 2011 performance |
| 4 June 2008 | 670.7p | 4 June 2011 | Performance condition for release of maximum matching award met. Real compound annual growth in earnings per share for 2007 to 2010 of 15.3% against target of 5%. Shares held pending release on 4 June 2011 |
| 22 May 2007 (See note 1) | 899.9p | 50% on 22 May 2010 | Target met as reported in report on directors' remuneration for 2009. Shares held pending release on 22 May 2012 |
| | | 100% on 22 May 2012 | Outstanding subject to 2006 to 2011 performance |
| 12 April 2006 (See note 1) | 776.2p | 100% on 12 April 2011 | Performance condition for release of 100% of matching award met. Real compound annual growth in earnings per share for 2005 to 2010 of 14.1% against target of 3%. Shares held pending release on 12 April 2011 |
| 15 April 2005 (See note 1) | 631.0p | 100% on 2 March 2010 | Target met as reported in report on directors' remuneration for 2009. Shares released on 2 March 2010 (see note 2) |

Note 1 For awards made prior to 2008, the annual bonus share matching plan operated on the basis of a 50% match after three years and 100% match after five years, subject to the earnings per share growth targets being met over the relevant performance periods.

Note 2 Having satisfied itself that the necessary performance conditions had been met, the committee agreed that for this award the shares be released earlier than the normal vesting date of the fifth anniversary of the date of the award.

All of the executive directors hold or held awards under this plan in 2010. Details are set out in table 4 on pages 82 to 84 and itemised as a or a*.

# Report on directors' remuneration continued

## Long-term incentives

We are asking shareholders by separate resolution to approve the renewal of the long-term incentive plan first introduced in 2001 and renewed again in 2006. Full details are set out in the circular to shareholders.

The committee has reviewed the operation of this plan in light of the company's strategic goals. The committee has concluded that the plan is achieving its objectives and, looking forward, will continue to enable the company to recruit and retain the most able managers worldwide and to ensure their long-term incentives encourage outstanding performance and are competitive in the markets in which we operate.

We are therefore seeking approval of its renewal on broadly its existing terms. Subject to shareholders' approval, executive directors, senior executives and other managers can participate in this plan which can deliver restricted stock and/or stock options. Approximately 6% of the company's employees currently hold awards under this plan.

The aim is to give the committee a range of tools with which to link corporate performance to management's long-term reward in a flexible way. It is not the committee's intention to grant stock options in 2011 or for the foreseeable future.

Restricted stock granted to executive directors vests only if stretching corporate performance targets over a specified period have been met. Awards vest on a sliding scale based on performance over the period. There is no retesting.

### Performance measures

The committee determines the performance measures and targets governing an award of restricted stock prior to grant.

The performance measures that will apply for the executive directors for awards in 2011 and subsequent years will continue to be focused on delivering and improving returns to shareholders. These measures, which have applied since 2004, are relative total shareholder return (TSR), return on invested capital (ROIC) and earnings per share (EPS) growth.

*Total shareholder return* is the return to shareholders from any growth in Pearson's share price and reinvested dividends over the performance period. For long-term incentive awards, TSR is measured relative to the constituents of the FTSE World Media Index over a three-year period. Companies that drop out of the index are normally excluded i.e. only companies in the index for the entire period are counted.

Share price is averaged over 20 days at the start and end of the performance period, commencing on the date of Pearson's results announcement in the year of grant and the year of vesting. Dividends are treated as reinvested on the ex-dividend date, in line with the Datastream methodology.

The vesting of shares based on relative TSR is subject to the committee satisfying itself that the recorded TSR is a genuine reflection of the underlying financial performance of the business.

The committee chose TSR relative to the constituents of the FTSE World Media Index because, in line with many of our shareholders, it felt that part of executive directors' rewards should be linked to performance relative to the company's peers.

*Return on invested capital* is adjusted operating profit less cash tax expressed as a percentage of gross invested capital (net operating assets plus gross goodwill).

We chose ROIC because, over the past few years, the transformation of Pearson has significantly increased the capital invested in the business (mostly in the form of goodwill associated with acquisitions) and required substantial cash investment to integrate those acquisitions.

*Adjusted earnings per share* is calculated by dividing the adjusted earnings attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding any ordinary shares purchased by the company and held in trust (see note 8 of the financial statements for a detailed description of adjusted earnings per share).

Since 2008, EPS growth has been calculated using the point-to-point method. This method compares the adjusted EPS in the company's accounts for the financial year ended prior to the grant date with the adjusted EPS for the financial year ending three years later and calculates the implicit compound annual growth rate over the period.

We chose EPS growth because strong bottom-line growth is imperative if we are to improve our TSR and our ROIC.

Pearson's reported financial results for the relevant periods are used to measure performance.

The committee has discretion to make adjustments taking into account exceptional factors that distort underlying business performance. In exercising such discretion, the committee is guided by the principle of aligning shareholder and management interests. Restricted stock may be granted without performance conditions to satisfy recruitment and retention objectives. Restricted stock awards that are not subject to performance conditions will not be granted to any of the current executive directors.

### Performance targets

We will set targets for the 2011 awards that are consistent with the company's strategic objectives over the period to 2013 and that are no less stretching than in previous years. Full details of the performance targets for 2011 will be set out in the circular to shareholders on the renewal of the plan and in the report on directors' remuneration for 2011.

### Value of awards

Our approach to the level of individual awards takes into account a number of factors.

First, we take into account the face value of individual awards at the time of grant assuming that the performance targets are met in full. Secondly, we take into account the assessments by our independent advisers of market practice for comparable companies and of directors' total remuneration relative to the market. And thirdly, we take into account individual roles and responsibilities, and company and individual performance.

### Future awards

For awards beyond 2011, the committee may use the same performance measures and targets, or apply different ones that are consistent with the company's objectives and which it considers to be similarly demanding. The committee also has the flexibility to vary individual award levels.

The committee will consult with shareholders before making any significant changes to its approach to, or policy on, performance measures or targets or the range of award levels established by awards in recent years.

### Dividends

Where shares vest, in accordance with the plan, participants also receive additional shares representing the gross value of dividends that would have been paid on these shares during the performance period and reinvested.

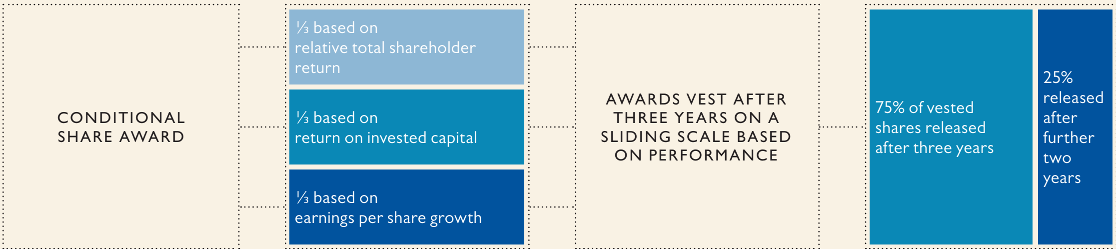
### Retention period

We encourage executives and managers to build up a long-term holding of shares so as to demonstrate their commitment to the company.

To achieve this, for awards of restricted stock that are subject to performance conditions over a three-year period, a percentage of the award (normally 75%) vests at the end of the three-year period. The remainder of the award (normally 25%) only vests if the participant retains the after-tax number of shares that vest at year three for a further two years.

All of the executive directors hold awards under the long-term incentive plan. Details are set out in table 4 on pages 82 to 84 and itemised as b or b*.

# Report on directors' remuneration continued




## Outstanding awards

Details of awards made, outstanding, vested and held or released under the long-term incentive plan are as follows (subject to audit):

| Date of award | Share price on date of award | Vesting date | Performance measures (award split equally across three measures) | Performance period | Payout at threshold | Payout at maximum | Actual performance | % of award vested | Status of award |
|---|---|---|---|---|---|---|---|---|---|
| 03/03/10 | 962.0p | 03/03/13 | Relative TSR | 2010 to 2013 | 30% at median | 100% at upper quartile | – | – | Outstanding |
| | | | ROIC | 2012 | 25% for ROIC of 8.5% | 100% for ROIC of 10.5% | – | – | Outstanding |
| | | | EPS growth | 2012 compared to 2009 | 30% for EPS growth of 6.0% | 100% For EPS growth of 12.0% | – | – | Outstanding |
| 03/03/09 | 654.0p | 03/03/12 | Relative TSR | 2009 to 2012 | 30% at median | 100% at upper quartile | – | – | Outstanding |
| | | | ROIC | 2011 | 25% for ROIC of 8.5% | 100% for ROIC of 10.5% | – | – | Outstanding |
| | | | EPS growth | 2011 compared to 2008 | 30% for EPS growth of 6.0% | 100% for EPS growth of 12.0% | – | – | Outstanding |
| 04/03/08 | 649.5p | 04/03/11 | Relative TSR | 2008 to 2011 | 30% at median | 100% at upper quartile | – | – | Outstanding |
| | | | ROIC | 2010 | 25% for ROIC of 8.5% | 100% for ROIC of 10.5% | 10.3% | 92.5% | Vested and remain held pending release |
| | | | EPS growth | 2010 compared to 2007 | 30% for EPS growth of 6.0% | 100% for EPS growth of 12.0% | 18.4% | 100% | Vested and remain held pending release |

| Date of award | Share price on date of award | Vesting date | Performance measures (award split equally across three measures) | Performance period | Payout at threshold | Payout at maximum | Actual performance | % of award vested | Status of award |
|---|---|---|---|---|---|---|---|---|---|
| 30/07/07 | 778.0p | 02/03/10 | Relative TSR | 2007 to 2010 | 30% at median | 100% at upper quartile | 94th percentile (6th out of 85 companies) | 100% | 80% of shares vested. Three-quarters released on 2 March 2010 (See note 2). If after tax number of shares are retained for a further two years, the remaining quarter will be released on 30 July 2012. |
| | | | ROIC | 2009 | 25% for ROIC of 8.5% | 100% for ROIC of 10.5% | 8.9% | 40% | |
| | | | EPS growth | 2007 to 2009 compared to 2006 (see note 1) | 30% for EPS growth of 6.0% | 100% for EPS growth of 12.0% | 14.3% | 100% | |

Note 1 For awards prior to 2008, EPS growth is calculated using the aggregate method that sums the results for each year and calculates the compound aggregate average annual growth assuming a constant increase on the base year throughout the period.

Note 2 Having satisfied itself that the necessary performance conditions have been met, the committee agreed that for this award the shares be released earlier than the normal vesting date of the third anniversary of the date of the award.

## All-employee share plans

Executive directors can participate in the company's all-employee share plans on the same terms as other employees.

These plans comprise savings-related share acquisition programmes in the UK and the US.

These plans operate within specific tax legislation (including a requirement to finance acquisition of shares using the proceeds of a monthly savings contract) and the acquisition of shares under these plans is not subject to the satisfaction of a performance target.

## Dilution and use of equity

We can use existing shares bought in the market, treasury shares or newly-issued shares to satisfy awards under the company's various stock plans.

For restricted stock awards under the long-term incentive plan and matching share awards under the annual bonus share matching plan, we would normally expect to use existing shares.

There are limits on the amount of new-issue equity we can use. In any rolling ten-year period, no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans, and no more than 5% of Pearson equity will be issued, or be capable of being issued, under executive or discretionary plans.

At 31 December 2010, stock awards to be satisfied by new-issue equity granted in the last ten years under all Pearson share plans amounted to 2.4% of the company's issued share capital and under executive or discretionary share plans amounted to 0.9%.

In addition, for existing shares no more than 5% of Pearson equity may be held in trust at any time. Against this limit, shares held in trust at 31 December 2010 amounted to 1.7% of the company's issued share capital.

# Report on directors' remuneration continued

The headroom available for all Pearson plans, executive or discretionary plans and shares held in trust is as follows:

| Headroom | 2010 | 2009 | 2008 |
|---|---|---|---|
| All Pearson plans | 7.6% | 6.4% | 6.2% |
| Executive or discretionary plans | 4.1% | 3.0% | 2.8% |
| Shares held in trust | 3.3% | 3.3% | 3.3% |

## Shareholding of executive directors

The committee expects executive directors to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership. To complement the operation of the company's long-term incentive arrangements, we will in future operate formal shareholding guidelines for executive directors. The target holding will be 200% of the salary for the chief executive and 125% of salary for the other executive directors consistent with median practice in FTSE 100 companies that operate such arrangements.

Shares that count towards these guidelines will include any shares held unencumbered by the executive, their spouse and/or dependent children (as set out in table 3 on page 81). They will also include any shares vested but held pending release under a restricted share plan (as marked as * in table 4 on pages 82 to 84).

Executive directors will have five years from the date of appointment to reach the guideline.

The value of the executive directors' holdings based on the middle market value of Pearson shares on 25 February 2011 (which is the latest practicable date before the results announcement) comfortably exceeded these guidelines.

## Service agreements

In accordance with long established policy, all continuing executive directors have rolling service agreements under which, other than by termination in accordance with the terms of these agreements, employment continues until retirement.

The committee reviewed the policy on executive service agreements in 2008 and again in 2010. Our policy is that future executive director agreements should provide that the company may terminate these agreements by giving no more than 12 months' notice. As an alternative, the company may at its discretion pay in lieu of that notice. Payment in lieu of notice may be made in instalments and may be subject to mitigation.

We will keep the application of the policy on executive service agreements, including provisions for payment in lieu of notice, under review, particularly with regard to the arrangements for any new executive directors.

In the case of the longer serving directors with legacy agreements, the compensation payable in circumstances where the company terminates the agreements without notice or cause takes the form of liquidated damages.

There are no special provisions for notice, pay in lieu of notice or liquidated damages in the event of termination of employment in the event of a change of control of Pearson.

On termination of employment, executive directors' entitlements to any vested or unvested awards under Pearson's discretionary share plans are treated in accordance with the terms of the relevant plan.

We summarise the service agreements that applied during 2010 and that continue to apply for 2011 as follows:

| Name | Date of agreement | Notice periods | Compensation on termination by the company without notice or cause |
|---|---|---|---|
| Glen Moreno | 29 July 2005 | 12 months from the director; 12 months from the company | 100% of annual fees at the date of termination |
| Marjorie Scardino | 27 February 2004 | Six months from the director; 12 months from the company | 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential annual incentive |
| Will Ethridge | 26 February 2009 | Six months from the director; 12 months from the company | 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and target annual incentive |
| Rona Fairhead | 24 January 2003 | Six months from the director; 12 months from the company | 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential annual incentive |
| Robin Freestone | 5 June 2006 | Six months from the director; 12 months from the company | No contractual provisions |
| John Makinson | 24 January 2003 | Six months from the director; 12 months from the company | 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential annual incentive |

## Retirement benefits

We describe the retirement benefits for each of the executive directors. Details of directors' pension arrangements are set out in table 2 on page 80 of this report.

Executive directors participate in the pension arrangements set up for Pearson employees.

Marjorie Scardino, Will Ethridge, John Makinson, Rona Fairhead and Robin Freestone will also have other retirement arrangements because of the cap on the amount of benefits that can be provided from the pension arrangements in the US and the UK.

The differences in the arrangements for the current executive directors reflect the different arrangements in the UK and the US and the changes in pension arrangements generally over the periods of their employment.

Executive directors are entitled to life insurance cover while in employment, and to a pension in the event of ill-health or disability. A pension for their spouse and/or dependants is also available on death.

In the US, the defined benefit arrangement is the Pearson Inc. Pension Plan. This plan provides a lump sum convertible to an annuity on retirement. The lump sum accrued at 6% of capped compensation until 31 December 2001 when further benefit accruals ceased for most employees. Employees who satisfied criteria of age and service at that time continued to accrue benefits under the plan. Will Ethridge is included in this group and continues to accrue benefits under this plan. Marjorie Scardino is not and her benefit accruals under this plan ceased at the end of 2001.

The defined contribution arrangement in the US is a 401(k) plan. At retirement, the account balances will be used to provide benefits. In the event of death before retirement, the account balances will be used to provide benefits for dependants.

# Report on directors' remuneration continued

In the UK, the pension plan is the Pearson Group Pension Plan and executive directors participate in either the Final Pay or the Money Purchase 2003 section. Normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55. In the Final Pay section, the accrued pension is reduced on retirement prior to age 60. Pensions in payment are guaranteed to increase each year at 5% or the rise in inflation each year, if lower. Pensions for a member's spouse, dependant children and/or nominated financial dependant are payable in the event of death. In the Money Purchase 2003 section the account balances are used to provide benefits at retirement. In the event of death before retirement pensions for a member's spouse, dependant children and/or nominated financial dependant are payable.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at 6 April 2006, was abolished by the Finance Act 2004. However the Pearson Group Pension Plan has retained its own 'cap', which will increase annually in line with the UK Government's Index of Retail Prices (All Items). The cap was £123,600 as at 6 April 2010.

As a result of the UK Government's A-Day changes effective from April 2006, UK executive directors and other members of the Pearson Group Pension Plan who are, or become, affected by the lifetime allowance are provided with a cash supplement as an alternative to further accrual of pension benefits on a basis that is broadly cost neutral to the company.

### Marjorie Scardino

Marjorie Scardino participates in the Pearson Inc. Pension Plan and the approved 401(k) plan. Until 2010, additional benefits were provided through an unfunded unapproved defined contribution plan.

Since 2010, additional pension benefits are provided through a taxable and non-pensionable cash supplement in place of the unfunded plan, a funded defined contribution plan approved by HM Revenue and Customs as a corresponding plan, and amounts in the legacy unfunded plan. In aggregate, the cash supplement and contributions to the funded plan are based on a percentage of salary and a fixed cash amount index-linked to inflation.

The notional cash balance of the legacy unfunded plan increases annually by a specified notional interest rate. The unfunded plan also provides the opportunity to convert a proportion of this notional cash account into a notional share account reflecting the value of a number of Pearson ordinary shares. The number of shares in the notional share account is determined by reference to the market value of Pearson shares at the date of conversion.

### Will Ethridge

Will Ethridge is a member of the Pearson Inc. Pension Plan and the approved 401(k) plan. He also participates in an unfunded, non-qualified Supplemental Executive Retirement Plan (SERP) that provides an annual accrual of 2% of final average earnings, less benefits accrued in the Pearson Inc. Pension Plan and US Social Security. Additional defined contribution benefits are provided through a funded, non-qualified Excess Plan.

### Rona Fairhead

Rona Fairhead is a member of the Pearson Group Pension Plan. Her pension accrual rate is 1/30th of pensionable salary per annum, restricted to the plan earnings cap.

Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on her behalf. Since April 2006, she has received a taxable and non-pensionable cash supplement in replacement of the FURBS.

### Robin Freestone

Robin Freestone is a member of the Money Purchase 2003 section of the Pearson Group Pension Plan. Company contributions are 16% of pensionable salary per annum, restricted to the plan earnings cap.

Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.

### John Makinson

John Makinson is a member of the Pearson Group Pension Plan under which his pensionable salary is restricted to the plan earnings cap. The company ceased contributions on 31 December 2001 to his FURBS arrangement. During 2002 it set up an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for him. The UURBS tops up the pension payable from the Pearson Group Pension Plan and the closed FURBS to target a pension of two-thirds of a revalued base salary on retirement at age 62. The revalued base salary is defined as £450,000 effective at 1 June 2002, increased at 1 January each year by reference to the increase in the UK Government's Index of Retail Prices (All Items). In the event of his death a pension from the Pearson Group Pension Plan, the FURBS and the UURBS will be paid to his spouse or nominated financial dependant. Early retirement is currently possible from age 55, with company consent.

The pension is reduced to reflect the shorter service, and before age 60, further reduced for early payment.

### Executive directors' non-executive directorships

The committee's policy is that executive directors may, by agreement with the board, serve as non-executives of other companies and retain any fees payable for their services.

The following executive directors served as non-executive directors elsewhere and received fees or other benefits for the period covered by this report as follows:

| | Company | Fees/benefits |
|---|---|---|
| Marjorie Scardino | Nokia Corporation | €150,000 |
| | MacArthur Foundation | $27,000 |
| Rona Fairhead | HSBC Holdings plc | £151,844 |
| | Spencer Stuart Advisory Board | £15,000 |

Other executive directors served as non-executive directors elsewhere but did not receive fees.

### Chairman's remuneration

The committee's policy is that the chairman's pay should be set at a level that is competitive with those of chairmen in similar positions in comparable companies. He is not entitled to any annual or long-term incentive, retirement or other benefits.

There were no changes in the chairman's remuneration in 2010. With effect from 1 January 2007, his remuneration was £450,000 per year. We reviewed the chairman's remuneration at the end of 2010 and agreed that this would be increased to £500,000 per year with effect from 1 April 2011. The next review would take place in three years' time.

### Non-executive directors

Fees for non-executive directors are determined by the full board having regard to market practice and within the restrictions contained in the company's Articles of Association. Non-executive directors receive no other pay or benefits (other than reimbursement for expenses incurred in connection with their directorship of the company) and do not participate in the company's equity-based incentive plans. With effect from 1 July 2010, the structure and fees are as follows:

| | Fees payable from 1 July 2010 |
|---|---|
| Non-executive director | £65,000 |
| Chairmanship of audit committee | £25,000 |
| Chairmanship of remuneration committee | £20,000 |
| Membership of audit committee | £10,000 |
| Membership of remuneration committee | £5,000 |
| Senior independent director | £20,000 |

A minimum of 25% of the basic fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

Non-executive directors serve Pearson under letters of appointment and do not have service contracts. There is no entitlement to compensation on the termination of their directorships.

# Report on directors' remuneration continued

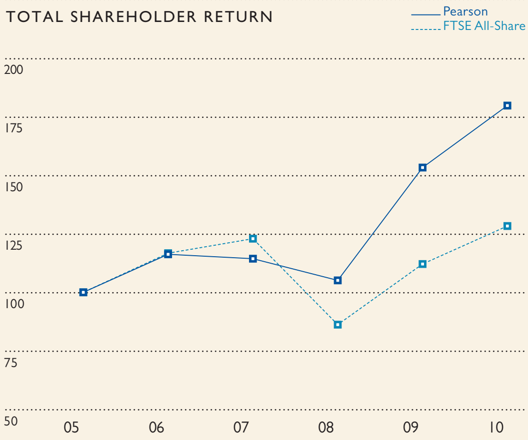
## Total shareholder return performance

Below we set out Pearson's total shareholder return on three bases. Pearson is a constituent of all the indices shown.

First, we set out Pearson's total shareholder return performance relative to the FTSE All-Share index on an annual basis over the five-year period 2005 to 2010.

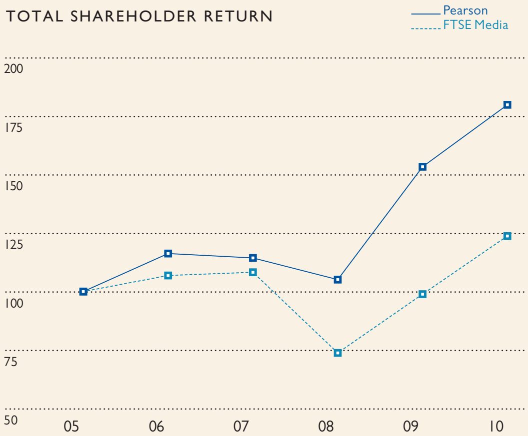
We have chosen this index, and used it consistently in each report on directors' remuneration since 2002, on the basis that it is a recognisable reference point and an appropriate comparator for the majority of our investors.

TOTAL SHAREHOLDER RETURN



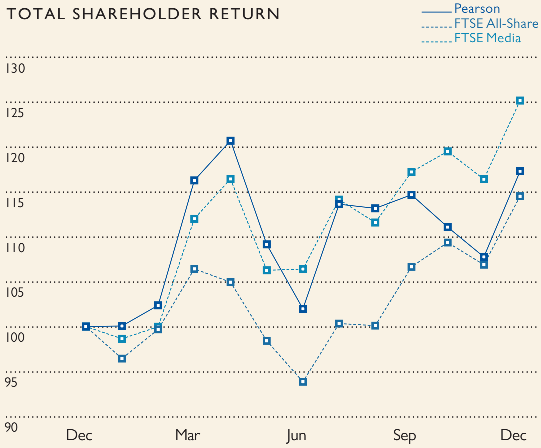

Secondly, to illustrate performance against our sector, we show Pearson's total shareholder return relative to the FTSE Media index over the same five-year period.

TOTAL SHAREHOLDER RETURN




And thirdly, we show Pearson's total shareholder return relative to the FTSE All-Share and Media indices on a monthly basis over 2010, the period to which this report relates.

TOTAL SHAREHOLDER RETURN



## Items subject to audit

The following tables form the auditable part of the remuneration report, except table 3 which is not subject to audit.

## Table 1: Remuneration of the directors

Excluding contributions to pension funds and related benefits set out in table 2, directors' remuneration was as follows:

| | | | | | 2010 | 2009 |
|---|---|---|---|---|---|---|
| All figures in £000s | Salaries/fees | Annual incentive | Allowances | Benefits | Total | Total |
| **Chairman** | | | | | | |
| Glen Moreno | 450 | – | – | – | 450 | 450 |
| **Executive directors** | | | | | | |
| Marjorie Scardino | 969 | 1,606 | 70 | 17 | 2,662 | 2,328 |
| Will Ethridge | 661 | 1,010 | – | – | 1,671 | 1,513 |
| Rona Fairhead | 516 | 826 | 12 | 19 | 1,373 | 1,104 |
| Robin Freestone | 460 | 685 | 7 | 6 | 1,158 | 1,102 |
| John Makinson | 536 | 801 | 232 | 6 | 1,575 | 1,425 |
| **Non-executive directors** | | | | | | |
| David Arculus | 90 | – | – | – | 90 | 85 |
| Terry Burns (stepped down on 30 April 2010) | 28 | – | – | – | 28 | 83 |
| Patrick Cescau | 86 | – | – | – | 86 | 70 |
| Susan Fuhrman | 73 | – | – | – | 73 | 70 |
| Ken Hydon | 90 | – | – | – | 90 | 85 |
| CK Prahalad (deceased 16 April 2010) | 30 | – | – | – | 30 | 60 |
| **Total** | 3,989 | 4,928 | 321 | 48 | 9,286 | 8,375 |
| Total 2009 (including former directors) | 4,127 | 4,246 | 272 | 97 | – | 8,742 |

Note 1 Allowances for Marjorie Scardino include £45,005 in respect of housing costs and a US payroll supplement of £11,754. John Makinson is entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US and received £218,653 for 2010.

Note 2 Benefits include company car, car allowance and UK healthcare premiums. US health and welfare benefits for Marjorie Scardino and Will Ethridge are self-insured and the company cost, after employee contributions, is tax free to employees. For Marjorie Scardino, benefits include £15,450 for pension planning and financial advice. Marjorie Scardino, Rona Fairhead and John Makinson have the use of a chauffeur.

Note 3 No amounts as compensation for loss of office and no expense allowances chargeable to UK income tax were paid during the year.

# Report on directors' remuneration continued

## Table 2: Directors' pensions and other pension-related items

| Directors' pensions | Age at 31 Dec 10 | Accrued pension at 31 Dec 10 £000[1] | Increase in accrued pension over the period £000[2] | Transfer value at 31 Dec 09 £000[3] | Transfer value at 31 Dec 10 £000[4] | Increase in transfer value over the period £000[5] | Increase/ (decrease) in accrued pension over the period £000[6] | Transfer value of the increase/ (decrease) in accrued pension at 31 Dec 10 £000[5/6] | Other pension costs to the company over the period £000[7] | Other allowances in lieu of pension £000[8] | Other pension related benefit costs £000[9] |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Marjorie Scardino | 63 | 4.6 | 0.1 | 44.1 | 47.3 | 3.2 | 0.0 | 0.0 | 9.0 | 620.7 | 59.1 |
| Will Ethridge | 58 | 160.0 | 33.0 | 1,037.2 | 1,418.4 | 381.2 | 29.1 | 258.0 | 32.8 | – | 1.0 |
| Rona Fairhead | 49 | 38.1 | 5.8 | 466.0 | 489.2 | 17.1 | 4.8 | 55.4 | – | 120.7 | 13.5 |
| Robin Freestone | 52 | – | – | – | – | – | – | – | 19.8 | 114.8 | 4.8 |
| John Makinson | 56 | 277.4 | 22.6 | 4,897.6 | 4,767.0 | (136.8) | 14.8 | 248.1 | – | – | 12.2 |

Note 1 The accrued pension at 31 December 2010 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2010. For Marjorie Scardino this relates to a fixed pension from the US plan. For Will Ethridge the pension quoted in this column relates to his pension from the US Plan and the US SERP. For Rona Fairhead it relates to the pension payable from the UK Plan. For John Makinson it relates to the pension from the UK Plan, the FURBS and the UURBS in aggregate. Robin Freestone does not accrue defined benefits.

Note 2 This is the change in accrued pension over the year compared with the accrued pension at the end of the previous year.

Note 3 This is the transfer value quoted at the end of the previous year.

Note 4 The UK transfer values at 31 December 2010 are calculated using the assumptions for cash equivalents payable from the UK Plan and are based on the accrued pension at that date. During 2010 the Trustee of the UK Plan revised the transfer value methodology. Prior to the review the discount rates included a prudence margin. Following the review the Trustee agreed to remove this margin which, all other things being equal, had the effect of reducing transfer values from the UK Plan. The effect of this change was offset by changes to the mortality assumptions. For the US SERP, transfer values are calculated using a discount rate equivalent to current US long term bond yields. The US Plan is a lump sum plan and the accrued balance is included where applicable.

Note 5 Less directors' contributions.

Note 6 Net of UK inflation (where inflation is the increase in CPI to the previous September, subject to a minimum of 0%).

Note 7 This column comprises contributions to deferred contribution arrangements for UK benefits. For US benefits, it includes company contributions to funded defined contribution plans.

Note 8 This column represents the cash allowances paid in lieu of the previous unfunded defined contribution plan for Marjorie Scardino and of the previous FURBS arrangements for Rona Fairhead and Robin Freestone.

Note 9 This column comprises life cover and long-term disability insurance not covered by the retirement plans.

## Table 3: Interests of directors

| | Ordinary shares at 1 Jan 10 | Ordinary shares at 31 Dec 10 |
|---|---|---|
| Glen Moreno | 210,000 | 150,000 |
| Marjorie Scardino | 824,124 | 1,107,118 |
| David Arculus | 13,044 | 14,053 |
| Terry Burns (stepped down on 30 April 2010 ) | 12,008 | 12,222 |
| Patrick Cescau | 5,356 | 6,282 |
| Will Ethridge | 262,988 | 333,395 |
| Rona Fairhead | 270,982 | 342,669 |
| Robin Freestone | 118,996 | 193,954 |
| Susan Fuhrman | 9,384 | 11,363 |
| Ken Hydon | 9,774 | 10,715 |
| John Makinson | 474,581 | 551,039 |
| CK Prahalad (deceased 16 April 2010) | 2,197 | 2,410 |

Note 1 Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals investing part of their own after-tax annual bonus in Pearson shares under the annual bonus share matching plan.

Note 2 From 2004, Marjorie Scardino is also deemed to be interested in a further number of shares under her unfunded pension arrangement described in this report, which provides the opportunity to convert a proportion of her notional cash account into a notional share account reflecting the value of a number of Pearson shares.

Note 3 The register of directors' interests (which is open to inspection during normal office hours) contains full details of directors' shareholdings and options to subscribe for shares. The market price on 31 December 2010 was 1,008.0p per share and the range during the year was 855.0p to 1,051.0p.

Note 4 At 31 December 2010, Patrick Cescau held 168,000 Pearson bonds.

Note 5 There were no movements in ordinary shares between 1 January 2011 and a month prior to the sign-off of this report.

Note 6 ordinary shares do not include any shares vested but held pending release under a restricted share plan.

# Report on directors' remuneration continued

## Table 4: Movements in directors' interests in restricted shares

Restricted shares designated as: a annual bonus share matching plan; b long-term incentive plan; * where shares at 31 December 2010 have vested and are held pending release; and ** where dividend-equivalent shares were added to the released shares.

| Date of award | 1 Jan 10 | Awarded | Released | Lapsed | 31 Dec 10 | Market value at date of award | Earliest release date | Date of release | Market value at date of release |
|---|---|---|---|---|---|---|---|---|---|
| **Marjorie Scardino** | | | | | | | | | |
| a* 22/5/07 | 30,143 | | | | 30,143 | 899.9p | 22/5/10 | | |
| a 22/5/07 | 30,144 | | | | 30,144 | 899.9p | 22/5/12 | | |
| a* 4/6/08 | 99,977 | | | | 99,977 | 670.7p | 4/6/11 | | |
| a 21/4/10 | 0 | 63,497 | | | 63,497 | 1,024.1p | 21/4/13 | | |
| b 26/9/03 | 120,200 | | 24,040 | 96,160 | 0 | 582.0p | 29/9/06 | 29/3/10 | 1,032.0p |
| b 21/12/04 | 83,197 | | 83,197 | | 0 | 613.0p | 21/12/09 | 3/3/10 | 962.0p |
| b 23/9/05 | 97,500 | | 97,500 | | 0 | 655.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 13/10/06 | 93,750 | | | | 93,750 | 767.5p | 13/10/09 | | |
| b* 30/7/07 | 336,000 | | 252,000 | | 84,000 | 778.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 4/3/08 | 266,667 | | | 10,000 | 256,667 | 649.5p | 4/3/11 | | |
| b 4/3/08 | 133,333 | | | | 133,333 | 649.5p | 4/3/11 | | |
| b 3/3/09 | 450,000 | | | | 450,000 | 654.0p | 3/3/12 | | |
| b 3/3/10 | 0 | 400,000 | | | 400,000 | 962.0p | 3/3/13 | | |
| b** 2/3/10 | 0 | 32,256 | 32,256 | | 0 | 951.0p | 2/3/10 | 3/3/10 | 962.0p |
| **Total** | 1,740,911 | 495,753 | 488,993 | 106,160 | 1,641,511 | | | | |
| **Will Ethridge** | | | | | | | | | |
| a* 22/5/07 | 1,254 | | | | 1,254 | 899.9p | 22/5/10 | | |
| a 22/5/07 | 1,254 | | | | 1,254 | 899.9p | 22/5/12 | | |
| a 16/4/09 | 112,515 | | | | 112,515 | 670.0p | 16/4/12 | | |
| a 21/4/10 | 0 | 7,880 | | | 7,880 | 1,024.1p | 21/4/13 | | |
| b 23/9/05 | 21,017 | | 21,017 | | 0 | 655.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 13/10/06 | 41,667 | | | | 41,667 | 767.5p | 13/10/09 | | |
| b* 30/7/07 | 120,000 | | 90,000 | | 30,000 | 778.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 4/3/08 | 100,000 | | | 3,750 | 96,250 | 649.5p | 4/3/11 | | |
| b 4/3/08 | 50,000 | | | | 50,000 | 649.5p | 4/3/11 | | |
| b 3/3/09 | 175,000 | | | | 175,000 | 654.0p | 3/3/12 | | |
| b 3/3/10 | 0 | 150,000 | | | 150,000 | 962.0p | 3/3/13 | | |
| b** 2/3/10 | 0 | 11,520 | 11,520 | | 0 | 951.0p | 2/3/10 | 3/3/10 | 962.0p |
| **Total** | 622,707 | 169,400 | 122,537 | 3,750 | 665,820 | | | | |

## Table 4: Movements in directors' interests in restricted shares continued

Restricted shares designated as: a annual bonus share matching plan; b long-term incentive plan; * where shares at 31 December 2010 have vested and are held pending release; and ** where dividend-equivalent shares were added to the released shares.

| Date of award | 1 Jan 10 | Awarded | Released | Lapsed | 31 Dec 10 | Market value at date of award | Earliest release date | Date of release | Market value at date of release |
|---|---|---|---|---|---|---|---|---|---|
| **Rona Fairhead** | | | | | | | | | |
| a 15/4/05 | 19,746 | | 19,746 | | 0 | 631.0p | 2/3/10 | 3/3/10 | 962.0p |
| a* 12/4/06 | 16,101 | | | | 16,101 | 776.2p | 12/4/11 | | |
| b 26/9/03 | 82,400 | | 16,480 | 65,920 | 0 | 582.0p | 26/9/06 | 29/3/10 | 1,032.0p |
| b 21/12/04 | 33,002 | | 33,002 | | 0 | 613.0p | 21/12/09 | 3/3/10 | 962.0p |
| b 23/9/05 | 43,334 | | 43,334 | | 0 | 655.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 13/10/06 | 29,167 | | | | 29,167 | 767.5p | 13/10/09 | | |
| b* 30/7/07 | 100,000 | | 75,000 | | 25,000 | 778.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 4/3/08 | 83,333 | | | 3,125 | 80,208 | 649.5p | 4/3/11 | | |
| b 4/3/08 | 41,667 | | | | 41,667 | 649.5p | 4/3/11 | | |
| b 3/3/09 | 150,000 | | | | 150,000 | 654.0p | 3/3/12 | | |
| b 3/3/10 | 0 | 125,000 | | | 125,000 | 962.0p | 3/3/13 | | |
| b** 2/3/10 | 0 | 9,600 | 9,600 | | 0 | 951.0p | 2/3/10 | 3/3/10 | 962.0p |
| **Total** | 598,750 | 134,600 | 197,162 | 69,045 | 467,143 | | | | |
| **Robin Freestone** | | | | | | | | | |
| a* 12/4/06 | 3,435 | | | | 3,454 | 776.2p | 12/4/11 | | |
| a* 22/5/07 | 2,354 | | | | 2,354 | 899.9p | 22/5/10 | | |
| a 22/5/07 | 2,354 | | | | 2,354 | 899.9p | 22/5/12 | | |
| a* 4/6/08 | 37,906 | | | | 37,906 | 670.7p | 4/6/11 | | |
| a 16/4/09 | 35,446 | | | | 35,446 | 670.0p | 16/4/12 | | |
| a 21/4/10 | 0 | 31,114 | | | 31,114 | 1,024.1p | 21/4/13 | | |
| b* 13/10/06 | 26,042 | | | | 26,042 | 767.5p | 13/10/09 | | |
| b* 30/7/07 | 100,000 | | 75,000 | | 25,000 | 778.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 4/3/08 | 83,333 | | | 3,125 | 80,208 | 649.5p | 4/3/11 | | |
| b 4/3/08 | 41,667 | | | | 41,667 | 649.5p | 4/3/11 | | |
| b 3/3/10 | 150,000 | | | | 150,000 | 654.0p | 3/3/12 | | |
| b 3/3/10 | 0 | 125,000 | | | 125,000 | 962.0p | 3/3/13 | | |
| b** 2/3/10 | 0 | 9,600 | 9,600 | | 0 | 951.0p | 2/3/10 | 3/3/10 | 962.0p |
| **Total** | 482,537 | 165,714 | 84,600 | 3,125 | 560,526 | | | | |

# Report on directors' remuneration continued

## Table 4: Movements in directors' interests in restricted shares continued

Restricted shares designated as: a annual bonus share matching plan; b long-term incentive plan; * where shares at 31 December 2010 have vested and are held pending release; and ** where dividend-equivalent shares were added to the released shares.

| Date of award | 1 Jan 10 | Awarded | Released | Lapsed | 31 Dec 10 | Market value at date of award | Earliest release date | Date of release | Market value at date of release |
|---|---|---|---|---|---|---|---|---|---|
| **John Makinson** | | | | | | | | | |
| b 26/9/03 | 82,400 | | 16,480 | 65,920 | 0 | 582.0p | 26/9/06 | 29/3/10 | 1,032.0p |
| b 21/12/04 | 33,002 | | 33,002 | | 0 | 613.0p | 21/12/09 | 3/3/10 | 962.0p |
| b 23/9/05 | 39,000 | | 39,000 | | 0 | 655.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 13/10/06 | 29,167 | | | | 29,167 | 767.5p | 13/10/09 | | |
| b* 30/7/07 | 80,000 | | 60,000 | | 20,000 | 778.0p | 2/3/10 | 3/3/10 | 962.0p |
| b* 4/3/08 | 83,333 | | | 3,125 | 80,208 | 649.5p | 4/3/11 | | |
| b 4/3/08 | 41,667 | | | | 41,667 | 649.5p | 4/3/11 | | |
| b 3/3/09 | 150,000 | | | | 150,000 | 654.0p | 3/3/12 | | |
| b 3/3/10 | 0 | 125,000 | | | 125,000 | 962.0p | 3/3/13 | | |
| b** 2/3/10 | 0 | 7,680 | 7,680 | | 0 | 951.0p | 2/3/10 | 3/3/10 | 962.0p |
| **Total** | 538,569 | 132,680 | 156,162 | 69,045 | 446,042 | | | | |
| **Total** | 3,983,474 | 1,098,147 | 1,049,454 | 251,125 | 3,781,042 | | | | |

Note 1 The number of shares shown represents the maximum number of shares that may vest, subject to any performance conditions being met.

Note 2 No variations to the terms and conditions of plan interests were made during the year.

Note 3 The performance and other conditions that apply to outstanding awards under the annual bonus share matching plan and the long-term incentive plan and that have yet to be met were set out in the reports on directors' remuneration for the years in which they were granted.

Note 4 In the case of the long-term incentive plan awards made on 4 March 2008, we detail separately the part of the award based on ROIC and EPS growth (two-thirds of total award) and that part based on relative TSR (one-third of total award), because vesting of that part of the awards based on TSR was not known at the date of the 2010 report.

Note 5 The performance condition for the long-term incentive award made in 2003 was the Pearson share price.

## Table 5: Movements in directors' interests in share options

Shares under option are designated as: a worldwide save for shares; b long-term incentive; and * where options are exercisable.

| Date of grant | 1 Jan 10 | Granted | Exercised | Lapsed | 31 Dec 10 | Option price | Earliest exercise date | Expiry date | Date of exercise | Price on exercise | Gain on exercise |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Marjorie Scardino** | | | | | | | | | | | |
| a 8/5/09 | 1,672 | | | | 1,672 | 547.2p | 1/8/12 | 1/2/13 | | | |
| b* 9/5/01 | 41,550 | | | | 41,550 | 1,421.0p | 9/5/02 | 9/5/11 | | | |
| b* 9/5/01 | 41,550 | | | | 41,550 | 1,421.0p | 9/5/03 | 9/5/11 | | | |
| b* 9/5/01 | 41,550 | | | | 41,550 | 1,421.0p | 9/5/04 | 9/5/11 | | | |
| b* 9/5/01 | 41,550 | | | | 41,550 | 1,421.0p | 9/5/05 | 9/5/11 | | | |
| **Total** | 167,872 | 0 | 0 | 0 | 167,872 | | | | | | £0 |
| **Will Ethridge** | | | | | | | | | | | |
| b* 9/5/01 | 11,010 | | | | 11,010 | $21.00 | 9/5/02 | 9/5/11 | | | |
| b* 9/5/01 | 11,010 | | | | 11,010 | $21.00 | 9/5/03 | 9/5/11 | | | |
| b* 9/5/01 | 11,010 | | | | 11,010 | $21.00 | 9/5/04 | 9/5/11 | | | |
| b* 9/5/01 | 11,010 | | | | 11,010 | $21.00 | 9/5/05 | 9/5/11 | | | |
| b* 1/11/01 | 14,680 | | 14,680 | | 0 | $11.97 | 1/11/02 | 1/11/11 | 18/3/10 | $15.40 | $50,352 |
| b* 1/11/01 | 14,680 | | 14,680 | | 0 | $11.97 | 1/11/03 | 1/11/11 | 18/3/10 | $15.40 | $50,352 |
| b* 1/11/01 | 14,680 | | 14,680 | | 0 | $11.97 | 1/11/04 | 1/11/11 | 18/3/10 | $15.40 | $50,352 |
| **Total** | 88,080 | 0 | 44,040 | 0 | 44,040 | | | | | | $151,057 |
| **Rona Fairhead** | | | | | | | | | | | |
| a 4/5/07 | 2,371 | | | | 2,371 | 690.4p | 1/8/12 | 1/2/13 | | | |
| b* 1/11/01 | 20,000 | | | | 20,000 | 822.0p | 1/11/02 | 1/11/11 | | | |
| b* 1/11/01 | 20,000 | | | | 20,000 | 822.0p | 1/11/03 | 1/11/11 | | | |
| b* 1/11/01 | 20,000 | | | | 20,000 | 822.0p | 1/11/04 | 1/11/11 | | | |
| **Total** | 62,371 | 0 | 0 | 0 | 62,371 | | | | | | £0 |

# Report on directors' remuneration continued

## Table 5: Movements in directors' interests in share options continued

Shares under option are designated as: a worldwide save for shares; b long-term incentive; and * where options are exercisable.

| | Date of grant | 1 Jan 10 | Granted | Exercised | Lapsed | 31 Dec 10 | Option price | Earliest exercise date | Expiry date | Date of exercise | Price on exercise | Gain on exercise |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Robin Freestone** | | | | | | | | | | | | |
| a | 9/5/08 | 1,757 | | | | 1,757 | 534.8p | 1/8/11 | 1/2/12 | | | |
| **Total** | | 1,757 | 0 | 0 | 0 | 1,757 | | | | | | £0 |
| **John Makinson** | | | | | | | | | | | | |
| a | 9/5/03 | 4,178 | | 4,178 | | 0 | 424.8p | 1/8/10 | 1/2/11 | 24/11/10 | 945.5p | £21,755 |
| b* | 9/5/01 | 19,785 | | | | 19,785 | 1,421.0p | 9/5/02 | 9/5/11 | | | |
| b* | 9/5/01 | 19,785 | | | | 19,785 | 1,421.0p | 9/5/03 | 9/5/11 | | | |
| b* | 9/5/01 | 19,785 | | | | 19,785 | 1,421.0p | 9/5/04 | 9/5/11 | | | |
| b* | 9/5/01 | 19,785 | | | | 19,785 | 1,421.0p | 9/5/05 | 9/5/11 | | | |
| **Total** | | 83,318 | 0 | 4,178 | 0 | 79,140 | | | | | | £21,755 |
| **Total** | | 403,398 | 0 | 48,218 | 0 | 355,180 | | | | | | |
| **Total (£)** | | | | | | | | | | | | £21,755 |
| **Total ($)** | | | | | | | | | | | | $151,057 |

Note 1 No variations to the terms and conditions of share options were made during the year.

Note 2 Each plan is described below.

a Worldwide save for shares – The acquisition of shares under the worldwide save for shares plan is not subject to the satisfaction of a performance target.

Marjorie Scardino, Rona Fairhead, Robin Freestone and John Makinson hold options under this plan. Details of these holdings are itemised as a.

b Long-term incentive – All options that remain outstanding are exercisable and lapse if they remain unexercised at the tenth anniversary of the date of grant.

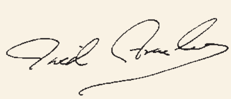
Details of the option grants under this plan for Marjorie Scardino, Will Ethridge, Rona Fairhead and John Makinson are itemised as b.

Note 3 Marjorie Scardino contributes US$1,000 per month (the maximum allowed) to the US employee stock purchase plan. The terms of this plan allow participants to make monthly contributions for six month periods and to acquire shares twice annually at the end of these periods at a price that is the lower of the market price at the beginning or the end of each period, both less 15%.

Note 4 The 1,672 share options granted to Marjorie Scardino under the Worldwide Save for Shares plan on 8 May 2009 were inadvertently omitted from the 2009 report.

Note 5 The market price on 31 December 2010 was 1,008.0p per share and the range during the year was 855.0p to 1,051.0p.

Approved by the board and signed on its behalf by



**David Arculus** Director
7 March 2011

# Financial statements: contents

# Consolidated income statement
## Year ended 31 December 2010

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| Sales | 2 | 5,663 | 5,140 |
| Cost of goods sold | 4 | (2,588) | (2,382) |
| **Gross profit** | | 3,075 | 2,758 |
| Operating expenses | 4 | (2,373) | (2,169) |
| Share of results of joint ventures and associates | 12 | 41 | 30 |
| **Operating profit** | 2 | 743 | 619 |
| Finance costs | 6 | (109) | (122) |
| Finance income | 6 | 36 | 26 |
| **Profit before tax** | | 670 | 523 |
| Income tax | 7 | (146) | (146) |
| **Profit for the year from continuing operations** | | 524 | 377 |
| Profit for the year from discontinued operations | 3 | 776 | 85 |
| **Profit for the year** | | 1,300 | 462 |
| **Attributable to:** | | | |
| Equity holders of the company | | 1,297 | 425 |
| Non-controlling interest | | 3 | 37 |
| **Earnings per share for profit from continuing and discontinued operations attributable to equity holders of the company during the year** (expressed in pence per share) | | | |
| – basic | 8 | 161.9p | 53.2p |
| – diluted | 8 | 161.5p | 53.1p |
| **Earnings per share for profit from continuing operations attributable to equity holders of the company during the year** (expressed in pence per share) | | | |
| – basic | 8 | 66.0p | 47.0p |
| – diluted | 8 | 65.9p | 47.0p |

# Consolidated statement of comprehensive income

## Year ended 31 December 2010

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| Profit for the year | | 1,300 | 462 |
| Net exchange differences on translation of foreign operations | | 173 | (388) |
| Currency translation adjustment disposed – subsidiaries | | 13 | – |
| Actuarial gains/(losses) on retirement benefit obligations – Group | 25 | 70 | (299) |
| Actuarial gains/(losses) on retirement benefit obligations – associate | 12 | 1 | (3) |
| Net increase in fair values of proportionate holding arising on stepped acquisition | | – | 18 |
| Tax on items recognised in other comprehensive income | 7 | (41) | 91 |
| **Other comprehensive income/(expense) for the year** | | 216 | (581) |
| **Total comprehensive income/(expense) for the year** | | 1,516 | (119) |
| **Attributable to:** | | | |
| Equity holders of the company | | 1,502 | (127) |
| Non-controlling interest | | 14 | 8 |

# Consolidated balance sheet
## As at 31 December 2010

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | 366 | 388 |
| Intangible assets | 11 | 5,467 | 5,129 |
| Investments in joint ventures and associates | 12 | 71 | 30 |
| Deferred income tax assets | 13 | 276 | 387 |
| Financial assets – Derivative financial instruments | 16 | 134 | 112 |
| Other financial assets | 15 | 58 | 62 |
| Trade and other receivables | 22 | 129 | 112 |
| | | 6,501 | 6,220 |
| **Current assets** | | | |
| Intangible assets – Pre-publication | 20 | 647 | 650 |
| Inventories | 21 | 429 | 445 |
| Trade and other receivables | 22 | 1,337 | 1,284 |
| Financial assets – Derivative financial instruments | 16 | 6 | – |
| Financial assets – Marketable securities | 14 | 12 | 63 |
| Cash and cash equivalents (excluding overdrafts) | 17 | 1,736 | 750 |
| | | 4,167 | 3,192 |
| **Total assets** | | 10,668 | 9,412 |
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Financial liabilities – Borrowings | 18 | (1,908) | (1,934) |
| Financial liabilities – Derivative financial instruments | 16 | (6) | (2) |
| Deferred income tax liabilities | 13 | (471) | (473) |
| Retirement benefit obligations | 25 | (148) | (339) |
| Provisions for other liabilities and charges | 23 | (42) | (50) |
| Other liabilities | 24 | (246) | (253) |
| | | (2,821) | (3,051) |
| **Current liabilities** | | | |
| Trade and other liabilities | 24 | (1,605) | (1,467) |
| Financial liabilities – Borrowings | 18 | (404) | (74) |
| Financial liabilities – Derivative financial instruments | 16 | – | (7) |
| Current income tax liabilities | | (215) | (159) |
| Provisions for other liabilities and charges | 23 | (18) | (18) |
| | | (2,242) | (1,725) |
| **Total liabilities** | | (5,063) | (4,776) |
| **Net assets** | | 5,605 | 4,636 |

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Equity** | | | |
| Share capital | 27 | 203 | 203 |
| Share premium | 27 | 2,524 | 2,512 |
| Treasury shares | 28 | (137) | (226) |
| Translation reserve | | 402 | 227 |
| Retained earnings | | 2,546 | 1,629 |
| **Total equity attributable to equity holders of the company** | | 5,538 | 4,345 |
| Non-controlling interest | | 67 | 291 |
| **Total equity** | | 5,605 | 4,636 |

These financial statements have been approved for issue by the board of directors on 7 March 2011 and signed on its behalf by

**Robin Freestone** Chief financial officer

# Consolidated statement of changes in equity

## Year ended 31 December 2010

| All figures in £ millions | Share capital | Share premium | Treasury shares | Translation reserve | Retained earnings | Total | Non-controlling interest | Total equity |
|---|---|---|---|---|---|---|---|---|
| | Equity attributable to equity holders of the company | | | | | | | |
| At 1 January 2010 | 203 | 2,512 | (226) | 227 | 1,629 | 4,345 | 291 | 4,636 |
| Profit for the year | – | – | – | – | 1,297 | 1,297 | 3 | 1,300 |
| Other comprehensive income | – | – | – | 175 | 30 | 205 | 11 | 216 |
| Equity-settled transactions | – | – | – | – | 50 | 50 | – | 50 |
| Tax on equity-settled transactions | – | – | – | – | 4 | 4 | – | 4 |
| Issue of ordinary shares under share option schemes | – | 12 | – | – | – | 12 | – | 12 |
| Purchase of treasury shares | – | – | (77) | – | – | (77) | – | (77) |
| Release/cancellation of treasury shares | – | – | 166 | – | (166) | – | – | – |
| Changes in non-controlling shareholding | – | – | – | – | (6) | (6) | (231) | (237) |
| Dividends | – | – | – | – | (292) | (292) | (7) | (299) |
| **At 31 December 2010** | 203 | 2,524 | (137) | 402 | 2,546 | 5,538 | 67 | 5,605 |

| All figures in £ millions | Share capital | Share premium | Treasury shares | Translation reserve | Retained earnings | Total | Non-controlling interest | Total equity |
|---|---|---|---|---|---|---|---|---|
| | Equity attributable to equity holders of the company | | | | | | | |
| At 1 January 2009 | 202 | 2,505 | (222) | 586 | 1,679 | 4,750 | 274 | 5,024 |
| Profit for the year | – | – | – | – | 425 | 425 | 37 | 462 |
| Other comprehensive expense | – | – | – | (359) | (193) | (552) | (29) | (581) |
| Equity-settled transactions | – | – | – | – | 37 | 37 | – | 37 |
| Tax on equity-settled transactions | – | – | – | – | 6 | 6 | – | 6 |
| Issue of ordinary shares under share option schemes | 1 | 7 | – | – | – | 8 | – | 8 |
| Purchase of treasury shares | – | – | (33) | – | – | (33) | – | (33) |
| Release of treasury shares | – | – | 29 | – | (29) | – | – | – |
| Put option over non-controlling interest | – | – | – | – | (23) | (23) | – | (23) |
| Changes in non-controlling shareholding | – | – | – | – | – | – | 24 | 24 |
| Dividends | – | – | – | – | (273) | (273) | (15) | (288) |
| At 31 December 2009 | 203 | 2,512 | (226) | 227 | 1,629 | 4,345 | 291 | 4,636 |

The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments.

# Consolidated cash flow statement
## Year ended 31 December 2010

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net cash generated from operations | 31 | 1,169 | 1,012 |
| Interest paid | | (78) | (90) |
| Tax paid | | (85) | (103) |
| Net cash generated from operating activities | | 1,006 | 819 |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries, net of cash acquired | 29 | (535) | (208) |
| Acquisition of joint ventures and associates | | (22) | (14) |
| Purchase of investments | | (7) | (10) |
| Purchase of property, plant and equipment | | (76) | (62) |
| Proceeds from sale of property, plant and equipment | 31 | – | 1 |
| Purchase of intangible assets | | (56) | (58) |
| Disposal of subsidiaries, net of cash disposed | 30 | 984 | – |
| Tax paid on disposal of subsidiaries | | (250) | – |
| Interest received | | 10 | 3 |
| Dividends received from joint ventures and associates | | 23 | 22 |
| Net cash received from/(used in) investing activities | | 71 | (326) |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of ordinary shares | | 12 | 8 |
| Purchase of treasury shares | | (77) | (33) |
| Proceeds from borrowings | | 241 | 296 |
| Liquid resources acquired | | – | (13) |
| Liquid resources sold | | 53 | – |
| Repayment of borrowings | | (13) | (343) |
| Finance lease principal payments | | (3) | (2) |
| Dividends paid to company's shareholders | 9 | (292) | (273) |
| Dividends paid to non-controlling interest | | (6) | (20) |
| Transactions with non-controlling interest | | (7) | 14 |
| Net cash used in financing activities | | (92) | (366) |
| Effects of exchange rate changes on cash and cash equivalents | | (1) | (36) |
| **Net increase in cash and cash equivalents** | | 984 | 91 |
| Cash and cash equivalents at beginning of year | | 680 | 589 |
| **Cash and cash equivalents at end of year** | 17 | 1,664 | 680 |

The consolidated cash flow statement includes discontinued operations (see note 3).

# Independent auditors' report to the members of Pearson plc

We have audited the consolidated and company financial statements (together the 'financial statements') of Pearson plc for the year ended 31 December 2010. The consolidated financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes to the consolidated financial statements. The company financial statements comprise the company balance sheet, the company statement of changes in equity, the company cash flow statement and the related notes to the company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

## Respective responsibilities of directors and auditors

As explained more fully in the statement of directors' responsibilities set out in the Governance section of the directors' report, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## Opinion on financial statements

### In our opinion:

- The financial statements give a true and fair view of the state of the Group's and of the company's affairs as at 31 December 2010 and of the Group's profit and Group's and company's cash flows for the year then ended;
- The consolidated financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- The company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- The part of the report on directors' remuneration to be audited has been properly prepared in accordance with the Companies Act 2006; and
- The information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- Adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- The company financial statements and the part of the report on directors' remuneration to be audited are not in agreement with the accounting records and returns; or
- Certain disclosures of directors' remuneration specified by law are not made; or
- We have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- The directors' statement set out in the Governance section of the directors' report in relation to going concern;
- The parts of the corporate governance statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- Certain elements of the report to shareholders by the board on directors' remuneration.

**Ranjan Sriskandan** (Senior Statutory Auditor)

**for and on behalf of PricewaterhouseCoopers LLP**
Chartered Accountants and Statutory Auditors
London
7 March 2011

# Notes to the consolidated financial statements

## General information

Pearson plc (the company) and its subsidiaries (together the Group) are international media businesses covering education, business information and consumer publishing.

The company is a public limited liability company incorporated and domiciled in England. The address of its registered office is 80 Strand, London WC2R 0RL.

The company has its primary listing on the London Stock Exchange and is also listed on the New York Stock Exchange.

These consolidated financial statements were approved for issue by the board of directors on 7 March 2011.

## 1. Accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

### a. Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. In respect of the accounting standards applicable to the Group there is no difference between EU-adopted and IASB-adopted IFRS. The Group transitioned from UK GAAP to IFRS on 1 January 2003.

These consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) to fair value.

*1. Interpretations and amendments to published standards effective in 2010*

- IFRS 3 (Revised) 'Business Combinations' and amendments to IAS 27 'Consolidated and Separate Financial Statements', effective for annual reporting periods beginning on or after 1 July 2009. The amendments affect the accounting for business combinations, including the requirement to re-measure the fair value of previously held interests in step acquisitions with any gain or loss arising being recognised in the income statement, the requirement to expense acquisition costs and the requirement to recognise adjustments to contingent consideration in the income statement.
- Amendments to IAS 39 'Financial Instruments: Recognition and Measurement', effective for annual reporting periods beginning on or after 1 July 2009. The amendments clarify that inflation may only be hedged where changes in inflation are a specified portion of cash flows of a financial instrument, and also clarify hedging with options. Management have assessed that the amendments have no impact on the Group's financial statements.
- Amendments to IFRS 2 'Share-based Payment': Group cash-settled share-based payment transactions, effective for annual reporting periods beginning on or after 1 January 2010. The amendments clarify the scope and accounting for group cash-settled share-based payment transactions. Management have assessed that the amendments have no impact on the Group's financial statements.
- IFRIC 17 'Distributions of Non-cash Assets to Owners', effective for annual reporting periods beginning on or after 1 July 2009. IFRIC 17 provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends, including recognition upon authorisation and measurement at fair value of assets distributed, with any difference between fair value and carrying value of these assets being recognised in the income statement when an entity settles the dividend payable. This does not apply to distributions of non-cash assets under common control. Management have assessed that this interpretation has no impact on the Group's financial statements as the Group does not currently distribute non-cash assets.
- IFRIC 18 'Transfers of Assets from Customers', effective for transfers of assets from customers received on or after 1 July 2009. IFRIC 18 states that when an item of property, plant and equipment is received from a customer and it meets the definition of an asset from the perspective of the recipient, the recipient should recognise the asset at its fair value at the date of transfer and recognise the credit in accordance with IAS 18 'Revenue'. Management have assessed that this interpretation has no impact on the Group's financial statements as the Group has not received such assets from customers.

## 1. Accounting policies continued

### a. Basis of preparation continued

*1. Interpretations and amendments to published standards effective in 2010 – continued*

- 'Improvements to IFRSs – 2009', effective dates vary upon the amendment. This is the second set of amendments published under the IASB's annual improvements process and incorporates minor amendments to 12 standards and interpretations. Management have assessed that these amendments have no impact on the Group's financial statements.

*2. Standards, interpretations and amendments to published standards that are not yet effective*

The Group has not early adopted the following new pronouncements that are not yet effective:

- Amendments to IAS 24 'Related Parties', effective for annual reporting periods beginning on or after 1 January 2011. The amendments simplify disclosure for government related entities and clarify the definition of a related party.
- Amendments to IAS 32 'Financial Instruments: Presentation' – Classification of Rights, effective for annual reporting periods beginning on or after 1 February 2010. The amendments clarify that rights, options or warrants issued to acquire a fixed number of an entity's own non-derivative equity instruments for a fixed amount in any currency are classified as equity instruments provided the offer is made pro-rata to all existing owners of the same class of the entity's own non-derivative equity instruments.
- IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2013. The new standard details the requirements for the classification and measurement of financial assets and liabilities.
- IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments', effective for annual reporting periods beginning on or after 1 July 2010. IFRIC 19 clarifies accounting required by entities issuing equity instruments to extinguish all or part of a financial liability.
- Amendments to IFRIC 14 'Prepayments of a Minimum Funding Requirement', effective for annual reporting periods beginning on or after 1 January 2011. The amendments remedy a consequence of IFRIC 14 where, in certain circumstances, an entity was not permitted to recognise prepayments of a minimum funding requirement as an asset.
- Amendments to IFRS 7 'Financial Instruments: Disclosures' – Transfers of Financial Assets, effective for annual reporting periods beginning on or after 1 July 2011. The amendments require enhanced disclosure where an asset is transferred but not derecognised, and new disclosure for assets that are derecognised but to which the entity continues to have an exposure.
- Amendments to IAS 12 'Deferred Tax' – Recoverability of Underlying Assets, effective for annual reporting periods beginning on or after 1 January 2012. The amendments provide, for certain investment properties, an exception to the principle that the measurement of deferred tax assets and liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset.
- 'Improvements to IFRSs – 2010', effective dates vary upon the amendment. This is the third set of amendments published under IASB's annual improvements process and incorporates minor amendments to seven standards and interpretations.

Management are currently assessing the impact of these new standards, interpretations and amendments on the Group's financial statements.

*3. Critical accounting assumptions and judgements*

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting assumptions. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas requiring a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are discussed in the relevant accounting policies under the following headings:

Intangible assets: Goodwill
Intangible assets: Pre-publication assets
Royalty advances
Taxation
Employee benefits: Pension obligations
Revenue recognition

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

### b. Consolidation

*1. Business combinations* The acquisition method of accounting is used to account for business combinations of the Group with an acquisition date on or after 1 January 2010. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred.

Identifiable assets and contingent assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. For material acquisitions, the fair value of the acquired intangible assets is determined by an external, independent valuer. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. See note 1e(1) for the accounting policy on goodwill. If this is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

*2. Subsidiaries* Subsidiaries are entities over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

*3. Transactions with non-controlling interests* Transactions with non-controlling interests are treated as transactions with shareholders. Any surplus or deficit arising from disposals to a non-controlling interest is recorded in equity. For purchases from a non-controlling interest, the difference between consideration paid and the relevant share acquired of the carrying value of the subsidiary is recorded in equity.

*4. Joint ventures and associates* Joint ventures are entities in which the Group holds an interest on a long-term basis and which are jointly controlled, with one or more other venturers, under a contractual arrangement. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at cost.

The Group's share of its joint ventures' and associates' post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves. The Group's share of its joint ventures' and associates' results is recognised as a component of operating profit as these operations form part of the core publishing business of the Group and are an integral part of existing wholly-owned businesses.
The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in a joint venture or associate equals or exceeds its interest in the joint venture or associate the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the joint venture or associate.

### c. Foreign currency translation

*1. Functional and presentation currency* Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in sterling, which is the company's functional and presentation currency.

## 1. Accounting policies continued

### c. Foreign currency translation continued

*2. Transactions and balances* Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying net investment hedges.

*3. Group companies* The results and financial position of all Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

i) assets and liabilities are translated at the closing rate at the date of the balance sheet;

ii) income and expenses are translated at average exchange rates;

iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. The Group treats specific inter-company loan balances, which are not intended to be repaid in the foreseeable future, as part of its net investment. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

At the date of transition to IFRS the cumulative translation differences in respect of foreign operations have been deemed to be zero.

Any gains and losses on disposals of foreign operations will exclude translation differences that arose prior to the transition date.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.54 (2009: $1.57) and the year end rate was $1.57 (2009: $1.61).

### d. Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives as follows:

| | |
|---|---|
| Buildings (freehold): | 20–50 years |
| Buildings (leasehold): | over the period of the lease |
| Plant and equipment: | 3–10 years |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

The carrying value of an asset is written down to its recoverable amount if the carrying value of the asset is greater than its estimated recoverable amount.

### e. Intangible assets

*1. Goodwill* For the acquisition of subsidiaries made on or after 1 January 2010 goodwill represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired. For the acquisition of subsidiaries made from the date of transition to IFRS to 31 December 2009 goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets acquired. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisition of associates and joint ventures represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets acquired. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. An impairment loss is recognised to the extent that the carrying value of goodwill exceeds the recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. These calculations require the use of estimates and significant management judgement. A description of the key assumptions and sensitivities is included in note 11. Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

### e. Intangible assets continued

*1. Goodwill continued*

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

IFRS 3 'Business Combinations' has not been applied retrospectively to business combinations before the date of transition to IFRS. Subject to the transition adjustments to IFRS required by IFRS 1, the accounting for business combinations before the date of transition has been grandfathered.

*2. Acquired software* Software separately acquired for internal use is capitalised at cost. Software acquired in material business combinations is capitalised at its fair value as determined by an independent valuer. Acquired software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

*3. Internally developed software* Internal and external costs incurred during the preliminary stage of developing computer software for internal use are expensed as incurred. Internal and external costs incurred to develop computer software for internal use during the application development stage are capitalised if the Group expects economic benefits from the development. Capitalisation in the application development stage begins once the Group can reliably measure the expenditure attributable to the software development and has demonstrated its intention to complete and use the software. Internally developed software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

*4. Acquired intangible assets* Acquired intangible assets include customer lists and relationships, trademarks and brands, publishing rights, content and technology. These assets are capitalised on acquisition at cost and included in intangible assets. Intangible assets acquired in material business combinations are capitalised at their fair value as determined by an independent valuer. Intangible assets are amortised over their estimated useful lives of between two and 20 years, using an amortisation method that reflects the pattern of their consumption.

*5. Pre-publication assets* Pre-publication assets represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating life cycle of the title, with a higher proportion of the amortisation taken in the earlier years.

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 31).

The assessment of the recoverability of pre-publication assets and the determination of the amortisation profile involve a significant degree of judgement based on historical trends and management estimation of future potential sales. An incorrect amortisation profile could result in excess amounts being carried forward as intangible assets that would otherwise have been written off to the income statement in an earlier period.

Reviews are performed regularly to estimate recoverability of pre-publication assets. The carrying amount of pre-publication assets is set out in note 20.

### f. Other financial assets

Other financial assets, designated as available for sale investments, are non-derivative financial assets measured at estimated fair value. Changes in the fair value are recorded in equity in the fair value reserve. On the subsequent disposal of the asset, the net fair value gains or losses are taken to the income statement.

### g. Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale. Provisions are made for slow moving and obsolete stock.

## 1. Accounting policies continued

### h. Royalty advances
Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realisable value of author contracts is overstated, this will have an adverse effect on operating profits as these excess amounts will be written off.

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors. The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non-current assets.

### i. Newspaper development costs
Investment in the development of newspaper titles consists of measures to increase the volume and geographical spread of circulation. The measures include additional and enhanced editorial content, extended distribution and remote printing. These costs are expensed as incurred as they do not meet the criteria under IAS 38 'Intangible Assets' to be capitalised as intangible assets.

### j. Cash and cash equivalents
Cash and cash equivalents in the cash flow statement include cash in hand, deposits held on call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are included in borrowings in current liabilities in the balance sheet.

Short-term deposits and marketable securities with maturities of greater than three months do not qualify as cash and cash equivalents. Movements on these financial instruments are classified as cash flows from financing activities in the cash flow statement as these amounts are used to offset the borrowings of the Group.

### k. Share capital
Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where any Group company purchases the company's equity share capital (treasury shares) the consideration paid, including any directly attributable incremental costs, net of income taxes, is deducted from equity attributable to the company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable transaction costs and the related income tax effects, is included in equity attributable to the company's equity holders.

### l. Borrowings
Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. Accrued interest is included as part of borrowings. Where a debt instrument is in a fair value hedging relationship, an adjustment is made to its carrying value in the income statement to reflect the hedged risk. Interest on borrowings is expensed in the income statement as incurred.

### m. Derivative financial instruments
Derivatives are recognised at fair value and re-measured at each balance sheet date. The fair value of derivatives is determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models. The Group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of its bonds (fair value hedges) or hedges of net investments in foreign operations (net investment hedges).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

### m. Derivative financial instruments continued

The effective portion of changes in the fair value of derivatives that are designated and qualify as net investment hedges are recognised in other comprehensive income. Gains and losses accumulated in equity are included in the income statement when the corresponding foreign operation is disposed of. Gains or losses relating to the ineffective portion are recognised immediately in finance income or finance costs in the income statement.

Certain derivatives do not qualify or are not designated as hedging instruments. Such derivatives are classified at fair value and any movement in their fair value is recognised immediately in finance income or finance costs in the income statement.

### n. Taxation

Current tax is recognised on the amounts expected to be paid or recovered under the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided in respect of the undistributed earnings of subsidiaries other than where it is intended that those undistributed earnings will not be remitted in the foreseeable future.

Current and deferred tax are recognised in the income statement, except when the tax relates to items charged or credited directly to equity or other comprehensive income, in which case the tax is also recognised in equity or other comprehensive income.

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, significant judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income together with any future tax planning strategies.

### o. Employee benefits

*1. Pension obligations* The retirement benefit asset and obligation recognised in the balance sheet represents the net of the present value of the defined benefit obligation and the fair value of plan assets at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high quality corporate bonds which have terms to maturity approximating the terms of the related liability.

The determination of the pension cost and defined benefit obligation of the Group's defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth, longevity and expected return on scheme assets.

Actuarial gains and losses arising from differences between actual and expected returns on plan assets, experience adjustments on liabilities and changes in actuarial assumptions are recognised immediately in other comprehensive income.

## 1. Accounting policies continued

### o. Employee benefits continued

*1. Pension obligations continued*
The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. The unwinding of the discount rate on the scheme liabilities and the expected return on scheme assets are presented as finance costs or finance income.

Obligations for contributions to defined contribution pension plans are recognised as an operating expense in the income statement as incurred.

*2. Other post-retirement obligations* The expected costs of post-retirement healthcare and life assurance benefits are accrued over the period of employment, using a similar accounting methodology as for defined benefit pension obligations. The liabilities and costs relating to significant other post-retirement obligations are assessed annually by independent qualified actuaries.

*3. Share-based payments* The fair value of options or shares granted under the Group's share and option plans is recognised as an employee expense after taking into account the Group's best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised. The Group has applied IFRS 2 'Share-based Payment' retrospectively to all options granted but not fully vested at the date of transition to IFRS.

### p. Provisions

Provisions are recognised if the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are discounted to present value where the effect is material.

The Group recognises a provision for deferred consideration when the payment of the deferred consideration is probable.

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

The provision is based on the present value of future payments for surplus leased properties under non-cancellable operating leases, net of estimated sub-leasing income.

### q. Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services net of sales taxes, rebates and discounts, and after eliminating sales within the Group.

Revenue from the sale of books is recognised when title passes. A provision for anticipated returns is made based primarily on historical return rates. If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period.

Circulation and advertising revenue is recognised when the newspaper or other publication is published. Subscription revenue is recognised on a straight-line basis over the life of the subscription.

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials with textbooks, revenue is recognised for each element as if it were an individual contractual arrangement.

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

### q. Revenue recognition continued

On certain contracts, where the Group acts as agent, only commissions and fees receivable for services rendered are recognised as revenue. Any third-party costs incurred on behalf of the principal that are rechargeable under the contractual arrangement are not included in revenue.

Income from recharges of freight and other activities which are incidental to the normal revenue generating activities is included in other income.

### r. Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges to achieve a constant rate on the finance balance outstanding.
The corresponding rental obligations, net of finance charges, are included in financial liabilities – borrowings. The interest element of the finance cost is charged to the income statement over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases by the lessee. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

### s. Dividends

Dividends are recorded in the Group's financial statements in the period in which they are approved by the company's shareholders. Interim dividends are recorded in the period in which they are approved and paid.

### t. Non-current assets and liabilities held for sale

Assets and liabilities are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is intended to recover their carrying amount principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale. Amounts relating to non-current assets and liabilities held for sale are classified as discontinued operations in the income statement where appropriate.

### u. Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1q).

## 2. Segment information

The Group is organised into five business segments:

*North American Education* Educational publishing, assessment and testing for the school and higher education market within the USA and Canada;

*International Education* Educational publishing, assessment and testing for the school and higher education market outside of North America;

*Professional* Business and technology publishing, training, testing and certification for professional bodies;

*FT Group* Publisher of the *Financial Times*, business magazines and specialist information;

*Penguin* Publisher with brand imprints such as Penguin, Putnam, Berkley, Viking and Dorling Kindersley.

For more detail on the services and products included in each business segment refer to the business review.

The results of the Interactive Data segment are shown as discontinued.

| | | | | | | | | | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| All figures in £ millions | Notes | North American Education | International Education | Professional | FT Group | Penguin | Corporate | Discontinued operations | Group |
| **Continuing operations** | | | | | | | | | |
| Sales (external) | | 2,640 | 1,234 | 333 | 403 | 1,053 | – | – | 5,663 |
| Sales (inter-segment) | | – | – | 5 | – | 3 | – | – | 8 |
| Adjusted operating profit | | 469 | 171 | 51 | 60 | 106 | – | – | 857 |
| Amortisation of acquired intangibles | | (53) | (35) | (7) | (9) | (1) | – | – | (105) |
| Acquisition costs | | (1) | (7) | (2) | (1) | – | – | – | (11) |
| Other net gains and losses | | – | (10) | – | 12 | – | – | – | 2 |
| **Operating profit** | | 415 | 119 | 42 | 62 | 105 | – | – | 743 |
| Finance costs | 6 | | | | | | | | (109) |
| Finance income | 6 | | | | | | | | 36 |
| **Profit before tax** | | | | | | | | | 670 |
| Income tax | 7 | | | | | | | | (146) |
| **Profit for the year from continuing operations** | | | | | | | | | 524 |
| Segment assets | | 4,401 | 2,122 | 601 | 447 | 1,138 | 1,888 | – | 10,597 |
| Joint ventures | 12 | 15 | – | 1 | 1 | 1 | – | – | 18 |
| Associates | 12 | 24 | 6 | – | 23 | – | – | – | 53 |
| **Total assets** | | 4,440 | 2,128 | 602 | 471 | 1,139 | 1,888 | – | 10,668 |
| **Other segment items** | | | | | | | | | |
| Share of results of joint ventures and associates | 12 | (3) | 1 | 1 | 42 | – | – | – | 41 |
| Capital expenditure | 10, 11 | 45 | 27 | 16 | 17 | 18 | – | 21 | 144 |
| Pre-publication investment | 20 | 215 | 61 | 7 | – | 36 | – | – | 319 |
| Depreciation | 10 | 23 | 19 | 9 | 5 | 13 | – | 13 | 82 |
| Amortisation | 11, 20 | 307 | 111 | 18 | 23 | 43 | – | 12 | 514 |

# Notes to the consolidated financial statements continued

## 2. Segment information continued

| All figures in £ millions | Notes | North American Education | International Education | Professional | FT Group | Penguin | Corporate | Discontinued operations | Group |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 2009 |
| **Continuing operations** | | | | | | | | | |
| Sales (external) | | 2,470 | 1,035 | 275 | 358 | 1,002 | – | – | 5,140 |
| Sales (inter-segment) | | – | – | 7 | – | 24 | – | – | 31 |
| Adjusted operating profit | | 403 | 141 | 43 | 39 | 84 | – | – | 710 |
| Amortisation of acquired intangibles | | (49) | (32) | (1) | (8) | (1) | – | – | (91) |
| **Operating profit** | | 354 | 109 | 42 | 31 | 83 | – | – | 619 |
| Finance costs | 6 | | | | | | | | (122) |
| Finance income | 6 | | | | | | | | 26 |
| **Profit before tax** | | | | | | | | | 523 |
| Income tax | 7 | | | | | | | | (146) |
| **Profit for the year from continuing operations** | | | | | | | | | 377 |
| Segment assets | | 4,382 | 1,635 | 377 | 420 | 1,173 | 924 | 471 | 9,382 |
| Joint ventures | 12 | 13 | – | 1 | 1 | 3 | – | – | 18 |
| Associates | 12 | – | 5 | – | 7 | – | – | – | 12 |
| **Total assets** | | 4,395 | 1,640 | 378 | 428 | 1,176 | 924 | 471 | 9,412 |
| **Other segment items** | | | | | | | | | |
| Share of results of joint ventures and associates | 12 | (2) | 6 | 1 | 25 | – | – | – | 30 |
| Capital expenditure | 10, 11 | 38 | 22 | 12 | 15 | 10 | – | 29 | 126 |
| Pre-publication investments | 20 | 220 | 58 | 8 | – | 36 | – | – | 322 |
| Depreciation | 10 | 24 | 16 | 10 | 5 | 9 | – | 21 | 85 |
| Amortisation | 11, 20 | 274 | 89 | 13 | 20 | 42 | – | 16 | 454 |

In 2010, sales from the provision of goods were £4,200m (2009: £3,838m) and sales from the provision of services were £1,463m (2009: £1,302m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing and other service businesses are classified as being from the provision of services.

## 2. Segment information continued

Corporate costs are allocated to business segments on an appropriate basis depending on the nature of the cost and therefore the segment result is equal to the Group operating profit. Inter-segment pricing is determined on an arm's-length basis. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combination were £311m (2009: £153m) (see note 29). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations.

The Group operates in the following main geographic areas:

| | Sales | | Non-current assets | |
|---|---|---|---|---|
| All figures in £ millions | 2010 | 2009 | 2010 | 2009 |
| **Continuing operations** | | | | |
| UK | 790 | 694 | 1,031 | 904 |
| Other European countries | 415 | 387 | 237 | 179 |
| USA | 3,361 | 3,146 | 3,790 | 3,607 |
| Canada | 228 | 198 | 235 | 204 |
| Asia Pacific | 577 | 497 | 364 | 319 |
| Other countries | 292 | 218 | 376 | 121 |
| **Total continuing** | 5,663 | 5,140 | 6,033 | 5,334 |
| **Discontinued operations** | | | | |
| UK | 31 | 54 | – | 37 |
| Other European countries | 48 | 86 | – | 63 |
| USA | 196 | 317 | – | 204 |
| Canada | 2 | 2 | – | – |
| Asia Pacific | 18 | 23 | – | 21 |
| Other countries | 1 | 2 | – | – |
| **Total discontinued** | 296 | 484 | – | 325 |
| **Total** | 5,959 | 5,624 | 6,033 | 5,659 |

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. Non-current assets are based on the subsidiary's country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

# Notes to the consolidated financial statements continued

## 3. Discontinued operations

Discontinued operations in 2009 and 2010 relate to the Group's interest in Interactive Data (sold on 29 July 2010).

An analysis of the results and cash flows of discontinued operations is as follows:

| All figures in £ millions | 2010 Interactive Data | 2009 Interactive Data |
|---|---|---|
| Sales | 296 | 484 |
| | | |
| Operating profit | 73 | 136 |
| Finance income | – | 1 |
| Profit before tax | 73 | 137 |
| Attributable tax expense | (28) | (52) |
| Profit after tax | 45 | 85 |
| Profit on disposal of discontinued operations before tax | 1,037 | – |
| Attributable tax expense | (306) | – |
| Profit for the year from discontinued operations | 776 | 85 |
| Operating cash flows | 85 | 132 |
| Investing cash flows | (35) | (23) |
| Financing cash flows | 49 | (80) |
| Total cash flows | 99 | 29 |

## 4. Operating expenses

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| By function: | | |
| Cost of goods sold | 2,588 | 2,382 |
| Operating expenses | | |
| Distribution costs | 298 | 275 |
| Administrative and other expenses | 2,190 | 2,014 |
| Other income | (115) | (120) |
| Total operating expenses | 2,373 | 2,169 |
| Total | 4,961 | 4,551 |

## 4. Operating expenses continued

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **By nature:** | | | |
| Utilisation of inventory | 21 | 836 | 843 |
| Depreciation of property, plant and equipment | 10 | 69 | 64 |
| Amortisation of intangible assets – Pre-publication | 20 | 350 | 307 |
| Amortisation of intangible assets – Other | 11 | 152 | 131 |
| Employee benefit expense | 5 | 1,849 | 1,725 |
| Operating lease rentals | | 166 | 157 |
| Other property costs | | 64 | 70 |
| Royalties expensed | | 524 | 479 |
| Advertising, promotion and marketing | | 250 | 219 |
| Information technology costs | | 78 | 72 |
| Other costs | | 738 | 604 |
| Other income | | (115) | (120) |
| **Total** | | 4,961 | 4,551 |

During the year the Group obtained the following services from the Group's auditors:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Fees payable to the company's auditors for the audit of parent company and consolidated financial statements | 4 | 4 |
| The audit of the company's subsidiaries pursuant to legislation | 2 | 2 |
| Tax services | 2 | 2 |
| Other services | 2 | 1 |
| **Total** | 10 | 9 |

Reconciliation between audit and non-audit service fees is shown below:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act | 6 | 6 |
| Non-audit fees | 4 | 3 |
| **Total** | 10 | 9 |

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Tax services include services related to tax planning and various other tax advisory matters. Other services is mainly due diligence on acquisitions, notably our Brazilian acquisition, Sistema Educacional Brasiliero (SEB), where we assessed that our auditors were best qualified and cost effective in taking on this role.

# Notes to the consolidated financial statements continued

## 5. Employee information

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Employee benefit expense** | | | |
| Wages and salaries (including termination benefits and restructuring costs) | | 1,588 | 1,496 |
| Social security costs | | 136 | 124 |
| Share-based payment costs | 26 | 35 | 27 |
| Retirement benefits – defined contribution plans | 25 | 66 | 60 |
| Retirement benefits – defined benefit plans | 25 | 22 | 16 |
| Other post-retirement benefits | 25 | 2 | 2 |
| | | 1,849 | 1,725 |

The details of the emoluments of the directors of Pearson plc are shown in the report on directors' remuneration.

| Average number employed | 2010 | 2009 |
|---|---|---|
| **Employee numbers** | | |
| North American Education | 14,828 | 15,606 |
| International Education | 10,713 | 8,899 |
| Professional | 3,721 | 2,662 |
| FT Group | 2,557 | 2,328 |
| Penguin | 3,470 | 4,163 |
| Other | 1,028 | 1,047 |
| **Continuing operations** | 36,317 | 34,705 |

The average number employed in discontinued operations in 2009 was 2,459.

## 6. Net finance costs

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| Interest payable | | (82) | (92) |
| Finance costs in respect of retirement benefits | 25 | (12) | (12) |
| Net foreign exchange losses | | (9) | (7) |
| Other losses on financial instruments in a hedging relationship: | | | |
| – fair value hedges | | – | (1) |
| Other losses on financial instruments not in a hedging relationship: | | | |
| – derivatives | | (6) | (10) |
| Finance costs | | (109) | (122) |
| Interest receivable | | 9 | 6 |
| Net foreign exchange gains | | 18 | – |
| Other gains on financial instruments in a hedging relationship: | | | |
| – fair value hedges | | – | 4 |
| Other gains on financial instruments not in a hedging relationship: | | | |
| – amortisation of transitional adjustment on bonds | | 2 | 3 |
| – derivatives | | 7 | 13 |
| Finance income | | 36 | 26 |
| Net finance costs | | (73) | (96) |
| Analysed as: | | | |
| Net interest payable | | (73) | (86) |
| Finance costs in respect of retirement benefits | 25 | (12) | (12) |
| Net finance costs reflected in adjusted earnings – continuing operations | | (85) | (98) |
| Other net finance income | | 12 | 2 |
| Total net finance costs | | (73) | (96) |

The £nil net gain (2009: £3m net gain) on fair value hedges comprises a £40m loss (2009: £96m gain) on the underlying bonds offset by a £40m gain (2009: £93m loss) on the related derivative financial instruments.

# Notes to the consolidated financial statements continued

## 7. Income tax

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Current tax** | | | |
| Charge in respect of current year | | (82) | (106) |
| Other adjustments in respect of prior years | | 13 | 7 |
| **Total current tax charge** | | (69) | (99) |
| **Deferred tax** | | | |
| In respect of temporary differences | | (77) | (51) |
| Other adjustments in respect of prior years | | – | 4 |
| **Total deferred tax charge** | 13 | (77) | (47) |
| **Total tax charge** | | (146) | (146) |

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the UK tax rate as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Profit before tax | 670 | 523 |
| Tax calculated at UK rate (2010: 28%, 2009: 28%) | (188) | (147) |
| Effect of overseas tax rates | (40) | (27) |
| Joint venture and associate income reported net of tax | 11 | 8 |
| Net income not subject to tax | 8 | 8 |
| Utilisation of previously unrecognised tax losses and credits | 56 | 2 |
| Unutilised tax losses | (6) | (1) |
| Prior year adjustments | 13 | 11 |
| **Total tax charge** | (146) | (146) |
| UK | (28) | (41) |
| Overseas | (118) | (105) |
| **Total tax charge** | (146) | (146) |
| Tax rate reflected in earnings | 21.8% | 27.9% |

A number of changes to the UK Corporation tax system were announced in the June 2010 Budget Statement. The Finance (No. 2) Act 2010 was enacted in July 2010 and reduces the main rate of corporation tax from 28% to 27% from 1 April 2011. A reduction in the rate of corporation tax from 28% to 27% resulted in a reduction in the net deferred tax asset provided at 31 December 2010 of £3m, of which £1m was charged to the income statement and £2m to other comprehensive income.

## 7. Income tax continued

The tax rate reflected in adjusted earnings is calculated as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Profit before tax | 670 | 523 |
| Adjustments: | | |
| Amortisation of acquired intangibles | 105 | 91 |
| Acquisition costs | 11 | – |
| Other net losses | (2) | – |
| Other net finance income | (12) | (2) |
| Adjusted profit before tax – continuing operations | 772 | 612 |
| Adjusted profit before tax – discontinued operations | 81 | 149 |
| **Total adjusted profit before tax** | 853 | 761 |
| | | |
| Total tax charge | (146) | (146) |
| Adjustments: | | |
| Tax benefit on amortisation of acquired intangibles | (35) | (33) |
| Tax benefit on acquisition costs | (4) | – |
| Tax benefit on other net losses | (1) | – |
| Tax charge on other net finance income | 3 | 1 |
| Recognition of pre-acquisition tax losses and capital losses | (37) | – |
| Tax amortisation benefit on goodwill and intangibles | 36 | 36 |
| Adjusted income tax charge – continuing operations | (184) | (142) |
| Adjusted income tax charge – discontinued operations | (31) | (52) |
| **Total adjusted income tax charge** | (215) | (194) |
| Tax rate reflected in adjusted earnings | 25.2% | 25.5% |

The tax (charge)/benefit recognised in other comprehensive income is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Pension contributions and actuarial gains and losses | (42) | 79 |
| Net investment hedges and other foreign exchange gains and losses | 1 | 12 |
| | (41) | 91 |

A tax benefit of £4m (2009: tax benefit £6m) relating to share-based payments has been recognised directly in equity.

# Notes to the consolidated financial statements continued

## 8. Earnings per share

### Basic

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares.

### Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares.

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| Profit for the year from continuing operations | | 524 | 377 |
| Non-controlling interest | | 5 | (1) |
| Earnings from continuing operations | | 529 | 376 |
| Profit for the year from discontinued operations | 3 | 776 | 85 |
| Non-controlling interest | | (8) | (36) |
| Earnings | | 1,297 | 425 |
| Weighted average number of shares (millions) | | 801.2 | 799.3 |
| Effect of dilutive share options (millions) | | 1.8 | 0.8 |
| Weighted average number of shares (millions) for diluted earnings | | 803.0 | 800.1 |
| Earnings per share from continuing and discontinued operations | | | |
| Basic | | 161.9p | 53.2p |
| Diluted | | 161.5p | 53.1p |
| Earnings per share from continuing operations | | | |
| Basic | | 66.0p | 47.0p |
| Diluted | | 65.9p | 47.0p |
| Earnings per share from discontinued operations | | | |
| Basic | | 95.9p | 6.2p |

### Adjusted

In order to show results from operating activities on a consistent basis, an adjusted earnings per share is presented. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

The following items are excluded from adjusted earnings:

*Other net gains and losses* represent profits and losses on the acquisition and disposal of subsidiaries, joint ventures, associates and other financial assets that are included within continuing or discontinued operations but which distort the performance of the Group.

*Amortisation of acquired intangibles, acquisition costs and movements in contingent acquisition consideration* are also excluded from adjusted earnings as these items are not considered to be fully reflective of the underlying performance of the Group.

## 8. Earnings per share continued

*Other net finance income/costs* are foreign exchange and other gains and losses that represent short-term fluctuations in market value and foreign exchange movements on transactions and balances that are no longer in a hedge relationship. These gains and losses are subject to significant volatility and may not be realised in due course as it is normally the intention to hold these instruments to maturity. Other net finance costs of Group companies are included in finance costs or finance income as appropriate. Other net finance costs of joint ventures and associates are included within the share of results of joint ventures and associates within operating profit.

*Tax* on the above items is excluded from adjusted earnings. The Group has excluded the benefit from recognising previously unrecognised pre-acquisition and capital losses. The Group adds the benefit of tax amortisation of goodwill and intangibles as this benefit more accurately aligns the adjusted tax charge with the expected medium-term rate of cash tax payments.

*Non-controlling interest* for the above items is excluded from adjusted earnings.

The following tables reconcile statutory earnings to adjusted earnings.

| | | | | | | | | | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| All figures in £ millions | Statutory income statement | Discontinued operations | Other net gains and losses | Acquisition costs | Amortisation of acquired intangibles | Other net finance income/ costs | Tax amortisation benefit | Tax loss recognition | Adjusted income statement |
| Operating profit | 743 | 81 | (2) | 11 | 105 | – | – | – | 938 |
| Net finance costs | (73) | – | – | – | – | (12) | – | – | (85) |
| Profit before tax | 670 | 81 | (2) | 11 | 105 | (12) | – | – | 853 |
| Income tax | (146) | (31) | (1) | (4) | (35) | 3 | 36 | (37) | (215) |
| Profit for the year from continuing operations | 524 | 50 | (3) | 7 | 70 | (9) | 36 | (37) | 638 |
| Profit for the year from discontinued operations | 776 | (50) | (731) | – | 5 | – | – | – | – |
| Profit for the year | 1,300 | – | (734) | 7 | 75 | (9) | 36 | (37) | 638 |
| Non-controlling interest | (3) | – | (12) | – | (2) | – | – | – | (17) |
| Earnings | 1,297 | – | (746) | 7 | 73 | (9) | 36 | (37) | 621 |
| Weighted average number of shares (millions) | 801.2 | | | | | | | | 801.2 |
| Adjusted earnings per share | 161.9p | | | | | | | | 77.5p |

# Notes to the consolidated financial statements continued

## 8. Earnings per share continued

| All figures in £ millions | Statutory income statement | Discontinued operations | Other net gains and losses | Acquisition costs | Amortisation of acquired intangibles | Other net finance income/ costs | Tax amortisation benefit | Tax loss recognition | Adjusted income statement |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 2009 |
| Operating profit | 619 | 148 | – | – | 91 | – | – | – | 858 |
| Net finance costs | (96) | 1 | – | – | – | (2) | – | – | (97) |
| Profit before tax | 523 | 149 | – | – | 91 | (2) | – | – | 761 |
| Income tax | (146) | (52) | – | – | (33) | 1 | 36 | – | (194) |
| Profit for the year from continuing operations | 377 | 97 | – | – | 58 | (1) | 36 | – | 567 |
| Profit for the year from discontinued operations | 85 | (97) | – | – | 8 | – | 4 | – | – |
| Profit for the year | 462 | – | – | – | 66 | (1) | 40 | – | 567 |
| Non-controlling interest | (37) | – | – | – | (5) | – | (2) | – | (44) |
| Earnings | 425 | – | – | – | 61 | (1) | 38 | – | 523 |
| Weighted average number of shares (millions) | 799.3 | | | | | | | | 799.3 |
| Adjusted earnings per share | 53.2p | | | | | | | | 65.4p |

## 9. Dividends

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Final paid in respect of prior year 23.3p (2009: 22.0p) | 187 | 176 |
| Interim paid in respect of current year 13.0p (2009: 12.2p) | 105 | 97 |
| | 292 | 273 |

The directors are proposing a final dividend in respect of the financial year ended 31 December 2010 of 25.7p per share which will absorb an estimated £206m of shareholders' funds. It will be paid on 6 May 2011 to shareholders who are on the register of members on 8 April 2011. These financial statements do not reflect this dividend.

## 10. Property, plant and equipment

| All figures in £ millions | Land and buildings | Plant and equipment | Assets in course of construction | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 January 2009 | 355 | 839 | 7 | 1,201 |
| Exchange differences | (21) | (55) | (1) | (77) |
| Additions | 14 | 46 | 7 | 67 |
| Disposals | (2) | (41) | – | (43) |
| Acquisition through business combination | 1 | 17 | – | 18 |
| Reclassifications | 1 | 5 | (6) | – |
| At 31 December 2009 | 348 | 811 | 7 | 1,166 |
| Exchange differences | 8 | 28 | – | 36 |
| Additions | 21 | 55 | 12 | 88 |
| Disposals | (4) | (58) | – | (62) |
| Acquisition through business combination | 8 | 25 | – | 33 |
| Disposal through business disposal | (48) | (201) | – | (249) |
| Reclassifications | 3 | 5 | (8) | – |
| **At 31 December 2010** | 336 | 665 | 11 | 1,012 |

| All figures in £ millions | Land and buildings | Plant and equipment | Assets in course of construction | Total |
|---|---|---|---|---|
| **Depreciation** | | | | |
| At 1 January 2009 | (170) | (608) | – | (778) |
| Exchange differences | 11 | 42 | – | 53 |
| Charge for the year | (17) | (68) | – | (85) |
| Disposals | 2 | 39 | – | 41 |
| Acquisition through business combination | – | (9) | – | (9) |
| At 31 December 2009 | (174) | (604) | – | (778) |
| Exchange differences | (4) | (19) | – | (23) |
| Charge for the year | (16) | (66) | – | (82) |
| Disposals | 3 | 58 | – | 61 |
| Acquisition through business combination | (3) | (13) | – | (16) |
| Disposal through business disposal | 28 | 164 | – | 192 |
| **At 31 December 2010** | (166) | (480) | – | (646) |
| **Carrying amounts** | | | | |
| At 1 January 2009 | 185 | 231 | 7 | 423 |
| At 31 December 2009 | 174 | 207 | 7 | 388 |
| **At 31 December 2010** | 170 | 185 | 11 | 366 |

# Notes to the consolidated financial statements continued

## 10. Property, plant and equipment continued

Depreciation expense of £10m (2009: £12m) has been included in the income statement in cost of goods sold, £7m (2009: £7m) in distribution expenses and £52m (2009: £45m) in administrative and other expenses. In 2010 £13m (2009: £21m) relates to discontinued operations.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £12m (2009: £15m).

## 11. Intangible assets

| All figures in £ millions | Goodwill | Software | Acquired customer lists and relationships | Acquired trademarks and brands | Acquired publishing rights | Other intangibles acquired | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| At 1 January 2009 | 4,570 | 310 | 341 | 128 | 165 | 258 | 5,772 |
| Exchange differences | (420) | (25) | (32) | (9) | (5) | (22) | (513) |
| Additions – internal development | – | 35 | – | – | – | – | 35 |
| Additions – purchased | – | 24 | – | – | – | – | 24 |
| Disposals | (9) | (5) | – | – | – | – | (14) |
| Acquisition through business combination | 205 | – | 38 | 24 | 55 | 25 | 347 |
| At 31 December 2009 | 4,346 | 339 | 347 | 143 | 215 | 261 | 5,651 |
| Exchange differences | 140 | 9 | 10 | 4 | 9 | 10 | 182 |
| Additions – internal development | – | 41 | – | – | – | – | 41 |
| Additions – purchased | – | 15 | – | – | – | – | 15 |
| Disposals | (11) | (18) | – | – | – | – | (29) |
| Acquisition through business combination | 288 | 9 | 159 | 40 | 6 | 76 | 578 |
| Disposal through business disposal | (195) | (43) | (85) | (1) | – | (41) | (365) |
| **At 31 December 2010** | 4,568 | 352 | 431 | 186 | 230 | 306 | 6,073 |

## 11. Intangible assets continued

| All figures in £ millions | Goodwill | Software | Acquired customer lists and relationships | Acquired trademarks and brands | Acquired publishing rights | Other intangibles acquired | Total |
|---|---|---|---|---|---|---|---|
| **Amortisation** | | | | | | | |
| At 1 January 2009 | – | (203) | (67) | (17) | (69) | (63) | (419) |
| Exchange differences | – | 19 | 6 | 1 | 6 | 8 | 40 |
| Charge for the year | – | (44) | (35) | (11) | (22) | (35) | (147) |
| Disposals | – | 4 | – | – | – | – | 4 |
| At 31 December 2009 | – | (224) | (96) | (27) | (85) | (90) | (522) |
| Exchange differences | – | (5) | (3) | (2) | (2) | (1) | (13) |
| Charge for the year | – | (51) | (39) | (12) | (24) | (38) | (164) |
| Disposals | – | 16 | – | – | – | – | 16 |
| Acquisition through business combination | – | (5) | – | – | – | – | (5) |
| Disposal through business disposal | – | 19 | 35 | – | – | 28 | 82 |
| **At 31 December 2010** | – | (250) | (103) | (41) | (111) | (101) | (606) |
| **Carrying amounts** | | | | | | | |
| At 1 January 2009 | 4,570 | 107 | 274 | 111 | 96 | 195 | 5,353 |
| At 31 December 2009 | 4,346 | 115 | 251 | 116 | 130 | 171 | 5,129 |
| **At 31 December 2010** | 4,568 | 102 | 328 | 145 | 119 | 205 | 5,467 |

### Goodwill

The goodwill carrying value of £4,568m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. £3,090m of the carrying value relates to acquisitions completed between 1 January 1998 and 31 December 2002 and £1,478m relates to acquisitions completed after 1 January 2003 (the date of transition to IFRS).

For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

### Other intangible assets

Other intangibles acquired include content, technology, contracts and software rights. Amortisation of £3m (2009: £5m) is included in the income statement in cost of goods sold and £149m (2009: £126m) in administrative and other expenses. In 2010 £12m (2009: £16m) of amortisation relates to discontinued operations.

# Notes to the consolidated financial statements continued

## 11. Intangible assets continued

### Impairment tests for cash-generating units containing goodwill

Impairment tests have been carried out where appropriate as described below. The recoverable amount for each unit tested exceeds its carrying value.

Goodwill in respect of continuing operations is allocated to 12 cash-generating units (CGUs) within the business segments as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| US Education Publishing | 1,976 | 1,876 |
| US School Assessment and Information | 683 | 652 |
| Canada | 197 | 181 |
| International Education Publishing | 686 | 468 |
| International Education Assessment and Testing | 227 | 222 |
| Professional Publishing | 13 | 13 |
| Professional Assessment and Training | 287 | 226 |
| Pearson Education total | 4,069 | 3,638 |
| Financial Times | 48 | 43 |
| Mergermarket | 136 | 125 |
| FT Group total | 184 | 168 |
| Penguin US | 196 | 190 |
| Penguin UK | 103 | 103 |
| Penguin Asia Pacific & International | 16 | 63 |
| Penguin total | 315 | 356 |
| Continuing operations | 4,568 | 4,162 |
| Interactive Data | – | 184 |
| Total goodwill | 4,568 | 4,346 |

As highlighted in the 2008 business review, integration of the US School and Higher Education businesses began in 2008. This integration continued throughout 2009 and advanced to a point where, from 1 January 2010, these companies have been combined into one CGU for impairment review purposes.

The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

### Key assumptions

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five-year period. The key assumptions used by management in the value in use calculations were:

*Discount rate* The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates used are in the range of 11.2% to 12.1% for the Pearson Education businesses (2009: 10.9% to 11.8%), 12.9% to 20.0% for the FT Group businesses (2009: 12.7% to 18.1%) and 10.5% to 13.0% for the Penguin businesses (2009: 9.5% to 11.4%).

## 11. Intangible assets continued

### Impairment tests for cash-generating units containing goodwill continued

*Perpetuity growth rates* A perpetuity growth rate of 2.0% was used for cash flows subsequent to the approved budget period for all CGUs in 2010 (2009: 2.0%). This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates.

*Cash flow growth rates* The cash flow growth rates are derived from management's latest forecast of sales taking into consideration experience of operating margins achieved in the CGU. Historically, such forecasts have been reasonably accurate.

### Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group's sensitivity analysis, a reasonably possible change in any of these assumptions is unlikely to cause an impairment in any of the CGUs.

## 12. Investments in joint ventures and associates

### Joint ventures

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| At beginning of year | 18 | 13 |
| Share of (loss)/profit after tax | (1) | 4 |
| Dividends | (3) | (3) |
| Loan repayment | – | (3) |
| Additions and further investment | 4 | 13 |
| Transfer to subsidiary | – | (6) |
| At end of year | 18 | 18 |

Investments in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost. The total goodwill recorded on acquisition of joint ventures at 31 December 2010 was £12m (2009: £11m).

# Notes to the consolidated financial statements continued

## 12. Investments in joint ventures and associates continued

The aggregate of the Group's share of its joint ventures' assets (including goodwill) and liabilities, none of which are individually significant, are as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Assets** | | |
| Non-current assets | 15 | 15 |
| Current assets | 14 | 11 |
| **Liabilities** | | |
| Current liabilities | (11) | (8) |
| **Net assets** | 18 | 18 |
| Income | 17 | 12 |
| Expenses | (18) | (8) |
| **(Loss)/profit after tax** | (1) | 4 |

### Associates

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| At beginning of year | 12 | 10 |
| Exchange differences | (1) | 4 |
| Share of profit after tax | 42 | 26 |
| Dividends | (20) | (19) |
| Additions | 17 | 1 |
| Reversal of distribution from associate in excess of carrying value | (7) | (7) |
| Actuarial gains/(losses) on retirement benefit obligations | 1 | (3) |
| Transfer from other financial assets | 9 | – |
| **At end of year** | 53 | 12 |

Included in the share of profit after tax is a gain in fair values of £12m (2009: £nil) arising on a stepped acquisition by FTSE International Ltd.

In addition to the amounts disclosed above, FTSE paid royalties of £11m (2009: £10m) to the FT Group during the year.

Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The total goodwill recorded on acquisition of associates at 31 December 2010 was £21m (2009: £nil).

The Group's interests in its principal associates, all of which are unlisted, are as follows:

| 2010<br>All figures in £ millions | Country of incorporation | % interest held | Assets | Liabilities | Revenues | Profit |
|---|---|---|---|---|---|---|
| The Economist Newspaper Ltd | England | 50 | 129 | (129) | 169 | 25 |
| FTSE International Ltd | England | 50 | 62 | (44) | 45 | 17 |
| Other | | | 41 | (6) | 9 | – |
| **Total** | | | 232 | (179) | 223 | 42 |

## 12. Investments in joint ventures and associates continued

| 2009<br>All figures in £ millions | Country of incorporation | % interest held | Assets | Liabilities | Revenues | Profit |
|---|---|---|---|---|---|---|
| The Economist Newspaper Ltd | England | 50 | 116 | (116) | 161 | 22 |
| FTSE International Ltd | England | 50 | 28 | (24) | 38 | 4 |
| Other | | | 14 | (6) | 12 | – |
| Total | | | 158 | (146) | 211 | 26 |

The interests held in associates are equivalent to voting rights.

## 13. Deferred income tax

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Deferred income tax assets** | | |
| Deferred income tax assets to be recovered after more than 12 months | 276 | 374 |
| Deferred income tax assets to be recovered within 12 months | – | 13 |
| | 276 | 387 |
| **Deferred income tax liabilities** | | |
| Deferred income tax liabilities to be settled after more than 12 months | (471) | (473) |
| Deferred income tax liabilities to be settled within 12 months | – | – |
| | (471) | (473) |
| Net deferred income tax | (195) | (86) |

Deferred income tax assets to be recovered within 12 months relate to the utilisation of losses in the US.

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The Group has unrecognised deferred income tax assets of £14m at 31 December 2010 in respect of UK losses, and approximately £16m in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| At beginning of year | | (86) | (75) |
| Exchange differences | | (4) | 10 |
| Income statement charge | 7 | (72) | (51) |
| Acquisition through business combination | 29 | (37) | (45) |
| Disposal through business disposal | 30 | 47 | – |
| Tax (charge)/benefit to other comprehensive income or equity | | (43) | 75 |
| At end of year | | (195) | (86) |

Included in the income statement charge above is a £5m credit relating to discontinued operations (2009: £4m charge).

# Notes to the consolidated financial statements continued

## 13. Deferred income tax continued

The movement in deferred income tax assets and liabilities during the year is as follows:

| All figures in £ millions | Trading losses | Goodwill and intangibles | Returns provisions | Retirement benefit obligations | Other | Total |
|---|---|---|---|---|---|---|
| **Deferred income tax assets** | | | | | | |
| At 1 January 2009 | 73 | 20 | 106 | 7 | 166 | 372 |
| Exchange differences | (5) | (2) | (10) | (1) | (17) | (35) |
| Acquisition through business combination | – | – | – | – | – | – |
| Income statement (charge)/benefit | (46) | (7) | (4) | (6) | 42 | (21) |
| Tax benefit to other comprehensive income or equity | – | – | – | 68 | 3 | 71 |
| **At 31 December 2009** | 22 | 11 | 92 | 68 | 194 | 387 |
| Exchange differences | 1 | – | 3 | – | 5 | 9 |
| Acquisition through business combination | – | – | – | – | 4 | 4 |
| Disposal through business disposal | – | – | – | – | (7) | (7) |
| Income statement (charge)/benefit | (18) | (7) | 1 | (9) | (35) | (68) |
| Tax (charge)/benefit to other comprehensive income or equity | – | – | – | (53) | 4 | (49) |
| **At 31 December 2010** | 5 | 4 | 96 | 6 | 165 | 276 |

Other deferred income tax assets include temporary differences on share-based payments, inventory and other provisions.

| All figures in £ millions | Goodwill and intangibles | Other | Total |
|---|---|---|---|
| **Deferred income tax liabilities** | | | |
| At 1 January 2009 | (318) | (129) | (447) |
| Exchange differences | 30 | 15 | 45 |
| Acquisition through business combination | (41) | (4) | (45) |
| Income statement benefit/(charge) | 10 | (40) | (30) |
| Tax benefit to other comprehensive income or equity | – | 4 | 4 |
| **At 31 December 2009** | (319) | (154) | (473) |
| Exchange differences | (9) | (4) | (13) |
| Acquisition through business combination | (41) | – | (41) |
| Disposal through business disposal | 25 | 29 | 54 |
| Income statement benefit/(charge) | 10 | (14) | (4) |
| Tax benefit to other comprehensive income or equity | – | 6 | 6 |
| **At 31 December 2010** | (334) | (137) | (471) |

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

## 14. Classification of financial instruments

The accounting classification of each class of the Group's financial assets and financial liabilities, together with their fair values, is as follows:

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 2010 |
| | | | | | Fair value | Amortised cost | | | |
| All figures in £ millions | Notes | Available for sale | Derivatives deemed held for trading | Derivatives in hedging relationships | Other liabilities | Loans and receivables | Other liabilities | Total carrying value | Total market value |
| Investments in unlisted securities | 15 | 58 | – | – | – | – | – | 58 | 58 |
| Cash and cash equivalents | 17 | – | – | – | – | 1,736 | – | 1,736 | 1,736 |
| Marketable securities | | 12 | – | – | – | – | – | 12 | 12 |
| Derivative financial instruments | 16 | – | 28 | 112 | – | – | – | 140 | 140 |
| Trade receivables | 22 | – | – | – | – | 1,031 | – | 1,031 | 1,031 |
| **Total financial assets** | | 70 | 28 | 112 | – | 2,767 | – | 2,977 | 2,977 |
| Derivative financial instruments | 16 | – | (6) | – | – | – | – | (6) | (6) |
| Trade payables | 24 | – | – | – | – | – | (470) | (470) | (470) |
| Other financial liabilities – put option over non-controlling interest | 24 | – | – | – | (25) | – | – | (25) | (25) |
| Bank loans and overdrafts | 18 | – | – | – | – | – | (73) | (73) | (73) |
| Borrowings due within one year | 18 | – | – | – | – | – | (331) | (331) | (333) |
| Borrowings due after more than one year | 18 | – | – | – | – | – | (1,908) | (1,908) | (1,939) |
| **Total financial liabilities** | | – | (6) | – | (25) | – | (2,782) | (2,813) | (2,846) |

# Notes to the consolidated financial statements continued

## 14. Classification of financial instruments continued

| | | | | | | | | | 2009 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Fair value | Amortised cost | | | |
| All figures in £ millions | Notes | Available for sale | Derivatives deemed held for trading | Derivatives in hedging relationships | Other liabilities | Loans and receivables | Other liabilities | Total carrying value | Total market value |
| Investments in unlisted securities | 15 | 62 | – | – | – | – | – | 62 | 62 |
| Cash and cash equivalents | 17 | – | – | – | – | 750 | – | 750 | 750 |
| Marketable securities | | 63 | – | – | – | – | – | 63 | 63 |
| Derivative financial instruments | 16 | – | 42 | 70 | – | – | – | 112 | 112 |
| Trade receivables | 22 | – | – | – | – | 989 | – | 989 | 989 |
| **Total financial assets** | | 125 | 42 | 70 | – | 1,739 | – | 1,976 | 1,976 |
| Derivative financial instruments | 16 | – | (9) | – | – | – | – | (9) | (9) |
| Trade payables | 24 | – | – | – | – | – | (461) | (461) | (461) |
| Other financial liabilities – put option over non-controlling interest | 24 | – | – | – | (23) | – | – | (23) | (23) |
| Bank loans and overdrafts | 18 | – | – | – | – | – | (70) | (70) | (70) |
| Borrowings due within one year | 18 | – | – | – | – | – | (4) | (4) | (4) |
| Borrowings due after more than one year | 18 | – | – | – | – | – | (1,934) | (1,934) | (1,969) |
| **Total financial liabilities** | | – | (9) | – | (23) | – | (2,469) | (2,501) | (2,536) |

Certain of the Group's derivative financial instruments are classified as held for trading either as they do not meet the hedge accounting criteria specified in IAS 39 'Financial Instruments: Recognition and Measurement' or the Group has chosen not to seek hedge accounting for these instruments. None of these derivatives are held for speculative trading purposes. Transactions in derivative financial instruments are only undertaken to manage risks arising from underlying business activity, in accordance with the Group's treasury policy as described in note 19.

The Group designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The Group also designates certain of its borrowings and derivative financial instruments as hedges of its investments in foreign operations (net investment hedges). Movements in the fair value of these financial instruments (to the extent they are effective) are recognised in other comprehensive income.

None of the Group's financial assets or liabilities are designated at fair value through the income statement upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies. The Group's approach to managing risks in relation to financial instruments is described in note 19.

## 15. Other financial assets

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| At beginning of year | 62 | 63 |
| Exchange differences | 1 | (6) |
| Acquisition of investments | 7 | 10 |
| Transfers to associates | (9) | – |
| Disposal of investments | (3) | (5) |
| At end of year | 58 | 62 |

Other financial assets comprise non-current unlisted securities.

## 16. Derivative financial instruments

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| All figures in £ millions | Gross notional amounts | Assets | Liabilities | Gross notional amounts | Assets | Liabilities |
| Interest rate derivatives – in a fair value hedge relationship | 1,327 | 112 | – | 1,103 | 70 | – |
| Interest rate derivatives – not in a hedge relationship | 256 | 8 | – | 486 | 13 | (7) |
| Cross currency rate derivatives – in a net investment hedge relationship | 220 | 20 | (6) | 220 | 29 | (2) |
| Total | 1,803 | 140 | (6) | 1,809 | 112 | (9) |
| **Analysed as expiring:** | | | | | | |
| In less than one year | 319 | 6 | – | 238 | – | (7) |
| Later than one year and not later than five years | 749 | 74 | (6) | 844 | 60 | (2) |
| Later than five years | 735 | 60 | – | 727 | 52 | – |
| Total | 1,803 | 140 | (6) | 1,809 | 112 | (9) |

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

At the end of 2010, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross currency rate derivatives, was US dollar £(97)m, sterling £259m and South African rand £(28)m (2009: US dollar £(127)m, sterling £252m and South African rand £(22)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2010 range from 3.65% to 9.28% (2009: 3.65% to 9.28%) and the floating rates are based on LIBOR in US dollar and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

# Notes to the consolidated financial statements continued

## 16. Derivative financial instruments continued

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

## 17. Cash and cash equivalents (excluding overdrafts)

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Cash at bank and in hand | 763 | 580 |
| Short-term bank deposits | 973 | 170 |
| | 1,736 | 750 |

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2010 the currency split of cash and cash equivalents was US dollar 73% (2009: 35%), sterling 9% (2009: 22%), euro 6% (2009: 18%) and other 12% (2009: 25%).

Cash and cash equivalents have fair values that approximate to their carrying value due to their short-term nature.

Cash and cash equivalents include the following for the purpose of the cash flow statement:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | 1,736 | 750 |
| Bank overdrafts | (72) | (70) |
| | 1,664 | 680 |

## 18. Financial liabilities – Borrowings

The Group's current and non-current borrowings are as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Non-current** | | |
| 7.0% Global Dollar Bonds 2011 (nominal amount $500m) | – | 322 |
| 5.5% Global Dollar Bonds 2013 (nominal amount $350m) | 236 | 226 |
| 5.7% US Dollar Bonds 2014 (nominal amount $400m) | 288 | 274 |
| 7.0% Sterling Bonds 2014 (nominal amount £250m) | 256 | 254 |
| 6.0% Sterling Bonds 2015 (nominal amount £300m) | 297 | 297 |
| 4.0% US Dollar Notes 2016 (nominal amount $350m) | 227 | – |
| 6.25% Global Dollar Bonds 2018 (nominal amount $550m) | 389 | 359 |
| 4.625% US Dollar Notes 2018 (nominal amount $300m) | 208 | 191 |
| Finance lease liabilities | 7 | 11 |
| | 1,908 | 1,934 |
| **Current** | | |
| **Due within one year or on demand:** | | |
| Bank loans and overdrafts | 73 | 70 |
| 7.0% Global Dollar Bonds 2011 (nominal amount $500m) | 325 | – |
| Finance lease liabilities | 6 | 4 |
| | 404 | 74 |
| **Total borrowings** | 2,312 | 2,008 |

Included in the non-current borrowings above is £12m of accrued interest (2009: £12m). Included in the current borrowings above is £1m of accrued interest (2009: £nil).

The maturity of the Group's non-current borrowing is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Between one and two years | 4 | 327 |
| Between two and five years | 1,080 | 760 |
| Over five years | 824 | 847 |
| | 1,908 | 1,934 |

# Notes to the consolidated financial statements continued

## 18. Financial liabilities – Borrowings continued

The carrying amounts and market values of borrowings are as follows:

| All figures in £ millions | 2010 Effective interest rate | 2010 Carrying value | 2010 Market value | 2009 Carrying value | 2009 Market value |
|---|---|---|---|---|---|
| Bank loans and overdrafts | n/a | 73 | 73 | 70 | 70 |
| 7.0% Global Dollar Bonds 2011 | 7.16% | 325 | 327 | 322 | 331 |
| 5.5% Global Dollar Bonds 2013 | 5.76% | 236 | 241 | 226 | 232 |
| 5.7% US Dollar Bonds 2014 | 5.88% | 288 | 277 | 274 | 266 |
| 7.0% Sterling Bonds 2014 | 7.20% | 256 | 282 | 254 | 276 |
| 6.0% Sterling Bonds 2015 | 6.27% | 297 | 329 | 297 | 317 |
| 4.0% US Dollar Notes 2016 | 4.26% | 227 | 226 | – | – |
| 6.25% Global Dollar Bonds 2018 | 6.46% | 389 | 385 | 359 | 360 |
| 4.625% US Dollar Notes 2018 | 4.69% | 208 | 192 | 191 | 176 |
| Finance lease liabilities | n/a | 13 | 13 | 15 | 15 |
| | | 2,312 | 2,345 | 2,008 | 2,043 |

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| US dollar | 1,759 | 1,457 |
| Sterling | 553 | 551 |
| Euro | – | – |
| | 2,312 | 2,008 |

The Group has the following undrawn capacity on its committed borrowing facilities as at 31 December:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Floating rate | | |
| – expiring within one year | – | – |
| – expiring beyond one year | 1,118 | 1,084 |
| | 1,118 | 1,084 |

In addition to the above facilities, there are a number of short-term facilities that are utilised in the normal course of business.

All of the Group's borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

## 18. Financial liabilities – Borrowings continued

The maturity of the Group's finance lease obligations is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Finance lease liabilities – minimum lease payments** | | |
| Not later than one year | 6 | 4 |
| Later than one year and not later than two years | 4 | 5 |
| Later than two years and not later than three years | 3 | 3 |
| Later than three years and not later than four years | – | 3 |
| Later than four years and not later than five years | – | – |
| Later than five years | – | – |
| Future finance charges on finance leases | – | – |
| **Present value of finance lease liabilities** | 13 | 15 |

The present value of finance lease liabilities is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Not later than one year | 6 | 4 |
| Later than one year and not later than five years | 7 | 11 |
| Later than five years | – | – |
| | 13 | 15 |

The carrying amounts of the Group's lease obligations approximate their fair value.

## 19. Financial risk management

The Group's approach to the management of financial risks together with sensitivity analyses is set out below.

### Treasury policy

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. The Group borrows principally in US dollars and sterling, at both floating and fixed rates of interest, using derivative financial instruments ('derivatives'), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised below. All the treasury policies remained unchanged throughout 2010, except for a revision to the Group's bank counterparty limits.

The audit committee receives reports on the Group's treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.

# Notes to the consolidated financial statements continued

## 19. Financial risk management continued

### Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39 'Financial Instruments: Recognition and Measurement') to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2010 the fixed to floating hedging ratio, on the above basis, was approximately 136%. This above-policy level reflects the receipt of the proceeds from the divestment of Interactive Data in 2010, combined with strong cash collections, resulting in lower than typical net debt and hence a higher hedging ratio. Our policy does not require us to cancel derivative contracts and we expect to return to compliance with this policy during 2011. A simultaneous 1% change on 1 January 2011 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £2m effect on profit before tax.

### Use of interest rate derivatives

The policy described in the section above creates a group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a second group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates. The Group's accounting objective in its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces sharply the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

### Liquidity and refinancing risk management

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2010 the average maturity of gross borrowings was 4.4 years (2009: 5.1 years) of which bonds represented 96% (2009: 96%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of the Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2010 the committed facilities amounted to £1,118m and their weighted average maturity was 4.9 years.

## 19. Financial risk management continued

### Analysis of Group debt, including the impact of derivatives

The following tables analyse the Group's sources of funding and the impact of derivatives on the Group's debt instruments.

The Group's net debt position is set out below:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | 1,736 | 750 |
| Marketable securities | 12 | 63 |
| Derivative financial instruments | 134 | 103 |
| Bank loans, overdrafts and loan notes | (73) | (70) |
| Bonds | (2,226) | (1,923) |
| Finance lease liabilities | (13) | (15) |
| Net debt | (430) | (1,092) |

The split of net debt between fixed and floating rate, stated after the impact of rate derivatives, is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Fixed rate | 577 | 772 |
| Floating rate | (147) | 320 |
| Total | 430 | 1,092 |

Gross borrowings, after the impact of cross-currency rate derivatives, analysed by currency are as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| US dollar | 1,954 | 1,656 |
| Sterling | 333 | 330 |
| Other | 25 | 22 |
| Total | 2,312 | 2,008 |

As at 31 December 2010 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows:

| All figures in £ millions | Less than one year | One to five years | More than five years | Total |
|---|---|---|---|---|
| Re-pricing profile of borrowings | 403 | 1,084 | 825 | 2,312 |
| Effect of rate derivatives | 1,264 | (529) | (735) | – |
| Total | 1,667 | 555 | 90 | 2,312 |

# Notes to the consolidated financial statements continued

## 19. Financial risk management continued

The maturity of contracted cash flows associated with the Group's financial liabilities are as follows:

| All figures in £ millions | USD | GBP | Other | Total |
|---|---|---|---|---|
| | | | | 2010 |
| Not later than one year | 571 | 117 | 160 | 848 |
| Later than one year and not later than five years | 767 | 399 | 32 | 1,198 |
| Later than five years | 792 | – | – | 792 |
| Total | 2,130 | 516 | 192 | 2,838 |
| Analysed as: | | | | |
| Bonds | 1,938 | 710 | – | 2,648 |
| Rate derivatives – inflows | (364) | (297) | – | (661) |
| Rate derivatives – outflows | 340 | 7 | 34 | 381 |
| Trade creditors | 216 | 96 | 158 | 470 |
| Total | 2,130 | 516 | 192 | 2,838 |

| All figures in £ millions | USD | GBP | Other | Total |
|---|---|---|---|---|
| | | | | 2009 |
| Not later than one year | 265 | 110 | 151 | 526 |
| Later than one year and not later than five years | 878 | 313 | 30 | 1,221 |
| Later than five years | 739 | 106 | – | 845 |
| Total | 1,882 | 529 | 181 | 2,592 |
| Analysed as: | | | | |
| Bonds | 1,692 | 745 | – | 2,437 |
| Rate derivatives – inflows | (386) | (313) | – | (699) |
| Rate derivatives – outflows | 353 | 8 | 32 | 393 |
| Trade creditors | 223 | 89 | 149 | 461 |
| Total | 1,882 | 529 | 181 | 2,592 |

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the Group net settles these amounts wherever possible.

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

### Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover our total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

## 19. Financial risk management continued

### Foreign currency risk management

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. Our policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross currency swaps) were: US dollar £683m, sterling £179m and South African rand £9m.

### Use of currency debt and currency derivatives

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

### Financial instruments – fair value measurement

The following table provides an analysis of those financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

# Notes to the consolidated financial statements continued

## 19. Financial risk management continued

### Financial instruments – fair value measurement continued

| All figures in £ millions | 2010 Level 1 | 2010 Level 2 | 2010 Level 3 | 2010 Total | 2009 Level 1 | 2009 Level 2 | 2009 Level 3 | 2009 Total |
|---|---|---|---|---|---|---|---|---|
| **Financial assets at fair value** | | | | | | | | |
| Derivative financial assets | – | 140 | – | 140 | – | 112 | – | 112 |
| Marketable securities | – | 12 | – | 12 | – | 63 | – | 63 |
| **Available for sale financial assets** | | | | | | | | |
| Investments in unlisted securities | – | – | 58 | 58 | – | – | 62 | 62 |
| **Financial liabilities at fair value** | | | | | | | | |
| Derivative financial liabilities | – | (6) | – | (6) | – | (9) | – | (9) |
| Other financial liabilities – put option over non-controlling interest | – | – | (25) | (25) | – | – | (23) | (23) |
| **Total** | – | 146 | 33 | 179 | – | 166 | 39 | 205 |

The following table analyses the movements in level 3 fair value measurements:

| All figures in £ millions | 2010 Investments in unlisted securities | 2010 Other financial liabilities |
|---|---|---|
| At beginning of year | 62 | (23) |
| Exchange differences | 1 | – |
| Additions | 7 | (2) |
| Disposals | (12) | – |
| **At end of year** | 58 | (25) |

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets. The fair value of other financial liabilities represents the present value of the estimated future liability.

### Financial instruments – sensitivity analysis

As at 31 December 2010 the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

| All figures in £ millions | Carrying value | Impact of 1% increase in interest rates | Impact of 1% decrease in interest rates | Impact of 10% strengthening in sterling | Impact of 10% weakening in sterling |
|---|---|---|---|---|---|
| Investments in unlisted securities | 58 | – | – | (2) | 3 |
| Cash and cash equivalents | 1,736 | – | – | (140) | 171 |
| Marketable securities | 12 | – | – | – | – |
| Derivative financial instruments | 134 | (62) | 67 | 11 | (14) |
| Bonds | (2,226) | 59 | (64) | 142 | (174) |
| Other borrowings | (86) | – | – | 8 | (9) |
| Put option over non-controlling interest | (25) | – | – | 2 | (3) |
| Other net financial assets | 556 | – | – | (42) | 51 |
| **Total financial instruments** | 159 | (3) | 3 | (21) | 25 |

## 19. Financial risk management continued

### Financial instruments – sensitivity analysis continued

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. The class 'Other net financial assets' comprises trade assets less trade liabilities.

The sensitivities of derivative instruments are calculated using established estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%. A large proportion of the movements shown above would impact equity rather than the income statement, depending on the location and functional currency of the entity in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

## 20. Intangible assets – Pre-publication

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Cost** | | |
| At beginning of year | 1,727 | 1,800 |
| Exchange differences | 52 | (160) |
| Additions | 319 | 322 |
| Disposals | (248) | (230) |
| Acquisition through business combination | 13 | (1) |
| Transfer to inventories | – | (4) |
| At end of year | 1,863 | 1,727 |
| **Amortisation** | | |
| At beginning of year | (1,077) | (1,105) |
| Exchange differences | (33) | 102 |
| Charge for the year | (350) | (307) |
| Disposals | 248 | 230 |
| Acquisition through business combination | (4) | 3 |
| At end of year | (1,216) | (1,077) |
| Carrying amounts | | |
| At end of year | 647 | 650 |

Included in the above are pre-publication assets amounting to £399m (2009: £398m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold.

# Notes to the consolidated financial statements continued

## 21. Inventories

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Raw materials | 34 | 32 |
| Work in progress | 19 | 23 |
| Finished goods | 376 | 390 |
| | 429 | 445 |

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £836m (2009: £843m). In 2010 £87m (2009: £75m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

## 22. Trade and other receivables

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Current** | | |
| Trade receivables | 1,028 | 989 |
| Royalty advances | 111 | 99 |
| Prepayments and accrued income | 77 | 75 |
| Other receivables | 121 | 121 |
| | 1,337 | 1,284 |
| **Non-current** | | |
| Trade receivables | 3 | – |
| Royalty advances | 89 | 86 |
| Prepayments and accrued income | 28 | 24 |
| Other receivables | 9 | 2 |
| | 129 | 112 |

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns. The movements on the provision for bad and doubtful debts are as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| At beginning of year | (76) | (72) |
| Exchange differences | (2) | 5 |
| Income statement movements | (33) | (26) |
| Utilised | 26 | 20 |
| Acquisition through business combination | (3) | (3) |
| Disposal through business disposal | 5 | – |
| **At end of year** | (83) | (76) |

Concentrations of credit risk with respect to trade receivables are limited due to the Group's large number of customers, who are internationally dispersed.

## 22. Trade and other receivables continued

The ageing of the Group's trade receivables is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Within due date | 1,180 | 1,096 |
| Up to three months past due date | 234 | 228 |
| Three to six months past due date | 39 | 51 |
| Six to nine months past due date | 6 | 20 |
| Nine to 12 months past due date | 13 | 4 |
| More than 12 months past due date | 21 | 20 |
| Total trade receivables | 1,493 | 1,419 |
| Less: provision for bad and doubtful debts | (83) | (76) |
| Less: provision for sales returns | (379) | (354) |
| Net trade receivables | 1,031 | 989 |

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historic payment profiles. Management believe all the remaining receivable balances are fully recoverable.

## 23. Provisions for other liabilities and charges

| All figures in £ millions | Deferred consideration | Leases | Other | Total |
|---|---|---|---|---|
| At 1 January 2010 | 38 | 9 | 21 | 68 |
| Exchange differences | 1 | 1 | – | 2 |
| Charged to income statement | 2 | – | 5 | 7 |
| Deferred consideration on acquisition – current year | 8 | – | – | 8 |
| Deferred consideration on acquisition – prior year adjustments | (10) | – | – | (10) |
| Acquisition through business combination – current year | 10 | – | – | 10 |
| Utilised | (20) | – | (5) | (25) |
| At 31 December 2010 | 29 | 10 | 21 | 60 |

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Analysis of provisions | | |
| Non-current | 42 | 50 |
| Current | 18 | 18 |
| | 60 | 68 |

Deferred consideration primarily relates to the acquisition of Fronter in 2009.

# Notes to the consolidated financial statements continued

## 24. Trade and other liabilities

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Trade payables | 470 | 461 |
| Social security and other taxes | 22 | 30 |
| Accruals | 559 | 504 |
| Deferred income | 559 | 487 |
| Interest payable | 12 | 10 |
| Put option over non-controlling interest | 25 | 23 |
| Other liabilities | 204 | 205 |
| | 1,851 | 1,720 |
| Less: non-current portion | | |
| Accruals | 26 | 23 |
| Deferred income | 120 | 116 |
| Put option over non-controlling interest | 25 | 23 |
| Other liabilities | 75 | 91 |
| | 246 | 253 |
| Current portion | 1,605 | 1,467 |

The carrying value of the Group's trade and other liabilities approximates its fair value.

The deferred income balance comprises principally: multi-year obligations to deliver workbooks to adoption customers in school businesses; advance payments in assessment and testing businesses; subscription income in school and newspaper businesses; and obligations to deliver digital content in future periods.

The put option over non-controlling interest is the fair value of an option held by the non-controlling interest in the Group's South African business. The option enables the non-controlling interest to sell their 15% share of Pearson South Africa to Pearson from 1 January 2012 at a price determined by the future performance of that business.

## 25. Retirement benefit and other post-retirement obligations

### Background

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world. For the defined benefit plans, benefits are based on employees' length of service and final pensionable pay. Defined contribution benefits are based on the amount of contributions paid in respect of an individual member, the investment returns earned and the amount of pension this money will buy when a member retires.

The largest plan is the Pearson Group Pension Plan ('UK Group plan') with both defined benefit and defined contribution sections. From 1 November 2006, all sections of the UK Group plan were closed to new members with the exception of a defined contribution section that was opened in 2003. This section is available to all new employees of participating companies. The other major defined benefit plans are based in the US.

Other defined contribution plans are operated principally overseas with the largest plan being in the US. The specific features of these plans vary in accordance with the regulations of the country in which employees are located.

Pearson also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

### Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

| | | | 2010 | | | 2009 |
|---|---|---|---|---|---|---|
| % | UK Group plan | Other plans | PRMB | UK Group plan | Other plans | PRMB |
| Inflation | 3.5 | 2.5 | 2.5 | 3.5 | 2.5 | 2.5 |
| Rate used to discount plan liabilities | 5.5 | 5.1 | 5.1 | 5.7 | 5.3 | 5.5 |
| Expected return on assets | 6.0 | 6.6 | – | 6.0 | 6.8 | – |
| Expected rate of increase in salaries | 4.7 | 4.0 | – | 5.0 | 4.0 | – |
| Expected rate of increase for pensions in payment and deferred pensions | 2.6 to 4.4 | – | – | 2.6 to 4.4 | – | – |
| Initial rate of increase in healthcare rate | – | – | 8.0 | – | – | 8.5 |
| Ultimate rate of increase in healthcare rate | – | – | 5.0 | – | – | 5.0 |

The UK discount rate is based on the annualised yield on the iBoxx over 15-year AA-rated corporate bond index, adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model. The expected return on assets is based on market expectations of long-term asset returns for the defined portfolio at the end of the year.

The inflation rate of 3.5% reflects the RPI rate. In line with changes to legislation certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.8% has been used. The change from RPI to CPI for deferred revaluation and Post 88 GMP pension increases in payment has been included in these results, resulting in a gain of £23m, taken as an actuarial gain on the obligation.

The expected rates of return on categories of plan assets are determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio, plus a diversification premium.

The expected rate of increase in salaries has been set at 4.7% for 2010 with a short-term assumption of 3.3% for two years.

# Notes to the consolidated financial statements continued

## 25. Retirement benefit and other post-retirement obligations continued

In 2008 the UK mortality assumptions were derived by adjusting standard mortality tables (PMFA 92 tables projected forward with medium cohort improvement factors). In 2009 the Group changed its mortality assumptions in the UK. The mortality base table assumptions have been derived from the SAPS 'all pensioners' tables for males and the SAPS 'normal health pensioners' tables for females, adjusted to reflect the observed experience of the plan, with medium cohort improvement factors. In 2008 a 1% improvement floor on the medium cohort was applied. In 2009 this was changed to 1.5% for males and 1.25% for females, with tapering.

For the US plans, the assumptions used were based on standard US mortality tables. In 2008 a switch from GAM94 to RP2000 was made, to reflect the mortality assumption now more prevalent in the US, and in 2010 a 10 year projection was added.

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK and US Group plans is as follows:

| | UK | | US | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Male | 22.8 | 22.7 | 18.4 | 17.6 |
| Female | 23.6 | 23.5 | 20.6 | 20.2 |

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

| | UK | | US | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Male | 25.4 | 25.3 | 18.4 | 17.6 |
| Female | 25.7 | 25.6 | 20.6 | 20.2 |

### Financial statement information

The amounts recognised in the income statement are as follows:

| | | | | | | 2010 |
|---|---|---|---|---|---|---|
| All figures in £ millions | UK Group plan | Defined benefit other | Sub-total | Defined contribution | PRMB | Total |
| Current service cost | 21 | 2 | 23 | 68 | 2 | 93 |
| Curtailments | (5) | – | (5) | – | – | (5) |
| **Total operating expense** | 16 | 2 | 18 | 68 | 2 | 88 |
| Expected return on plan assets | (93) | (7) | (100) | – | – | (100) |
| Interest on plan liabilities | 100 | 9 | 109 | – | 3 | 112 |
| **Net finance expense** | 7 | 2 | 9 | – | 3 | 12 |
| **Net income statement charge** | 23 | 4 | 27 | 68 | 5 | 100 |
| | | | | | | |
| **Actual return on plan assets** | 177 | 13 | 190 | – | – | 190 |

## 25. Retirement benefit and other post-retirement obligations continued

| All figures in £ millions | UK Group plan | Defined benefit other | Sub-total | Defined contribution | PRMB | Total |
|---|---|---|---|---|---|---|
| | | | | | | 2009 |
| Current service cost | 14 | 3 | 17 | 62 | 2 | 81 |
| Past service cost | – | 1 | 1 | – | – | 1 |
| Total operating expense | 14 | 4 | 18 | 62 | 2 | 82 |
| Expected return on plan assets | (83) | (5) | (88) | – | – | (88) |
| Interest on plan liabilities | 89 | 8 | 97 | – | 3 | 100 |
| Net finance expense | 6 | 3 | 9 | – | 3 | 12 |
| Net income statement charge | 20 | 7 | 27 | 62 | 5 | 94 |
| Actual return on plan assets | 136 | 8 | 144 | – | – | 144 |

Included within the 2010 results are discontinued operations of £5m relating to the curtailment credit, a £1m charge relating to defined benefit schemes and a £2m charge relating to defined contribution schemes (2009: £2m charge relating to defined benefit schemes and £2m charge relating to defined contribution schemes).

The amounts recognised in the balance sheet are as follows:

| All figures in £ millions | 2010 UK Group plan | 2010 Other funded plans | 2010 Other unfunded plans | 2010 Total | 2009 UK Group plan | 2009 Other funded plans | 2009 Other unfunded plans | 2009 Total |
|---|---|---|---|---|---|---|---|---|
| Fair value of plan assets | 1,847 | 135 | – | 1,982 | 1,609 | 118 | – | 1,727 |
| Present value of defined benefit obligation | (1,852) | (158) | (20) | (2,030) | (1,798) | (151) | (18) | (1,967) |
| Net pension liability | (5) | (23) | (20) | (48) | (189) | (33) | (18) | (240) |
| Other post-retirement medical benefit obligation | | | | (72) | | | | (65) |
| Other pension accruals | | | | (28) | | | | (34) |
| Net retirement benefit obligations | | | | (148) | | | | (339) |
| Analysed as: | | | | | | | | |
| Retirement benefit assets | | | | – | | | | – |
| Retirement benefit obligations | | | | (148) | | | | (339) |

The following gains/(losses) have been recognised in other comprehensive income:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Amounts recognised for defined benefit plans | 75 | (295) |
| Amounts recognised for post-retirement medical benefit plans | (5) | (4) |
| Total recognised in year | 70 | (299) |
| Cumulative amounts recognised | (176) | (246) |

# Notes to the consolidated financial statements continued

## 25. Retirement benefit and other post-retirement obligations continued

The fair value of plan assets comprises the following:

| % | 2010 UK Group plan | 2010 Other funded plans | 2010 Total | 2009 UK Group plan | 2009 Other funded plans | 2009 Total |
|---|---|---|---|---|---|---|
| Equities | 27.0 | 3.3 | 30.3 | 27.4 | 2.4 | 29.8 |
| Bonds | 49.3 | 2.7 | 52.0 | 47.2 | 2.1 | 49.3 |
| Properties | 11.2 | 0.1 | 11.3 | 9.4 | 0.0 | 9.4 |
| Other | 5.6 | 0.8 | 6.4 | 10.4 | 1.1 | 11.5 |

The plan assets do not include any of the Group's own financial instruments, or any property occupied by the Group.

Changes in the values of plan assets and liabilities of the retirement benefit plans are as follows:

| All figures in £ millions | 2010 UK Group plan | 2010 Other plans | 2010 Total | 2009 UK Group plan | 2009 Other plans | 2009 Total |
|---|---|---|---|---|---|---|
| **Fair value of plan assets** | | | | | | |
| Opening fair value of plan assets | 1,609 | 118 | 1,727 | 1,478 | 100 | 1,578 |
| Exchange differences | – | 4 | 4 | – | (6) | (6) |
| Expected return on plan assets | 93 | 7 | 100 | 83 | 5 | 88 |
| Actuarial gains | 84 | 6 | 90 | 53 | 3 | 56 |
| Contributions by employer | 132 | 13 | 145 | 64 | 26 | 90 |
| Contributions by employee | 3 | – | 3 | 3 | – | 3 |
| Benefits paid | (74) | (13) | (87) | (72) | (10) | (82) |
| **Closing fair value of plan assets** | 1,847 | 135 | 1,982 | 1,609 | 118 | 1,727 |
| **Present value of defined benefit obligation** | | | | | | |
| Opening defined benefit obligation | (1,798) | (169) | (1,967) | (1,429) | (165) | (1,594) |
| Exchange differences | – | (5) | (5) | – | 14 | 14 |
| Current service cost | (21) | (2) | (23) | (14) | (3) | (17) |
| Past service cost | – | – | – | – | (1) | (1) |
| Curtailment | 5 | – | 5 | – | – | – |
| Interest cost | (100) | (9) | (109) | (89) | (8) | (97) |
| Actuarial losses | (9) | (6) | (15) | (335) | (16) | (351) |
| Contributions by employee | (3) | – | (3) | (3) | – | (3) |
| Benefits paid | 74 | 13 | 87 | 72 | 10 | 82 |
| **Closing defined benefit obligation** | (1,852) | (178) | (2,030) | (1,798) | (169) | (1,967) |

## 25. Retirement benefit and other post-retirement obligations continued

Changes in the value of the US PRMB are as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Opening defined benefit obligation | (65) | (68) |
| Exchange differences | (2) | 8 |
| Current service cost | (2) | (2) |
| Interest cost | (3) | (3) |
| Actuarial losses | (5) | (4) |
| Benefits paid | 5 | 4 |
| Closing defined benefit obligation | (72) | (65) |

The history of the defined benefit plans is as follows:

| All figures in £ millions | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Fair value of plan assets | 1,982 | 1,727 | 1,578 | 1,853 | 1,633 |
| Present value of defined benefit obligation | (2,030) | (1,967) | (1,594) | (1,811) | (1,810) |
| Net pension (liability)/asset | (48) | (240) | (16) | 42 | (177) |
| Experience adjustments on plan assets | 90 | 56 | (268) | 29 | 74 |
| Experience adjustments on plan liabilities | (15) | (351) | 194 | 50 | 28 |

### Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group. The trustees of the plan are required to act in the best interest of the plan's beneficiaries. The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2009 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by 31 December 2020. In 2010 the Group contributed £41m (2009: £42m) towards the funding shortfall and has agreed to contribute a similar amount per annum until 2020 in excess of regular contributions. Regular contributions to the plan are estimated to be £22m for 2011.

Under UK law (section 75 debt) a company that participates in a multi-employer defined benefit plan is liable, on withdrawal from that pension plan, for its share of the total deficit in the plan calculated on a 'solvency' or 'buy out' basis. The Interactive Data sale and the termination of Interactive Data Corporation (Europe) Ltd's participation in the UK Group plan triggered this 'section 75' liability. £68m was contributed to the plan in respect of this liability.

The Group expects to contribute $94m in 2011 and $97m in 2012 to its US pension plans.

### Sensitivities

The net retirement benefit obligations are calculated using a number of assumptions, the most significant being the discount rate used to calculate the defined benefit obligation. The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows:

| | 2010 | |
|---|---|---|
| All figures in £ millions | 1% increase | 1% decrease |
| **Effect on:** | | |
| (Decrease)/increase in defined benefit obligation – UK Group plan | (262.0) | 324.0 |
| (Decrease)/increase of aggregate of service cost and interest cost – UK Group plan | (13.7) | 16.3 |
| (Decrease)/increase in defined benefit obligation – US plan | (2.5) | 1.3 |

# Notes to the consolidated financial statements continued

## 25. Retirement benefit and other post-retirement obligations continued

The effect of members living one year more or one year less on the defined benefit obligation is as follows:

| | 2010 | |
|---|---|---|
| All figures in £ millions | 1 year increase | 1 year decrease |
| **Effect on:** | | |
| Increase/(decrease) in defined benefit obligation – UK Group plan | 52.7 | (50.5) |
| Increase/(decrease) in defined benefit obligation – US plan | 1.6 | (1.7) |

The effect of a one percentage point increase and decrease in the assumed medical cost trend rates is as follows:

| | 2010 | |
|---|---|---|
| All figures in £ millions | 1% increase | 1% decrease |
| **Effect on:** | | |
| Increase/(decrease) in post-retirement medical benefit obligation | 3.1 | (2.8) |
| Increase/(decrease) of aggregate of service cost and interest cost | 0.1 | (0.1) |

## 26. Share-based payments

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Pearson plans | 35 | 27 |

Share-based payments included in discontinued operations amounted to £4m (2009: £10m).

The Group operates the following equity-settled employee option and share plans:

*Worldwide Save for Shares Plan* Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

*Employee Stock Purchase Plan* In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six month periods. At the end of the period, the employee has the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

*Long-Term Incentive Plan* This plan was introduced in 2001 and renewed in 2006 and consists of two parts: share options and/or restricted shares.

Options were last granted under this plan in 2001 based on a pre-grant earnings per share growth test and are not subject to further performance conditions on exercise. The options became exercisable in tranches and lapse if they remain unexercised at the tenth anniversary of the date of grant.

## 26. Share-based payments continued

The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in March 2009 and March 2010 vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2009 and 2010 vest depending on continuing service over a three-year period.

*Annual Bonus Share Matching Plan* This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares.

In addition to the above, share options remain outstanding under Executive Share Option, Reward and Special Share Option Plans. These are legacy plans which were replaced with the introduction of the Long-Term Incentive Plan in 2001.

The number and weighted average exercise prices of share options granted under the Group's plans are as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Number of share options 000s | Weighted average exercise price £ | Number of share options 000s | Weighted average exercise price £ |
| Outstanding at beginning of year | 12,487 | 12.78 | 14,379 | 13.14 |
| Granted during the year | 628 | 8.06 | 1,320 | 5.47 |
| Exercised during the year | (1,154) | 7.12 | (656) | 5.91 |
| Forfeited during the year | (457) | 9.08 | (2,488) | 13.02 |
| Expired during the year | (2,626) | 23.47 | (68) | 5.20 |
| **Outstanding at end of year** | 8,878 | 10.20 | 12,487 | 12.78 |
| **Options exercisable at end of year** | 5,825 | 12.40 | 9,264 | 15.28 |

Options were exercised regularly throughout the year. The weighted average share price during the year was £9.63 (2009: £7.15). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

# Notes to the consolidated financial statements continued

## 26. Share-based payments continued

The options outstanding at the end of the year have weighted average remaining contractual lives and exercise prices as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| Range of exercise prices £ | Number of share options 000s | Weighted average contractual life Years | Number of share options 000s | Weighted average contractual life Years |
| 0 – 5 | 38 | 0.65 | 172 | 1.07 |
| 5 – 10 | 4,757 | 1.86 | 5,523 | 2.37 |
| 10 – 15 | 4,083 | 0.36 | 4,225 | 1.36 |
| 15 – 20 | – | – | 270 | 0.75 |
| 20 – 25 | – | – | 344 | 0.19 |
| >25 | – | – | 1,953 | 0.19 |
| | 8,878 | 1.17 | 12,487 | 1.57 |

In 2010 and 2009 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

| | 2010 Weighted average | 2009 Weighted average |
|---|---|---|
| Fair value | £2.14 | £1.69 |
| Weighted average share price | £9.48 | £7.13 |
| Weighted average exercise price | £8.06 | £5.47 |
| Expected volatility | 28.28% | 27.32% |
| Expected life | 4.0 years | 4.0 years |
| Risk free rate | 2.24% | 2.45% |
| Expected dividend yield | 3.75% | 4.74% |
| Forfeiture rate | 3.5% | 3.5% |

The expected volatility is based on the historic volatility of the company's share price over the previous three to seven years depending on the vesting term of the options.

## 26. Share-based payments continued

The following shares were granted under restricted share arrangements:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Number of shares 000s | Weighted average fair value £ | Number of shares 000s | Weighted average fair value £ |
| Long-Term Incentive Plan | 4,742 | 9.45 | 4,519 | 5.77 |
| Annual Bonus Share Matching Plan | 266 | 10.25 | 271 | 6.70 |

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. Participants of the Long-Term Incentive Plan are entitled to dividends during the vesting period. The number of shares to vest has been adjusted, based on historical experience, to account for any potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Shares granted include the entitlement to dividends during the vesting period and therefore the share price is not discounted.

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions were considered by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

## 27. Share capital and share premium

| | Number of shares 000s | Ordinary shares £m | Share premium £m |
|---|---|---|---|
| At 1 January 2009 | 809,276 | 202 | 2,505 |
| Issue of ordinary shares – share option schemes | 1,523 | 1 | 7 |
| At 31 December 2009 | 810,799 | 203 | 2,512 |
| Issue of ordinary shares – share option schemes | 1,878 | – | 12 |
| At 31 December 2010 | 812,677 | 203 | 2,524 |

The ordinary shares have a par value of 25p per share (2009: 25p per share). All issued shares are fully paid. All shares have the same rights.

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings.

The Group reviews its capital structure on a regular basis and will balance its overall capital structure through payments of dividends, new share issues as well as the issue of new debt or the redemption of existing debt in line with the financial risk policies outlined in note 19.

# Notes to the consolidated financial statements continued

## 28. Treasury shares

| | Pearson plc | | Interactive Data | | Total |
|---|---|---|---|---|---|
| | Number of shares 000s | £m | Number of shares 000s | £m | £m |
| At 1 January 2009 | 10,448 | 112 | 9,205 | 110 | 222 |
| Purchase of treasury shares | 2,200 | 13 | 1,280 | 20 | 33 |
| Release of treasury shares | (2,983) | (29) | – | – | (29) |
| At 31 December 2009 | 9,665 | 96 | 10,485 | 130 | 226 |
| Purchase of treasury shares | 8,000 | 77 | – | – | 77 |
| Release/cancellation of treasury shares | (3,656) | (36) | (10,485) | (130) | (166) |
| **At 31 December 2010** | 14,009 | 137 | – | – | 137 |

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.7% (2009: 1.2%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £3.5m (2009: £2.4m).

At 31 December 2010 the market value of Pearson plc treasury shares was £141.2m (2009: £86.1m).

## 29. Business combinations

On 17 June 2010 the Group acquired 100% of the shares of Melorio plc, a vocational training provider. On 19 August 2010 the Group acquired 100% of the shares of Wall Street Institute Education S.a.r.l (WSI), a group providing spoken English training for adults. On 1 September 2010 the Group acquired 69% of the voting equity of Sistema Educacional Brasiliero's (SEB) school learning systems division. On 7 September 2010 the Group acquired 100% of the shares of America's Choice Inc, a provider of school improvement services.

Provisional values for the assets and liabilities arising from these and other acquisitions completed in the year together with adjustments to prior year acquisitions are as follows:

| | | | | | | | 2010 | 2009 |
|---|---|---|---|---|---|---|---|---|
| All figures in £ millions | Notes | Melorio fair value | SEB fair value | WSI fair value | America's Choice fair value | Other fair value | Total fair value | Total fair value |
| Property, plant and equipment | 10 | 4 | 7 | 3 | – | 3 | 17 | 9 |
| Intangible assets | 11 | 89 | 103 | 32 | 24 | 37 | 285 | 142 |
| Intangible assets – Pre-publication | 20 | – | 3 | – | – | 6 | 9 | 2 |
| Inventories | | – | 5 | 1 | 1 | (5) | 2 | 14 |
| Trade and other receivables | | 8 | 13 | 8 | 7 | 5 | 41 | 23 |
| Cash and cash equivalents | | 3 | 5 | 2 | 12 | 4 | 26 | 29 |
| Financial liabilities – Borrowings | | (13) | – | – | – | – | (13) | – |
| Net deferred income tax liabilities | 13 | (24) | – | (3) | (4) | (6) | (37) | (45) |
| Retirement benefit obligations | | – | – | – | – | (1) | (1) | (1) |
| Provisions for other liabilities and charges | 23 | (10) | – | – | – | – | (10) | – |
| Trade and other liabilities | | (9) | (10) | (14) | (5) | 1 | (37) | (91) |
| Current income tax liabilities | | – | – | (3) | – | – | (3) | (4) |
| Non-controlling interest | | – | (39) | – | – | – | (39) | (16) |
| **Net assets acquired at fair value** | | 48 | 87 | 26 | 35 | 44 | 240 | 62 |
| Goodwill | 11 | 50 | 141 | 39 | 30 | 28 | 288 | 205 |
| Increase in fair values of proportionate holding arising on stepped acquisition | | – | – | – | – | – | – | (23) |
| **Total** | | 98 | 228 | 65 | 65 | 72 | 528 | 244 |
| Satisfied by: | | | | | | | | |
| Cash | | (98) | (228) | (65) | (65) | (74) | (530) | (201) |
| Other consideration | | – | – | – | – | – | – | (5) |
| Deferred consideration | | – | – | – | – | (8) | (8) | (27) |
| Net prior year adjustments | | – | – | – | – | 10 | 10 | (11) |
| **Total consideration** | | (98) | (228) | (65) | (65) | (72) | (528) | (244) |

The goodwill arising on these acquisitions results from substantial cost and revenue synergies and from benefits that cannot be separately recognised, such as the assembled workforce.

The fair value of trade and other receivables is £41m and includes trade receivables with a fair value of £34m. The gross contractual amount for trade receivables due is £37m of which £3m is expected to be uncollectable.

A provisional value of £12m of goodwill arising on 2010 acquisitions is expected to be deductible for tax purposes.

The non-controlling interest in SEB was measured using the non-controlling interest's proportionate share of the acquiree's net assets.

# Notes to the consolidated financial statements continued

## 29. Business combinations continued

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Cash flow on acquisitions** | | |
| Cash – Current year acquisitions | (530) | (201) |
| Cash – Acquisitions yet to complete | – | (4) |
| Deferred payments for prior year acquisitions and other items | (20) | (32) |
| Cash and cash equivalents acquired | 26 | 29 |
| Acquisition costs paid | (11) | – |
| **Net cash outflow** | (535) | (208) |

In 2010, acquisitions contributed £84m to sales and £6m to operating profit before acquisition costs and amortisation of acquired intangibles from the date of acquisition to the balance sheet date. Of these amounts, Melorio contributed £38m of sales and £5m of profit, SEB contributed £11m of sales and a loss of £2m, WSI contributed £13m of sales and £1m of profit and America's Choice contributed £9m of sales and £nil of profit.

If the acquisitions had completed on 1 January 2010, the Group estimates that sales for the period would have been £5,799m and profit before tax would have been £676m.

## 30. Disposals

| All figures in £ millions | Notes | 2010 Total | 2009 Total |
|---|---|---|---|
| **Disposal of subsidiaries** | | | |
| Property, plant and equipment | 10 | (57) | – |
| Intangible assets | 11 | (88) | – |
| Other financial assets | | (3) | – |
| Trade and other receivables | | (103) | – |
| Cash and cash equivalents | | (165) | – |
| Net deferred income tax liabilities | 13 | 47 | – |
| Retirement benefit obligations | | 8 | – |
| Trade and other liabilities | | 132 | – |
| Current income tax liabilities | | 12 | – |
| Non-controlling interest | | 271 | – |
| Attributable goodwill | 11 | (195) | – |
| Cumulative translation adjustment | | (13) | – |
| **Net assets disposed** | | (154) | – |
| Cash received | | 1,234 | – |
| Costs | | (43) | – |
| **Profit on sale** | | 1,037 | – |

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Cash flow from disposals** | | |
| Cash – Current year disposals | 1,234 | – |
| Cash and cash equivalents disposed | (165) | – |
| Costs paid | (32) | – |
| Pension contribution paid on disposal | (53) | – |
| **Net cash inflow** | 984 | – |

The disposals above all relate to Interactive Data. Further details are shown in note 3.

# Notes to the consolidated financial statements continued

## 31. Cash generated from operations

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| Profit | | 1,300 | 462 |
| Adjustments for: | | | |
| Income tax | | 480 | 198 |
| Depreciation | 10 | 82 | 85 |
| Amortisation of acquired intangible assets | 11 | 113 | 103 |
| Amortisation of other intangible assets | 11 | 51 | 44 |
| Loss on sale of property, plant and equipment | | 3 | 2 |
| Net finance costs | 3, 6 | 73 | 95 |
| Share of results of joint ventures and associates | 12 | (41) | (30) |
| Profit on disposal of discontinued operations | 3 | (1,037) | – |
| Loss on disposal | | 10 | – |
| Acquisition costs | | 11 | – |
| Net foreign exchange adjustment from transactions | | (3) | (14) |
| Share-based payment costs | 26 | 39 | 37 |
| Pre-publication | | 29 | (16) |
| Inventories | | 37 | 32 |
| Trade and other receivables | | (82) | (14) |
| Trade and other liabilities | | 165 | 103 |
| Retirement benefit obligations | | (64) | (72) |
| Provisions for other liabilities and charges | | 3 | (3) |
| Net cash generated from operations | | 1,169 | 1,012 |
| Dividends from joint ventures and associates | | 23 | 22 |
| Purchase of property, plant and equipment | | (76) | (62) |
| Purchase of intangible assets | | (56) | (58) |
| Finance lease principal payments | | (3) | (2) |
| Proceeds from sale of property, plant and equipment | | – | 1 |
| Operating cash flow | | 1,057 | 913 |
| Operating tax paid | | (85) | (103) |
| Net operating finance costs paid | | (68) | (87) |
| Free cash flow | | 904 | 723 |
| Dividends paid (including to non-controlling interests) | | (298) | (293) |
| Net movement of funds from operations | | 606 | 430 |
| Acquisitions and disposals (net of tax) | | 150 | (218) |
| Purchase of treasury shares | | (77) | (33) |
| New equity | | 12 | 8 |
| Other movements on financial instruments | | 2 | 3 |
| Net movement of funds | | 693 | 190 |
| Exchange movements on net debt | | (31) | 178 |
| Total movement in net debt | | 662 | 368 |

## 31. Cash generated from operations continued

Net cash generated from operations is translated at an exchange rate approximating to the rate at the date of cash flow. The difference between this rate and the average rate used to translate profit gives rise to a currency adjustment in the reconciliation between net profit and net cash generated from operations. This adjustment reflects the timing difference between recognition of profit and the related cash receipts or payments.

Operating cash flow, operating free cash flow and total free cash flow are non-GAAP measures and have been disclosed as they are part of Pearson's corporate and operating measures.

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Net book amount | 3 | 3 |
| Loss on sale of property, plant and equipment | (3) | (2) |
| Proceeds from sale of property, plant and equipment | – | 1 |

The principal other non-cash transactions are movements in finance lease obligations of £2m (2009: £8m).

## 32. Contingencies

There are contingent Group liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries, joint ventures and associates. In addition there are contingent liabilities of the Group in respect of legal claims and rights and royalty agreements. None of these claims are expected to result in a material gain or loss to the Group.

## 33. Commitments

There were no commitments for capital expenditure contracted for at the balance sheet date but not yet incurred.

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. The lease expenditure charged to the income statement during the year is disclosed in note 4.

The future aggregate minimum lease payments in respect of operating leases are as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Not later than one year | 164 | 153 |
| Later than one year and not later than two years | 151 | 144 |
| Later than two years and not later than three years | 130 | 129 |
| Later than three years and not later than four years | 112 | 114 |
| Later than four years and not later than five years | 95 | 99 |
| Later than five years | 785 | 848 |
| | 1,437 | 1,487 |

# Notes to the consolidated financial statements continued

## 34. Related party transactions

### Joint ventures and associates

Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. There are no material amounts falling due from joint ventures and associates.

### Key management personnel

Key management personnel are deemed to be the members of the board of directors of Pearson plc. It is this board which has responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the directors' remuneration report.

There were no other material related party transactions.

No guarantees have been provided to related parties.

## 35. Events after the balance sheet date

On 22 November 2010, the Group announced the proposed acquisition of a 75% stake in CTI Education Group, a leading South African education company for £31m. As at the end of December 2010, this acquisition had not been completed but is expected to complete in the first half of 2011.

On 18 January 2011, the Group announced that it had agreed to increase its shareholding in TutorVista, the Bangalore based tutoring services company, to a controlling 76% stake for a consideration of $127m.

On 7 March 2011, the Group and Education Development International plc (EDI) announced that they had reached agreement on the terms of a recommended cash offer to be made by Pearson for the entire issued share capital of EDI. The offer values EDI at approximately £112.7m. EDI is a leading provider of education and training qualifications and assessment services, with a strong reputation for the use of information technology to administer learning programmes and deliver on-screen assessments.

# Company balance sheet
## As at 31 December 2010

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Investments in subsidiaries | 2 | 9,180 | 8,547 |
| Amounts due from subsidiaries | | 323 | 464 |
| Financial assets – Derivative financial instruments | 6 | 134 | 112 |
| | | 9,637 | 9,123 |
| **Current assets** | | | |
| Amounts due from subsidiaries | | 1,602 | 2,151 |
| Prepayments | | 8 | – |
| Financial assets – Derivative financial instruments | 6 | 6 | – |
| Current income tax assets | | 9 | 21 |
| Cash and cash equivalents (excluding overdrafts) | 4 | 944 | 124 |
| | | 2,569 | 2,296 |
| **Total assets** | | 12,206 | 11,419 |
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Amounts due to subsidiaries | | (2,752) | (3,808) |
| Financial liabilities – Borrowings | 5 | (464) | (767) |
| Financial liabilities – Derivative financial instruments | 6 | (6) | (2) |
| | | (3,222) | (4,577) |
| **Current liabilities** | | | |
| Amounts due to subsidiaries | | (4,306) | (2,535) |
| Financial liabilities – Borrowings | 5 | (859) | (419) |
| Financial liabilities – Derivative financial instruments | 6 | – | (7) |
| | | (5,165) | (2,961) |
| **Total liabilities** | | (8,387) | (7,538) |
| **Net assets** | | 3,819 | 3,881 |
| **Equity** | | | |
| Share capital | 7 | 203 | 203 |
| Share premium | 7 | 2,524 | 2,512 |
| Treasury shares | 8 | (82) | (47) |
| Special reserve | | 447 | 447 |
| Retained earnings | | 727 | 766 |
| **Total equity attributable to equity holders of the company** | | 3,819 | 3,881 |

These financial statements have been approved for issue by the board of directors on 7 March 2011 and signed on its behalf by

**Robin Freestone** Chief financial officer

# Company statement of changes in equity

## Year ended 31 December 2010

| All figures in £ millions | Equity attributable to equity holders of the company | | | | | |
|---|---|---|---|---|---|---|
| | Share capital | Share premium | Treasury shares | Special reserve | Retained earnings | Total |
| At 1 January 2010 | 203 | 2,512 | (47) | 447 | 766 | 3,881 |
| Profit for the year | – | – | – | – | 289 | 289 |
| Issue of ordinary shares under share option schemes | – | 12 | – | – | – | 12 |
| Net purchase of treasury shares | – | – | (71) | – | – | (71) |
| Release of treasury shares | – | – | 36 | – | (36) | – |
| Dividends | – | – | – | – | (292) | (292) |
| **At 31 December 2010** | 203 | 2,524 | (82) | 447 | 727 | 3,819 |

| All figures in £ millions | Equity attributable to equity holders of the company | | | | | |
|---|---|---|---|---|---|---|
| | Share capital | Share premium | Treasury shares | Special reserve | Retained earnings | Total |
| At 1 January 2009 | 202 | 2,505 | (63) | 447 | 835 | 3,926 |
| Profit for the year | – | – | – | – | 233 | 233 |
| Issue of ordinary shares under share option schemes | 1 | 7 | – | – | – | 8 |
| Purchase of treasury shares | – | – | (13) | – | – | (13) |
| Release of treasury shares | – | – | 29 | – | (29) | – |
| Dividends | – | – | – | – | (273) | (273) |
| At 31 December 2009 | 203 | 2,512 | (47) | 447 | 766 | 3,881 |

The special reserve represents the cumulative effect of cancellation of the company's share premium account.

Included within retained earnings is an amount of £131m (2009: £131m) relating to profit on intra-group disposals that is not distributable.

# Company cash flow statement
## Year ended 31 December 2010

| All figures in £ millions | Notes | 2010 | 2009 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net profit | | 289 | 233 |
| **Adjustments for:** | | | |
| Income tax | | (40) | (57) |
| Net finance costs | | 115 | 169 |
| Amounts due from subsidiaries | | 873 | 115 |
| Net cash generated from operations | | 1,237 | 460 |
| Interest paid | | (156) | (130) |
| Tax received | | 50 | 65 |
| Net cash generated from operating activities | | 1,131 | 395 |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries, net of cash acquired | | (93) | (1) |
| Interest received | | 1 | – |
| Net cash used in investing activities | | (92) | (1) |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of ordinary shares | 7 | 12 | 8 |
| Net purchase of treasury shares | | (71) | (13) |
| Repayment of borrowings | | – | (131) |
| Dividends paid to company's shareholders | | (292) | (273) |
| Net cash used in financing activities | | (351) | (409) |
| Effects of exchange rate changes on cash and cash equivalents | | 17 | 15 |
| **Net increase in cash and cash equivalents** | | 705 | – |
| Cash and cash equivalents at beginning of year | | (295) | (295) |
| **Cash and cash equivalents at end of year** | 4 | 410 | (295) |

# Notes to the company financial statements

## 1. Accounting policies

The financial statements on pages 157 to 165 comprise the separate financial statements of Pearson plc. As permitted by section 408 of the Companies Act 2006, only the Group's income statement and statement of comprehensive income has been presented.

The company has no employees.

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the Group financial statements with the addition of the following:

### Investments

Investments in subsidiaries are stated at cost less provision for impairment, with the exception of certain hedged investments that are held in a foreign currency and revalued at each balance sheet date.

## 2. Investments in subsidiaries

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| At beginning of year | 8,547 | 6,912 |
| Subscription for share capital in subsidiaries | 1,884 | 1,658 |
| Disposals/liquidations | (1,291) | (1) |
| Currency revaluations | 40 | (22) |
| At end of year | 9,180 | 8,547 |

## 3. Financial risk management

The company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments and current and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. The company's approach to the management of financial risks is consistent with the Group's treasury policy, as discussed in note 19 to the Group's financial statements. The company believes the value of its financial assets to be fully recoverable.

The company designates certain of its qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in a £47m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £51m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £115m, while a 10% decrease in the value of sterling would increase the carrying value by £141m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

### 3. Financial risk management continued

The maturity of contracted cash flows on the company's borrowings and all of its derivative financial instruments are as follows:

| | | | | 2010 |
|---|---|---|---|---|
| All figures in £ millions | USD | GBP | Other | Total |
| Not later than one year | 297 | 3 | 3 | 303 |
| Later than one year and not later than five years | 109 | 27 | 32 | 168 |
| Later than five years | 158 | – | – | 158 |
| **Total** | 564 | 30 | 35 | 629 |
| Analysed as: | | | | |
| Bonds | 589 | 320 | – | 909 |
| Rate derivatives – inflows | (364) | (297) | – | (661) |
| Rate derivatives – outflows | 339 | 7 | 35 | 381 |
| **Total** | 564 | 30 | 35 | 629 |

| | | | | 2009 |
|---|---|---|---|---|
| All figures in £ millions | USD | GBP | Other | Total |
| Not later than one year | (5) | 3 | 2 | – |
| Later than one year and not later than five years | 249 | 241 | 30 | 520 |
| Later than five years | 324 | (212) | – | 112 |
| **Total** | 568 | 32 | 32 | 632 |
| Analysed as: | | | | |
| Bonds | 601 | 337 | – | 938 |
| Rate derivatives – inflows | (386) | (313) | – | (699) |
| Rate derivatives – outflows | 353 | 8 | 32 | 393 |
| **Total** | 568 | 32 | 32 | 632 |

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the company net settles these amounts wherever possible.

Amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

# Notes to the company financial statements continued

## 4. Cash and cash equivalents (excluding overdrafts)

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Cash at bank and in hand | 2 | 2 |
| Short-term bank deposits | 942 | 122 |
| | 944 | 124 |

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2010 the currency split of cash and cash equivalents was US dollar 86% (2009: 26%), sterling 13% (2009: 72%), euro 0% (2009: 2%) and Hong Kong dollar 1% (2009: 0%).

Cash and cash equivalents have fair values that approximate to their carrying amounts due to their short-term nature.

Cash and cash equivalents include the following for the purpose of the cash flow statement:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | 944 | 124 |
| Bank overdrafts | (534) | (419) |
| | 410 | (295) |

## 5. Financial liabilities – Borrowings

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| **Non-current** | | |
| 7.0% Global Dollar Bonds 2011 (nominal amount $500m) | – | 322 |
| 7.0% Sterling Bonds 2014 (nominal amount £250m) | 256 | 254 |
| 4.625% US Dollar notes 2018 (nominal amount $300m) | 208 | 191 |
| | 464 | 767 |
| **Current** | | |
| **Due within one year or on demand:** | | |
| Bank loans and overdrafts | 534 | 419 |
| 7.0% Global Dollar Bonds 2011 (nominal amount $500m) | 325 | – |
| | 859 | 419 |
| **Total borrowings** | 1,323 | 1,186 |

Included in the non-current borrowings above is £4m of accrued interest (2009: £4m).

Included in the current borrowings above is £1m of accrued interest (2009: £nil).

## 5. Financial liabilities – Borrowings continued

The maturity of the company's non-current borrowings is as follows:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Between one and two years | – | 322 |
| Between two and five years | 256 | 254 |
| Over five years | 208 | 191 |
| | 464 | 767 |

As at 31 December 2010 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows:

| All figures in £ millions | One year | One to five years | More than five years | Total |
|---|---|---|---|---|
| Re-pricing profile of borrowings | 859 | 256 | 208 | 1,323 |
| Amounts due to subsidiaries | 5,961 | 523 | 574 | 7,058 |
| Effect of rate derivatives | 1,264 | (529) | (735) | – |
| | 8,084 | 250 | 47 | 8,381 |

The carrying amounts and market values of borrowings are as follows:

| | | 2010 | | 2009 | |
|---|---|---|---|---|---|
| All figures in £ millions | Effective interest rate | Carrying amount | Market value | Carrying amount | Market value |
| Bank loans and overdrafts | n/a | 534 | 534 | 419 | 419 |
| 7.0% Global Dollar Bonds 2011 | 7.16% | 325 | 327 | 322 | 331 |
| 7.0% Sterling Bonds 2014 | 7.20% | 256 | 282 | 254 | 276 |
| 4.625% US Dollar notes 2018 | 4.69% | 208 | 192 | 191 | 176 |
| | | 1,323 | 1,335 | 1,186 | 1,202 |

The market values are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the company's borrowings are denominated in the following currencies:

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| US dollar | 579 | 523 |
| Sterling | 736 | 648 |
| Euro | 8 | 15 |
| | 1,323 | 1,186 |

# Notes to the company financial statements continued

## 6. Derivative financial instruments

The company's outstanding derivative financial instruments are as follows:

| All figures in £ millions | 2010 Gross notional amounts | 2010 Assets | 2010 Liabilities | 2009 Gross notional amounts | 2009 Assets | 2009 Liabilities |
|---|---|---|---|---|---|---|
| Interest rate derivatives – in a fair value hedge relationship | 369 | 24 | – | 360 | 17 | – |
| Interest rate derivatives – not in a hedge relationship | 1,214 | 96 | – | 1,229 | 66 | (7) |
| Cross currency rate derivatives | 220 | 20 | (6) | 220 | 29 | (2) |
| **Total** | 1,803 | 140 | (6) | 1,809 | 112 | (9) |
| **Analysed as expiring:** | | | | | | |
| In less than one year | 319 | 6 | – | 238 | – | (7) |
| Later than one year and not later than five years | 749 | 74 | (6) | 844 | 60 | (2) |
| Later than five years | 735 | 60 | – | 727 | 52 | – |
| **Total** | 1,803 | 140 | (6) | 1,809 | 112 | (9) |

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

## 7. Share capital and share premium

| | Number of shares 000s | Ordinary shares £m | Share premium £m |
|---|---|---|---|
| At 1 January 2009 | 809,276 | 202 | 2,505 |
| Issue of shares – share option schemes | 1,523 | 1 | 7 |
| At 31 December 2009 | 810,799 | 203 | 2,512 |
| Issue of shares – share option schemes | 1,878 | – | 12 |
| **At 31 December 2010** | 812,677 | 203 | 2,524 |

The ordinary shares have a par value of 25p per share (2009: 25p per share). All issued shares are fully paid. All shares have the same rights.

## 8. Treasury shares

| | Number of shares 000s | £m |
|---|---|---|
| At 1 January 2009 | 10,448 | 63 |
| Purchase of treasury shares | 2,200 | 13 |
| Release of treasury shares | (2,983) | (29) |
| At 31 December 2009 | 9,665 | 47 |
| Purchase of treasury shares | 8,000 | 77 |
| Contribution from subsidiaries | – | (6) |
| Release of treasury shares | (3,656) | (36) |
| At 31 December 2010 | 14,009 | 82 |

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £3.5m (2009: £2.4m). At 31 December 2010 the market value of the company's treasury shares was £141.2m (2009: £86.1m).

## 9. Contingencies

There are contingent liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries. In addition there are contingent liabilities in respect of legal claims. None of these claims are expected to result in a material gain or loss to the company.

## 10. Audit fees

Statutory audit fees relating to the company were £35,000 (2009: £35,000).

## 11. Related party transactions

### Subsidiaries

The company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the company balance sheet.

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £209m (2009: £232m) and interest receivable from subsidiaries for the year of £56m (2009: £147m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £33m (2009: £37m). Dividends received from subsidiaries were £1,695m (2009: £383m).

### Key management personnel

Key management personnel are deemed to be the members of the board of directors of the company. It is this board which has responsibility for planning, directing and controlling the activities of the company. Key management personnel compensation is disclosed in the directors' remuneration report of the Group.

There were no other material related party transactions.

# Principal subsidiaries

The principal operating subsidiaries at 31 December 2010 are listed below. They operate mainly in the countries of incorporation or registration. The investments are in equity share capital and they are all 100% owned.

| | Country of incorporation or registration |
|---|---|
| **Pearson Education** | |
| Pearson Education Inc. | US |
| Pearson Education Ltd | England |
| Edexcel Ltd* | England |
| NCS Pearson Inc. | US |
| **FT Group** | |
| The Financial Times Ltd | England |
| Mergermarket Ltd | England |
| **The Penguin Group** | |
| Penguin Group (USA) Inc. | US |
| The Penguin Publishing Co Ltd | England |
| Dorling Kindersley Holdings Ltd* | England |

* Direct investment of Pearson plc.

The company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements. A complete list of subsidiary and associated undertakings will be included in the next Pearson plc annual return filed with the Registrar of Companies.

# Five year summary

| All figures in £ millions | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| **Sales** | | | | | |
| North American Education | 1,679 | 1,667 | 2,002 | 2,470 | 2,640 |
| International Education | 640 | 735 | 866 | 1,035 | 1,234 |
| Professional | 211 | 226 | 244 | 275 | 333 |
| **Education** | 2,530 | 2,628 | 3,112 | 3,780 | 4,207 |
| **FT Group** | 280 | 344 | 390 | 358 | 403 |
| **Penguin** | 848 | 846 | 903 | 1,002 | 1,053 |
| **Continuing** | 3,658 | 3,818 | 4,405 | 5,140 | 5,663 |
| Discontinued | 765 | 511 | 414 | 484 | 296 |
| **Total sales** | 4,423 | 4,329 | 4,819 | 5,624 | 5,959 |
| | | | | | |
| **Adjusted operating profit** | | | | | |
| North American Education | 280 | 273 | 303 | 403 | 469 |
| International Education | 73 | 92 | 135 | 141 | 171 |
| Professional | 17 | 27 | 36 | 43 | 51 |
| **Education** | 370 | 392 | 474 | 587 | 691 |
| **FT Group** | 27 | 56 | 74 | 39 | 60 |
| **Penguin** | 66 | 74 | 93 | 84 | 106 |
| **Continuing** | 463 | 522 | 641 | 710 | 857 |
| Discontinued | 129 | 112 | 121 | 148 | 81 |
| **Total adjusted operating profit** | 592 | 634 | 762 | 858 | 938 |
| | | | | | |
| **Operating margin – continuing** | 12.7% | 13.7% | 14.6% | 13.8% | 15.1% |
| | | | | | |
| **Adjusted earnings** | | | | | |
| Total adjusted operating profit | 592 | 634 | 762 | 858 | 938 |
| Net finance costs | (90) | (85) | (88) | (97) | (85) |
| Income tax | (130) | (145) | (178) | (194) | (215) |
| Non-controlling interest | (28) | (32) | (36) | (44) | (17) |
| **Adjusted earnings** | 344 | 372 | 460 | 523 | 621 |
| Weighted average number of shares (millions) | 798.4 | 796.8 | 797.0 | 799.3 | 801.2 |
| **Adjusted earnings per share** | 43.1p | 46.7p | 57.7p | 65.4p | 77.5p |

# Five year summary continued

| All figures in £ millions | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| **Cash flow** | | | | | |
| Operating cash flow | 575 | 684 | 796 | 913 | 1,057 |
| Operating cash conversion | 97% | 108% | 104% | 106% | 113% |
| Operating free cash flow | 434 | 533 | 631 | 723 | 904 |
| Operating free cash flow per share | 54.4p | 66.9p | 79.2p | 90.5p | 112.8p |
| Total free cash flow | 433 | 407 | 631 | 723 | 904 |
| Total free cash flow per share | 54.2p | 51.1p | 79.2p | 90.5p | 112.8p |
| | | | | | |
| Net assets | 3,644 | 3,874 | 5,024 | 4,636 | 5,605 |
| | | | | | |
| Net debt | 1,059 | 973 | 1,460 | 1,092 | 430 |
| | | | | | |
| **Return on invested capital (gross basis)** | | | | | |
| Total adjusted operating profit | 592 | 634 | 762 | 858 | 938 |
| Cash tax paid | (59) | (61) | (89) | (103) | (85) |
| Return | 533 | 573 | 673 | 755 | 853 |
| Average invested capital | 6,553 | 6,423 | 7,337 | 8,504 | 8,315 |
| Return on invested capital | 8.1% | 8.9% | 9.2% | 8.9% | 10.3% |
| | | | | | |
| Dividend per share | 29.3p | 31.6p | 33.8p | 35.5p | 38.7p |

# Corporate and operating measures

## Sales – underlying and constant exchange rate movement

Sales movement for continuing operations excluding the impact of acquisitions and disposals and movements in exchange rates.

| All figures in £ millions | 2010 |
|---|---|
| Underlying increase | 275 |
| Portfolio changes | 120 |
| Exchange differences | 128 |
| Total sales increase | 523 |
| Underlying increase | 5% |
| Constant exchange rate increase | 8% |

## Adjusted income statement

Reconciliation of the consolidated income statement to the adjusted numbers presented as non-GAAP measures in the financial statements.

| | 2010 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| All figures in £ millions | Statutory income statement | Discontinued operations | Other net gains and losses | Acquisition costs | Amortisation of acquired intangibles | Other net finance income/ costs | Tax amortisation benefit | Tax loss recognition | Adjusted income statement |
| Operating profit | 743 | 81 | (2) | 11 | 105 | – | – | – | 938 |
| Net finance costs | (73) | – | – | – | – | (12) | – | – | (85) |
| Profit before tax | 670 | 81 | (2) | 11 | 105 | (12) | – | – | 853 |
| Income tax | (146) | (31) | (1) | (4) | (35) | 3 | 36 | (37) | (215) |
| Profit for the year from continuing operations | 524 | 50 | (3) | 7 | 70 | (9) | 36 | (37) | 638 |
| Profit for the year from discontinued operations | 776 | (50) | (731) | – | 5 | – | – | – | – |
| Profit for the year | 1,300 | – | (734) | 7 | 75 | (9) | 36 | (37) | 638 |
| Non-controlling interest | (3) | – | (12) | – | (2) | – | – | – | (17) |
| Earnings | 1,297 | – | (746) | 7 | 73 | (9) | 36 | (37) | 621 |

# Corporate and operating measures continued

## Adjusted income statement continued

| All figures in £ millions | Statutory income statement | Discontinued operations | Other net gains and losses | Acquisition costs | Amortisation of acquired intangibles | Other net finance income/costs | Tax amortisation benefit | Tax loss recognition | Adjusted income statement |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 2009 |
| Operating profit | 619 | 148 | – | – | 91 | – | – | – | 858 |
| Net finance costs | (96) | 1 | – | – | – | (2) | – | – | (97) |
| Profit before tax | 523 | 149 | – | – | 91 | (2) | – | – | 761 |
| Income tax | (146) | (52) | – | – | (33) | 1 | 36 | – | (194) |
| Profit for the year from continuing operations | 377 | 97 | – | – | 58 | (1) | 36 | – | 567 |
| Profit for the year from discontinued operations | 85 | (97) | – | – | 8 | – | 4 | – | – |
| Profit for the year | 462 | – | – | – | 66 | (1) | 40 | – | 567 |
| Non-controlling interest | (37) | – | – | – | (5) | – | (2) | – | (44) |
| Earnings | 425 | – | – | – | 61 | (1) | 38 | – | 523 |

## Adjusted operating profit – underlying and constant exchange rate movement

Operating profit movement excluding the impact of acquisitions, disposals and movements in exchange rates.

| All figures in £ millions | 2010 |
|---|---|
| Underlying increase | 103 |
| Portfolio changes | 5 |
| Exchange differences | 39 |
| Total adjusted operating profit increase | 147 |
| Underlying increase | 14% |
| Constant exchange rate increase | 15% |

## Free cash flow per share

Operating cash flow for continuing and discontinued operations before tax and finance charges, divided by the weighted average number of shares in issue.

| All figures in £ millions | 2010 | 2009 |
|---|---|---|
| Adjusted operating profit | 938 | 858 |
| Cash conversion | 113% | 106% |
| Operating cash flow | 1,057 | 913 |
| Operating tax paid | (85) | (103) |
| Net operating finance costs paid | (68) | (87) |
| Total operating free cash flow | 904 | 723 |
| Non operating tax paid | – | – |
| Total free cash flow | 904 | 723 |
| Weighted average number of shares in issue (millions) | 801.2 | 799.3 |
| Operating free cash flow per share | 112.8p | 90.5p |
| Total free cash flow per share | 112.8p | 90.5p |

## Return on invested capital

| | Net invested capital | | Gross invested capital | |
|---|---|---|---|---|
| All figures in £ millions | 2010 | 2009 | 2010 | 2009 |
| Total adjusted operating profit | 938 | 858 | 938 | 858 |
| Amortisation of acquired intangibles | (113) | (103) | – | – |
| Operating tax paid | (85) | (103) | (85) | (103) |
| Return | 740 | 652 | 853 | 755 |
| Average goodwill and other intangibles | 5,362 | 5,152 | 7,341 | 7,194 |
| Average net operating assets | 974 | 1,310 | 974 | 1,310 |
| Average invested capital | 6,336 | 6,462 | 8,315 | 8,504 |
| Return on invested capital | 11.7% | 10.1% | 10.3% | 8.9% |

Return on invested capital is calculated using two methods:

Gross basis – total adjusted operating profit less operating cash tax paid expressed as a percentage of average gross invested capital. Gross invested capital includes the original unamortised goodwill and intangibles.

Net basis – total adjusted operating profit less intangible amortisation and operating cash tax paid expressed as a percentage of average net invested capital. Net invested capital includes the carrying value (after amortisation) of goodwill and intangibles.

# Other risks

Principal risks and uncertainties are outlined on page 35 of section 3 'Our performance'. Additional risks are set out below.

| Other risks | Mitigating factors |
|---|---|
| Changes in students' buying and distribution behaviour put downward pressure on price. | We are continuing to improve our pricing strategies, product bundling and contract terms. We are monitoring the development of rental programs. |
| Our professional services and school assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed. | In addition to the internal business procedures and controls implemented to ensure we successfully deliver on our contractual commitments, we also seek to develop and maintain good relationships with our customers to minimise associated risks. We also look to diversify our portfolio to minimise reliance on any single contract. |
| We operate in markets which are dependent on Information Technology (IT) systems and technological change. | We mitigate these IT risks by establishing strong IT policies and operational controls, employing project management techniques to manage new software developments and/or system implementations and have implemented an array of security measures to protect our IT assets from attacks or failures that could impact the confidentiality, availability or integrity of our systems. |
| Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions could lead to goodwill and intangible asset impairments. | We perform pre-acquisition due diligence and closely monitor the post-integration performance to ensure we are meeting operational and financial targets. Any divergence from these plans will result in management action to improve performance and minimise the risk of any impairments. Executive management and the board receive regular reports on the status of acquisition performance. |
| Expected benefits from our finance transformation programme initiatives may not be realised. | We monitor the programme performance closely and seek to mitigate this risk through strong project management techniques and developed project plans. The project is managed by an executive committee and governance programmes have been established with our outsource providers. |
| Changes in our tax position can significantly affect our reported earnings and cash flows. | We employ internal tax professionals in the UK and the US who review all significant arrangements around the world and respond to changes in tax legislation. They work closely with local management and external tax advisors. |
| We generate a substantial proportion of our revenue in foreign currencies particularly the US dollar, and foreign exchange rate fluctuations could adversely affect our earnings and the strength of our balance sheet. | The Group's policy on managing foreign currency risk is described in note 19 to the financial statements. |

| Other risks | Mitigating factors |
| --- | --- |
| The inherent volatility of advertising could adversely affect the profitability of our newspaper business. | The diversification of the FT Group into other business models and revenue streams, e.g. subscription based businesses, digital revenues, business to business products, conferences, in addition to its global reach, offsets reliance on newspaper print advertising and circulation revenue streams. |
| A significant deterioration in Group profitability and/or cash flow caused by a severe economic depression could reduce our liquidity and/or impair our financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate our banking covenants. | The Group's approach to funding is described on page 31 and the Group's approach to the management of financial risks is set out in note 19 to the financial statements. |
| Social, environmental and ethical risk. | We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. Our 2009 risk assessment did not identify any significant under-managed SEE risks, nor have any of our most important SEE risks, many concerned with reputational risks, changed year-on-year. These are: journalistic/author integrity, ethical business behaviour, intellectual copyright protection, compliance with UN Global Compact standards, environmental impact, people and data privacy.<br><br>For more information, see the Pearson corporate responsibility report 'Live and Learn: Our Impact on Society'. The web link is available at www.pearson.com |

# Shareholder information

Pearson ordinary shares are listed on the London Stock Exchange and on the New York Stock Exchange in the form of American Depositary Receipts.

## Corporate website

The investors' section of our corporate website www.pearson.com provides a wealth of information for shareholders. It is also possible to sign up to receive email alerts for reports and press releases relating to Pearson.

## Shareholder information online

Equiniti provides a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at www.shareview.co.uk. For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2233* or, for those shareholders with hearing difficulties, textphone number 0871 384 2255*.

## Information about the Pearson share price

The company's share price can be found on our website at www.pearson.com. It also appears in the financial columns of the national press.

## Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0871 384 2043*.

## Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0871 384 2268*.

## Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to www.shareview.co.uk/dealing or call customer services on 0845 300 0430*.

## Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact them on 08456 037 037 (telephone dealing – weekdays only) or log on to www.shareview.co.uk/dealing (online dealing). You will need your shareholder reference number as shown on your share certificate.

A weekly postal dealing service is also available through Equiniti. Please telephone 0871 384 2248* for details or log on to www.shareview.co.uk to download a form.

## ShareGift

Shareholders with small holdings of shares, whose value makes them uneconomic to sell, may wish to donate them to ShareGift, the share donation charity (registered charity number 1052686). Further information about ShareGift and the charities it has supported may be obtained from their website, www.ShareGift.org or by contacting them at 17 Carlton House Terrace, London SW1Y 5AH.

## American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact BNY Mellon Shareowner Services, PO Box 358516, Pittsburgh, PA 15252-8516, telephone 1 866 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively, you may e-mail shrrelations@bnymellon.com, or log on to www.bnymellon.com/shareowner. Voting rights for registered ADR holders can be exercised through The Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

*Calls to these numbers are charged at 8p per minute from a BT landline. Other provider costs may vary. Lines open 8.30am to 5.30pm Monday to Friday.

## Share register fraud: protecting your investment

Pearson does not contact its shareholders directly to provide recommendation advice and neither does it appoint third parties to do so. As required by law, our shareholder register is available for public inspection but we cannot control the use of information obtained by persons inspecting the register. Please treat any approaches purporting to originate from Pearson with caution.

## Tips on protecting your shares

- Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation.
- Inform the registrar promptly when you change address.
- Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or better still, make arrangements to have the dividend paid directly into your bank account.
- Consider holding your shares electronically in a CREST account via a nominee.

For more information, please log on to our website at www.pearson.com/shareholderfaqs

## Advisers

Auditors PricewaterhouseCoopers LLP
Bankers HSBC Bank plc
Brokers JPMorgan Cazenove Limited and Citigroup
Financial advisers Goldman Sachs, JPMorgan Cazenove Limited and Citigroup
Solicitors Freshfields Bruckhaus Deringer LLP, Herbert Smith LLP and Morgan, Lewis & Bockius LLP

## 2011 Financial calendar

| | |
|---|---|
| Ex-dividend date | 6 April |
| Record date | 8 April |
| Last date for dividend reinvestment election | 12 April |
| Annual General Meeting | 28 April |
| Payment date for dividend and share purchase date for dividend reinvestment | 6 May |
| Interim results | 1 August |
| Payment date for interim dividend | 16 September |

# Principal offices worldwide

**Pearson plc**
80 Strand, London WC2R 0RL, UK
T +44 (0)20 7010 2000
F +44 (0)20 7010 6060
firstname.lastname@pearson.com
www.pearson.com

**Pearson Inc.**
1330 Avenue of the Americas,
New York City, NY 10019, USA
T +1 212 641 2400
F +1 212 641 2500
firstname.lastname@pearson.com
www.pearson.com

**Pearson North America**
One Lake Street,
Upper Saddle River,
NJ 07458, USA
T +1 201 236 7000
F +1 201 236 3222
firstname.lastname@pearson.com
www.pearsoned.com

**Pearson International**
190 High Holborn,
London WC1V 7BH, UK
T +44 (0)20 7190 4190
firstname.lastname@pearson.com
www.pearson.com

**Financial Times Group**
Number One Southwark Bridge,
London SE1 9HL, UK
T +44 (0)20 7873 3000
F +44 (0)20 7873 3076
firstname.lastname@ft.com
www.ft.com

**The Penguin Group (UK)**
80 Strand, London WC2R 0RL, UK
T +44 (0)20 7010 2000
F +44 (0)20 7010 6060
firstname.lastname@uk.penguingroup.com
www.penguin.co.uk

**The Penguin Group (USA)**
375 Hudson Street, New York City,
NY 10014, USA
T +1 212 366 2000
F +1 212 366 2666
firstname.lastname@us.penguingroup.com
us.penguingroup.com

**Pearson plc**
Registered number 53723 (England)

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