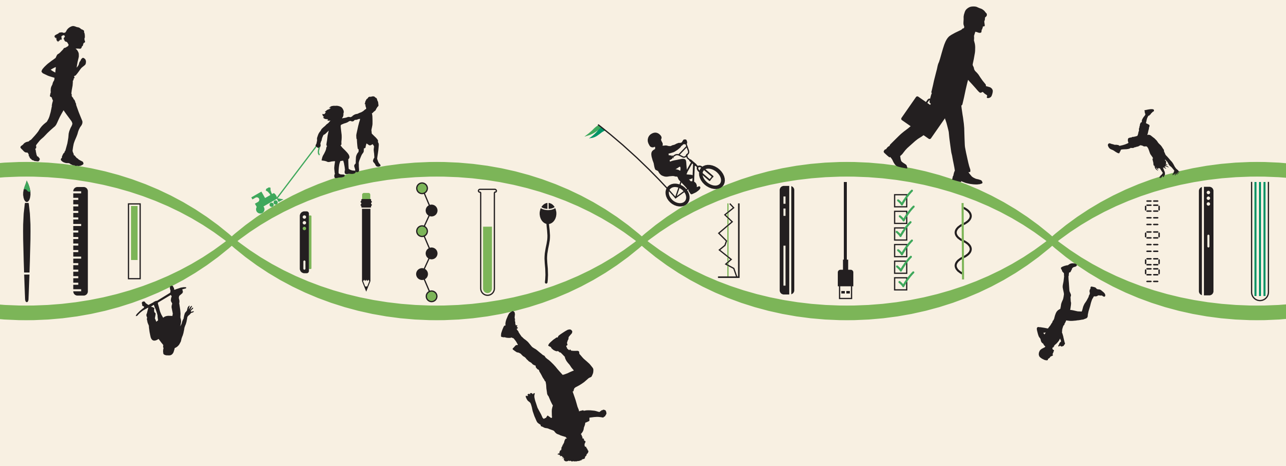
OUR STRATEGY
To find out more about our business strategy go to page 06

OUR PERFORMANCE
For an in-depth analysis of how we performed in 2012 go to page 11

OUR IMPACT ON SOCIETY
For an explanation of our approach to corporate responsibility go to page 34

ANNUAL REPORT AND ACCOUNTS 2012



ALWAYS LEARNING

PEARSON

Always learning

Pearson is the world's leading learning company. We have 48,000 people in more than 70 countries, helping people of all ages to make progress in their lives through all kinds of learning.

WE HAVE THREE WORLD-LEADING BUSINESSES:

PEARSON

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

Consumer publishing
Penguin publishes thousands of 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.

FT

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.

VISIT OUR ONLINE REPORTING CENTRE:

Learn more

ar2012.pearson.com

SUMMARY REPORT
Quick, visual presentation of the year's highlights

VIDEO CONTENT
Interviews with:
› Chairman Glen Moreno
› Chief executive John Fallon
› Chief financial officer Robin Freestone

Global trends film

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Directors' report

Business review

1 Overview

A summary of who we are and what we do, including performance highlights, our business strategy and key areas of investment and focus.

2 Our performance

An in-depth analysis of how we performed in 2012, the outlook for 2013 and the principal risks and uncertainties affecting our businesses.

3 Our impact on society

Explains Pearson's approach to corporate responsibility, giving a summary of our work in 2012 and our plans for 2013.

4 Governance

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

5 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.

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 consistent and considerable growth on all measures. In 2012, though we performed well competitively in tough market conditions, headline earnings and cash were lower than the previous year. Our return on invested capital was level at 9.1% and we are proposing a 7% dividend increase.

	2012 £m	2011 £m	HEADLINE GROWTH	CER GROWTH	UNDERLYING GROWTH
Business performance*					
Sales	6,112	5,862	4%	5%	(1)%
Adjusted operating profit	936	942	(1)%	1%	(2)%
Adjusted earnings per share	84.2p	86.5p	(3)%		
Operating cash flow	788	983	(20)%		
Free cash flow	657	772	(15)%		
Free cash flow per share	81.7p	96.5p	(15)%		
Return on invested capital	9.1%	9.1%	–		
Net debt	(918)	(499)	(84)%		
Statutory results					
Sales	5,059	4,817	5%		
Operating profit	515	1,118	(54)%		
Profit before tax	434	1,047	(59)%		
Basic earnings per share	40.5p	119.6p	(66)%		
Cash generated from operations	916	1,093	(16)%		
Dividend per share	45.0p	42.0p	7%		

*Total business (Includes Penguin, which is discontinued in our statutory accounts.)

Note
Pearson's 2011 statutory results include a £412m profit on the sale of our 50% stake in FTSE International. The 2012 statutory results include £113m in closure costs related to Pearson in Practice.

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. Sales and operating profit are stated on a continuing basis, unless otherwise stated.
b) The 'business performance' measures are non-GAAP measures and reconciliations to the equivalent statutory heading under IFRS are included in notes 2, 8 and 34 to the annual report.

2012 SALES

£6.1bn

+5%

2012 ADJUSTED OPERATING PROFIT

£936m

+1%

OUR FIVE-YEAR RECORD

Average annual growth in headline terms 2007–2012

Adjusted earnings per share

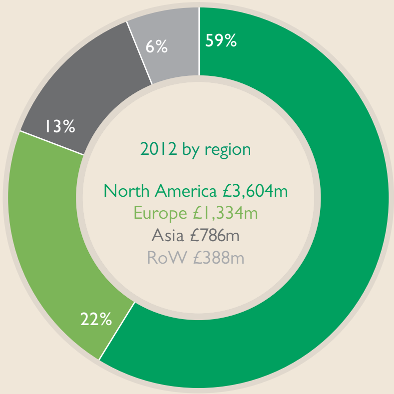
+13%

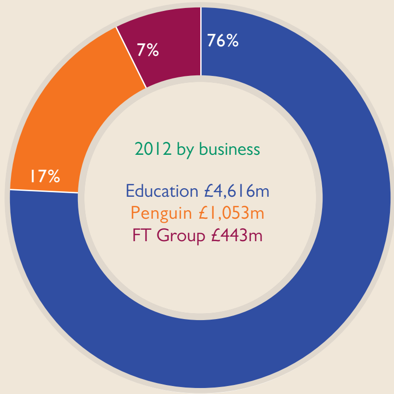
Operating cash flow

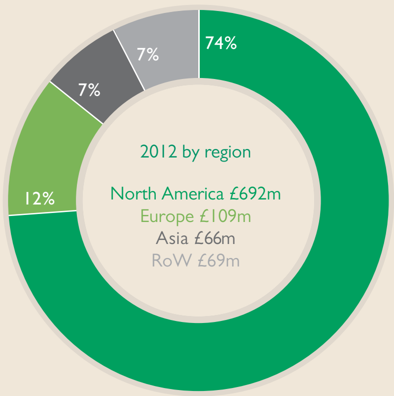
+3%

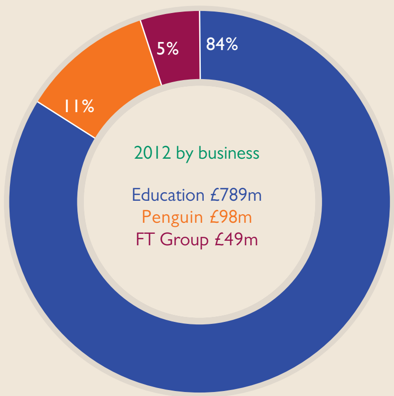
Dividend

+7%

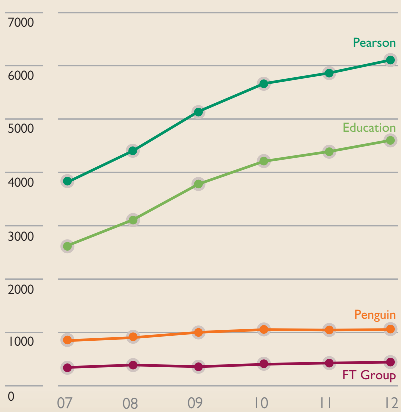




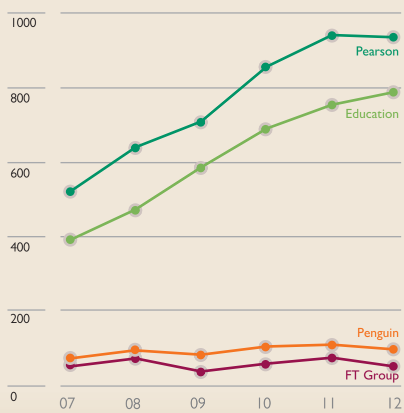




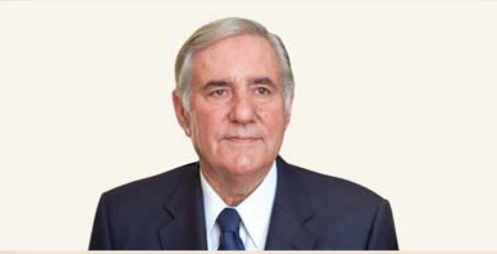
Sales £m



Adjusted operating profit £m



Chairman's introduction



Watch an interview with Glen Moreno, Chairman of Pearson.

ar2012.pearson.com

The basic direction of our strategy is unchanged, and we are travelling faster in our transformation.

Dear shareholders,
2012 was a year of significant leadership transition at Pearson. Marjorie Scardino retired on 31 December, after a remarkable 16-year tenure as chief executive, and John Fallon assumed the role on 1 January of this year.

Marjorie's contribution to Pearson has been defining:

- she led the transformation of a traditional family holding company into a modern global enterprise;
- she established a clear company purpose: to help people improve their lives through learning;
- she developed a company culture – to be brave, imaginative and decent – which will be a lasting legacy;
- and she leaves behind a thriving company which has benefited customers, staff and shareholders.

We all are hugely grateful for her efforts and accomplishments.

CEO succession

CEO succession is a very important board responsibility, and one that we have been working on for several years. In 2012, the nomination committee spent a great deal of time evaluating candidates and planning for a seamless handover of duties.

We are confident that John Fallon is the right person to lead Pearson in its next phase of development, and his leadership over the past few months has reinforced that confidence.

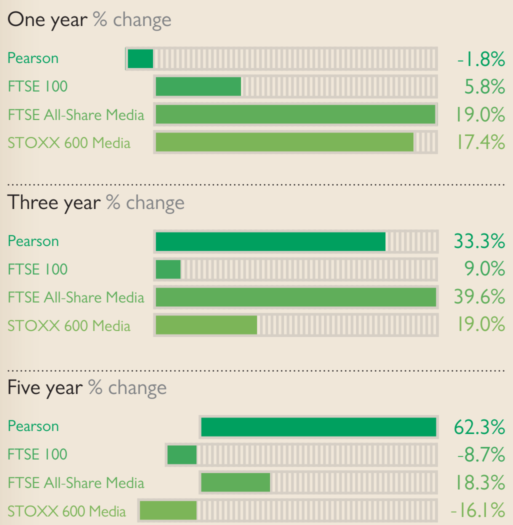
We are now focused on the future development of our board, which I address in the Governance section of this report.

Pearson's transformation so far

Over the past decade or so, Pearson has focused on three fundamental transformations:

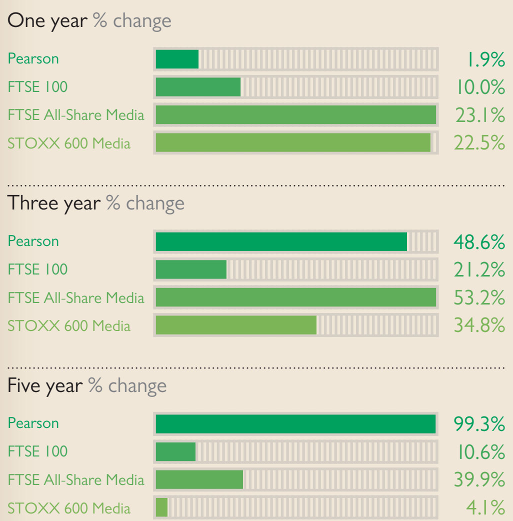
- from a media holding company to an integrated education company;
- from a largely Anglo-American company to a truly global enterprise;
- from an analogue print publisher to a digital content and services company.

SHARE PRICE PERFORMANCE



Source: Datastream to 31 December 2012

TOTAL SHAREHOLDER RETURN



Source: Datastream to 31 December 2012

The driving forces behind these transformations are building. They include the recognised need for more effective and affordable education, especially from the growing middle class across the globe, and the inexorable tide of "disruptive" technologies which are transforming education models.

These forces provide Pearson with huge opportunities, but also challenges.

A challenging 2012

As CFO Robin Freestone outlines in his report on our financial performance, 2012 was a challenging year for many of our businesses, offset by encouraging growth in our newer global and digital initiatives.

These challenges were reflected in our share price performance, which underperformed our indices.

On a longer-term basis, our share price and total shareholder return continue to reflect outperformance. (See charts opposite.)

Transformation and acceleration

As John explains in his CEO report, the basic direction of Pearson's strategy will not change. Indeed, our efforts to transform the company will accelerate.

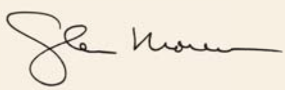
Significant restructuring (including the Penguin Random House merger), accelerated technology investment and increased operating efficiency will enable us to reach our strategic goals more rapidly.

As a shareholder, I am very confident about Pearson's future.

All great businesses are based on fundamental customer demand, and the global demand for affordable, effective education is huge and growing.

We believe that Pearson, as the world's leading education company, is uniquely positioned to help meet that demand – and we are rapidly transforming the company to do so effectively and profitably.

We are determined to succeed, and our efforts will be of great benefit to both our customers and our shareholders.



Glen Moreno Chairman

Pearson's strategy: John Fallon, Chief executive

Watch an interview with John Fallon, Chief executive of Pearson.

ar2012.pearson.com

As the world's leading learning company, Pearson has a once-in-a-generation opportunity. To seize it, we must transform the company again. Our strategy is settled and sound; we are now accelerating its implementation.

Dear shareholders,
I really do consider it to be a great privilege to be writing to you for the first time as Pearson's chief executive. I had the good fortune to join the company 16 years ago; since then I've worked for Pearson in London, New York and Harlow and travelled to all corners of the world as we've built our education business. I've learned many things in that time, but above all that this is a very special company, with a great sense of purpose and many talented and dedicated people.

In the months since my appointment was announced, I've spent a good deal of time talking to a wide range of stakeholders – customers, shareholders, colleagues and partners – about the company.

Faster into digital, services and emerging markets

My conclusion – based on what I've heard in recent months and learned first hand over the past 16 years – is very straightforward. The Pearson strategy is settled and sound, and we need to accelerate its implementation. We need to move faster in our digital transformation, our move into services and the building of our presence in emerging markets.

OUR STRATEGY

1 Four global businesses

We are focusing on school, higher education, English language learning and business education. We are taking an increasingly global view of educational needs and trends.

2 Four types of geographic market

We will carefully evaluate when we offer global products and services, when we customise for local needs, and when we require a true local approach. We will focus our investment on markets with the biggest growth opportunities.

3 Four business models

We will channel our investment into four proven business models: direct-to-consumer; 'Pearson Inside' (our shorthand for institutional services to schools and universities); assessment; and learning systems.

I want to use this letter to explain why we need to accelerate, and how we will do it.

If you've read Marjorie's letters over the years, you'll be familiar with the key tenets of our strategy and the progress that Pearson has already made. Under her leadership, Pearson set out to become a world-leading education company, and that is a privilege and responsibility we now enjoy. We wanted to make a radical shift from traditional print products to digital and services businesses, and, for the first time in Pearson's history, those now account for half of our revenues. We aimed to become a significant player in the world's most dynamic education markets, and Pearson is now a meaningful education company in China, India, Brazil and Southern Africa. And we've achieved this transformation while sustaining a disciplined approach to capital allocation.

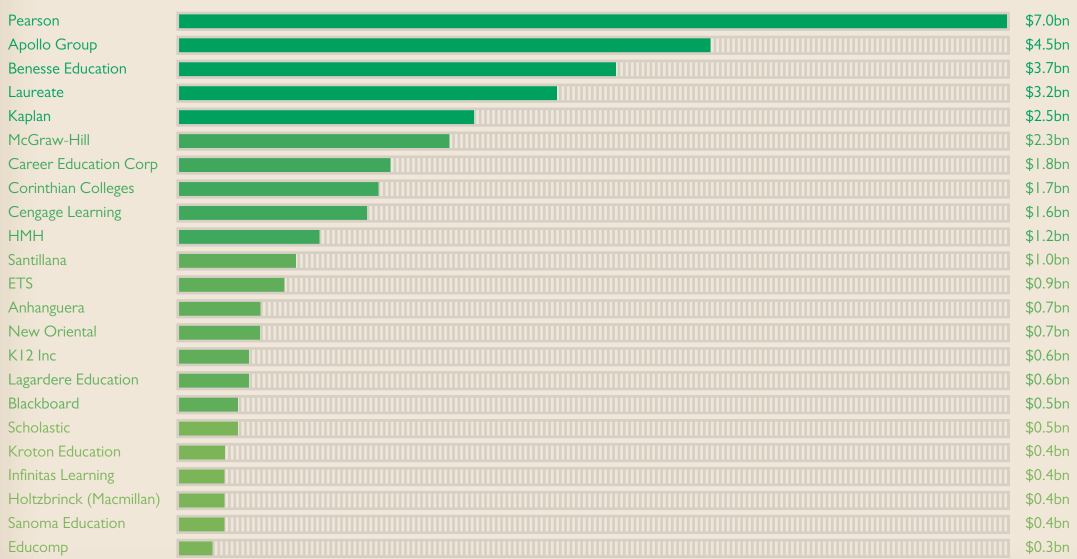
Structural change in the world of education

This is a powerful set of advantages with which to tackle a changing external environment. We continue to see significant structural change, including a shift from print to digital content and from classroom instruction to online learning. Spending on textbooks is flat or declining, while mobile devices, personalised learning and MOOCs (massive open online courses) are on the rise. This shift to digital is profoundly changing the business model for content: it means one-off sales will diminish while subscription sales, most bundled with services, will grow. That same shift to digital causes considerable change and consolidation in the retail channel, with a dramatic shift to online sales and different sales patterns for physical and digital formats.

I'm not going to dwell on the 2012 results here, because Robin Freestone covers them in detail in the next section. But in 2012 we saw plenty of evidence to suggest that those structural changes are gathering speed and force. In many of our traditional publishing markets, we posted another excellent competitive performance. Yet the reward for those efforts was that in some markets we declined at a slower rate than our rivals. At the same time, we draw confidence from strong growth in some of our 'emerging' markets. (We see our fast-growing markets as *categories* as much as *geographies* – they are digital products and services, learning systems, the direct delivery of effective education and learning; as well as fast-growing economies.)

UNIQUE MARKET POSITION

2011 Education revenues

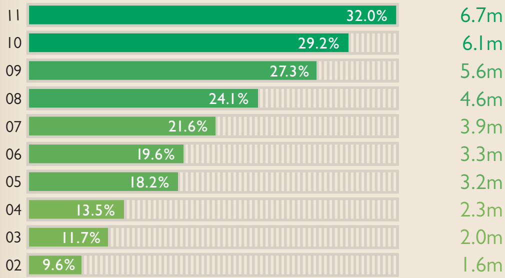


Pearson's strategy: John Fallon, Chief executive continued

Trends

PRINT TO DIGITAL

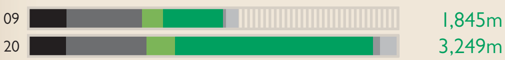
Number of US college students taking at least one online course % total enrolments/millions



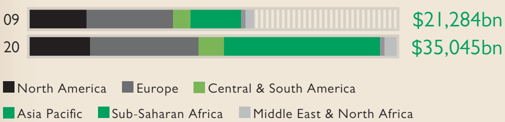
Source: Babson annual online learning survey

THE RISE OF THE MIDDLE CLASS

Numbers of middle class people millions



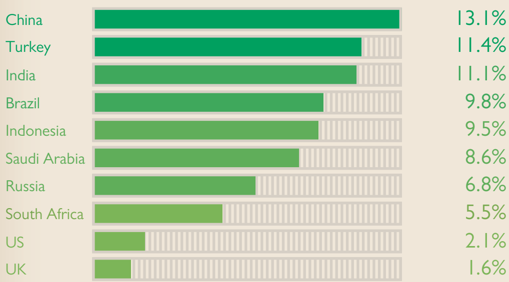
Middle class consumption, $bn (2005$)



Source: The Brookings Institution

THE CONSUMER EDUCATION MARKET

Household income spent on education %



Source: Bureau of Labor Statistics, Office of National Statistics, Credit Suisse

Our motto, as you might know, is 'always learning' and there are some lessons for us to learn from all this. We have to manage disruption in our traditional businesses while building direct relationships with learners and leading the digital transformation of education. Our future customers will be consumers, or learners, just as much as the institutions that serve them. We have to tilt the company more quickly toward the biggest sources of future demand. We have to work ever harder to help our customers do more, and better, with less. And we have to focus less on what we *make*, and much more on the measurable impact our products and services can actually *deliver*.

Global education is a once-in-a-generation opportunity

If that all sounds a little daunting, there is another side to the Pearson story. We think education will turn out to be the great growth industry of the 21st Century.

People the world over increasingly understand the fundamental truth perhaps best expressed by Benjamin Franklin: 'An investment in knowledge always pays the best interest.'

The economic returns to education are very clear. For example, 90% of the fastest-growing jobs in the US economy require a college degree and a college graduate will earn, on average over their career lifetime, one million dollars more than a high-school drop-out.

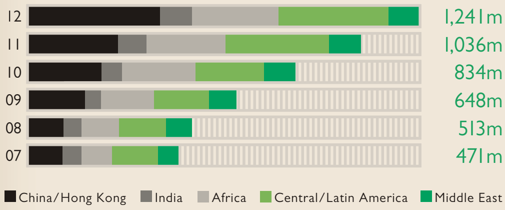
Our growth prospects are also fuelled by a remarkable socio-economic trend: in this decade, the global middle class will almost double in size to more than three billion people. Nearly all of that growth will be in the developing world. That's important to many industries but especially to ours, because as consumers join the middle class and earn higher incomes, they tend to invest more in education – either to advance their careers or give their children a good start in life.

We draw two conclusions from those kinds of trends. The first is that global education is a once-in-a-generation opportunity and Pearson is uniquely placed to grasp it. The second is that, to seize that opportunity, we need to transform the company again.

Our business

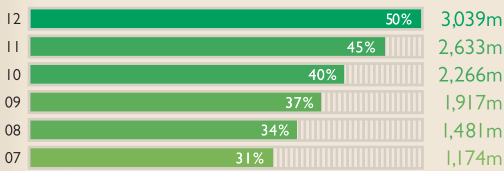
STRENGTH IN HIGH-GROWTH MARKETS

Pearson emerging markets revenues $m



SHIFT TO DIGITAL AND SERVICES

Pearson's digital and services revenues % sales/£m



THE NEED FOR TRANSFORMATION – WHERE ARE OUR CUSTOMERS?

Pearson revenues 2012
£bn

K-20 % of students
(% CAGR 1998-2010)

Emerging	£0.8bn
Developed	£5.3bn

North America & Europe	0.2%
RoW	0.6%
Emerging markets	3.1%

Source: Pearson, UNESCO

Transforming the company again

Digital learning services now account for around one-third of our sales. They are growing at more than 20%, but we need to make them a much bigger part of Pearson. Emerging markets are another 15% of our sales. But they already account for more than one-third of the world economy and are forecast to produce more than two-thirds of global growth over the next decade. So, we must radically shift our focus, attention and resources to those very big opportunities. And that is the reason for the changes in the company that we announced with our 2012 results. We need to shift resources more quickly from textbook publishing activities, primarily in the developed world, where demand is flat or declining, so we can invest more quickly in our fast-growing digital and services businesses, with a special emphasis on emerging markets.

Our transformation includes a focus on four global businesses: School, Higher Education, English and Business Education. We are taking an increasingly global view of educational needs, consumer trends and product development for these businesses.

We are applying a new model where we group markets, or countries, in four categories and allocate capital accordingly: 'growth' markets where we see the biggest opportunities; 'watch' markets where we see potential for big growth; 'maintain' markets where we have good businesses but see more modest future growth; and 'drive' markets where we will work through local partners to meet those countries' needs more effectively.

Our framework also involves shifting an increasing proportion of investment into our faster-growing and proven service-oriented models. They are: direct to consumer, building on the success of initiatives such as our language schools in China; 'Pearson Inside,' shorthand for comprehensive institutional services such as our virtual schools in the US and school systems in Brazil; assessment and certification of students and professionals; and personalised learning systems, which deliver individual learning through systems of instruction combined with measurement frameworks and diagnostic assessment.

Pearson's strategy: John Fallon, Chief executive continued

An important part of that transformation is the merger of our consumer publishing business, Penguin, with Bertelsmann's Random House, which we expect to complete this year. Penguin has been part of Pearson for more than four decades. It is a special company that is deeply intertwined with Pearson's culture and operations. But it had become increasingly clear that, in a rapidly-changing consumer books industry, Penguin's creative and financial success could best be secured in combination with Random House, which we viewed as the ideal partner. This will be an excellent business and we will be active long-term partners in it.

Another important component will be business education, which we see as part of our once-in-a-generation opportunity. There is a substantial market for learning for globally minded, highly aspirational business people, and if there is one brand in the world that could turbo-charge our ability to capture that market, it is the *Financial Times*. We are actively exploring this opportunity.

A focus on outcomes

There is one other major component to the changes we are making. For decades, Pearson has provided *inputs* into the process of education: a textbook, an assessment, a course, a qualification. We would put all of those things in the hands of an experienced teacher or an enthusiastic student. In most cases, we would not be able to predict or measure learning *outcomes*.

Under the leadership of our chief education advisor, Sir Michael Barber, we have spent the past two years developing a framework and a set of tools that will change that. The Pearson efficacy framework is a unique, rigorous and scalable quality assurance system that checks that the necessary conditions are in place for an education programme to deliver the intended learning outcomes. We have reviewed almost 100 Pearson programmes under this framework, and we are improving our products and services by acting on the findings. We also are now making an efficacy review a requirement for any new product investment of $3m or more, and for any acquisition proposal. Over time, this will also improve our rate of innovation and invention.

Building on our record of strong performance

Those measures on efficacy complement our more traditional financial measures and goals but they do not, of course, replace them. We will build on Pearson's record of consistently strong financial performance, because profits and cash will fuel the transformational investments that we need to make. Meeting those financial measures will require us to make hard choices about where we choose to invest and what we have to do less of or stop doing altogether.

For, if 2012 was tough, then there are many reasons – cyclical, structural, competitive, consumer led – why 2013 is likely to be tougher still. Many of our markets – especially in the developed economies and where we are particularly dependent on our more traditional product models – have been in decline for some years now.

All this change is going to be challenging for Pearson. It is not a revolution: Marjorie's own leadership of the company was characterised by constant, restless change. However, we do need to accelerate that change – into emerging markets, into services and in our digital transformation – very quickly now.

As we do that, we very much appreciate and rely on the support of our shareholders. By investing in Pearson, you've made an investment in knowledge and education. We will be working as hard as we possibly can to be sure that Benjamin Franklin's words apply to your investment, too. And we'll be inspired, too, by Marjorie's great achievement – demonstrating time and time again that the best and most sustainable way for a company to prosper is to meet an important need in society and to do it really well. We'll be striving very hard to live up to her example.

John Fallon Chief executive

Our performance: 2012 financial overview

Watch an interview with Robin Freestone, Chief financial officer of Pearson.

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In 2012, Pearson increased sales by 4% in headline terms to £6.1bn generating a total adjusted operating profit of £936m (2011: £942m).

The headline growth rates were reduced by currency movements and helped by acquisitions. Currency movements reduced sales by £27m and operating profits by £11m. This was the result of non-dollar currency depreciation relative to sterling. At constant exchange rates (i.e. stripping out the impact of those currency movements), our sales and adjusted operating profit grew 5% and 1% respectively.

Acquisitions, primarily in our education company, contributed £318m to sales and £39m to operating profits. This includes integration costs and investments related to our newly-acquired companies, which we expense. The disposal of our 50% stake in FTSE International in 2011 reduced operating profits by £20m.

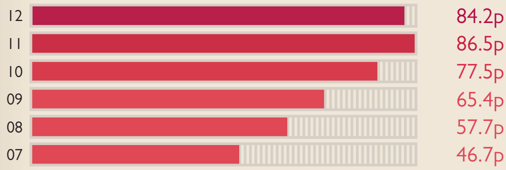
Our underlying revenue and adjusted operating profit (i.e. stripping out the impact of both portfolio changes and currency movements) declined by 1% and 2% respectively.

Our tax rate in 2012 was 23.1% compared to 22.4% in 2011 reflecting movements in tax settlements with revenue authorities in each year.

Adjusted earnings per share were 84.2p (2011: 86.5p).

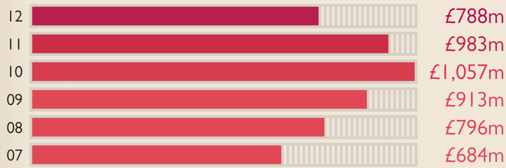
KEY FINANCIAL GOALS

Adjusted earnings per share Pence

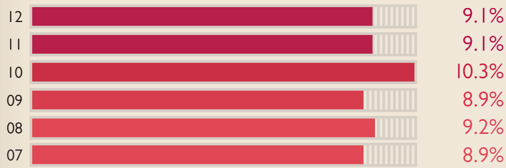


Average annual growth (headline) 13%.

Operating cash flow £m



Return on invested capital %



Average capital/actual cash tax

Cash generation

Headline operating cash flow declined by £195m due to longer debtor days, currency fluctuations and increased investment in new education programmes. Free cash flow declined by £115m to £657m, additionally reflecting from lower tax payments. Our average working capital to sales ratio improved by a further 0.4 percentage points to 13.8% reflecting the benefits from our shift to more digital and service-orientated businesses.

Return on invested capital

Our return on average invested capital was 9.1%, well ahead of our cost of capital and level with 2011. ROIC was affected by profit decline at Pearson in Practice and the sale of FTSE International (one of our least capital-intensive businesses), offset by a lower cash tax charge.

Our performance: 2012 financial overview continued

Statutory results

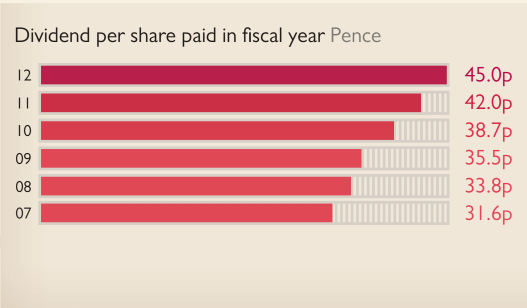
Our statutory results show a decrease of £603m in operating profit to £515m, from £1,118m in 2011, reflecting the absence in 2012 of the £412m profit on the sale of FTSE International in 2011 and the £113m closure-related costs on Pearson in Practice in 2012. Basic earnings per share similarly fell to 40.5p in 2012, down from 119.6p in 2011.

Balance sheet

Our net debt increased to £918m (£499m in 2011) reflecting acquisition investment of £759m and sustained organic investment in our business, partly offset by cash generation. Since 2000, Pearson's net debt/EBITDA ratio has fallen from 3.9x to 0.9x and our interest cover has increased from 3.1x to 18.0x.

Dividend

The board is proposing a dividend increase of 7% to 45.0p, subject to shareholder approval. 2012 will be Pearson's 21st straight year of increasing our dividend above the rate of inflation. Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning more than £2.5bn to shareholders. We have a progressive dividend policy: we intend to sustain our dividend cover at around 2.0x over the long term, increasing our dividend more in line with earnings growth.



Outlook: 2013

We expect the external environment to remain challenging for our developed world and publishing businesses in 2013 owing to a combination of cyclical and structural factors: pressures on education budgets and college enrolments; retail consolidation; the shift in our business model from print sales to digital subscriptions; changing consumer behaviour and a dynamic competitive landscape. In general, we expect market conditions to remain favourable for our businesses in developing economies and education software and services.

In order to reshape the company to take advantage of significant growth opportunities, we will expense approximately £150m of restructuring costs in 2013 (the restructuring cost will be approximately £100m net of cost savings achieved in the year). This investment has two objectives:

1. to accelerate our transition from print to digital business models and from developed to developing economies; and
2. to separate Penguin activities from Pearson central services and operations, and to reduce fixed cost infrastructure in Pearson, in preparation for the Penguin Random House merger.

We expect this transformation programme to generate approximately £100m of annual cost savings from 2014. In 2014, we intend to reinvest the £100m of cost savings in the organic development of our fast-growing digital, services and emerging markets businesses and further restructuring, including the Penguin Random House integration. We expect these businesses to contribute to faster organic growth, improving margins and improved cash flow and capital intensity from 2015. The precise phasing of restructuring costs and benefits will depend on timing of completion of the Penguin Random House combination, which remains subject to regulatory approval and which we expect to complete in the second half of 2013.

At this early stage in the year we expect Pearson 2013 operating profits and adjusted EPS to be broadly level with 2012 before expensing these restructuring costs (compared to 2012 adjusted EPS of 82.6p under revised IAS 19 which we will adopt in 2013) and including Penguin for the full year.

This guidance is struck at the 2012 average exchange rate of £1:$1.59 and reflects the following outlook:

Education

In Education, we expect to achieve modest revenue growth in 2013 with margins similar to 2012.

North America

In North America, we anticipate modest growth with challenging cyclical and structural market conditions in publishing offset by growth in digital and services.

International

We expect our International education business to show good growth. Austerity measures will continue to affect education spending in much of the developed world and we expect a slower year for UK examinations and qualifications. However, we see significant opportunity in emerging markets in Asia, Latin America, the Middle East and Sub-Saharan Africa – which together accounted for 45% of our International education revenues in 2012.

Professional

Our Professional education business will reflect the closure of our UK professional training business and continued growth from our professional certification business.

FT Group

We expect the FT Group to benefit from continued growth in digital and subscription revenues in 2013 but advertising to remain weak and volatile with profits reflecting further actions to accelerate the shift from print to digital. Mergermarket will benefit from its high subscription renewal rates, with market activity likely to boost its core product offerings.

Penguin

As previously announced, subject to regulatory approval, we expect Penguin's combination with Random House to be completed in the second half of 2013. We believe that the combined organisation will have a stronger platform and greater resources to invest in rich content, new digital publishing models and high-growth emerging markets. The organisation will generate synergies from shared resources such as warehousing, distribution, printing and central functions. We expect market conditions to remain similar to 2012 with a tough environment in the physical bookstore channel but helped by good growth in digital.

Interest and tax

In 2013, our net interest charge to adjusted earnings will exclude pension income and charges following the adoption of IAS 19 revised and be similar to the £65m reported in 2012 on a comparable basis. We anticipate our P&L tax charge against adjusted earnings to be in the 23–25% range with our cash tax rates around the same level.

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 2012 was £1:$1.59) has an impact of approximately 1.4p on adjusted earnings per share.

North American Education

KEY PERFORMANCE INDICATORS

North American Education is Pearson's largest business, with 2012 sales of £2.7bn and operating profit of £536m.

Sales	
2012	£2,658m
2011	£2,584m
Headline growth	3%
CER growth	2%
Underlying growth	(4)%

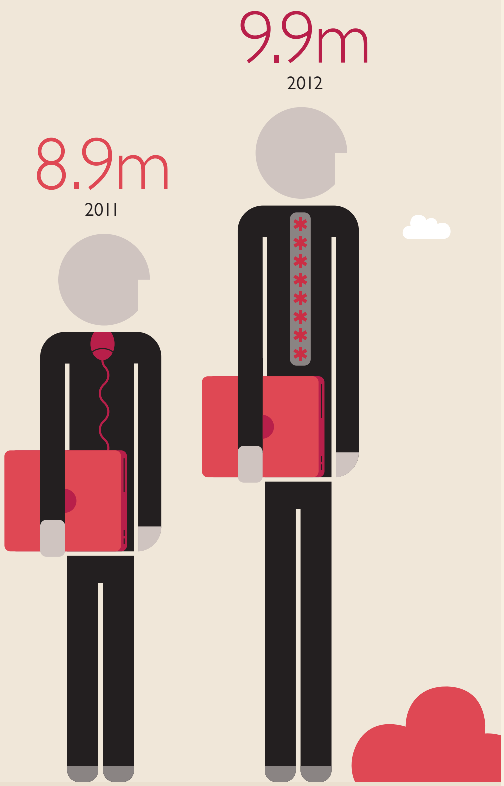
Adjusted operating profit	
2012	£536m
2011	£493m
Headline growth	9%
CER growth	8%
Underlying growth	3%

CASE STUDY

Online learning

Pearson's pioneering 'MyLab' digital learning, homework and assessment programmes grew well with student registrations in North America up 11% to almost 10 million, with graded submissions up 12% to almost 320 million across the globe. Evaluation studies show that the use of MyLab programmes can significantly improve student test scores and institutional efficiency. http://bit.ly/ymMMAi

Total number of MyLab registrations



In 2012, our strength in digital and services businesses and tight cost control enabled us to perform ahead of our more traditional print publishing markets, which declined by 10% for the industry as a whole and were adversely affected by state budget pressures and declines in college enrolments.

Higher Education highlights in 2012 include:

- In Higher Education, the publishing market declined by 6% net in 2012, according to the Association of American Publishers. Total US College enrolments were 2% lower in 2012 than in 2011, affected by rising employment rates, state budget pressures and regulatory change affecting the for-profit sector. In a difficult trading environment Pearson gained share for the 14th consecutive year, again benefiting from our lead in technology and customisation.
- We launched Pearson Workforce Education which delivers more than 60 online courses in high demand occupational training areas from IT and Healthcare to management and soft skills courses; and Propero, which combines on-demand tutoring, student support and online courses to expand access to higher education and support degree completion.
- We announced the acquisition of a 5% stake in NOOK Media for $89.5m in December 2012 with the option to purchase up to an additional 5%, subject to certain conditions. This strategic investment will help accelerate customer access to digital content by pairing the company's leading expertise in online learning with NOOK Media's expertise in online distribution and customer service. This will facilitate improved discovery of available digital content and services, as well as seamless access.

CASE STUDY

eCollege registrations

Student registrations at eCollege grew 3% to 8.7 million, despite pressure in the for-profit college market. We won new online enterprise learning contracts with California State University and Rutgers University. Our strong managed enrolment services and student marketing product offering, coupled with continued strong growth at Arizona State University, helped our online enterprise learning business to grow 150% to almost 44,000 enrolments. In November 2012, we acquired EmbanetCompass for $650 million which provides a full range of services targeted towards online graduate programmes.

OVERVIEW
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North American Education
continued

Assessment and Information highlights in 2012 include:

- At our Assessment and Information business, revenues were flat in 2012. State funding pressures and the transition to Common Core assessments continued to make market conditions tough for our state assessment and teacher testing businesses.
- The Partnership for Assessment of Readiness for College and Careers (PARCC), a consortium of 23 states, awarded Pearson and Educational Testing Service (ETS) the contract to develop test items that will be part of the new English and mathematics assessments to be administered from the 2014–2015 school year. The assessments will be based on what students need to be ready for college and careers, and will measure and track their progress along the way.
- We continued to produce strong growth in secure online testing, an important market for the future. We increased online testing volumes by more than 10%, delivering 6.5 million state accountability tests, 4.5 million constructed response items and 21 million spoken tests. We now assess oral proficiency in English, Spanish, French, Dutch, Arabic and Chinese. We also launched the Online Assessment Readiness Tool for the PARCC and the Smarter Balance Assessment Consortium (SBAC) Common Core consortia to help 45 states prepare for the transition to online assessments.
- We won new state contracts in Colorado and Missouri and a new contract with the College Board to deliver ReadiStep, a middle school assessment that measures and tracks college readiness skills. We extended our contract with the College Board to deliver the ACCUPLACER assessment, a computer-adaptive diagnostic, placement and online intervention system that supports 1,300 institutions and 7 million students annually.

CASE STUDY

Connections Education

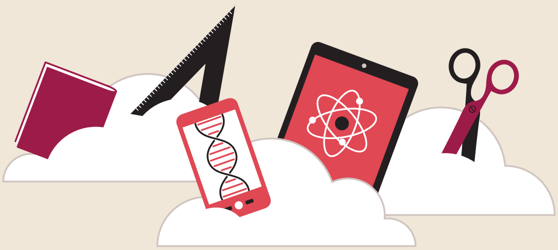
Connections Education, which operates online K-12 schools in 22 states and a nationwide charter school programme, served more than 43,000 students in 2012, up 31% from 2011 and broadened its product offering to include virtual classrooms for public school campuses. Connections Academy Schools have consistently high performance ratings, particularly in states focused on measuring growth in student learning.

- We won five Race To The Top (RTTT) state deals (Kentucky, Florida, Colorado, North Carolina and New York) led by Schoolnet. PowerSchool won three state/province-level contracts (North Carolina, New Brunswick and Northwest Territories). We launched our mobile PowerSchool applications and grew our third-party partner ecosystem to over 50 partners. PowerSchool supports more than 12 million students, up more than 20% on 2011 while Schoolnet supports 8.3 million students, up almost 160% on 2011.
- Our clinical assessment business was boosted by strong growth at AIMSweb, our progress monitoring service which enables early intervention and remediation for struggling students. AIMSweb delivered 58 million assessments in 2012, up 12%.

School highlights in 2012 include:

- In School, the textbook publishing market declined 15% in 2012, according to the Association of American Publishers. There were several pressures on the industry including weakness in state budgets, a lower new adoption opportunity (total opportunity of $380m in 2012 against $650m in 2011) and delays in purchasing decisions during the transition to the new Common Core standards.
- Pearson gained share in very tough market conditions, taking an estimated 31% of new adoptions where we competed. enVisionMATH continued to perform strongly, with a recent *What Works Clearing House* study showing that students using the programme outperformed peers by between six and eight percentiles in maths across a broad range of student populations. iLit, our new digital reading intervention programme, was successfully implemented in 20 districts with early results showing strong reading gains.

CASE STUDY



OpenClass

OpenClass, Pearson's free learning management system, has been installed by almost 1,300 K-12 and college institutions in the US and now serves approximately 100,000 users. In November 2012, we launched Project Blue Sky, a cloud-based content service that allows college instructors to combine Open Educational Resources (OER) with instructor-created and Pearson content.

International Education

KEY PERFORMANCE INDICATORS

Our businesses in emerging markets continued to perform strongly, supported by good enrolment trends and sustained investment.

Sales

2012	£1,568m
2011	£1,424m
Headline growth	10%
CER growth	13%
Underlying growth	7%

Adjusted operating profit

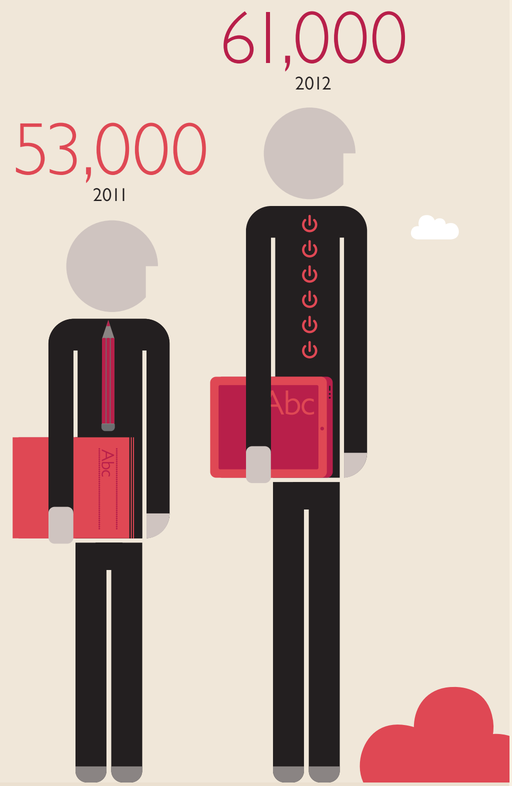
2012	£216m
2011	£196m
Headline growth	10%
CER growth	16%
Underlying growth	11%

CASE STUDY

Businesses in China

In China, student enrolments at Wall Street English increased 15% to almost 61,000, boosted by good underlying demand and the launch of ten new centres taking the total to 66. Our students rapidly acquired high-level English skills with average grade levels achieved rising by 8% during 2012. Enrolments at Global Education, our test preparation services for English language qualifications, increased 16% to more than 1 million, through 73 owned and 372 franchised learning centres.

Wall Street English student enrolments in China



Our businesses in emerging markets continued to perform strongly, supported by good enrolment trends and sustained investment. Our UK business was resilient during the year despite significant regulatory and policy changes across vocational and general qualifications, apprenticeships and higher education. In the rest of the world, a recovery in Japan following the 2011 tsunami and a strong competitive performance in Italy more than offset weak market conditions in Spain.

Key highlights in 2012 include:

- In English Language Learning, Wall Street English (WSE), Pearson's worldwide chain of English language centres for professionals, opened a net of 11 new centres around the world, bringing the total number to 460. Student numbers fell by 2% to more than 191,000, primarily due to the closure of a large franchise centre in Chile with approximately 7,000 students. MyEnglishLabs enrolments grew 60% to 263,000 supported by the launch of our next generation platform which supports 13 languages and 43 new courses. We acquired GlobalEnglish, a leading provider of cloud-based, on-demand Business English learning, assessment and performance support software, for $90m in cash in July 2012.
- More than 1.1 million students registered for our MyLab digital learning, homework and assessment programmes, an increase of 18%, with good growth in school, ELT and institutional selling in higher education.

United Kingdom highlights in 2012 include:

- In the United Kingdom, we marked more than 6.3 million GCSE, A/AS Level and other examinations with 90% using onscreen technology and more than 3.8 million test scripts for over half a million pupils taking National Curriculum Tests at Key Stage Two in 2012. We launched our Next Generation BTECs which are now the leading vocational qualification on the new funding and accountability frameworks in schools. Our vocational qualifications business grew well with the continued popularity of BTEC amongst employers and universities and a strong performance in work-based learning (with registrations now up to 170,000) further boosted by a good performance from EDI.

CASE STUDY

Sistema success in Brazil

In Brazil, we ended 2012 with 533,000 students in our public and private sistemas (or learning systems) and added 24,000 students in our two largest private sistemas, COC and Dom Bosco, up 8% on 2011. Our public sistema, NAME, includes the top performing lower secondary school in Brazil and test scores for all our public school students are, on average, 20% above the 2011 national IDEB standard for 4th and 8th grade students.

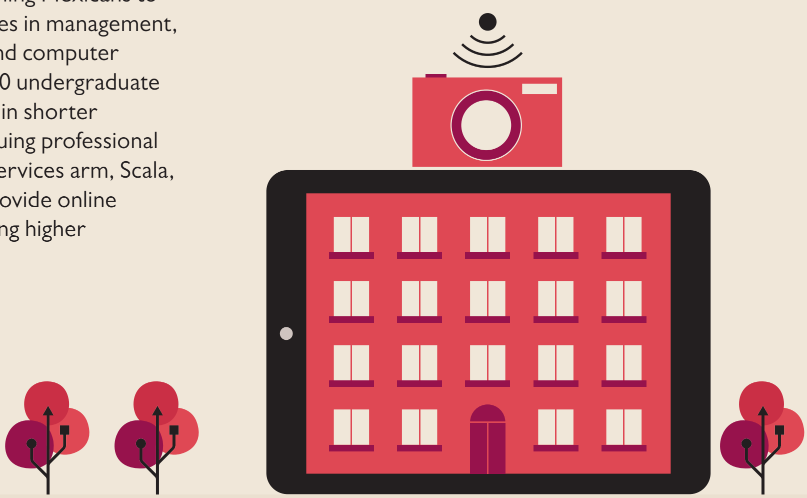
International Education
continued

- In South Africa we held share in school publishing in market conditions which were tougher than expected despite a year of major curriculum reform. Student enrolments grew strongly at CTI, up 19% to more than 10,000. We partnered with UNISA, South Africa's largest university and the largest distance learning provider in Africa, to provide 30,000 students with access to our MyLabs software, digital resources and customised eBooks.
- In India, TutorVista is now managing 35 schools and its multimedia teaching solution Digiclass is installed in approximately 17,000 classrooms. ActiveTeach, our digital learning platform for schools, was adopted by 200 schools serving approximately 100,000 students.
- In the Middle East, the Abu Dhabi Education Council purchased our print and digital Maths and Science resources for all schools from grades 6 to 10, the American University of Sharjah adopted MyLabs for four mathematics courses and three science courses, and we are providing access to digital course content for 5,000 students at Abu Dhabi's Higher Colleges of Technology through our Pearson e-texts iPad app.

CASE STUDY

New online university launch in Mexico

In Mexico, we partnered with local curriculum and technology experts INITE to launch UTEL, a new university enabling Mexicans to enrol in online degree courses in management, IT, marketing, engineering and computer science. UTEL enrolled 2,500 undergraduate students and 4,000 learners in shorter corporate training or continuing professional education courses. UTEL's services arm, Scala, signed its first contract to provide online learning services to an existing higher education institution.



Professional Education

KEY PERFORMANCE INDICATORS

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

Sales		Adjusted operating profit	
2012	£390m	2012	£37m
2011	£382m	2011	£66m
Headline growth	2%	Headline growth	(44)%
CER growth	2%	CER growth	(44)%
Underlying growth	(9)%	Underlying growth	(54)%

Our Professional Education business is focused on publishing, training, testing and certification for professionals. The weakness in our UK training business, Pearson in Practice, had a significant negative impact on our 2012 performance and resulted in our decision to exit the business. Other parts of the Professional division performed well.

Professional testing highlights in 2012 include:

› Professional testing continued to see good revenue and profit growth with test volumes at Pearson VUE up 7% on 2011 to almost 8 million with Certiport adding an additional 2.3 million tests, up 13% on 2011. There were key renewals of the National Council of State Boards of Nursing contract running until 2019 and the Computing Technology Industry Association contract was secured with Pearson VUE as the single vendor running through to 2017.

› We won a number of new contracts including a ten-year contract to administer all computer and paper-based tests for the Australia CPA Professional exams and five-year contracts with the National Center for Assessment in Saudi Arabia and the National Council of State Boards of Nursing to provide the NCLEX-RN in Canada beginning in 2015 for ten Canadian registered nurse (RN) regulatory bodies.

› The partnership with the American Council on Education to develop an online General Educational Development (GED) test aligned with new Common Core standards has now launched computer-based testing in 37 jurisdictions.

› Continuing our digital transformation, we adapted our booking service for the Driving Standards Agency (DSA) to work on mobile devices. We also introduced one-to-many biometric matching technology into testing centres to enhance fraud detection.

Professional training

› Professional training was very weak with our UK adult training business, Pearson in Practice, facing a dramatic fall in demand as a result of changes to the apprenticeships programme. We believe this business no longer has a sustainable model and announced in January that we are to exit Pearson in Practice. The cost of exit and impairment is £113m and is reported as a loss on closure in Pearson's 2012 statutory accounts.

› TQ continues to make significant progress in the direct delivery of training services overseas. In Saudi Arabia, we extended the contract to operate the Saudi Petroleum Services Institute for five years and won a five-year contract to run a new Institute at Al Khafji. In Oman, a TQ-led consortium won the bid to provide training to BP, including a wide range of technical and English language training for BP workers as they prepare to open up the Khazzan oilfield for full scale production in 2016.

Professional publishing highlights in 2012 include:

› Professional publishing grew modestly with good profit growth. In the US, growth of eBook sales and other digital products and services continued to outpace ongoing challenges in the traditional retail channel.

Financial Times Group

KEY PERFORMANCE INDICATORS

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

Sales

2012	£443m
2011	£427m
Headline growth	4%
CER growth	4%
Underlying growth	4%

Adjusted operating profit*

2012	£49m
2011	£76m
Headline growth	(36)%
CER growth	(32)%
Underlying growth	(7)%

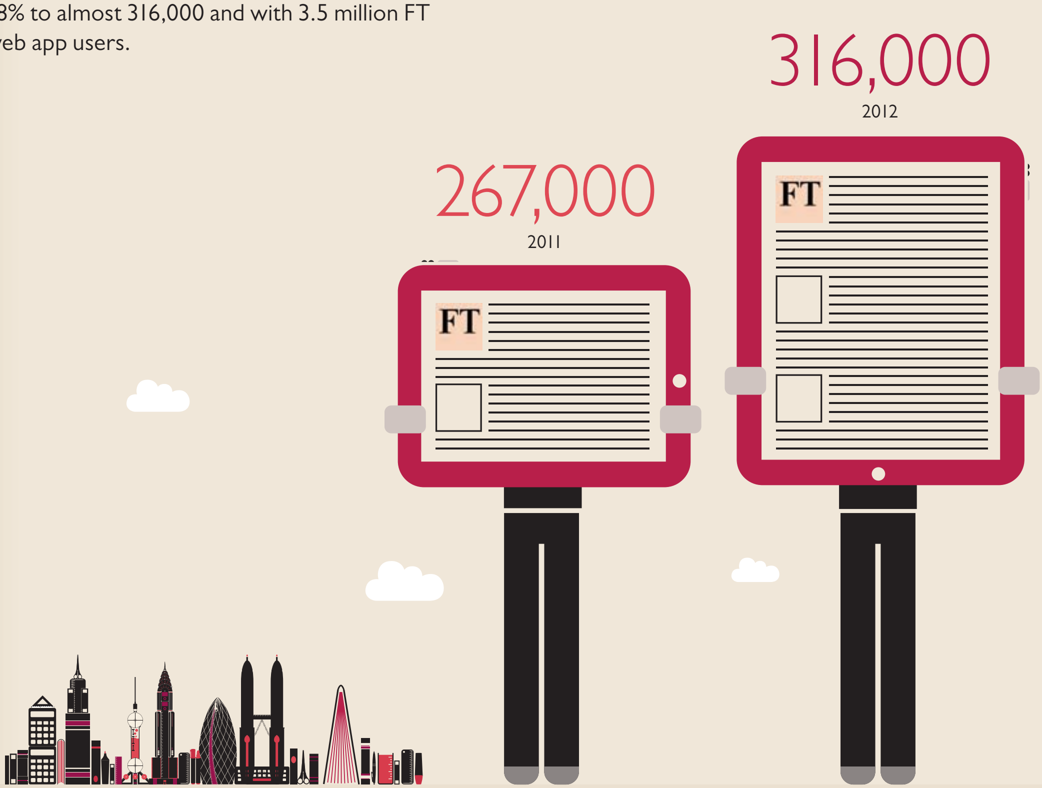
*Reflects the absence in 2012 of the £20m 2011 profit from Pearson's stake in FTSE International following its sale.

CASE STUDY

Growth in digital readership

The *Financial Times* digital readership continues to grow strongly with digital subscriptions increasing 18% to almost 316,000 and with 3.5 million FT web app users.

Financial Times digital subscriptions



Digital and services revenues accounted for 50% of FT Group revenues (31% in 2008). Content revenues comprised 61% of revenues (48% in 2008), while advertising accounted for 39% of FT Group revenues (52% in 2008).

Financial Times highlights in 2012 include:

- The *Financial Times* digital readership continues to grow strongly with digital subscriptions increasing 18% to almost 316,000 and with 3.5 million FT web app users. The FT's total paid circulation was more than 602,000 across print and online, modestly up on 2011, with digital subscriptions exceeding print circulation for the first time. The FT now has almost 2,800 direct corporate licences, up 40% on 2011.
- We continued to invest in new products and innovation, including launching a Windows 8 app and the FT web app on Chrome for Android; a bespoke web app for Latin America; a rebrand of the conferences division, FT Live, with the introduction of live streaming at key events; and the launch of GatekeeperIQ, a new subscription service to track large, retail investment platforms.
- Advertising was generally weak and volatile with poor visibility but the FT grew market share with mobile, luxury and business education showing good growth. Digital revenues benefited from the launch of FT SmartMatch, which automatically puts client content such as articles, white papers and videos in front of FT.com users while they're reading related FT news stories.
- FT Live, our events business, continued to grow strongly and launch new events, including the Global Commodities Summit, delivering more than 200 events that attracted over 17,000 delegates. We launched a digital portal that offers on-demand webinars, livestreamed events and social media tools.

CASE STUDY

Growth in mobile

Mobile devices now account for 30% of FT.com traffic and 15% of new subscriptions.

- Educational services are an important area of expansion. The FT Non-Executive Director Certificate (in partnership with Pearson Learning Studio and Edexcel) was attended by over 150 candidates across five intakes. FT Newslines, an annotations tool on FT.com that allows students and faculties from around the world to create and share annotations on FT articles, is now being used at many business schools. The new FTChinese MBA Gym App, which features tailored training courses categorised by topic, has ranked among the top paid-for education apps on the iTunes Store and was recognised as one of the 'App Store Best of 2012' by Apple in China.
- Money-Media revenues and profits continued to grow well boosted by a strong subscription performance, with the number of individual users growing 6% year on year to 220,000, and new product launches, including Ignites Retirement Research which broadens Money-Media's product offering into the investment industry research sector.

Economist Group highlights in 2012 include:

- In The Economist Group (50% owned by Pearson), *The Economist* launched three HTML5-powered apps in collaboration with FT Labs. *The Economist*'s worldwide print and digital circulation increased by 2% to 1.67 million (at 31 December 2012) of which 150,000 customers bought digital-only copies. The Economist Intelligence Unit acquired Clearstate in Singapore and Bazian, a London-based healthcare research company, as part of its strategy to build a healthcare information business.

Mergermarket highlights in 2012 include:

- Mergermarket grew well, despite challenging markets, due to a good performance from Debtwire, mergermarket, Xtract and Remark underpinned by a strong offering following investment in its product breadth, strong editorial analysis and global presence. We launched several new products and services, including a new mergermarket Android app, a Debtwire Analytics platform in Europe and Policy and Regulatory Report (PaRR), a global intelligence, analysis and proprietary data product focused on competition law, IP and trade law, and sector-specific regulatory change. We also expanded our coverage in faster growth markets such as Latin America, China and the Middle East, generating new business and extending our international reach.

Penguin

KEY PERFORMANCE INDICATORS

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.

Sales

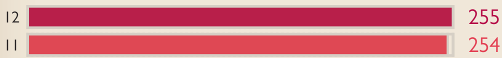
2012	£1,053m
2011	£1,045m
Headline growth	1%
CER growth	1%
Underlying growth	(2)%

Adjusted operating profit

2012	£98m
2011	£111m
Headline growth	(12)%
CER growth	(11)%
Underlying growth	(14)%

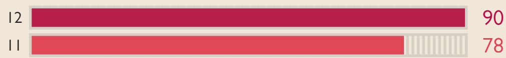
CASE STUDY

US bestsellers No.



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

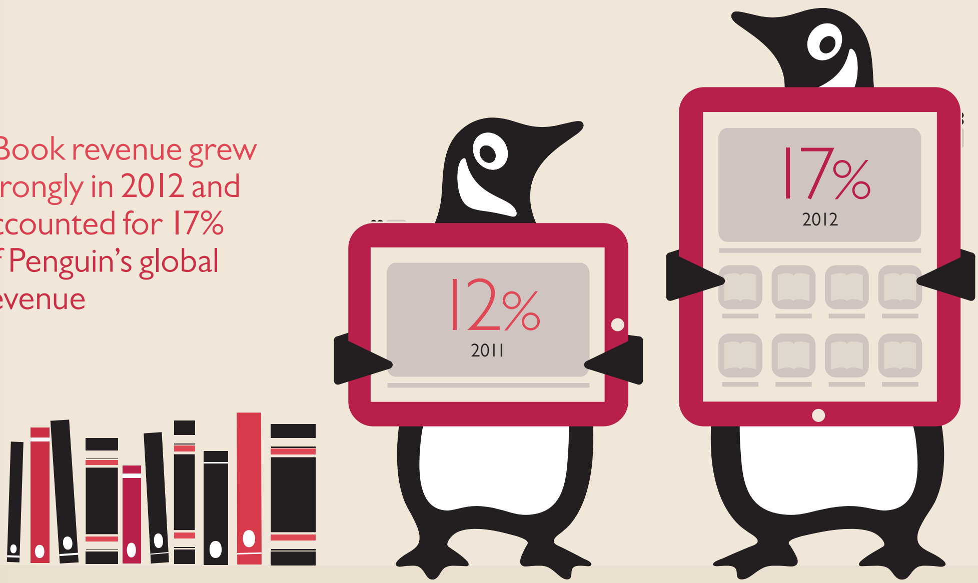
UK bestsellers No.



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

eBook sales % of sales

eBook revenue grew strongly in 2012 and accounted for 17% of Penguin's global revenue



In October 2012, Pearson and Bertelsmann announced an agreement to create the world's leading consumer publishing company by combining Penguin and Random House. Pearson will own 47% of the combined organisation, which is subject to regulatory approval and is expected to complete in the second half of 2013. We believe that the combined organisation will have a stronger platform and greater resources to invest in rich content, new digital publishing models and high-growth emerging markets.

In market conditions that remained challenging, Penguin had a solid year with momentum and share improving in the second half of the year. It also made several moves to offer a broader range of services to more authors across more platforms in more markets.

Key highlights in 2012 include:

- In the United States, we published 255 *New York Times* bestsellers (254 in 2011) including *No Easy Day: The Firsthand Account of the Mission that Killed Osama bin Laden* by 'Mark Owen', *Bared to You* by Sylvia Day and Nate Silver's *The Signal and the Noise* as well as new titles from bestselling authors including Ken Follett, Nora Roberts, Tom Clancy and Harlan Coben.
- In the UK, we published 90 Bookscan bestsellers, our best year on record (and compared to 78 in 2011) including Sylvia Day's *Bared to You*; Jamie Oliver's *15 Minute Meals*; Clare Balding's *My Animals and Other Family* and Daniel Kahneman's *Thinking, Fast and Slow*.
- eBook revenue grew strongly in 2012 and accounted for 17% of Penguin's global revenue (12% in 2011), and almost 30% in the US (20% in 2011). We continued to invest in digital publishing programmes, making eBooks available in new markets including Australia, India, Brazil and China; launching a number of digital-only imprints around the world and expanding our eSpecials list. Global app sales grew by more than 200% driven by brands including Wreck this App, Mad Libs, Moshi Monsters and LEGO®. DK was Apple's only trade publisher launch partner for the January launch of the iBooks Author 2 platform and now has more than 50 interactive titles available.

CASE STUDY

Strong publishing list for 2013

Penguin has a strong publishing list for 2013 with major new books from authors including Khaled Hosseini, Elizabeth Gilbert, Sylvia Day, Nora Roberts, Nathaniel Philbrick and Sarah Dessen in the US, and Jamie Oliver, John Le Carré, Jennifer Saunders, Malcolm Gladwell, Steven D Levitt & Stephen J Dubner, Jeremy Paxman, Jonathan Coe and John Green in the UK. DK will launch more LEGO® titles, including the LEGO® Play book, and *Mary Berry's Cookery Course*. New apps for 2013 include *Anne Frank: The Diary of a Young Girl*, *I'm Ready to Spell* and *Poems by Heart*.

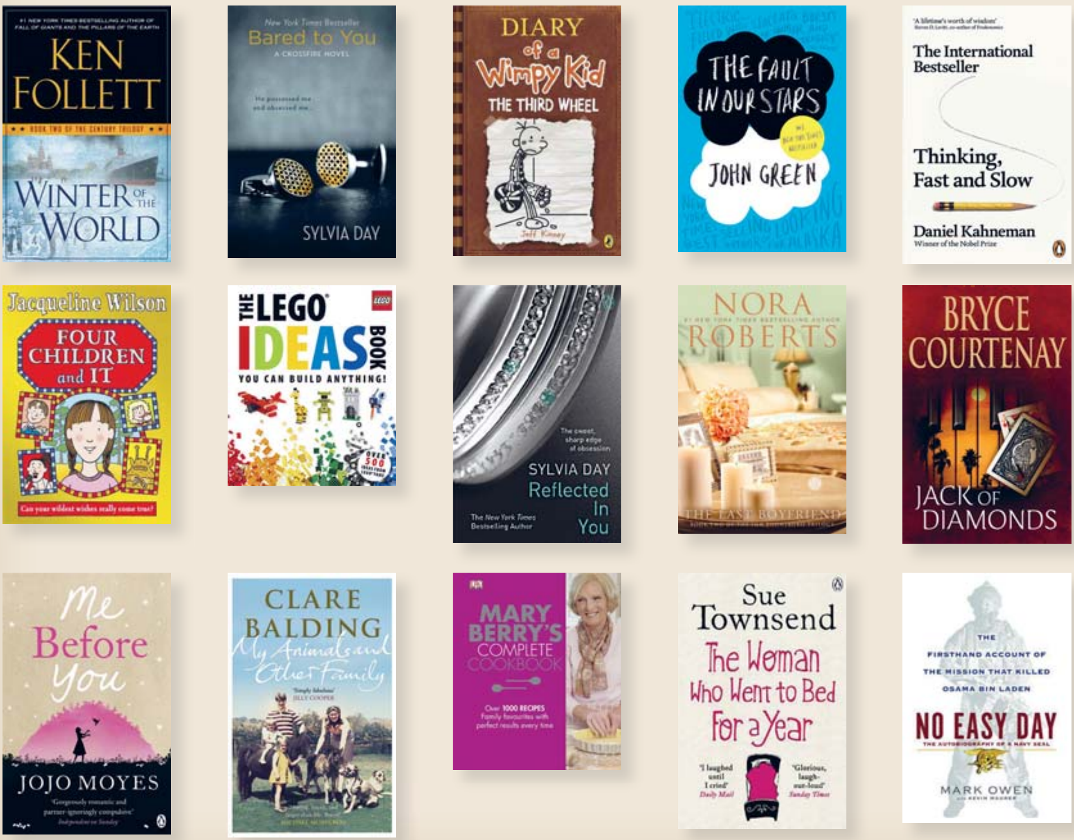
Penguin
continued

- In Brazil, we acquired 45% of Companhia das Letras, a leading trade book publisher. In India, we launched a local eBook programme and enjoyed considerable success in commercial fiction with bestselling authors including Ravinder Singh and Shobhaa De. In China, we expanded our local publishing programmes in both Chinese and English with more than 100 titles now available, including a first local language top ten title, tennis player Li Na's autobiography, and we launched our first list of eBooks.
- DK performed strongly and grew share globally led by our LEGO® publishing list. In the UK, DK celebrated a number one bestseller with *Mary Berry's Complete Cookbook*, which has sold more than one million copies worldwide. BradyGames had bestsellers with *Borderlands 2*, *Skylanders Giants* and *Call of Duty: Black Ops II*.
- Author Solutions, which we acquired in July 2012 for $116m, had a good start. It is the world's leading provider of professional self-publishing services and broadens our expertise in online marketing, consumer analytics, professional services and user-generated content. In February 2013 Penguin India launched Partridge, a new self-publishing imprint, in partnership with Author Solutions.

CASE STUDY

Pick of the year

In 2012, Penguin enjoyed bestseller success around the world, including publishing 255 *New York Times* bestsellers and 90 top ten bestsellers in the UK. Here's a taste of the highlights:



Other financial information

	2012 £m	2011 £m
Net finance costs		
Net interest payable	(65)	(55)
Finance income in respect of employee benefit plans	13	3
Net finance costs reflected in adjusted earnings	(52)	(52)
Other net finance costs	(29)	(19)
Total net finance costs	(81)	(71)

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

Net interest payable in 2012 was £65m, up from £55m in 2011. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low 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) rose by 0.2% to 0.5%. This increase in floating market interest rates combined with an increase in the Group's average net debt helped drive the Group's higher interest charge. These factors combined with a decrease in interest income on deposits and the impact of new notes issued in 2012 created an increase in the Group's average net interest payable from 6.5% to 7.0%. The Group's average net debt rose by £92m, largely reflecting the acquisition activity during 2012.

Net finance income relating to post-retirement plans was £13m in 2012 compared to £3m in 2011. Also included in the statutory definition of net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. Finance costs for put options and deferred consideration are excluded from adjusted earnings as they relate to future earn outs and similar payments on acquisitions and therefore do not reflect cash expended. Foreign exchange and other gains and losses 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 2012, the total of these items excluded from adjusted earnings was a loss of £29m compared to a loss of £19m in 2011. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2011 the loss relates mainly to foreign exchange differences on a proportion of the unhedged US dollar proceeds from the Interactive Data sale in 2010.

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.

	2012 £m	2011 £m
Cash and cash equivalents	1,062	1,369
Marketable securities	6	9
Net derivative assets	178	174
Bonds	(2,200)	(1,955)
Bank loans and overdrafts	(55)	(78)
Finance leases	(17)	(18)
Net debt – continuing	(1,026)	(499)
Net cash classified as held for sale	108	–
Total net debt	(918)	(499)

Acquisition activity in 2012, is a large contributor to the increase in the Group's net debt. 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 strengthening of sterling against the US dollar during 2012 (from $1.55 to $1.63:£1) decreases the sterling equivalent value of our reported net debt.

Other financial information
continued

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 2012, the Group accessed the capital markets, raising $500m through the sale of notes maturing in May 2022 and bearing interest at 3.75%. The notes were swapped to floating rate to conform with the policy described in note 19.

The Group has a $1,750m committed revolving credit facility which matures in November 2015. At 31 December 2012 this facility was undrawn. The facility is 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 June. At 31 December 2012, 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 2012 was 23.1% as compared to an effective rate of 22.4% in 2011. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 24.5% in 2012 and 26.5% in 2011). These higher tax rates were offset by amortisation-related tax deductions and by prior year adjustments including those arising from settlements with tax authorities.

The reported tax charge on a statutory basis was £148m (34.1%) compared to a charge of £162m (15.5%) in 2011. The increase in the statutory rate is largely due to the lack of tax relief on the loss on closure of Pearson in Practice together with the effect of a low tax charge in 2011 on the gain on disposal of FTSE International.

Tax paid in 2012 was £65m compared to £151m in 2011. The reduction in the 2012 tax paid is largely the result of the permitted deferral of US tax payments into 2013 following Hurricane Sandy.

Discontinued operations

In October 2012, Pearson and Bertelsmann announced an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction is expected to complete in 2013 and, at that point, Pearson will no longer control the Penguin Group of companies but will equity account for its 47% associate interest. The loss of control results in the Penguin business being classified as held for sale on the Pearson balance sheet at 31 December 2012 and the results for both 2011 and 2012 have been included in discontinued operations. Also included in discontinued operations are the costs associated with the formation of the Penguin Random House venture including provision for the settlement of litigation associated with the agency arrangements for ebooks.

Non-controlling interest

There are non-controlling interests in the Group's businesses in South Africa, China and India although none of these are material to the Group numbers.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The loss on translation of £238m in 2012 compares to a loss in 2011 of £44m. The Group is principally exposed to movements in the US dollar as a significant proportion of the Group's operations are based in the US. In 2011 the US dollar strengthened only slightly from an opening rate of £1:$1.57 to a closing rate at the end of that year of £1:$1.55. Other currency movements were relatively more significant in 2011 causing a small loss. In 2012 the US dollar has weakened to close at £1:$1.63 and was the most significant contributor to the increase in the loss.

Also included in other comprehensive income in 2012 is an actuarial loss of £122m in relation to post-retirement plans. This loss arose largely because of unfavourable changes in the discount rate and other assumptions used in the actuarial valuation that offset the effect of continuing asset returns and deficit funding in the UK plan. In 2011 the loss of £64m was also due to discount rate and other assumption changes outweighing improved asset returns and deficit funding.

Dividends

The dividend accounted for in our 2012 financial statements totalling £346m represents the final dividend in respect of 2011 (28.0p) and the interim dividend for 2012 (15.0p). We are proposing a final dividend for 2012 of 30.0p, bringing the total paid and payable in respect of 2012 to 45.0p, a 7% increase on 2011. This final 2012 dividend was approved by the board in February 2013, is subject to approval at the forthcoming AGM and will be charged against 2013 profits. For 2012, the dividend is covered 1.9 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 charge to profit in respect of worldwide pensions and post-retirement benefits for continuing operations amounted to £84m in 2012 (2011: £82m) of which a charge of £97m (2011: £85m) was reported in operating profit and a net benefit of £13m (2011: £3m) was reported against net finance costs. In addition to these amounts, in 2012 a charge of £11m (2011: £11m) has been reported in operating profit in respect of discontinued operations.

The overall surplus on the UK Group plan of £25m at the end of 2011 has become a deficit of £19m at 31 December 2012. The deficit has arisen due to unfavourable movements in the discount rate and other assumptions used to value the liabilities, offset by continuing asset returns and deficit funding. In total, our worldwide deficit in respect of pensions and post-retirement benefits increased from £141m in 2011 to £198m at the end of 2012; this amount includes a deficit of £26m which specifically relates to Penguin and has been classified as a liability held for sale.

Acquisitions

In May 2012, the Professional business acquired Certiport Inc. for $140m. Certiport is based in the US and is a leading provider of certification and assessment programmes in IT and digital literacy. In July 2012, the International Education business completed the purchase of GlobalEnglish Corporation, a leading provider of cloud-based, on demand business English learning, assessment and performance support software for a net cash consideration of $90m. Also in July 2012, Penguin acquired Author Solutions, Inc., the world's leading provider of professional self-publishing services, for $116m in cash. The $650m acquisition of EmbanetCompass by the North American Education business was completed in November 2012. EmbanetCompass partners with leading non-profit colleges in North America to provide online learning solutions for university programmes.

Net cash consideration for all acquisitions made in the year ended 31 December 2012 was £759m and provisional goodwill recognised was £505m. In total, acquisitions completed in the year contributed an additional £45m of sales and £5m of operating profit before acquisition costs and intangible amortisation.

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 remained flat at 9.1% in both 2011 and 2012. The impact of lower cash tax payments in 2012 has been offset by slightly lower profit and increased investment in new acquisitions.

Other financial information
continued

Capital expenditure

Net capital expenditure in the year on property, plant equipment and software amounted to £152m. The analysis of capital expenditure and details of capital commitments are shown in notes 10, 11 and 36 of the financial statements.

Related party transactions

Transactions with related parties are shown in note 37 of the financial statements.

Post balance sheet events

In January 2013, the Group completed the purchase of a 5% equity investment in NOOK Media, LLC for $89.5m. NOOK Media is a new company consisting of Barnes & Noble's digital businesses including its NOOK e-reader and tablets, the NOOK digital bookstore and its 674 college bookstores across America.

In February 2013 the Group completed the purchase of the remaining minority interest in Tutorvista, the Bangalore-based tutoring services company for £17m.

Supplier payment policy

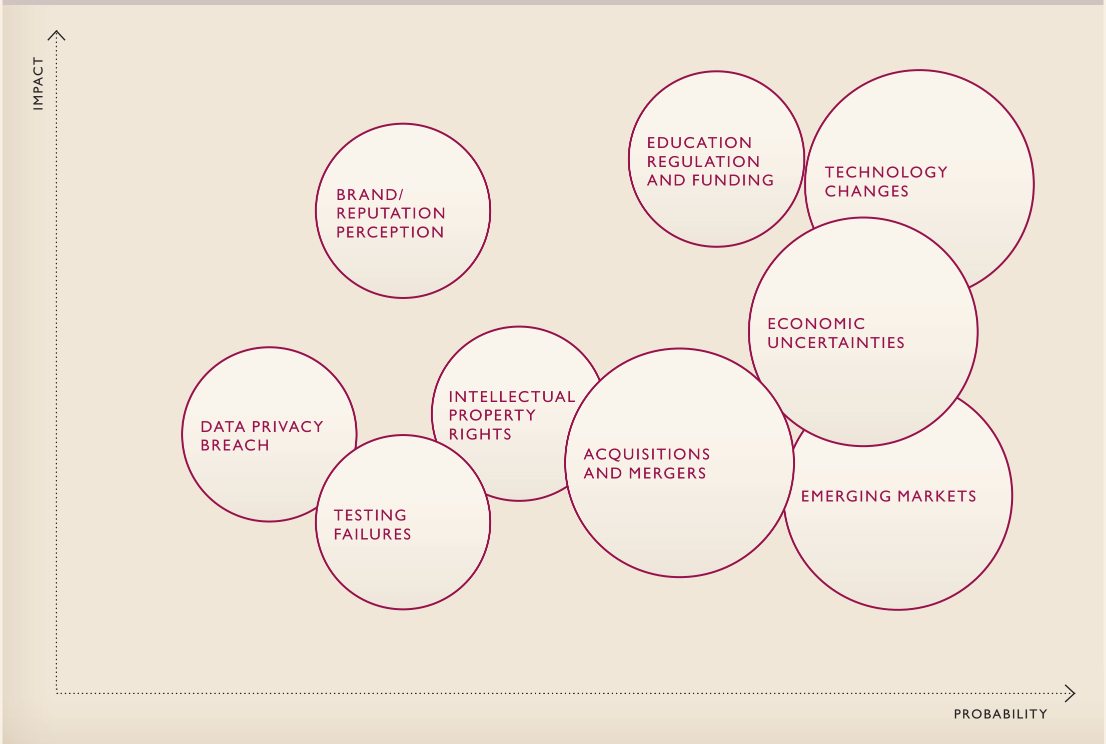
Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. These supplier payment terms vary by operating company, reflecting the different industries and countries in which they operate. It is company policy that suppliers 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 2012 were equivalent to approximately 34 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 higher 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 twice per year, 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 and risk assurance 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.

PRINCIPAL RISKS – IMPACT AND PROBABILITY



Principal risks and uncertainties
continued

Principal risks	Mitigating factors
TECHNOLOGY CHANGES	
Our education, business information and book publishing businesses will be impacted by the rate of and state of technological change, including the digital revolution and other disruptive technologies. We operate in markets which are dependent on Information Technology (IT) systems and technological change.	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 continue to monitor contraction in the consumer book market to minimise the impact of customer bankruptcy. We mitigate IT risks by establishing strong IT policies and operational controls, employing project management techniques to manage new software developments and/or systems 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.
EDUCATION REGULATION AND FUNDING	
Our US educational solutions and assessment businesses and our UK training businesses may be adversely affected by changes in government funding resulting from either general economic conditions, changes in government educational funding, programmes, policy decisions, legislation and/or changes in the procurement processes.	In the US 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. In the UK we maintain relationships with those government departments and agencies that are responsible for policy and funding. We work proactively with them to ensure our education, training and apprenticeship programmes meet existing and new government objectives at the right quality. Changes in the UK government's funding policy for apprenticeships affected the business model for the Pearson in Practice adult training business. As a result, in January 2013 we announced that we will exit this particular business. We will continue to provide training and support for young adults who wish to develop skills and enter the UK workforce through our qualifications and curriculum businesses.
ECONOMIC UNCERTAINTIES	
Global economic conditions may adversely impact our financial performance. A significant deterioration in Group profitability and/or cash flow caused by prolonged economic instability 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. We generate a substantial proportion of our revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuation could adversely affect our earnings and the strength of our balance sheet.	The Group's approach to funding is described on page 27 and the Group's approach to the management of financial risks is set out in note 19 to the financial statements.

Principal risks	Mitigating factors
INTELLECTUAL PROPERTY RIGHTS	
If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit 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. Digital rights management standards and monitoring programmes have been developed. We have a piracy task force to identify weaknesses and remediate breaches. We monitor activities and regulations in each market for developments in copyright/intellectual property law and enforcement and take legal action where necessary.
EMERGING MARKETS	
Our investment into inherently riskier emerging markets is growing and the returns 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 continue to strengthen 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.
DATA PRIVACY BREACH	
Failure to comply with data privacy regulations and standards or weakness in internet security could result in a major data privacy breach causing reputational damage to our brands and financial loss.	Through our global security team 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 pursue appropriate privacy accreditations, e.g., TRUSTe Privacy and Safe Harbor Seal. We regularly monitor regulation changes to assess impact on existing processes and programmes.
TESTING FAILURES	
A control breakdown or service failure in our school assessment businesses could result in financial loss and reputational damage. 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.	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. 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.
ACQUISITIONS AND MERGERS	
Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations could lead to goodwill and intangible asset impairments.	We perform pre-transaction due diligence and closely monitor actual 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 and mergers. In October 2012, we announced an agreement with Bertelsmann to combine our respective consumer publishing businesses in a newly-created venture named Penguin Random House. The combination is subject to customary regulatory and other approvals and is expected to complete in the second half of 2013.
BRAND/REPUTATION PERCEPTION	
Our business depends on a strong brand, and any failure to maintain, protect and enhance our brand would hurt our ability to retain or expand our business.	We mitigate this risk through the development of comprehensive processes to enable our business units to effectively manage relationships with stakeholders, customers, communities and employees. We have an ongoing process to understand and evaluate potential brand threats and monitor and evaluate information about our brand across media sources.

Our impact on society

We believe our commercial goals and our social purpose are mutually reinforcing.

Across many industries, a strong sense of fundamental purpose is a characteristic shared by many leading businesses. Pearson's purpose is to help people make progress in their lives through learning.

This purpose informs and shapes our company strategy and is the starting point of our responsibility framework:

PEARSON'S PURPOSE

Our purpose is to help people make progress in their lives through learning.

OUR FOCUS

In 2010, we defined three key issues as the focus of Pearson's corporate responsibility strategy: literacy, learning outcomes and contributing to competitiveness. These three key issues are where Pearson can make a unique contribution to people's social and economic wellbeing on a global scale.

RESPONSIBLE BUSINESS PRACTICE

Beyond these three issues, we have a wider agenda of responsible business practice. This covers areas such as nurturing and developing talent and diversity, environmental responsibility and supporting the work of the Pearson Foundation.

OUR VALUES

Our approach to ethics and how we behave is grounded by our culture and values – to be brave, imaginative and decent.

We continue to be recognised in external benchmarks as a leader in corporate responsibility – a testament to the commitment and efforts of our people. We were (for a fourth year) ranked gold in the Dow Jones Sustainability Index.

2013 will be a year of considerable change as we merge Penguin with Random House and develop our global education strategy.

Our commitment to helping people make progress in their lives through learning is enduring. However, against that wider backdrop of change, we will ask some key questions about our responsibility framework this year:

- What are the big unmet educational needs which we can help tackle?
- How should we measure and report the educational impact of our products and services?
- Are the three key issues still the right ones for us to focus on?
- What commitments and targets should we set ourselves?

If you have thoughts on these four questions or would like to play a part in helping us find the answers, please let us know and contact our head of corporate responsibility at peter.hughes@pearson.com

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

Overview

We have developed our own responsible business framework to reflect what we do, where we can have the most impact and the expectations that our investors, customers and the people who work at Pearson have of us. It is unique to Pearson. It is also dynamic – we will update the framework to reflect how we change as a company and the views and priorities of our stakeholders.

OUR PURPOSE

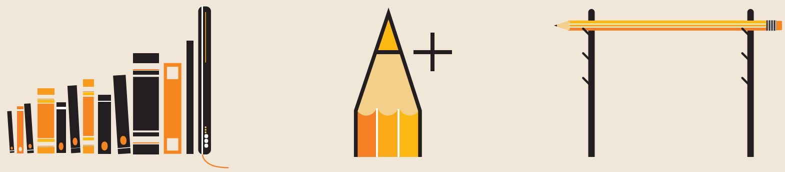
To help people make progress in their lives through learning

ALWAYS LEARNING

OUR FOCUS

Three priority issues where we can make the most difference

1 RAISING LITERACY LEVELS	2 IMPROVING LEARNING OUTCOMES	3 CONTRIBUTING TO COMPETITIVENESS
AT HOME	OUR PROGRAMMES	PERSONAL PROGRESS
IN THE CLASSROOM	CLOSING ACHIEVEMENT GAPS	INFORMED BUSINESS
WITH OUR PARTNERS	SHARING WHAT WORKS	



BUSINESS STRATEGY

- LONG-TERM ORGANIC INVESTMENT IN CONTENT
- DIGITAL PRODUCTS AND SERVICES BUSINESSES
- INTERNATIONAL EXPANSION
- EFFICIENCY

To learn more about our business strategy, visit the Our strategy section, page 06 in this report

RESPONSIBLE BUSINESS PRACTICE

- ENVIRONMENT
- SUPPLY CHAIN MANAGEMENT
- PEOPLE
- OUR CUSTOMERS
- COMMUNITIES

OUR VALUES

BRAVE, IMAGINATIVE, DECENT

Our impact on society continued

1 RAISING LITERACY LEVELS

The economic and social cost of illiteracy is immense – affecting as many as two billion people – it may be as high as one trillion US dollars per year.

Illiteracy is a global challenge affecting both developed and emerging countries. For example, in the UK, 22% of the population are deemed as functionally illiterate, struggling with basic tasks, such as applying for a job by e-mail or reading their child's school report. The cost to the UK alone is estimated at £8 billion a year.

Our approach

Raising literacy levels is one of our three focus areas because:

- Good reading skills are the basic cornerstone essential for people to learn.
- All our businesses depend on the premise that people can read and enjoy doing so.
- Our mix of businesses means that we can make a unique contribution to tackling illiteracy.

We play a part in three main ways:

- Our reading programmes – both print and digital – are found in classrooms the world over.
- For many, the first story that they read or that is read aloud to them will be a Penguin title.
- We partner with others to run projects and campaigns to give books and to inspire reading.

Reading in the classroom

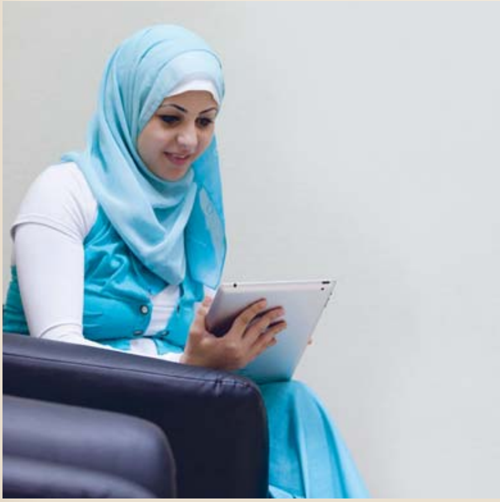
We have a full range of reading programmes designed to help students learn to read. Whether print or online, whole school or for students that need a little extra help, they all share a commitment to improving the reading standards of individual learners.

CASE STUDY

iLit (inspire Literacy)

iLit is the first reading programme built and delivered completely on the iPad. Launched in the United States, it targets readers aged 9 to 16 and supports, rewards and instructs based around the needs of the individual reader. iLit is currently available for readers aged 14 to 16. For more information about iLit and the research evidence that underpins it, visit:

www.redefiningliteracy.com



Reading in the home

Enthusiastic readers are inspired by great stories. Our Penguin books for children – Puffin, Frederick Warne and Ladybird books – all provide plenty of options.

In this digital age, how we read and write may change radically, but the ability to do so is more important than ever. We believe in offering stories that are engaging and fun, regardless of format, for parents and their children to read at home or on the move.

CASE STUDY

Ladybird: I'm ready for phonics app

Giving a child a reading head-start before they start school helps build confident readers. New apps such as Ladybird's 'I'm Ready for Phonics!' gives parents new ways to help prepare a child for synthetic phonics learning at school.

Partnering with others to encourage reading

Tackling illiteracy demands that we work together in an open and collaborative way. We have focused on building partnerships that extend access to books and opportunities for shared reading. Highlights include:

- We gave our eight millionth book under our Booktime programme which sees every child starting school in England and Wales receive a book pack containing two free books to take home and keep.
- We Give Books, the digital reading challenge run by the Pearson Foundation, exceeded 1.5 million books donated to literacy charities around the world as chosen by online readers.
- We gave our one millionth book to Book Aid, the charity that supports the development of libraries in schools and communities in Sub-Saharan Africa. We were the largest book donor to Book Aid in 2012.

2 IMPROVING LEARNING OUTCOMES

Our responsibility as a company is to play our full part in informing, shaping and making learning effective for people of all ages, abilities and locations. This focus on learning outcomes is a critical part of our responsibility vision.

In the past, there were limitations on the extent to which a textbook publisher selling products to education institutions could measure their impact on learning outcomes.

Our strategy is to become an education technology and solutions provider with global reach. As the strategy gathers pace, so do the opportunities to help understand what works best to help students succeed. We recognise that as we become more directly involved in the process of learning, we are more accountable for outcomes.

We have:

- Conducted nearly 50 reviews to assess and improve learning outcomes and trained over 100 people in the process.
- Run a series of events reaching over 1,200 people and presented on our approach at the company senior strategy conference and to the next generation of our leaders.

We will:

- Conduct at least 100 additional reviews to assess the learning outcomes from our programmes and services.
- Make it a precondition of any new investment of US$3m or more that it is assessed for its impact on learning.
- Make a series of commitments around how we will deepen and accelerate our approach to assessing learning outcomes.

Our impact on society continued

CASE STUDY

Pearson Affordable Learning Fund

A global challenge is how we can all ensure that every child can benefit from learning, but with over 60 million children not in school, there is a need for urgent innovation. We believe that low-cost private education is part of the answer and that there is a need to encourage new ideas, models and ways of working. So, we have launched the Pearson Affordable Learning Fund whose purpose is to make minority equity investments in for-profit companies that help meet a burgeoning demand for affordable education services in Africa, Asia and Latin America. The fund launched in July 2012 with $15 million of initial Pearson capital, and made its first investment in a chain of private schools in Ghana. See more at: www.affordable-learning.com

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

Getting a job depends on having relevant skills. As many countries continue to wrestle with the economic, social and personal cost of unemployment, particularly for the young, it is even more important that we help people develop the skills they need 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.
- The 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.

CASE STUDY

Next Generation BTECs

Pearson launched Next Generation BTECs, which meet new regulator and Department for Education criteria to make BTEC the best represented vocational qualification on the new accountability framework for schools in England.

Sharing knowledge and investing in research

Few companies participate in education on a global scale so we have a responsibility to support educational improvement and to actively share our experience on models that work and those that do not.

We have:

- Mapped current research activity and laid the foundation to launch our online research portal.
- Convened a Pearson Executive Research Council bringing together the research professionals within Pearson.
- Launched two publications with international acclaim – The Learning Curve and Oceans of Innovation: www.pearson.com/oceans

We will:

- Invest in research to help advance education as well as inform the products and services we develop.
- Partner with a range of organisations to conduct educational research and promote the dissemination of knowledge.
- Promote open discussion through participating in and convening conferences and events.
- Make research outcomes publicly available via: www.pearson.com/research

CASE STUDY

The Learning Curve

This year, we supported the Economist Intelligence Unit (EIU) in the development of The Learning Curve. The initiative brought together in one place a wide range of data sets designed to enable researchers and policymakers to correlate education outcomes with wider social and economic impact more easily than ever before. As international benchmarking of education systems has become ever more prevalent, the Learning Curve has the potential to add to our understanding of what successful education systems look like and how success can be achieved: thelearningcurve.pearson.com

Contributing to debate

We are committed to playing an active role in helping shape and inform the global debate around education and learning policy.

With the 2015 deadline for achieving the Millennium Development Goals and Education for All Goals fast approaching, it is certainly time to take stock on the role that education has played and should play for the future. We have joined with a range of organisations as an active member of the Global Compact on Learning. Ways we are helping include contributing to developing and agreeing common metrics to measure the success of the Global Compact: www.brookings.edu/learningmetrics

We are active participants in the Global Partnership for Education, having been one of the first companies to join the initiative and make a pledge at its replenishment conference. GPE brings together over 50 developing countries, donor governments, international organisations, the private sector, teachers, and civil society/NGO groups to support developing countries with their education sector plans through financial assistance and technical expertise: www.globalpartnership.org

We also believe that the wider private sector has an important contribution to make in developing education and learning policy. We supported and helped fund in 2012 the Global Business Coalition for Education. The aim is to help focus the wider business community on helping tackle the challenges faced by developing countries to promote learning: http://gbc-education.org/about-us

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.

RESPONSIBLE BUSINESS PRACTICE

Under the current responsible business framework at Pearson, we focus on the three areas where we believe we have a unique opportunity to make a positive impact – literacy, learning outcomes 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 inclusive to those with reading disabilities, 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.

Our impact on society continued

Highlights of our activities in 2012 include:

Environment: Climate change and avoiding deforestation

Climate change remains a focus for us as one of the most serious issues facing the planet. Minimising our own environmental impact is not just the right thing to do; it is fundamental to our future as a sustainable business and helps deliver cost savings.

We continue to be climate neutral, a commitment which focuses the company on carbon reduction.

Pearson is preparing for the introduction of mandatory Greenhouse Gas reporting in 2014. We have just been accredited against the Carbon Trust Standard globally – one of only two companies that currently hold that status.

Our second focus area is forests. As a purchaser of paper and newsprint for our books, magazines and newspapers, security and sustainability of supply are very important to us. We have focused on actively encouraging responsible forest management and being more efficient in how we use paper.

- Pearson was named the 32nd largest purchaser of renewable energy in the United States in the US Environmental Protection Agency Green Power Partnership list. We offset 100% of the electricity we use in North America through the purchase of wind power credits from across the United States and have invested in a project to install solar panels in schools in California. Our UK buildings – where we are responsible for purchasing utilities – are also powered by green electricity.
- Pearson came top in the 2012 Corporate Renewable Energy Index (CREX) produced by Bloomberg New Energy Finance. We were one of 35 global companies to achieve a maximum score of 100%.
- Pearson businesses in the UK and Australia are certified against ISO 14001, the environmental management standard.
- In the US, Pearson facilities are focusing on securing LEED – Leadership in Energy and Environmental Design certification. LEED recognises excellence in the design, construction, and operation of high performance green buildings. Over 800,000 sq ft across six Pearson buildings are LEED certified.
- We now have 2.3MW in on-site renewable energy assets (solar panels and wind) at our facilities.
- Pearson and the FT committed to a $1m three-year rainforest partnership in Colombia. We also continued to invest in Woodland Carbon offsets offered by the Woodland Trust in the UK and in a Nature Conservancy Council forest offset project in the United States.
- The *Financial Times* has reduced the volume of newsprint and magazine papers it uses by over 50% in five years. A key initiative has been to reduce the base weight of the papers used.

CASE STUDY

Tom Delay,

Chief Executive, Carbon Trust

"As only the second organisation ever to achieve global certification to the Carbon Trust Standard – by no means an easy task – Pearson is demonstrating real leadership in how to measure, manage and reduce carbon emissions year-on-year."

CARBON TRUST STANDARD
REDUCING CO2 YEAR ON YEAR

Our customers, our people and our 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. This benefits our customers, suppliers, the people that work at Pearson and the communities in which we operate.

Highlights of our activities in 2012 are:

- Pearson continued with its programme of Student Advisory Boards, providing an opportunity for students to input and influence our strategy in return for mentoring and company internships.
- Building on Pearson operations in the UK becoming accredited against ISO 18001, the international health and safety standard, a two-year project to review and update our global approach to health & safety management was started in 2012.
- Pearson in the US has been included in Working Mother magazine's 100 Best Companies list for its twelfth year.
- The Pearson Diversity Summer Internship Programme won the 'Widening the Talent Pool' category in the Race for Opportunity awards.

- Providing an opportunity for our employees to share in the success of the company through owning a part of it is important to us. Over 37,000 people in 98 countries have the opportunity to acquire and hold Pearson shares through participation in our employee share programmes. 1 in 5 employees participate.
- Pearson, alongside charity partner Booktrust, won a 2012 Lord Mayor's Dragon Award in the education category for the Booktime programme.
- The *Financial Times* seasonal appeal raised $4.89m on behalf of The Global Fund for Children, a charity working to transform the lives of the world's most vulnerable children.

CASE STUDY

The Pearson Foundation

The Pearson Foundation is an independent charity that aims to make a difference by promoting literacy, learning, and great teaching. The Pearson Foundation is the charity partner of choice for Pearson and we are its major funder. Three highlights from the Pearson Foundation year in 2012 were:

- The launch of 'Five Things I've Learned'. The project shares the thoughts of education leaders drawn from decades of real-world experience and insights about learning, teaching, and helping others. Available at www.thefivethings.org
- Read for the Record broke two world records. Nearly 2.4 million people read Lady Bug Girl and the Bug Squad on the same day with almost 400,000 of them reading the book online at www.wegivebooks.org. Read for the Record is run in partnership with the charity Jumpstart.
- BridgeIT, a partnership between the Pearson Foundation and Nokia has reached over 1 million children and their teachers across ten developing and emerging countries. BridgeIT uses mobile phones to deliver professional development materials and educational resources to teachers.

Values, principles and behaviour

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.

Our values are underpinned by our Code of Conduct that covers, among other things, individual conduct, the environment, employees, community and society. We make sure everyone is aware of and understands the code. Once a year, everyone working for Pearson gets a copy from the CEO, either electronically or on paper and is asked to read it. Everyone is asked to confirm that they have read it, understood it and that the company complies with it and, as a further check, it is mandatory for over 2,000 of our most senior people to respond to that request. The code forms a 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.

Pearson has a zero tolerance policy towards bribery and corruption. Our policy introduced in 2011 sets out our standards; we carry out risk assessments and have a network of designated managers across the business responsible for compliance with our policy.

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.

Our impact on society continued

External benchmarks

One way we assess how we are doing as a responsible business is to maintain our position in key indices and benchmarks of social responsibility:

	2012	2011	2010	2009
Dow Jones Sustainability Indexes	Gold class	Gold class and global sector leader		
BITC Corporate Responsibility Index	Platinum (retained)	Platinum	Platinum (retained)	
Inclusion in FTSE4Good	Yes			

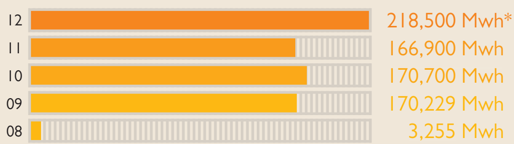
Seven commitments

Last year, we set out seven challenging aspirations and targets to help focus the business on achieving our responsible business vision while minimising our environmental impact. We believe this is a responsible and sustainable approach. We report on our progress against these and other commitments as part of our online Impact on Society report at http://cr2012.pearson.com

ENVIRONMENT

Challenges	Our commitment	How we measure progress
Climate change	1 To maintain our commitment to climate neutrality in 2013. Last year marked our third year of climate neutrality	Through carbon reduction; purchase of renewable energy; renewable energy generation at our sites and the purchase of carbon offsets
Resource use	2 To be ever more efficient in how we use paper as the most significant natural resource for us	We track the total metric tonnes of paper we use and how that compares to revenue. The paper used per £1m of non-digital revenue increased in 2012 reflecting a shift to digital services

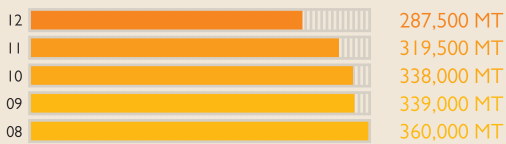
Electricity from renewable sources Mwh



Climate change data is published in April

*100% from renewable sources up from 84% in 2011

Total paper used Metric tonnes



ENVIRONMENT

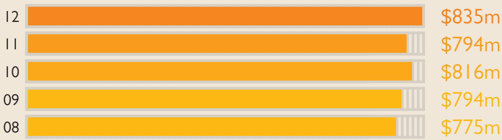
Challenges	Our commitment	How we measure progress
Avoiding global deforestation	**3** To use FSC papers where we can and our own grading system	We track and report the FSC volume we purchase and the grading system we use to meet our requirement to purchase from known, responsible sources

Paper by source %

SOCIAL

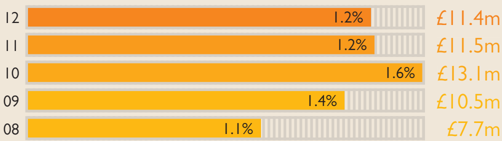
Challenges	Our commitment	How we measure progress
Investing in content	**4** To make sustained investment in new content	Pre-publication expenditure and authors' advances

Investing in content $m



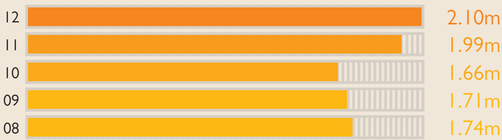
Challenges	Our commitment	How we measure progress
Access to learning, literacy and great teaching	**5** To maintain our total community investment at 1% or more of operating profit	One way we extend our reach is through partnerships with literacy and learning charities. We report on our community investment spend

Community investment spend £m

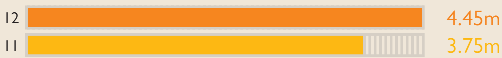


Challenges	Our commitment	How we measure progress
Literacy	**6** Using 2010 as our base, to expand our book gifting activities	Number of books donated to schools, libraries and literacy charities
	7 Growing take-up of digital-based reading	Unlike traditional print programmes, we can track the number of users of our digital reading programmes

Number of books donated Millions



Reading programmes Users million



Board of directors

Pearson's board brings a wide range of experience, skills and backgrounds.

CHAIRMAN

Glen Moreno Chairman
aged 69, appointed 1 October 2005

Chairman of the nomination committee and member of the remuneration committee

Glen has more than three decades of experience in business and finance, and is currently deputy chairman of The Financial Reporting Council Limited in the UK and non-executive director of Fidelity International Limited. Previously, Glen was deputy chairman and senior independent director at Lloyds Banking Group plc, 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 British banks.

EXECUTIVE DIRECTORS

John Fallon Chief executive
aged 50, appointed 3 October 2012

Member of the nomination committee

John became Pearson's chief executive on 1 January 2013. Since 2008 he had been responsible for the company's education businesses outside North America, and a member of the Pearson management committee. He joined Pearson in 1997 as director of communications and was appointed president of Pearson Inc., a role he combined with his communications responsibilities, in 2000. In 2003, he was appointed CEO of Pearson's educational publishing businesses for Europe, Middle East & Africa (EMA) and gradually took on a broader international education brief. Prior to joining Pearson, John was director of corporate affairs at Powergen plc, where he was also a member of the company's executive committee. Earlier in his career, John held senior public policy and communications roles in UK local government.

Will Ethridge Chief executive, Pearson North American Education
aged 61, appointed 1 May 2008

Will has three decades of experience in education and educational publishing, including a decade and a half at Pearson where he formerly headed our Higher Education, International and Professional Publishing business. Prior to joining Pearson in 1998, Will was a senior executive at Prentice Hall and Addison-Wesley, and before that an editor at Little, Brown and Co. where he published in the fields of economics and politics. Will is a board member and former chairman of the Association of American Publishers (AAP) and board chairman of CourseSmart, a consortium of electronic textbook publishers.

Rona Fairhead Chairman of the Financial Times Group
aged 51, appointed 1 June 2002

Rona, who has headed the Financial Times Group since 2006 and is a former finance director of Pearson, will step down from the Pearson board and leave the company at the annual general meeting in April 2013. She previously held senior management roles at specialty chemicals company ICI plc, and in aerospace with Bombardier/Shorts. She has an MBA from Harvard Business School. Rona currently serves as non-executive director of The Cabinet Office of UK government and of HSBC Holdings plc, where she chairs the risk committee. She is also a member of the Cambridge University Library Visiting Committee. She was made a Commander of the British Empire in 2012.

Robin Freestone Chief financial officer
aged 54, appointed 12 June 2006

Robin's experience in management and accounting includes a previous role as group financial controller of Amersham plc (now part of General Electric) and senior financial positions with ICI plc, Zeneca and Henkel UK. He joined Pearson in 2004 as deputy chief financial officer and became chief financial officer in June 2006. Robin qualified as a chartered accountant with Touche Ross (now Deloitte), and is currently a non-executive director and founder shareholder of eChem Limited. Robin sits on the Advisory Group of the ICAEW's Financial Reporting Faculty and is chairman of The Hundred Group of Finance Directors.

John Makinson Chairman and chief executive of The Penguin Group
aged 58, appointed 15 March 1996

John's diverse background spans business, consultancy, financial journalism and publishing. He was finance director of Pearson before heading Penguin, and previously served as managing director of the *Financial Times* newspaper, where he had earlier served as editor of the popular Lex column. John co-founded Makinson Cowell, an international financial consultancy, and was vice chairman of the US holding company of advertising firm Saatchi & Saatchi. John is chairman of the National Theatre and has been named chairman-designate of Penguin Random House, the consumer publishing venture planned by Pearson and Bertelsmann.

OVERVIEW
OUR PERFORMANCE
OUR IMPACT ON SOCIETY
GOVERNANCE
FINANCIAL STATEMENTS

Board of directors
continued

NON-EXECUTIVE DIRECTORS

David Arculus Non-executive director
aged 66, appointed 28 February 2006

Chairman of the remuneration committee and member of the audit and nomination committees

David has experience in banking, telecommunications and publishing in a long career in business. Currently he is chairman of Aldermore Bank plc, Numis Corporation plc and the Advisory Board of the British Library. David's previous roles include the chairmanship of O_2 plc, Severn Trent plc and IPC Group, as well as chief operating officer of United Business Media plc, group managing director of EMAP plc and a non-executive director of Telefonica S.A. David served from 2002 to 2006 as chairman of the British government's Better Regulation Task Force, which worked on reducing burdens on business.

Vivienne Cox Senior independent director
aged 53, appointed 1 January 2012

Member of the audit, remuneration and nomination committees

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years, in Britain and continental Europe, in posts including executive vice president and chief executive of BP's Gas, Power & Renewables business and its Alternative Energy unit. She is non-executive director of mining company Rio Tinto plc, energy company BG Group plc, and Vallourec, which supplies tubular systems for the energy industry. She is also lead independent director at the UK Department for International Development. Vivienne sits on the board of INSEAD and is a commissioner of the Airports Commission, which was set up by the UK government to examine any requirements for additional UK airport capacity.

Susan Fuhrman Non-executive director
aged 68, appointed 27 July 2004

Member of the audit and nomination committees

Susan's extensive experience in education includes her current role as president of Teachers College at Columbia University, America's oldest and largest graduate school of education. She is president of the National Academy of Education, and 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.

Ken Hydon Non-executive director
aged 68, appointed 28 February 2006

Chairman of the audit committee and member of the remuneration and nomination committees

Ken's experience in finance and business includes roles in electronics, consumer products and healthcare. He is a non-executive director of Reckitt Benckiser Group plc, one of the world's leading manufacturers and marketers of branded products in household cleaning and health and personal care. From 2004 to 2013 he was a non-executive director of Tesco plc. Previously, Ken was chief financial officer of Vodafone Group plc and financial director of subsidiaries of Racal Electronics.

Josh Lewis Non-executive director
aged 50, appointed 1 March 2011

Member of the audit and nomination committees

Josh's experience spans finance, education and the development of digital enterprises. He is founder of Salmon River Capital LLC, a New York-based private equity/venture capital firm focused on technology-enabled businesses in education, financial services and other sectors. Over a 25 year career in active, principal investing, he has been involved in a broad range of successful companies, including several pioneering enterprises in the education sector.
In addition, he has long been active in the non-profit education sector, with associations including New Leaders, New Classrooms, and the Bill & Melinda Gates Foundation.
He is also a non-executive director of eVestment and Axioma, both financial technology companies, Parchment, an education data company, and PeriGen, a healthcare information technology provider.

Chairman's letter

Dear shareholders

This year, we are reporting, as is required, against the 2010 edition of the UK Corporate Governance Code (the Code). We have endeavoured, where possible, to report in the spirit of the 2012 Code which will only apply for reporting periods beginning on or after 1 October 2012.

As I have highlighted elsewhere within this report, Pearson is currently undergoing a period of transition in its leadership following the appointment of John Fallon as our new chief executive, and I would like to take this opportunity to share with you further details of the recent and forthcoming changes to our board as well as providing an insight into how the board operates.

The Pearson board consists of senior executive management alongside a strong group of non-executive directors drawn from successful international businesses and education institutions with experience of corporate strategy, education, consumer marketing and technology.

We are continually assessing and refreshing the board to ensure we maintain an appropriate balance and diversity of skills and experience.

In addition to Marjorie Scardino's departure as chief executive, at the end of 2012 we also said goodbye to Patrick Cescau, who served on the board for over ten years, including three years as our senior independent director. The board joins me in thanking Patrick for his commitment and invaluable contribution to Pearson as we have navigated our international expansion.

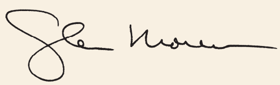
Following Patrick's departure, we are pleased to confirm that Vivienne Cox has been appointed as senior independent director. We welcome Vivienne to the role and believe that her broad commercial knowledge and experience both as an executive and non-executive director make her highly suitable for this position.

As announced late last year, Rona Fairhead will be stepping down from the board, and from her role as chairman of The Financial Times Group, to pursue other opportunities. Rona handed over her responsibilities as chief executive of the FT to John Ridding at the end of 2012. Rona has played an important role during her 12-year career at Pearson having held a number of senior roles within the group, and we wish her continued success in the next phase of her career.

Pearson has a wealth of talent within its workforce with a diverse and experienced senior management team heading the company's operations. To complement our strong management structure, we believe that the most effective board is one which maximises the contributions of non-executive directors, adding a wide range of valuable external perspectives and encouraging robust, open debate over significant business issues. Our goal is to improve the balance of independent non-executive directors on the board, while retaining an overall board size which is manageable and effective. To this end, we are actively seeking additional non-executive directors who bring expertise in education, emerging markets and digital technologies to continue to drive our strategy and vision, whilst ensuring the board adheres to Pearson's core values. We are keen to maintain the gender diversity of the board in light of recent and forthcoming departures and, consequently, the nomination committee is actively seeking to identify suitable female candidates.

The board is deeply engaged in developing and measuring the company's long-term strategy, performance and value. We organise our work around four major themes where we believe the board can add value: governance, strategy, business performance and people. Our board calendar and agenda provide ample time to focus on these themes and we have set out some examples of the business considered by the board, as well as the governance practices to which we adhere, on the pages that follow.

We hope this report clearly sets out how your company is run, and how we align governance and our board agenda with the strategic direction of Pearson. We always welcome questions or comments from shareholders, either via our website (www.pearson.com) or in person at our annual shareholders' meeting.



Glen Moreno Chairman

Board governance

Corporate governance

Introduction

The board believes that during 2012 the company was in full compliance with the UK Corporate Governance Code (the Code). A detailed account of the provisions of the Code can be found on the FRC's website at www.frc.org.uk and we encourage readers to view our compliance schedule on the company website at www.pearson.com/investors/shareholder-information/governance

The board embraces the Code's underlying principles with regard to board balance and diversity and the nomination committee, led by the chairman, is actively seeking additional suitable candidates who possess the right mix of knowledge, skills and experience to enhance debate and decision-making.

Composition of the board

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

As reported, Rona Fairhead will step down from the board at the forthcoming AGM. Additionally, subject to completion of the Penguin Random House venture, John Makinson will be appointed as chairman of Penguin Random House and it is intended that he will step down from the Pearson board at that time.

Chairman and chief executive

There is a defined split of responsibilities between the chairman and the chief executive. The chairman is primarily responsible for the leadership of the board and ensuring its effectiveness; the chief executive is responsible for the operational management of the business and for the development and implementation of the company's strategy as agreed by the board. The roles and responsibilities of the chairman and chief executive are clearly defined, set out in writing and reviewed and agreed by the board annually.

Chairman

In May 2012, Glen Moreno stood down from his role as deputy chairman and senior independent director of Lloyds Banking Group. Apart from this, there were no changes to the chairman's significant commitments during the course of 2012.

Senior independent director

Vivienne Cox is the company's senior independent director, having been appointed to the role on 1 January 2013 following Patrick Cescau's resignation from the board.

Vivienne's role will include meeting regularly with the chairman and chief executive to discuss specific issues, e.g. strategy, attending meetings with major shareholders to understand any issues or concerns they may have, as well as being available to shareholders generally if they should have concerns that have not been addressed through the normal channels. In her first year with Pearson, Vivienne has been instrumental in the introduction of the board's reputation and responsibility committee, which she chairs, and in improving the quality of health and safety reporting to the board.

During 2012, Patrick Cescau held separate sessions with the other non-executive directors and the chief executive to appraise the performance of the chairman, including in relation to the effectiveness of the nomination committee. Following his departure in December, Patrick was invited back in February 2013 to conduct similar sessions in respect of the chairman's performance during 2012 as part of the annual board evaluation process. Vivienne, as senior independent director, will then take responsibility for appraising the chairman's performance during 2013 and beyond.

The senior independent director would be expected to chair the nomination committee in the event that it was considering succession to the role of chairman of the board.

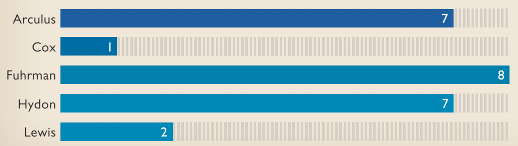
Independence of directors

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 2012.

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 in order to ensure that there are no relationships or circumstances likely to affect their character or judgement.

Susan Fuhrman has now served on the board for more than eight years. Throughout that time, Susan, as a leader in educational reform and efficacy, has made a very positive contribution to our board and committee work. Susan has indicated that she intends to stand down from the board at the 2014 AGM.

Length of tenure of non-executive directors Years



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. The company's Articles of Association (Articles) 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, or relationships with, companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Once notified to the chairman or company secretary, such conflicts are considered for authorisation by the board at its next scheduled meeting. 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 held six scheduled meetings in 2012, with some meetings taking place over two or more days. 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 2012 the major items covered by the board included:

BUSINESS PERFORMANCE: 23 FEBRUARY 2012, LONDON

- 2011 report and accounts and dividend recommendation
- 2012 operating plan
- Risk assessment and review of mitigating actions
- Annual review of authorised conflicts
- Review of division of responsibilities between chairman and chief executive
- Review of treasury policy
- Presentation by Sir Michael Barber on efficacy, research and educational reform

GOVERNANCE AND SHAREHOLDER MATTERS: 26 AND 27 APRIL 2012, LONDON

- Focus on forthcoming AGM and review of shareholder issues
- Findings of external report on shareholders' views
- Review of corporate social responsibility
- Board effectiveness review
- Acquisition of Certiport
- Acquisition of Global English

STRATEGY: 4, 5 AND 6 JUNE 2012, SÃO PAULO

- Strategy discussions – review of Brazilian education business
- Review of Pearson's 'Leading on Standards' publication on the future of examinations in Britain
- Acquisition of Author Solutions, Inc.

BUSINESS PERFORMANCE: 25 AND 26 JULY 2012, LONDON

- Interim results and dividend approval
- Post-acquisition reviews
- Discussion on formation of reputation and responsibility committee
- Acquisition of Inframation Group

STRATEGY: 4 OCTOBER 2012, LONDON

- Trading update
- Five-year strategic plan
- Review of standing committee terms of reference
- Acquisition of EmbanetCompass
- Discussion of Penguin Random House venture
- John Fallon's first meeting following his appointment to the board

STRATEGIC PLAN: 6 DECEMBER 2012, NEW YORK

- Strategic plan – India business
- Options for Pearson in Practice business
- Risk assessment and review of mitigating actions
- Triennial valuation of UK defined benefit pension fund
- Annual review of chief executive authorisation limits and procedures
- Review of chief executive transition

In addition to the six scheduled meetings, the board held one further full meeting to approve the Penguin Random House venture and undertook discussions as required to consider the terms of corporate transactions.

Board governance continued

The following table sets out the attendance of the company's directors at board and committee meetings during 2012:

	Board meetings (max 6)	Audit committee meetings (max 4)	Rem. committee meetings (max 6)	Nom. committee meetings (max 6)
Chairman				
Glen Moreno	6	–	6	6
Executive directors				
Marjorie Scardino	6	–	–	6
Will Ethridge	6	–	–	–
John Fallon*	2	–	–	–
Rona Fairhead	5	–	–	–
Robin Freestone	6	–	–	–
John Makinson	6	–	–	–
Non-executive directors				
David Arculus	6	4	6	6
Patrick Cescau**	6	2	3	6
Vivienne Cox	5	4	5	5
Susan Fuhrman	6	4	–	6
Ken Hydon	6	4	6	6
Josh Lewis	6	4	–	6

*appointed to the board on 3 October 2012.

**stood down from audit and remuneration committees on 30 April 2012.

The role and business of the board

The board is deeply engaged in developing and measuring the company's long-term strategy, performance and value. We believe that it adds a valuable and diverse set of external perspectives and that robust, open debate about significant business issues brings a valuable additional discipline to major decisions.

A schedule of formal matters reserved for the board's decision and approval is available on our website, at www.pearson.com/investors/shareholder-information/governance

A standing committee of the board has been established to approve certain ordinary course of business items such as banking matters, guarantees, intra-group transactions and employee share plan matters. The committee has written terms of reference, reviewed and approved annually, which clearly set out its authority and duties. These can be found on the company website at www.pearson.com/investors/shareholder-information/governance

The board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive board papers are circulated to the board and committee members at least one week in advance of each meeting and the board receives monthly reports from the chief executive. In addition to meeting papers, a library of current and historic corporate information is made available to directors electronically to support the board's decision-making process. 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.

Non-executive directors meet with local senior management every time board and committee meetings are held at the locations of operating companies. This allows the non-executive directors to share their experience and expertise with senior managers and also enables the non-executive directors to better understand the abilities of senior management, which in turn will help them assess the company's prospects and plans for succession.

Succession planning

The board views succession planning – not only at board and executive committee level but for all key positions throughout the business – as one of its prime responsibilities. This is especially the case in a creative business like Pearson which is heavily dependent on talented people.

It is our intention to devote one full meeting each year to organisation structure and succession planning, and how they support the delivery of our strategic goals. During 2012, the board's succession planning activities focused on the role of chief executive. In a typical year however, we look in detail at 20 to 30 of the most senior roles in Pearson, ensuring that there are several credible candidates for each role. Those candidates will be well known to the board – who spend considerable time visiting our businesses and people outside the regular schedule of board meetings – and will have development plans in place to round out their experience and skills and give them every possible chance of progressing their careers.

Board evaluation

The board conducts an annual review of its effectiveness. For the review of 2011, conducted during the early part of 2012, the chairman met with each of the directors, executive and non-executive, on a one-to-one basis to discuss the board's effectiveness and progress made against objectives. He also took the opportunity to discuss with each director their individual training and development needs.

Following that review, the chairman presented his findings at the April 2012 board meeting. He noted that from his one-to-one sessions with each of the directors he was able to conclude that the board members believe that they work well together, that the board culture is good, that they add value as a board, focus on the right things and that they have a good mix of both people and skills. He also detailed how the board might improve its effectiveness, and explained that a common theme in his discussions related to the board's understanding of reputational and other risks.

Following that review the senior management team was tasked with thinking about how the board might gain a deeper understanding of the reputational risks that affect the business, and later in the year, as a direct result of their recommendation, the board formed the reputation and responsibility committee. The purpose of this committee is to have oversight of Pearson's strategy and our plans to build and protect our corporate reputation, and the reputation of our major brands. The committee membership includes two non-executive directors, the chief executive and the director of communications; it reports regularly to the board and meets on a quarterly basis. The committee held its first meeting in December 2012, and the agenda for that meeting included a consideration of Pearson's major reputational risks, and a focus on the public affairs team in North America.

During the course of the year the executive directors were also evaluated by the chief executive on their performance against personal objectives under the company's appraisal mechanism. A proportion (which for 2012 may be up to 20%) of the total annual incentive opportunity is based on functional, operational, strategic and non-financial objectives relevant to the executives' specific area of responsibility. The chairman leads the assessment of the chief executive and the non-executive directors, led by the senior independent director, conduct a review of the chairman's performance.

In addition to the review of the board and individual directors, the audit and remuneration committees each undergo an annual evaluation process to review their performance and effectiveness. The process covers areas such as roles and responsibilities, quality and timeliness of meeting materials, opportunity for discussion and debate, dialogue with management and access to independent advice.

For the board effectiveness review of 2012, the chairman is planning to spend time with the senior independent director talking about their plans for the board in terms of structure and focus for the coming year as well as reviewing the previous board evaluation to ensure that recommendations have been followed through. They will also start to plan a more structured, external evaluation of 2013.

Last year, we reported that the board's evaluation process had highlighted a need to deepen the board's knowledge of emerging markets. Building on this, the board visited Brazil in 2012 to learn first hand about the Group's Latin American operations and strategy.

CASE STUDY

Brazil

In June 2012, the Pearson board held a three day meeting in São Paulo, Brazil. The purpose of this board meeting was to review our businesses in Brazil, and to better understand the opportunities in the Latin American education market. During their three day stay, the board met with key local management of all our businesses operating in Brazil, including the recently acquired Companhia das Letras business (Pearson acquired 45% in January 2012), as well as with senior executives and the regional heads of Pearson's Latin America operation.
The board also met with former President Lula to discuss Brazilian education policy. Whilst in Brazil, the board visited a school to learn first-hand about the benefits of the Brazilian sistema method of education, and a university where an interactive panel session was held involving university professors, business students and certain board members. During 2013 the board plans to have similar meetings with local businesses in South Africa and the US.

Board governance continued

Directors' training and induction

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.

The directors' training is supplemented with presentations 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. The company secretary monitors developments in governance and directors' fiduciary duties and updates the board on such matters as agreed with the chairman. Directors can also make use of external courses.

Directors' indemnities

In accordance with section 232 of 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 monies are repaid not later than when the outcome becomes final if: (i) they are convicted in the proceedings; (ii) judgment 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.

Shareholder engagement

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

In 2012, we continued with our shareholder outreach programme, seeing approximately 650 institutional and private investors at more than 350 different institutions in Australia, Canada, China, Continental Europe, Japan, Malaysia, Singapore, South Korea, the UK and the US.

There are five trading updates each year and the chief executive and chief financial officer present our preliminary and interim results updates. They also attend regular meetings throughout the year with investors both in the UK and around the world, tailored to investor requirements, to discuss the performance of the company, the company's strategy, structural changes in our markets and risks and opportunities for the future.

The chairman meets regularly with significant shareholders to understand any issues and concerns they may have. This is in accordance with both the Code and the UK Stewardship Code. The non-executive directors meet informally with shareholders both before and after the AGM and respond to shareholder queries and requests as necessary. The chairman ensures that the board is kept informed of principal investors' and advisers' views on strategy and corporate governance.

We also 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

Private investors represent over 80% of the shareholders on our register and we make a concerted effort to engage with them regularly. Shareholders who cannot attend the AGM are invited to email questions to the chairman in advance at glenmoreno-agm@pearson.com

We encourage our private shareholders to become more informed investors and have provided a wealth of information on our website about managing Pearson shareholdings, see www.pearson.com/investors/shareholder-information for further information, or turn to p181 of this report. We also encourage all shareholders, who have not already done so, to register their email addresses through our website and with our registrar. This enables them to receive email alerts when trading updates and other important announcements are added to our website.

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

We are committed to ensuring that all our shareholders receive their dividends and during 2012 we informed any shareholder who had outstanding unclaimed dividends of the amounts owed to them and how they could claim these. To this end, during the year, we also reminded shareholders of our dividend mandate service which enables UK and many overseas shareholders to receive dividends directly into their nominated bank account, and we invite any shareholders who have not yet done so to consider using this method for dividend payments.

We recently provided shareholders with smaller holdings the opportunity to use our registrar's low-cost share dealing service, giving them the chance to add to or reduce their stake in Pearson at significantly reduced dealing rates, or to donate shares to charity with ease. This service proved very popular with shareholders, and consequently we intend to offer this service again at a future date.

We believe it is important that our employees have a shared interest in the direction and achievements of Pearson and are pleased to say that a large number of our employees are shareholders in the company.

Our AGM – which will be held on 26 April this year – is an opportunity for all shareholders to meet the board and to hear presentations about Pearson's businesses and results.

Board committees

The board has established three formal 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.

In addition to these board committees, three further committees operate with board input: the Pearson management committee (PMC), the standing committee and the recently-established reputation and responsibility committee.

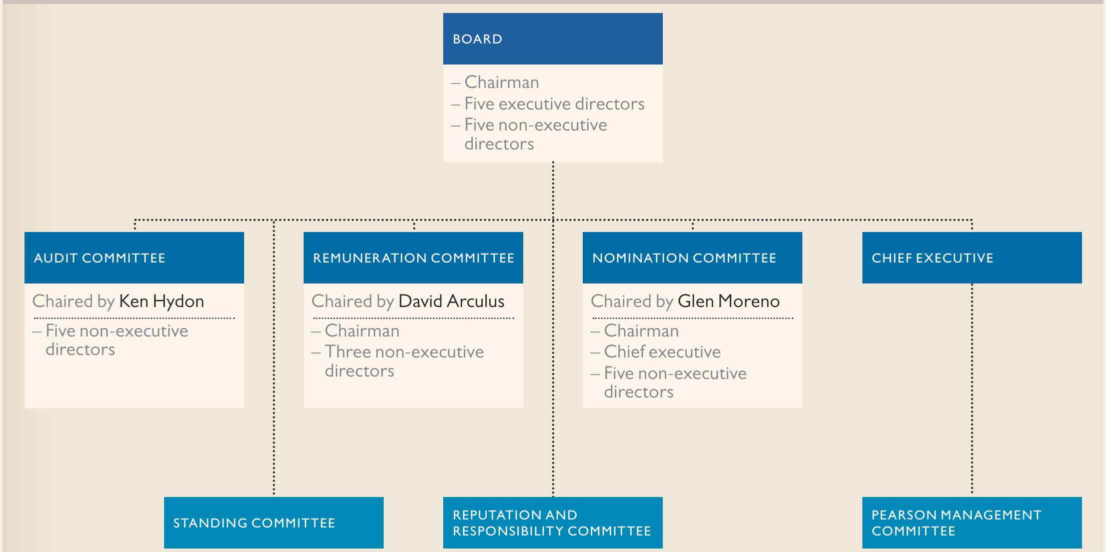
NOMINATION COMMITTEE

Chairman Glen Moreno

Members David Arculus, Vivienne Cox, John Fallon, Susan Fuhrman, Ken Hydon, Josh Lewis and Glen Moreno

The nomination committee meets at least once a year and 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.

BOARD AND COMMITTEE FRAMEWORK



The schedule of matters reserved for the board and the terms of reference of the audit, remuneration, nomination and standing committees are available at www.pearson.com/investors/shareholder-information/governance

Board governance continued

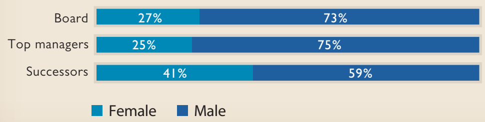
During 2012, the committee's primary focus was the appointment of Pearson's new chief executive following Marjorie Scardino's decision to step down at the end of 2012, and consequently the committee met six times during the course of the year. At its February meeting, the committee reviewed succession planning for non-executive and executive board positions and senior management, as well as board committee membership.

The committee ensures that the directors of Pearson demonstrate a broad balance of skills, experience, independence, knowledge and diversity (including gender diversity). There are currently three female directors on the board, one of whom is an executive director. The committee and the board always take account of diversity when considering board appointments and will continue to do so, whilst ensuring that appointments are made based on merit and relevant experience.

The plan for 2013 is to continue to develop programmes and relationships that help attract talented diverse people into our business and retain them and to continue to track our progress. In particular, Pearson intends to commence work on a comprehensive gender diversity strategy, and to develop a global diversity strategy focusing on the key emerging markets of India, China and Brazil.

Pearson continues to show evidence of progress in relation to the retention of people with diverse backgrounds for both entry level and management positions and has made significant progress over the years in advancing women and culturally diverse people. As at December 2012, 25% of Pearson's top managers were women, and 41% of successors for such roles were female, including an increasing number of business leaders as well as functional roles such as HR and finance, ensuring that the pipeline of talented women within Pearson remains strong. To support this pipeline, a diversity toolkit for managers was launched in the UK, to provide managers with advice and guidance on developing their diversity management skills. We hope to launch a US version during 2013.

Gender balance %



Whilst the chairman of the board chairs the nomination committee, he is not permitted to chair meetings when the appointment of his successor is being considered or during a discussion regarding his performance. At such times, the senior independent director will chair the meetings.

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

REMUNERATION COMMITTEE

Chairman David Arculus

Members David Arculus, Vivienne Cox, Ken Hydon and Glen Moreno

The remuneration committee reports to the full board and a letter from the chairman of the remuneration committee and its report on directors' remuneration, which has been considered and adopted by the board, is set out on pages 64 to 92.

The committee met six 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

AUDIT COMMITTEE

Chairman Ken Hydon

Members David Arculus, Vivienne Cox, Susan Fuhrman, Ken Hydon and Josh Lewis

As I described last year, in my role as audit committee chairman, I consider the key role of the committee to be in providing oversight and reassurance to the board, specifically with regard to the integrity of the company's financial reporting, accounting policies, risk management and internal control processes and governance framework.

Fundamental to this role is the committee's access to local management. Once again, committee meetings have been attended by the chief financial officer and head of Group internal audit and risk assurance, and often by the chief executive and chairman. Individual managers have joined meetings for specific topics, e.g. treasury, tax or business continuity planning. In total, 16 managers attended one or more meetings during the year. During the board's visit to São Paulo, members of the committee met with local senior financial management to discuss risk management, financial control and the Pearson code of conduct. In July, the committee met with the company's chief information officer and director of digital strategy to discuss the approach taken to data protection. Finally, in December, in its first 'risk deep-dive' session aimed at making the risk review process more tangible, the committee met with the president of the US assessment and information group to discuss risks and mitigation strategy related to the testing and assessment business. This approach worked well, and I am keen that the committee holds additional sessions in 2013 focusing on key risks within Pearson, as well as continuing to meet local management throughout the year and whenever the board is scheduled to meet in overseas locations.

The committee has a healthy interaction with group internal audit and PwC, who attend all of our regular committee meetings. Again, I see this as fundamental to the role of the committee and to my position as chairman.

We always need to be learning, as the business progresses and the environments in which we operate change.

Ken Hydon

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 have 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 Reckitt Benckiser Group plc, and until recently for Tesco plc and Royal Berkshire NHS Foundation Trust.

The qualifications and relevant experience of the other committee members are detailed on page 46.

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 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 pages 59 and 60), and ensures that there is an appropriate audit relationship and that auditor objectivity and independence is upheld.

Board governance continued

External audit

Based on management's recommendations, the committee reviews the proposal on the appointment of the external auditors. The committee reviewed the effectiveness and independence of the external auditors during 2012 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 five years and consequently will rotate following completion of the Group's 2012 year end audit.

In accordance with our external auditor policy, Group internal audit performs an annual assessment of audit fees, services and independence. This review forms the basis for a recommendation by the committee to the board in respect of the appointment and compensation of our external auditor. Having previously conducted a full tender exercise in 1996, and considered re-tendering in subsequent years, we intend to give consideration during 2013 to the timing of our next formal tender, mindful of the 2012 Code requirement to undertake a formal tendering process at least once every ten years.

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

At the July 2012 audit committee meeting, the committee discussed and approved the auditors' group audit plan and identified the following key risks of misstatement of the Group's financial statements, which were updated at the December 2012 committee meeting:

› Revenue recognition, in light of a number of products and services sold by Pearson where revenue recognition practices are complex and management assumptions and estimates are necessary;
› Accounting for acquisitions in light of material transactions in 2011 and 2012, in particular, valuation of acquired intangibles which involves significant judgement; and
› Disposal accounting, in particular relating to proposed Penguin Random House venture.

The committee discussed these issues with the auditors at the time of their review of the half year interim financial statements in July 2012 and again at the conclusion of their audit of the financial statements for the year in February 2013. In December 2012, 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 and calculations (encompassing provisions for doubtful debts and inventory, recoverability of pre-publication assets and authors' advances, reserves for sales returns, estimates of current and deferred tax and pension liabilities and other contingencies) and how they had satisfied themselves that these were reasonable;
› The impact of the board's decision on the future options for the Pearson in Practice business;
› The results of their review of the impairment model, including their challenge of management's underlying cash flow projections and consideration of key assumptions such as discount rates and perpetuity rates and sensitivities, which indicated that all cash-generating units had adequate headroom;
› The results of their controls testing to date for Sarbanes-Oxley Act section 404 reporting purposes and in support of their financial statements audit; and
› The review of the company's 'going concern' reports.

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

Training

The committee receives regular technical updates as well as specific or personal training as appropriate. During 2012, two committee members took advantage of a personal training session provided by PwC.

Committee members also meet with local management on an ongoing basis in order to gain a better understanding of how Group policies are embedded in operations. For example, during its visit to São Paulo in June 2012, the committee met with local senior finance managers.

Meetings

The committee met four times during the year with the following in attendance: the chief financial officer; head of Group internal audit and risk assurance; members of the senior management team; and the external auditors. The committee also met regularly in private with the external auditors and the head of Group internal audit and risk assurance.

At every meeting, the committee considered reports on the activities of the Group 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 2011 annual report and accounts: preliminary announcement, financial statements and income statement;
- The Group accounting policies;
- Compliance with the UK Corporate Governance Code;
- Form 20-F and related disclosures including the annual Sarbanes-Oxley Act section 404 attestation of financial reporting internal controls;
- Receipt of the external auditors' report on the Form 20-F and on the year end audit;
- Assessment of the effectiveness of the Group's internal control environment;
- Reappointment, remuneration and engagement letter of the external auditors;
- Provision of non-audit services by PwC; Review of the interim financial statements and announcement;
- Annual re-approval of the Group internal audit mandate;
- Compliance with SEC and NYSE requirements including Sarbanes-Oxley Act;
- Reviews of the effectiveness of the audit committee, the external auditors and the Group internal audit function;
- Pearson's anti-corruption programme;
- Pearson's data protection programme;
- Review of the committee's terms of reference;
- Annual internal audit plan;
- Risk deep-dive: testing and assessment business;
- Review of company risk returns including Social, Ethical and Environmental (SEE) risks;
- Group tax strategy review; and
- Annual review of treasury policy.

In February 2013, the committee also considered the 2012 annual report and accounts, including the preliminary announcement, financial statements, business review, directors' report and corporate governance compliance statement.

Internal control and risk management

The directors confirm they have conducted a review of the effectiveness of the group's systems of risk management and internal controls, including strategic, financial, operational and compliance controls and risk management systems, in accordance with the UK Corporate Governance Code and the Turnbull guidance as revised. These systems have been operating throughout the year and to the date of this report.

The key elements and procedures that have been established to provide effective risk management and internal control systems are described below:

Control environment

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

Responsibility for monitoring financial management and reporting and risk management and internal control systems has been delegated to the audit committee by the board. At each meeting, the audit committee considers reports from management, Group internal audit and the external auditors, with the aim of reviewing the effectiveness of the internal financial and operating control environment of the Group.

The identification and mitigation of significant 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, business environment and risk assessment,

Board governance continued

whilst complying with Group policies, standards and guidelines.

Financial management and 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, capital expenditures 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.

We have an ongoing process to monitor the risks and effectiveness of controls in relation to the financial reporting and consolidation process including the related information systems. 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 processes are monitored and assessed during the year by the Group internal audit and Group compliance functions.

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.

The effectiveness of key financial controls is subject to management review and self certification and independent evaluation by Group internal audit.

A risk management framework is in place to identify, evaluate and manage risks, including key financial reporting risks. Operating companies undertake 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 and risk assurance are held with Group and 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 reported to the board in 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 strategic, financial, operational and compliance risks. The risk-based annual internal audit plan 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. Group internal audit has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. 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 ethical, corruption and fraud allegations. The Pearson anti-bribery and corruption programme provides the framework to support our compliance with various anti-bribery and corruption regulations such as the UK Bribery Act 2010 and the US Foreign Corrupt Practices Act.

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, Spear Insurance Limited, and/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 2013 and 2014 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 135 to 143.

Share capital

Details of share issues are given in note 27 to the accounts on page 156. 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 2012, 817,042,980 ordinary shares were in issue. At the AGM held on 27 April 2012, the company was authorised, subject to certain conditions, to acquire up to 81,597,867 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 26 April 2013.

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 5 March 2013, being the last practicable date before the publication of this report, the company had been notified under DTR5 of the following significant voting rights in its shares:

	Number of voting rights	Percentage
BlackRock, Inc.	40,975,445	5.01%
Legal & General Group plc	32,385,175	3.98%
Libyan Investment Authority	24,431,000	3.01%

Annual General Meeting (AGM)

The notice convening the AGM, to be held at 12 noon on Friday, 26 April 2013 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 21 March 2013.

Registered auditors

In accordance with section 489 of the Act, 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 or disposal transactions and due diligence up to £100,000 per project may be performed by our external auditors, in light of the need for confidentiality. Any project/transaction generating fees in excess of £100,000 must be specifically approved by the audit committee;
- 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 a decision being made as to whether to award work to the auditors.

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

Board governance continued

During 2012, the significant non-audit work performed by PwC was:

- Tax compliance services related to a routine audit by the US Internal Revenue Service;
- Tax advisory services associated with the planned creation of the venture between Penguin and Random House;
- Assurance services on a corporate bond issued in May 2012; and
- Other assurance services which were individually less than £100,000 per project.

In each case, PwC was selected as they were best able to provide the services we required at a reasonable fee and within the terms of our external auditors policy. To assist in ensuring that independence and objectivity is maintained, for forward-looking tax planning and due diligence work PwC assign a different partner from the one leading the external audit.

A full statement of the fees for audit and services is provided in note 4 to the accounts on page 114.

Statement of directors' responsibilities

The directors are responsible for preparing the annual report, the report on directors' remuneration and the financial statements in accordance with applicable law and regulations.

The Act requires the directors to prepare financial statements for each financial year. 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 the Act 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 Act 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 UK 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 44 to 46, confirm that to the best of their knowledge and belief:

- The Group financial statements, prepared in accordance with IFRSs as adopted by the European Union, 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 2013 and signed on its behalf by

Philip Hoffman Secretary

Additional information for shareholders

Set out below is other statutory and regulatory information that Pearson is required to disclose in its directors' report.

Amendment to Articles of Association

Any amendments to the Articles of Association of the company (the Articles) 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 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 again be conducted on a poll, consistent with best practice.

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. In all cases the distributable profits of the company must be sufficient to justify the payment of the relevant dividend.

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 shareholders or different classes of shareholders. The liquidator can also, with the same sanction, transfer the whole or any part of the assets to trustees upon such trusts for the benefit of the shareholders.

Voting at general meetings

Any form of proxy sent by the shareholders to the company in relation to any general meeting must be delivered to the company (via its registrars), 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.

Board governance continued

There were 10,101,860 shares so held as at 31 December 2012. 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 4,710,567 shares so held as at 31 December 2012. The trustees holding these shares seek voting instructions from the relevant 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 prejudice 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.

The Articles provide that, at every AGM of the company, at least 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.

Notwithstanding the provisions of the Articles, the board has resolved that all directors should offer themselves for re-election annually, in accordance with the UK Corporate Governance Code.

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.

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 (the Facility), any such bank may, upon a change of control of the company, require its outstanding advances, together with accrued interest and any other amounts payable in respect of such Facility, 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

Dear shareholders

I am pleased to present our report on directors' remuneration for 2012, which will be put forward for your consideration and approval at the annual general meeting on 26 April 2013.

The remuneration committee believes that the purpose of its remuneration policy is to support the company's strategy and to help deliver sustained performance and consistent long-term value creation in the interests of all stakeholders.

Performance in 2012

Performance has been resilient in very tough conditions and the company has delivered:

- strong competitive performance
- operating profit broadly level with the record profits in 2011
- return on invested capital above our cost of capital
- Pearson's 21st straight year of increasing our dividend above the rate of inflation. Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning more than £2.5bn to shareholders

Principles of remuneration policy

Our reward policy is aligned with the interests of all stakeholders in providing:

- competitive base salaries that reflect the market and individual roles and contribution
- a high proportion of variable remuneration that is directly linked to the annual and long-term performance of the company
- annual incentives that reward achievement of strategic goals
- long-term incentives that drive long-term earnings and share price growth and encourage people to acquire and hold Pearson shares in line with shareholders' interests
- many people at Pearson with the opportunity to share in the company's success through cash-based annual incentives and bonuses and worldwide participation in share ownership plans, continuing practices first started in 1998

Market conditions

The remuneration committee is sensitive to the current social and economic environment surrounding executive compensation.

We welcome the coalition government's proposals to improve the clarity and transparency of remuneration disclosure. Although the regulations have not yet been finalised, we have adopted many of the recommendations in this year's report.

We hope that these changes will continue to demonstrate the link between our remuneration policy and practice and the company's strategy and performance, as well as our commitment to shareholder engagement.

We continue to keep our remuneration policy under review in light of the prevailing economic conditions and the impact of these on the company's objectives and strategy.

What we've planned for 2013

Looking forward, for 2013:

- we undertook a periodic review of base salaries for 2013 taking into account general economic and market conditions, the level of increases made across the company as a whole, the remuneration of executives in similar positions in comparable companies and individual performance
- we reviewed and established an appropriate starting remuneration package for the new CEO comprising base salary, annual and long-term incentives, allowances and benefits
- we reviewed and amended the service agreements for those executive directors, including the CEO, who will continue to serve throughout 2013. The consequence of this review has been to remove any entitlement to annual incentive from the calculation of any compensation that might be payable on termination of employment by the company without notice or cause

What we did in 2012

Looking back to some specific aspects of policy and practice in 2012:

- we undertook a periodic review of base salaries for 2012 and, in light of the prevailing economic conditions and consistent with the action that continues to be taken across the company to control costs, the committee endorsed the recommendation of the executive directors and other members of the Pearson Management Committee that they receive no increase in base salaries
- annual incentives paid to executives for 2012 performance were significantly lower than for 2011, reflecting performance in a tough business environment and more challenging incentive targets
- we reduced the number of shares awarded to the Pearson Management Committee as their long-term incentives

Our policy and implementation is summarised in more detail in the remainder of this report.

Finally, I would like to thank my fellow members of the committee and the people who have assisted us for their contribution over the past year and to give special appreciation to Patrick Cescau who stood down from the committee during 2012.

David Arculus
Chairman, Remuneration Committee

Report on directors' remuneration continued

Introduction

The rest of this report on directors' remuneration comprises:

- a policy report – a forward-looking statement on remuneration policy for 2013 and beyond; and
- an implementation report – a report on remuneration practice in 2012

Together, 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 2013.

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

Where required under current regulations, the following tables have been subject to audit:

- total remuneration (page 80)
- pension entitlements and pension-related benefits (page 83)
- movements in directors' interests in restricted shares (pages 86 to 88)
- movements in directors' interests in share options (page 89)

Policy report

Remuneration policy and business strategy

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. Our starting point continues to be that total remuneration should reward both short- and long-term results, delivering competitive rewards for target performance but outstanding rewards for exceptional performance.

Our goal as a company is to be the world's leading learning company and to help people of all ages make progress in their lives through all kinds of learning. Pearson's strategy has for some years focused on growth in digital products, educational services and emerging markets. We are now accelerating the implementation of that strategy through:

- four global businesses – we are focusing on school, higher education, English-language learning and business education. We are taking an increasingly global view of educational needs and trends
- four types of geographic market – we will carefully evaluate when we offer global products and services, when we customise for local needs, and when we require a true local approach. We will focus our investment on markets with the biggest growth opportunities
- four business models – we will channel our investment into four proven business models: direct-to-consumer; 'Pearson Inside' (our shorthand for institutional services such as our school systems in Brazil); assessment; and learning systems

Those measures complement our more traditional financial measures and goals but they do not, of course, replace them. 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. 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 sales, profit, and working capital) form the basis of our annual budgets and plans, and the basis for bonuses and long-term incentives.

Summary of remuneration policy

The following table summarises the company's policy on directors' remuneration that applies to executive directors and other members of the Pearson Management Committee for 2013 and, so far as practicable, for subsequent years. We have taken account of the coalition government's proposed regulations on the disclosure of remuneration policy but the format and level of detail in the policy table may evolve in subsequent years in line with the final disclosure requirements.

Report on directors' remuneration: Policy table

Introduction

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different strategic objectives. Total remuneration is normally reviewed annually and benchmarked against total remuneration for similar positions in comparable companies.

Base salary

PURPOSE AND LINK TO STRATEGY

- Helps to recruit, reward and retain.
- Reflects competitive market level, role, skills, experience and individual contribution.

OPERATION

Normally reviewed annually for the following year taking into account general economic and market conditions, the level of increases made across the company as a whole, the remuneration of executives in similar positions in comparable companies and individual performance.

OPPORTUNITY

Normally reviewed in line with increases across the company as a whole, subject to particular circumstances such as changes in role, responsibilities or organisation, current remuneration relative to the mid-market position across our comparator groups and the level of increases for executives generally.

PERFORMANCE CONDITIONS

None, although performance of both the company and the individual are taken into account when determining an appropriate level of base salary increase each year.

PERFORMANCE PERIOD

None.

IMPLEMENTATION

There were no increases to base salaries in 2012 for executive directors and other members of the Pearson Management Committee. Base salaries for 2012 are reported in the total remuneration table on page 80.

For 2013, we reviewed base salaries consistent with our policy set out above.

OTHER EMPLOYEES

The approach to setting base salary increases elsewhere in the company takes into account economic factors, competitive market rates, roles, skills, experience and individual performance.

The increase in wages and salaries for the company as a whole is reported in note 5 to the financial statements on page 115.

Allowances and benefits

PURPOSE AND LINK TO STRATEGY

- Help to recruit and retain.
- Reflect local competitive market.

OPERATION

Include *inter alia* cash allowances and non-cash benefits such as health and welfare and car benefits.

Allowances and benefits do not form part of pensionable earnings.

OPPORTUNITY

The provision and level of allowances and benefits are competitive and appropriate in the context of the local market.

PERFORMANCE CONDITIONS

None.

PERFORMANCE PERIOD

None.

IMPLEMENTATION

No change on prior year. Allowances and benefits for 2012 are reported in the total remuneration table on page 80.

OTHER EMPLOYEES

Allowances and benefits for employees reflect the local labour market in which they are based.

Retirement benefits

PURPOSE AND LINK TO STRATEGY

- Help to recruit and retain.
- Recognise long-term commitment to the company.

OPERATION

New employees in the UK are eligible to join the Money Purchase 2003 section of the Pearson Group Pension Plan. New employees in the US are eligible to join the 401(k) plan.

Under the Money Purchase 2003 section of the Pearson Group Pension Plan in the UK, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the company and the employee make contributions into a pension fund. Account balances are used to provide benefits at retirement. Pensions for a member's spouse, dependent children and/or nominated financial dependants are payable on death.

Under the 401(k) plan in the US, which is a defined contribution plan, account balances will be used to provide benefits at retirement. In the event of death before retirement, the account balances will be used to provide benefits for designated beneficiaries.

Longer serving directors with legacy arrangements may participate in the defined benefit Pearson Inc. Pension Plan in the US or the Final Pay section of the Pearson Group Pension Plan in the UK, which are closed to new members.

Under the Final Pay section of the Pearson Group Pension Plan in the UK, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the employee makes a contribution of 5% of pensionable salary and the pension fund builds up based on final pensionable salary and pensionable service. The accrued pension is reduced on retirement prior to age 60. Pensions for a member's spouse, dependent children and/or nominated financial dependants are payable on death.

In the US, the defined benefit Pearson Inc. Pension Plan provides a lump sum benefit that is convertible to an annuity on retirement. The lump sum benefit accrued at an age dependent percentage of capped compensation until 31 December 2001 when further benefit accruals ceased for most employees.

Employees who satisfied criteria of age and service as of 30 November 1998 continue to earn benefits under an alternative formula that provides for 1.5% of final average earnings, adjusted for US Social Security. The benefit paid to these employees is the maximum of the lump sum benefit converted to an annuity and the benefit earned under the alternative final average earnings formula.

Executive directors and other executives across the company are entitled to additional pension benefits to take account of the cap on the amount of benefits that can be provided from the all-employee pension arrangements in the US and the UK.

OPPORTUNITY

In the UK, company contributions to the Money Purchase 2003 section of the Pearson Group Pension Plan amount up to 16% of pensionable salary (double the amount of the employee contribution, which is limited according to certain age bands).

In the US, company contributions to the 401(k) plan amount to 100% of the first 3% of eligible compensation contributed by the employee and 50% of the next 3%, plus a basic annual company contribution of 1.25% of eligible compensation. Pearson Inc. Pension Plan participants who were at least age 40 at 31 December 2001 can receive an additional 0.5% – 1.5% of pay.

PERFORMANCE CONDITIONS

None.

PERFORMANCE PERIOD

None.

IMPLEMENTATION

No change.

Retirement benefits are reported on page 83.

OTHER EMPLOYEES

Executive directors participate in the same pension arrangements that have been set up for Pearson employees in the US and the UK.

Note 1 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 £137,400 as at 6 April 2012.

Note 2 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 may be 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. Effective from 6 April 2011, the annual allowance (i.e. the maximum amount of pension saving that benefits from tax relief each year) reduced from £255,000 to £50,000. Effective 6 April 2012, the lifetime allowance (i.e. the maximum amount of pension and/or lump sum that can benefit from tax relief) reduced from £1.8m to £1.5m.

Report on directors' remuneration: Policy table continued

Annual incentives

PURPOSE AND LINK TO STRATEGY

- Motivate achievement of annual strategic goals and personal objectives.
- Provide focus on key financial metrics.
- Reward individual contribution to the success of the company.

OPERATION

Up to 90% of total opportunity is based on financial performance at the corporate and business unit level. Up to 50% of total opportunity is based on performance against personal objectives.

The committee establishes threshold, target and maximum levels of performance for different levels of payout.

Performance is measured separately for each item.

Annual incentive payments do not form part of pensionable earnings.

OPPORTUNITY

For the chief executive, maximum opportunity is 180% of base salary.

For other members of the Pearson Management Committee, individual incentive opportunities take into account their membership of that committee and the relative contribution of their businesses or roles to the company's overall goals, with a maximum opportunity of up to 175% of salary.

For the chief executive and other members of the Pearson Management Committee, there is normally no payout for performance at threshold. The performance range sets a careful balance between upside opportunity and downside risk and is normally based on targets in accordance with the operating plan.

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

PERFORMANCE CONDITIONS

Subject to the achievement of targets for sales, growth in underlying earnings per share for continuing operations at constant exchange rates (for Pearson plc) or operating profit (for the operating companies), average working capital as a ratio to sales, operating cash flow and personal objectives.

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.

Personal objectives are agreed with the chief executive (or, in the case of the chief executive, the chairman) and may be functional, operational, strategic and non-financial and include *inter alia* objectives relating to environmental, social and governance issues.

PERFORMANCE PERIOD

One year.

IMPLEMENTATION

Annual incentive payments for 2012 are reported in the total remuneration table on page 80.

For 2013, the maximum annual incentive opportunity for the chief executive remains at 180% of base salary and up to 175% of base salary for the other members of the Pearson Management Committee.

OTHER EMPLOYEES

Many people participate in some form of cash-based annual incentive, bonus, profit-share or sales commission plan.

Annual incentive plans for the Pearson Management Committee form the basis of the annual incentive plans below the level of the principal operating companies and establish performance measures and standards and set the ceiling for individual incentive opportunities.

Long-term incentives

PURPOSE AND LINK TO STRATEGY

- Help to recruit, reward and retain.
- Drive long-term earnings and share price growth and value creation.
- Align interests of executives and shareholders.
- Encourage long-term shareholding and commitment to the company.
- Link corporate performance to management's long-term reward in a flexible way.

OPERATION

Last approved by shareholders in 2011. Awards may be delivered in restricted shares and/or share options, although it is not the committee's intention to grant share options for the foreseeable future.

Awards for executive directors and other members of the Pearson Management Committee vest on a sliding scale based on performance against stretching corporate performance targets. 75% of the vested award is released at the end of the three-year performance period and the remaining 25% only vests if the participant retains the after-tax number of shares for a further two years.

Restricted shares may be granted without performance conditions to satisfy recruitment and retention objectives, but not to any of the current executive directors.

Where shares vest, 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.

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. No such adjustments were made for performance periods ending in 2012.

OPPORTUNITY

We set the level of individual awards by taking into account:

- the face value of individual awards at the time of grant, assuming that performance targets are met in full;
- market practice for comparable companies and market assessments of total remuneration from our independent advisers;
- individual roles and responsibilities; and
- company and individual performance.

PERFORMANCE CONDITIONS

Subject to the achievement of targets for relative total shareholder return, return on invested capital and earnings per share growth, with normally one third of the award based on each. The committee determines the performance measures and targets governing an award of restricted shares prior to grant.

PERFORMANCE PERIOD

Three years.

IMPLEMENTATION

No change.

Awards are reported in the movements in directors' interests in restricted shares and share options tables on pages 86 to 89.

OTHER EMPLOYEES

Approximately 6% of the company's employees below the Pearson Management Committee – selected on the basis of their role, performance and potential – currently hold time-vesting shares under the long-term incentive plan.

All employees (including executive directors) are also eligible to participate in savings-related share acquisition programmes in the UK, US and rest of world, which are not subject to any performance conditions.

Note 3 **Total shareholder return** (TSR) 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.

Note 4 **Return on invested capital** (ROIC) 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.

Note 5 **Adjusted earnings per share** (EPS) 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). EPS growth is 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.

Report on directors' remuneration: Policy table continued

Bonus share matching

PURPOSE AND LINK TO STRATEGY

- Encourages executive directors and other senior managers to acquire and hold Pearson shares.
- Aligns interests of executives and shareholders.

OPERATION

First approved by shareholders in 1998; last approved by shareholders in 2008.

Senior managers across the company are invited to invest up to 50% of their after-tax annual incentive in Pearson shares and hold these shares for three years, in return for the opportunity to earn additional free matching shares and dividend shares, depending on performance against the earnings per share performance condition.

Where matching shares vest, 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.

OPPORTUNITY

Maximum matching award is equal to the number of shares that could have been acquired with the amount of pre-tax annual bonus invested in Pearson shares (i.e. one matching share for every one invested share, grossed up for tax).

PERFORMANCE CONDITIONS

Maximum matching award is achieved if the company's earnings per share increase in real terms by 5% per annum compound over the three-year performance period. 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 same period. Matching shares are calculated on a straight-line basis for performance between threshold and maximum.

PERFORMANCE PERIOD

Three years.

IMPLEMENTATION

No change.

Awards are reported in the movements in directors' interests in restricted shares table on pages 86 to 88.

OTHER EMPLOYEES

Around 450 senior managers across the company are eligible to participate in this plan, typically direct reports to the operating company CEOs, their senior management teams, and anyone who has a direct and significant influence on corporate strategy and financial performance.

Note 6 **Earnings per share growth** is calculated using the point-to-point method, which 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).

Share ownership guidelines

PURPOSE AND LINK TO STRATEGY

- Align interests of executives and shareholders.

OPERATION

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership. Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children plus any shares vested but held pending release under a restricted share plan.

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

OPPORTUNITY

Target holding is two times salary for the chief executive and 1.25 times salary for the other executive directors, consistent with median practice in FTSE 100 companies that operated such arrangements when the guideline was set.

PERFORMANCE CONDITIONS

None.

PERFORMANCE PERIOD

None.

IMPLEMENTATION

No change.

Directors' interests are reported on page 90. All executive directors comfortably exceeded these guidelines in 2012.

OTHER EMPLOYEES

There are no mandatory share ownership guidelines below executive director level, although employees are encouraged to become shareholders in the company by retaining shares acquired through the company's discretionary and all-employee stock programmes.

Service agreements

PURPOSE AND LINK TO STRATEGY

Provide an appropriate level of protection for the executive and the company by:

- setting out individual entitlements to elements of remuneration consistent with policy
- summarising notice periods and compensation on termination of employment by the company without notice or cause
- describing the obligations in relation to confidentiality, data protection, intellectual property and restraint on certain activities

OPERATION

The policy on executive directors' service agreements was reviewed in 2008, 2010 and again in 2012. In accordance with long established policy, all executive directors have rolling service agreements under which, other than by termination in accordance with the terms of these agreements, employment continues until retirement.

There are no special provisions for notice or compensation 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.

OPPORTUNITY

The company may terminate executive directors' service 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. Longer serving directors with legacy agreements are entitled to liquidated damages if the company terminates their agreement without notice or cause.

For executive directors whose service will continue throughout 2013, compensation on termination of employment by the company without notice or cause comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits.

PERFORMANCE CONDITIONS

None.

PERFORMANCE PERIOD

None.

IMPLEMENTATION

The service agreements for the executive directors, including the CEO, who will continue to serve throughout 2013 were reviewed and amended.

The consequence of this review has been to remove any entitlement to annual incentive from the calculation of any compensation that might be payable in the event of termination of employment by the company without notice or cause. Details of each individual's service agreement are reported in the notes below.

OTHER EMPLOYEES

Employment agreements for other employees below the Pearson Management Committee are determined according to local labour law and market practice.

Note 7 We summarise the service agreements that will apply to directors serving during 2013 as follows:

Name	Date of agreement	Notice periods	Compensation on termination of employment by the company without notice or cause
Glen Moreno	29 July 2005	12 months from the director; 12 months from the company	Payment-in-lieu of notice of 100% of annual fees at the date of termination
John Fallon	31 December 2012	Six months from the director; 12 months from the company	Payment-in-lieu of notice of 100% of annual salary at the date of termination and the annual cost of pension and all other benefits
Will Ethridge	31 December 2012	Six months from the director; 12 months from the company	Severance payments of 100% of annual salary at the date of termination and the annual cost of pension and all other benefits
Robin Freestone	17 December 2012	Six months from the director; 12 months from the company	Payment-in-lieu of notice of 100% of annual salary at the date of termination and the annual cost of pension and all other benefits
John Makinson	21 December 2012	Six months from the director; 12 months from the company	Liquidated damages of 100% of annual salary at the date of termination and the annual cost of pension and all other benefits

Note 8 Marjorie Scardino served under her service agreement dated 27 February 2004 until she left employment on 31 December 2012. This agreement provided for notice periods of six months from the director and 12 months from the company and compensation on termination of employment by the company without notice or cause of 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential annual incentive.

Note 9 Rona Fairhead's service agreement dated 24 January 2003 continues in effect for the first four months of 2013 until she leaves the company on 30 April 2013. This agreement provides for notice periods of six months from the director and 12 months from the company and compensation on termination of employment by the company without notice or cause of 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential annual incentive.

Report on directors' remuneration continued

Recruitment

The committee determines the remuneration package for any new appointment to the Pearson Management Committee, either from within or outside of Pearson. Remuneration includes base salary, annual and long-term incentive entitlements and awards, and pension arrangements.

The committee carefully considers factors such as the relative size and contribution of the role, the individual's skills and experience, the availability of skills and experience in the market, the individual's current remuneration package, the market rate for the job and internal comparisons within Pearson before determining an appropriate remuneration package for a new appointment. Occasionally this requires a degree of flexibility so that the remuneration policy boundaries are wider than under usual circumstances but at all times the committee seeks to minimise internal disparities and to avoid pay for poor performance. For someone joining from outside of Pearson, the offer may include compensation for the forfeiture of awards from a previous employer on a comparable basis, taking account of performance achieved or likely to be achieved, the proportion of performance period remaining and the form of the award.

Benchmarking

For benchmarking purposes, we review remuneration by reference to three separate comparator groups. First, we use a select peer group of FTSE 100 companies with very substantial overseas operations, excluding financial services. These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Towers Watson, use to make comparisons on remuneration takes this variation in size into account. Secondly, we look at a broad media industry group of US companies. And thirdly, we look at the FTSE 20-50, excluding financial services. 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 key 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 and for the performance scenarios below, the main elements of remuneration are valued as follows:

Element of remuneration	Valuation
Base salary	Actual base salary
Allowances, retirement and other benefits	Cost to company of providing allowances, retirement and other benefits
Annual incentive	Target level of annual incentive
Long-term incentive	Expected value of long-term incentive award
Bonus share matching	Expected value of matching award based on target level of annual incentive and assuming maximum amount (50% of annual incentive) is invested
Total remuneration	Sum of all elements of remuneration

Expected value means Towers Watson's assessment of the awards' net present value taking into account the vesting schedule and the probability that any performance targets will be met.

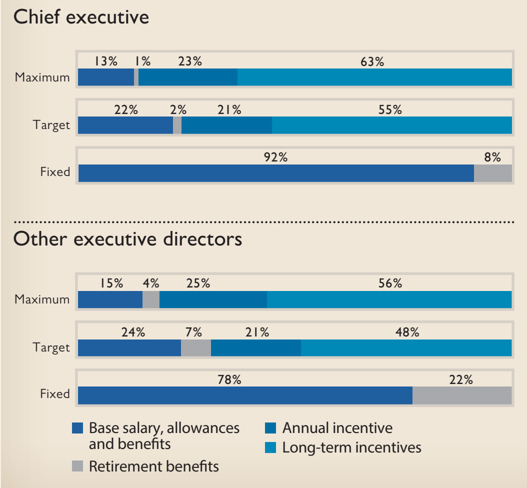
Pay and performance

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.

The committee considers what each director can expect to receive under different performance scenarios, based on the following definitions of performance:

Performance scenario	Elements of remuneration
Maximum	Base salary, allowances, benefits, retirement benefits, maximum annual incentive, maximum bonus share matching and maximum long-term incentive
Target	Base salary, allowances, benefits, retirement benefits, target annual incentive, target bonus share matching and target long-term incentive
Fixed	Base salary, allowances, benefits and retirement benefits only

The relative importance of fixed and performance-related remuneration for the chief executive and other executive directors is typically as follows:



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

Report on directors' remuneration continued

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.

Following the committee's last review in 2010, the chairman's remuneration was increased to its current level with effect from 1 April 2011. The next review will take place in 2014.

Non-executive directors

Fees 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.

Relative importance of pay spend

We show below the year-on-year change in the relative importance of pay spend compared to the return to shareholders (dividends) and reinvestment in the company (adjusted operating profit for continuing operations).

	2012 £m	2011 £m	Year-on-year change £	Year-on-year change %
Operating profit	936	942	(6)	(1%)
Dividends	346	318	28	9%
Wages and salaries	1,659	1,531	128	8%
Directors' salaries/fees, annual incentives, allowances and benefits	6	8	(2)	(25%)

Note 1 Wages and salaries include continuing operations only and exclude Penguin. 2011 is restated on the same basis. Employee numbers for continuing operations for 2012 were 42,980 (2011: 37,964). Further details are set out in note 5 to the financial statements on page 115.

Note 2 Directors' salaries/fees, annual incentives, allowances and benefits exclude retirement benefits and long-term incentives consistent with wages and salaries.

Employee engagement

In accordance with the committee's charter and terms of reference, the committee's remit does not include remuneration matters below that of the chief executive, the other executive directors and other members of the Pearson Management Committee. However, before the remuneration packages for the Pearson Management Committee are set for the year ahead, the committee considers a report from the chief executive and director for people on general pay trends in the market and the level of pay increases across the company as a whole. This helps to ensure that executive remuneration packages are reviewed in the context of the wider organisation.

The company consults with various employee representative bodies – including trade unions and works councils in some jurisdictions – about the company's strategy, competitiveness and performance of the business and other matters affecting employees. The company also conducts an employee engagement survey to find out how people feel about working for Pearson, what they think about the work they do, the opportunities they have and the rewards they get (including a section on pay and benefits). The company uses all of this feedback to inform decisions on people-related activities, resources and investment, local management action plans and wider business unit and organisational strategies.

It is the company's intention to continue to engage with employees and employee representatives in this way in the future.

Shareholder engagement

The company consults regularly with shareholders on all matters affecting its strategy and business operations. As part of that process, we also engage with shareholders on matters relating to executive remuneration.

In 2012, the committee amended the service contracts for all executive directors continuing to serve throughout 2013. The consequence of this review has been to remove any entitlement to annual incentive from the calculation of any compensation that might be payable on termination of employment by the company without notice or cause, in line with the prevailing view of best practice amongst shareholders and their representatives.

The committee continues to be aware of and respond to best practice guidelines of shareholders and their representative bodies.

Misstatement or misconduct

In 2011, the committee reviewed the company's powers to adjust and reclaim variable remuneration in exceptional circumstances of misstatement or misconduct. The committee already has long-standing discretionary powers to make downward adjustments under the annual and long-term incentive plans, as described in the remuneration policy table on pages 70 and 71. 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.

Report on directors' remuneration continued

Implementation report

The remuneration committee and its activities

David Arculus chaired the remuneration committee for the year 2012; the other members were Patrick Cescau (who stood down from the committee at the AGM), Vivienne Cox (who joined the committee during the year), Ken Hydon and Glen Moreno. David Arculus, Patrick Cescau, Vivienne Cox and Ken Hydon are independent non-executive directors. 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 Freestone, chief financial officer, Robin Baliszewski, director for people, Robert Head, director for executive reward, and Stephen Jones, head of company secretarial and deputy secretary, provided material assistance to the committee during the year. They attended meetings of the committee, although none of them 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. Towers Watson are members of the Remuneration Consultants' Group, the body which oversees the code of conduct in relation to executive remuneration consulting in the UK.

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 and other members of the Pearson Management Committee comprising CEOs of principal operating businesses and senior heads of strategic corporate functions. This includes base salary, annual and long-term incentives, retirement and any other benefits.

The committee's duties are also:

- to review and approve corporate goals and objectives relevant to executive compensation and to evaluate performance in light of those goals and objectives
- to approve the company's long-term incentive and other share plans
- to advise and decide on general and specific arrangements in connection with the termination of employment of executive directors and other members of the Pearson Management Committee
- to have delegated responsibility for determining the remuneration and benefits package of the chairman of the board
- to ensure that all provisions regarding disclosure of information are fulfilled
- to appoint and set the terms of reference for any remuneration consultants who advise the committee and monitor the cost of such advice

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

Annually, the committee reviews its own performance, constitution and charter and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the board for approval.

The committee participated in a survey to review its performance and effectiveness in July 2012, looking at areas such as the clarity of roles and responsibilities, the composition of the committee, the use of time, the quality and timeliness of meeting materials, the opportunity for discussion and debate, dialogue with management and access to independent advice. The committee concluded that it is operating effectively and noted the challenges for the year ahead.

The committee met six times during 2012. The matters discussed and actions taken were as follows:

20 AND 24 FEBRUARY 2012

- Reviewed and approved 2011 annual incentive plan payouts
- Reviewed and approved 2009 long-term incentive plan payouts and release of shares
- Approved vesting of 2007 and 2009 annual bonus share matching awards and release of shares
- Reviewed base salaries for the Pearson Management Committee and endorsed the recommendation of the executive directors and other members of the Pearson Management Committee that they receive no increase in base salaries for 2012
- Reviewed and approved 2012 Pearson and operating company annual incentive plan targets
- Reviewed and approved 2012 individual annual incentive opportunities for the Pearson Management Committee
- Reviewed and approved 2012 long-term incentive awards and associated performance conditions for the Pearson Management Committee
- Reviewed and approved 2011 report on directors' remuneration
- Noted company's use of equity for employee share plans
- Reviewed and approved the remuneration package for the chief executive

27 APRIL 2012

- Reviewed and approved 2012 long-term incentive awards for the Pearson Management Committee
- Noted the company's response to the UK pension tax relief changes for high earners

26 JULY 2012

- Noted the activity of the Standing Committee of the Board in relation to the operation of the company's equity-based reward programmes
- Ratified the 2012 annual incentive plans for Pearson plc and the operating companies
- Discussed Towers Watson's overview of the current remuneration environment
- Reviewed committee's charter and terms of reference

3 OCTOBER 2012

- Noted the activity of the Standing Committee of the board in relation to the operation of the company's equity-based reward programmes
- Noted the appointment of John Fallon to the board and reviewed his remuneration package
- Approved 2012 long-term incentive awards for executives and managers
- Reviewed committee's performance and effectiveness
- Reviewed remuneration policy and practice and the implications of the new reporting regulations

5 DECEMBER 2012

- Discussed Towers Watson's overview of the current remuneration environment
- Considered Towers Watson's report on remuneration for the Pearson Management Committee for 2013
- Reviewed status of outstanding long-term incentive awards
- Considered 2013 annual incentive plan metrics
- Considered the approach to 2013 long-term incentive plan awards for the Pearson Management Committee
- Noted the recommended format for the 2012 report on directors' remuneration taking account of the proposed reporting regulations
- Reviewed and approved the service agreement for John Fallon's appointment as chief executive
- Reviewed and approved the leaving arrangements for Marjorie Scardino, Rona Fairhead and one other member of the Pearson Management Committee

Report on directors' remuneration continued

Total remuneration

Total remuneration for the directors in 2012 was as follows:

All figures in £000s	Salaries/ fees	Annual incentive	Allowances	Benefits	Sub-total	Retirement benefits	Long-term incentives	Total (single figure) 2012	Sub-total	Retirement benefits	Long-term incentives	Total (single figure) 2011
Chairman												
Glen Moreno	500	–	–	–	500	–	–	500	488	–	–	488
Executive directors												
Marjorie Scardino	993	432	60	65	1,550	712	4,088	6,350	2,455	706	5,719	8,880
Will Ethridge	658	293	–	–	951	302	1,532	2,785	1,390	575	3,196	5,161
Rona Fairhead	529	192	–	25	746	267	1,109	2,122	999	182	1,574	2,755
John Fallon (appointed 3 October 2012)	146	63	–	4	213	64	317	594	–	–	–	–
Robin Freestone	500	252	–	15	767	151	1,461	2,379	1,094	150	2,087	3,331
John Makinson	549	238	211	16	1,014	–	1,081	2,095	1,417	346	1,571	3,334
Non-executive directors												
David Arculus	95	–	–	–	95	–	–	95	95	–	–	95
Patrick Cescau	90	–	–	–	90	–	–	90	100	–	–	100
Vivienne Cox (appointed 1 January 2012)	80	–	–	–	80	–	–	80	–	–	–	–
Susan Fuhrman	75	–	–	–	75	–	–	75	75	–	–	75
Ken Hydon	95	–	–	–	95	–	–	95	95	–	–	95
Josh Lewis	75	–	–	–	75	–	–	75	63	–	–	63
Total	4,385	1,470	271	125	6,251	1,496	9,588	17,335	8,271	1,959	14,147	24,377
Total 2011	4,139	3,752	316	64	8,271							

Note 1 For the full year, John Fallon's remuneration reflected nine months in his role as CEO, Pearson International and three months as Pearson CEO designate and was: salary/fees – £506; annual incentive – £259; benefits – £16; sub-total – £781; retirement benefits – £262; long-term incentives – £1,306; total – £2,349 (all figures in £000s).

Note 2 In anticipation of the proposed reporting regulations, we show a 'single figure' of total remuneration, which includes retirement benefits and long-term incentives in addition to the other elements of remuneration that have been shown in previous reports. Consistent with the methodology proposed by the Financial Reporting Council at the time of writing, retirement benefits include the increase in the value of the pension fund during the year, comprising company contributions to the plan during the year for defined contribution plans and the increase in the pension fund offset for inflation and multiplied by 20 for defined benefit plans, as well as other pension-related costs (see the retirement benefits table on page 83 for further detail). Long-term incentives include all awards under the long-term incentive plan, bonus share matching plan or all-employee share plan that vested during the year or that have not yet vested but where performance is known at year-end as well as dividend shares accruing and released on such shares in the year (see the tables on movements in restricted shares and share options on pages 86 to 89 for further detail).

Note 3 The company provided gifts to Patrick Cescau and Marjorie Scardino after they stepped down from the board. In the case of Patrick Cescau, the value of the gifts was £21,700. Marjorie Scardino received a painting originally purchased by the company for £12,000, which has an estimated value of approximately £50,000 – £100,000.

Salaries/fees

Salaries/fees paid by the company are reported in the table on total remuneration of the directors. Fees paid by other companies to the executive directors for their non-executive directorships elsewhere are reported separately on page 92.

Fees paid to non-executive directors in 2012 were comprised as follows:

All figures in £000s	Basic fee	Committee chairmanship	Committee membership	Senior independent directorship	Total
David Arculus	65	20	10	–	95
Patrick Cescau	65	–	5	20	90
Vivienne Cox	65	–	15	–	80
Susan Fuhrman	65	–	10	–	75
Ken Hydon	65	25	5	–	95
Josh Lewis	65	–	10	–	75

Annual incentive

For 2012, annual incentive opportunities were based on the following performance measures and performance against these measures (designated as: – below threshold, < between threshold and target, > between target and maximum and + above maximum) was as follows:

	Weighting of performance measures (% of maximum opportunity)			Performance in 2012								
				Pearson plc				Operating company/companies				
Name	Pearson plc	Operating company/ companies	Personal objectives	Underlying growth in adjusted EPS	Sales	Average working capital to sales ratio	Operating cash flow	Sales	Operating profit	Average working capital to sales ratio	Operating cash flow	Payout in 2012 (% of salary)
Marjorie Scardino	90%	–	10%	<	–	>	–					43.5%
Will Ethridge	30%	60% Pearson North America	10%	<	–	>	–	<	<	–	–	44.5%
Rona Fairhead	30%	50% Professional Assessment & Training	10%	<	–	>	–	–	–		–	36.4%
		10% FT Publishing						>	>		+	
John Fallon	30%	60% Pearson International	10%	<	–	>	–	<	<	+	–	51.1%
Robin Freestone	80%	–	20%	<	–	>	–					50.4%
John Makinson	30%	50% Penguin Group	10%	<	–	>	–	<	–	–	–	43.4%
		10% India										

Allowances

Allowances for Marjorie Scardino include £49,570 in respect of housing costs and a US payroll supplement of £9,985. 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 £210,937 for 2012.

Benefits

Benefits include company car, car allowance and UK healthcare premiums. US health benefits for Marjorie Scardino and Will Ethridge are self-insured and the cost is tax free to employees. For Marjorie Scardino, benefits include £48,600 for pension planning and financial advice. Marjorie Scardino, Rona Fairhead and John Makinson have the use of a chauffeur.

Report on directors' remuneration continued

Retirement benefits

Description of the directors' pension entitlements are as follows:

Director	Retirement benefits
Marjorie Scardino	Member of the Pearson Inc. Pension Plan (under which her benefit accruals ceased at the end of 2001) 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	Member of the Pearson Inc. Pension Plan (under which he continues to accrue benefits under the alternative formula because he satisfied criteria of age and service) 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	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.
John Fallon	Member of the Pearson Group Pension Plan. His 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 his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.
Robin Freestone	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	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 and the benefits were withdrawn in 2012, reducing the benefits payable under the UURBS. 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 and the UURBS will be paid to his spouse or nominated financial dependant. Early retirement is currently possible from age 55, with company consent.

Details of the directors' pension entitlements and pension-related benefits during the year are as follows:

Directors' pensions	Age at 31 Dec 12	Accrued pension at 31 Dec 12 £000[1]	Increase/ (decrease) in accrued pension over the period £000[2]	Transfer value at 31 Dec 11 £000[3]	Transfer value at 31 Dec 12 £000[4]	Increase/ (decrease) in transfer value over the period £000[5]	Increase/ (decrease) in accrued pension over the period £000[6]	Transfer value of the increase in accrued pension at 31 Dec 12 £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]	Value in 2012 single figure £000[10]
Marjorie Scardino	65	3.7	(1.0)	49.5	48.8	(0.7)	(1.1)	–	10.5	665.1	58.3	712
Will Ethridge	60	212.0	17.6	2,039.3	2,502.0	462.7	13.4	157.8	32.7	–	1.7	302
Rona Fairhead	51	48.6	6.4	579.3	700.8	115.0	5.4	72.0	–	133.9	25.3	267
John Fallon	50	65.5	7.1	815.7	965.9	143.7	5.9	80.0	–	131.4	13.0	64
Robin Freestone	54	–	–	–	–	–	–	–	20.7	123.3	6.7	151
John Makinson	58	221.2	(86.8)	5,906.5	4,420.9	(1,492.0)	(93.6)	–	–	–	17.7	–

Note 1 The accrued pension at 31 December 2012 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2012. For Marjorie Scardino this is the approximate pension payable in respect of her frozen benefit in the US plan. For Will Ethridge this is his pension from the US plan and the US SERP. For Rona Fairhead and John Fallon it relates to the pension payable from the UK plan. For John Makinson it relates to the pension from the UK Plan and his unapproved arrangements 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 2012 are calculated using the assumptions for cash equivalents payable from the UK plan and are based on the accrued pension at that date. There were no changes in the transfer value methodology over the year although the discount rates are updated each month to reflect changes in market conditions. 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% pa and a maximum of 5% pa). In the case of John Makinson, the accrued pension over the period has decreased because of a transfer made as a result of a pension sharing order.

Note 7 This column comprises contributions to defined contribution arrangements for UK benefits. For US benefits, it includes company contributions to funded defined contribution plans and notional contributions to unfunded 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, John Fallon and Robin Freestone. John Makinson's deferred FURBS entitlement is referred to in note 1 above.

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

Note 10 The single figure of total remuneration includes the following elements from the table on retirement benefits: the increase in accrued pension over the period offset for inflation and multiplied by 20 (defined benefit plans), other pension costs to the company over the period (the company's contributions to defined contribution plans), other allowances in lieu of pension (cash allowances paid in lieu of previous plans for Marjorie Scardino, Rona Fairhead, John Fallon and Robin Freestone) and other pension-related benefit costs (additional life cover and long-term disability insurance not covered by the retirement plans). In the case of John Fallon, the value included in the single figure of total remuneration is pro-rated to reflect his appointment to the board from 3 October 2012. In the case of John Makinson, the value for the single figure of total remuneration is nil because the decrease in accrued pension over the period offsets the other pension-related benefit costs.

Report on directors' remuneration continued

Long-term incentives

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

Date of award	Share price on date of award	Vesting	Status of award
15 May 2012	1,152.0p	15 May 2015	Outstanding subject to 2011 to 2014 performance
20 April 2011	1,129.0p	20 April 2014	Outstanding subject to 2010 to 2013 performance
21 April 2010	1,024.1p	21 April 2013	Performance condition for release of 84.5% of matching award met. Real compound annual growth in earnings per share for 2009 to 2012 of 4.4% against a range of 3% to 5%. Shares held pending release on 21 April 2013.
16 April 2009	670.0p	16 April 2012	Target met as reported in report on directors' remuneration for 2011. Shares released on 15 May 2012
22 May 2007[1]	899.9p	100% on 22 May 2012	Target met as reported in report on directors' remuneration for 2011. Shares released on 22 May 2012

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 For all awards, Pearson's reported financial results for the relevant period were used to measure performance and no discretion was exercised.

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

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
02/05/12	1,161.0p	02/05/15	Relative TSR	2012 to 2015	30% at median	100% at upper quartile	–	–	Outstanding
			ROIC	2014	0% for ROIC of 8.5%	100% for ROIC of 10.5%	–	–	
			EPS growth	2014 compared to 2011	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	–	–	
03/05/11	1,149.0p	03/05/14	Relative TSR	2011 to 2014	30% at median	100% at upper quartile	–	–	Outstanding
			ROIC	2013	25% for ROIC of 9.0%	100% for ROIC of 10.5%	–	–	
			EPS growth	2013 compared to 2010	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	–	–	
03/03/10	962.0p	03/03/13	Relative TSR	2010 to 2013	30% at median	100% at upper quartile	–	–	Outstanding Marked as ○ in the movements in restricted shares table
			ROIC	2012	25% for ROIC of 8.5%	100% for ROIC of 10.5%	9.1%	47.5%	Vested and remain held pending release. Marked as ● in the movements in restricted shares table
			EPS growth	2012 compared to 2009	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	8.8%	62.5%	
03/03/09	654.0p	03/03/12	Relative TSR	2009 to 2012	30% at median	100% at upper quartile	60th percentile	57.4%	68.3% of shares vested. Three-quarters released on 3 April 2012. If after tax number of shares are retained for a further two years, the remaining quarter will be released on 3 March 2014. The part based on relative TSR is marked as ○ and the part based on ROIC and EPS growth as ● in the movements in restricted shares table
			ROIC	2011	25% for ROIC of 8.5%	100% for ROIC of 10.5%	9.1%	47.5%	
			EPS growth	2011 compared to 2008	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	14.4%	100%	

Note 1 For all awards, Pearson's reported financial results for the relevant period were used to measure performance and no discretion was exercised.

Report on directors' remuneration continued

Movements in directors' interests in restricted shares (designated as: ABSMP annual bonus share matching plan; LTIP long-term incentive plan; Dividends where dividend-equivalent shares were added to the released shares; ● for the two-thirds of the award based on ROIC and EPS growth and ○ for the one third of the award based on relative TSR; we show these parts of the award separately where performance is known for only part of the award at year-end).

Date of award	Plan	1 Jan 12	Awarded	Released	Lapsed	31 Dec 12	Market value at date of award	Earliest release date	Date of release	Market value at date of release	Number of shares in 2012 single figure	Value in 2012 single figure £000
Marjorie Scardino												
22/5/07	ABSMP	60,287		60,287		0	899.9p	22/5/12	22/5/12	1,148.0p		
21/4/10	ABSMP	63,497			9,850	53,647	1,024.1p	21/4/13			53,647	£649
20/4/11	ABSMP	71,446			23,816	47,630	1,129.0p	20/4/14				
30/7/07	LTIP	84,000		84,000		0	778.0p	2/3/10	31/7/12	1,196.0p		
4/3/08	LTIP	97,500				97,500	649.5p	4/3/11				
3/3/09 ●	LTIP	221,250		165,938		55,312	654.0p	3/3/12	3/4/12	1,184.0p		
3/3/09 ○	LTIP	150,000		64,620	63,840	21,540	654.0p	3/3/12	3/4/12	1,184.0p	86,160	£1,020
3/3/10 ●	LTIP	266,667			119,976	146,691	962.0p	3/3/13			146,691	£1,776
3/3/10 ○	LTIP	133,333				133,333	962.0p	3/3/13				
3/5/11	LTIP	400,000			133,334	266,666	1,149.0p	3/5/14				
2/5/12	LTIP	0	250,000		166,667	83,333	1,161.0p	2/5/15				
3/4/12	Dividends	0	32,048	32,048		0	1,184.0p	3/4/12	3/4/12	1,184.0p	32,048	£379
30/7/12	Dividends	0	21,252	21,252		0	1,190.0p	30/7/12	30/7/12	1,190.0p	21,252	£253
Total		1,547,980	303,300	428,145	517,483	905,652					339,798	£4,077
Will Ethridge												
22/5/07	ABSMP	2,508		2,508		0	899.9p	22/5/12	22/5/12	1,148.0p		
16/4/09	ABSMP	112,515		112,515		0	670.0p	16/4/12	15/5/12	1,152.0p		
21/4/10	ABSMP	7,880			1,222	6,658	1,024.1p	21/4/13			6,658	£81
20/4/11	ABSMP	4,517				4,517	1,129.0p	20/4/14				
15/5/12	ABSMP	0	4,485			4,485	1,152.0p	15/5/12				
15/5/12	Dividends	0	13,053	13,053		0	1,152.0p	15/5/12	15/5/12	1,152.0p	13,053	£150
30/7/07	LTIP	30,000		30,000		0	778.0p	2/3/10	31/7/12	1,196.0p		
4/3/08	LTIP	36,562				36,562	649.5p	4/3/11				
3/3/09 ●	LTIP	86,042		64,531		21,511	654.0p	3/3/12	3/4/12	1,184.0p		
3/3/09 ○	LTIP	58,333		25,130	24,827	8,376	654.0p	3/3/12	3/4/12	1,184.0p	33,506	£397
3/3/10 ●	LTIP	100,000			44,991	55,009	962.0p	3/3/13			55,009	£666
3/3/10 ○	LTIP	50,000				50,000	962.0p	3/3/13				
3/5/11	LTIP	150,000				150,000	1,149.0p	3/5/14				
2/5/12	LTIP	0	100,000			100,000	1,161.0p	2/5/15				
3/4/12	Dividends	0	12,463	12,463		0	1,184.0p	3/4/12	3/4/12	1,184.0p	12,463	£148
30/7/12	Dividends	0	7,590	7,590		0	1,190.0p	30/7/12	30/7/12	1,190.0p	7,590	£90
Total		638,357	137,591	267,790	71,040	437,118					128,279	£1,532

Date of award	Plan	1 Jan 12	Awarded	Released	Lapsed	31 Dec 12	Market value at date of award	Earliest release date	Date of release	Market value at date of release	Number of shares in 2012 single figure	Value in 2012 single figure £000
Rona Fairhead												
30/7/07	LTIP	25,000		25,000		0	778.0p	2/3/10	31/7/12	1,196.0p		
4/3/08	LTIP	30,468				30,468	649.5p	4/3/11				
3/3/09 ●	LTIP	73,750		55,313		18,437	654.0p	3/3/12	3/4/12	1,184.0p		
3/3/09 ○	LTIP	50,000		21,540	21,280	7,180	654.0p	3/3/12	3/4/12	1,184.0p	28,720	£340
3/3/10 ●	LTIP	83,333			37,492	45,841	962.0p	3/3/13			45,841	£555
3/3/10 ○	LTIP	41,667				41,667	962.0p	3/3/13				
3/5/11	LTIP	165,000				165,000	1,149.0p	3/5/14				
2/5/12	LTIP	0	100,000			100,000	1,161.0p	2/5/15				
3/4/12	Dividends	0	10,683	10,683		0	1,184.0p	3/4/12	3/4/12	1,184.0p	10,683	£126
30/7/12	Dividends	0	6,325	6,325		0	1,190.0p	30/7/12	30/7/12	1,190.0p	6,325	£75
Total		469,218	117,008	118,861	58,772	408,593					91,569	£1,096
John Fallon												
16/4/09	ABSMP	7,595		7,595		0	670.0p	16/4/12	15/5/12	1,152.0p		
21/4/10	ABSMP	8,275			1,284	6,991	1,024.1p	21/4/13			6,991	£85
20/4/11	ABSMP	4,539				4,539	1,129.0p	20/4/14				
15/5/12	ABSMP	0	8,917			8,917	1,152.0p	15/5/15				
15/5/12	Dividends	0	882	882		0	1,152.0p	15/5/12	15/5/12	1,152.0p	882	£10
4/3/08	LTIP	24,375				24,375	649.5p	4/3/11				
3/3/09 ●	LTIP	86,042		64,531		21,511	654.0p	3/3/12	3/4/12	1,184.0p		
3/3/09 ○	LTIP	58,333		25,130	24,827	8,376	654.0p	3/3/12	3/4/12	1,184.0p	33,506	£397
3/3/10 ●	LTIP	100,000			44,991	55,009	962.0p	3/3/13			55,009	£666
3/3/10 ○	LTIP	50,000				50,000	962.0p	3/3/13				
3/5/11	LTIP	150,000				150,000	1,149.0p	3/5/14				
2/5/12	LTIP	0	100,000			100,000	1,161.0p	2/5/15				
3/4/12	Dividends	0	12,463	12,463		0	1,184.0p	3/4/12	3/4/12	1,184.0p	12,463	£148
Total		489,159	122,262	110,601	71,102	429,718					108,851	£1,306
Total (pro-rated for 2012 single figure, to reflect appointment 3 October 2012)											26,427	£317

Report on directors' remuneration continued

Date of award	Plan	1 Jan 12	Awarded	Released	Lapsed	31 Dec 12	Market value at date of award	Earliest release date	Date of release	Market value at date of release	Number of shares in 2012 single figure	Value in 2012 single figure £000
Robin Freestone												
22/5/07	ABSMP	4,708		4,708		0	899.9p	22/5/12	22/5/12	1,148.0p		
16/4/09	ABSMP	35,446		35,446		0	670.0p	16/4/12	15/5/12	1,152.0p		
21/4/10	ABSMP	31,114			4,827	26,287	1,024.1p	21/4/13			26,287	£318
20/4/11	ABSMP	29,049				29,049	1,129.0p	20/4/14				
15/5/12	ABSMP	0	17,833			17,833	1,152.0p	15/5/15				
15/5/12	Dividends	0	4,112	4,112		0	1,152.0p	15/5/12	15/5/12	1,152.0p	4,112	£47
30/7/07	LTIP	25,000		25,000		0	778.0p	2/3/10	31/7/12	1,196.0p		
4/3/08	LTIP	30,468				30,468	649.5p	4/3/11				
3/3/09 ●	LTIP	73,750		55,313		18,437	654.0p	3/3/12	3/4/12	1,184.0p		
3/3/09 ○	LTIP	50,000		21,540	21,280	7,180	654.0p	3/3/12	3/4/12	1,184.0p	28,720	£340
3/3/10 ●	LTIP	83,333			37,492	45,841	962.0p	3/3/13			45,841	£555
3/3/10 ○	LTIP	41,667				41,667	962.0p	3/3/13				
3/5/11	LTIP	125,000				125,000	1,149.0p	3/5/14				
2/5/12	LTIP	0	100,000			100,000	1,161.0p	2/5/15				
3/4/12	Dividends	0	10,683	10,683		0	1,184.0p	3/4/12	3/4/12	1,184.0p	10,683	£126
30/7/12	Dividends	0	6,325	6,325		0	1,190.0p	30/7/12	30/7/12	1,190.0p	6,325	£75
Total		529,535	138,953	163,127	63,599	441,762					121,968	£1,461
John Makinson												
30/7/07	LTIP	20,000		20,000		0	778.0p	2/3/10	31/7/12	1,196.0p		
4/3/08	LTIP	30,468				30,468	649.5p	4/3/11				
3/3/09 ●	LTIP	73,750		55,313		18,437	654.0p	3/3/12	3/4/12	1,184.0p		
3/3/09 ○	LTIP	50,000		21,540	21,280	7,180	654.0p	3/3/12	3/4/12	1,184.0p	28,720	£340
3/3/10 ●	LTIP	83,333			37,492	45,841	962.0p	3/3/13			45,841	£555
3/3/10 ○	LTIP	41,667				41,667	962.0p	3/3/13				
3/5/11	LTIP	125,000				125,000	1,149.0p	3/5/14				
2/5/12	LTIP	0	100,000			100,000	1,161.0p	2/5/15				
3/4/12	Dividends	0	10,683	10,683		0	1,184.0p	3/4/12	3/4/12	1,184.0p	10,683	£126
30/7/12	Dividends	0	5,060	5,060		0	1,190.0p	30/7/12	30/7/12	1,190.0p	5,060	£60
Total		424,218	115,743	112,596	58,772	368,593					90,304	£1,081
Total		4,098,467	934,857	1,201,120	840,768	2,991,436					798,342	£9,564

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

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

Note 3 Performance conditions and vesting for awards under the bonus share matching and long-term incentive plans are described in the long-term incentive tables on pages 84 and 85.

Note 4 Marjorie Scardino left the company on 31 December 2012.

In the case of the bonus share matching award made on 21 April 2010 and the long-term incentive awards made on 4 March 2008 and 3 March 2009, the performance period has ended and the number of shares held at 31 December 2012 will be released to Marjorie in 2013.

In the case of the bonus share matching award on 20 April 2011 and the long-term incentive awards made on 3 March 2010, 3 May 2011 and 2 May 2012, outstanding awards have been pro-rated according to the number of months worked in the performance period to the date of leaving and we show the remaining shares as lapsed. The shares held at 31 December 2012 remain outstanding subject to performance and will be released in line with the normal vesting schedule.

Note 5 In the case of the long-term incentive awards made on 3 March 2009 and 3 March 2010, we detail separately the parts based on ROIC and EPS growth (two-thirds of the total award) and the part based on relative TSR (one-third of the total award), because of the time lag in the corresponding performance periods. We disclosed the lapsed part of the 2009 award (based on ROIC and EPS growth) in the 2011 report as performance was known at year-end but the vesting of the part based on relative TSR is disclosed together with the release of shares in the 2012 report (as above). Similarly, for the 2010 award, we disclose the lapse of the parts based on ROIC and EPS growth but the vesting of the part based on relative TSR and the release of shares will be disclosed in the 2013 report.

Note 6 The below notes have been prepared in anticipation of the proposing reporting regulations.

All awards released during the year are included in the single figure of total remuneration for that year, unless they were subject to a performance condition (other than a stay-in-employment) and performance against that condition was known in an earlier reporting period. Awards that have not yet vested but where performance is known at year-end are also included in the single figure of total remuneration.

In the case of the long-term incentive award made on 3 March 2009, only the part based on relative TSR is included in the 2012 single figure of total remuneration (under the proposed single figure methodology, the part based on ROIC and EPS growth would have been included in the 2011 single figure of total remuneration and disclosed in the 2011 report). In the case of the long-term incentive award made on 3 March 2010, only the parts based on ROIC and EPS growth are included in the 2012 single figure of total remuneration (the part based on relative TSR will be included in the 2013 single figure of total remuneration and disclosed in the 2013 report).

The value of shares included in the single figure of total remuneration is the number of shares multiplied by the share price on release (or, if the shares have not yet been released, the average share price over the final quarter of the year which for 2012 was 1,210.4p).

Movements in directors' interests in share options (all under the worldwide save for shares plan) are as follows:

Date of grant	1 Jan 12	Granted	Exercised	Lapsed	31 Dec 12	Option price	Earliest exercise date	Expiry date	Date of exercise	Price on exercise	Gain on exercise £	Value in 2012 single figure £000
Marjorie Scardino												
8/5/09	1,672				1,672	547.2p	1/8/12	1/2/13				£11
Total	1,672	0	0	0	0						£0	£11
Rona Fairhead												
4/5/07	2,371		2,371		0	690.4p	1/8/12	1/2/13	31/10/12	1,245.0p	£13,150	£13
Total	2,371	0	2,371	0	0						£13,150	£13
John Fallon												
7/5/10	1,930				1,930	805.6p	1/8/15	1/2/16				
Total	1,930	0	0	0	1,930						£0	£0
Robin Freestone												
4/5/12	0	990			990	909.0p	1/8/15	1/2/16				
Total	0	990	0	0	990						£0	£0
Total	5,973	990	2,371	0	4,592						£13,150	£24

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

Note 2 The acquisition of shares under the worldwide save for shares plan is not subject to a performance condition.

Report on directors' remuneration continued

Note 3 Marjorie Scardino contributed 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 market price on 31 December 2012 was 1,188.0p per share and the range during the year was 1,111.0p to 1,294.0p.

Note 5 All share options that became exercisable during the year are included in the single figure of total remuneration for that year. The value included in the single figure of total remuneration is the number of options multiplied by the difference between the market value on the earliest exercise date (1,230.0p on 1 August 2012) and the option price.

Payments for loss of office

There were no payments for loss of office during 2012.

As announced on 3 October 2012, Marjorie Scardino stepped down from the board and left the company on 31 December 2012. She served the company under her service agreement dated 27 February 2004, the details of which are described in the policy table on page 73. There was no payment for loss of office.

As announced on 27 November 2012, Rona Fairhead is stepping down from the board at the annual general meeting on 26 April 2013 and leaving the company on 30 April 2013. Her service agreement dated 24 January 2003 provides for notice periods of six months from the director and 12 months from the company and compensation on termination of employment by the company without notice or cause of 100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential annual incentive.

The committee and the board determined that her leaving employment was a consequence of the planned incorporation of the professional education division overseen by Rona into other parts of Pearson's education business, coupled with the smaller size of the Financial Times Group owing to recent major divestments. The company therefore intends to pay compensation amounting to approximately £1.146m comprising the elements described above to Rona in 2013.

Interests of directors and value of shareholdings

	Ordinary shares at 1 Jan 12 (or date of appointment, if later)	Ordinary shares at 31 Dec 12	Conditional shares at 31 Dec 12	Total number of ordinary and conditional shares at 31 Dec 12	Value (x salary)	Guideline (x salary)	Guideline met
Chairman							
Glen Moreno	150,000	150,000	–	–	–	–	–
Executive directors							
Marjorie Scardino	1,346,618	1,550,745	374,690	1,925,435	23.6	2.00	✓
Will Ethridge	405,295	505,635	128,116	633,751	11.7	1.25	✓
Rona Fairhead	425,023	440,522	101,926	542,448	12.5	1.25	✓
John Fallon (appointed 3 October 2012)	218,546	218,546	116,262	334,808	6.8	1.25	✓
Robin Freestone	308,731	408,814	128,213	537,027	13.1	1.25	✓
John Makinson	438,667	510,213	101,926	612,139	13.6	1.25	✓
Non-executive directors							
David Arculus	14,798	15,560	–	–	–	–	–
Patrick Cescau	7,117	7,886	–	–	–	–	–
Vivienne Cox	0	670	–	–	–	–	–
Susan Fuhrman	12,927	14,476	–	–	–	–	–
Ken Hydon	14,028	17,111	–	–	–	–	–
Josh Lewis	3,891	4,886	–	–	–	–	–

Note 1 Conditional shares means shares which have vested but remain held subject to continuing employment for a pre-defined holding period.

Note 2 The current value of the executive directors' holdings of ordinary and conditional shares is based on the middle market value of Pearson shares of 1,216.0p on 22 February 2013 (which is the latest practicable date before the results announcement) against base salaries in 2012. All executive directors comfortably exceeded the shareholding guidelines. The shareholding guidelines do not apply to the chairman and non-executive directors.

Note 3 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.

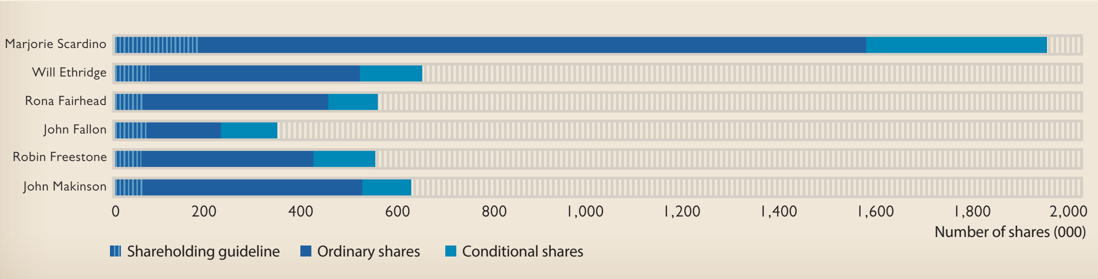
Note 4 From 2004, Marjorie Scardino is also deemed to be interested in a further number of shares under her unfunded pension arrangement described in this report, which provides the opportunity to convert a proportion of her notional cash account into a notional share account reflecting the value of a number of Pearson shares.

Note 5 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 2012 was 1,188.0p per share and the range during the year was 1,111.0p to 1,294.0p.

Note 6 At 31 December 2012, Patrick Cescau held 168,000 Pearson bonds.

Note 7 There were no movements in ordinary shares between 1 January 2012 and a month prior to the sign-off of this report.

Note 8 Ordinary shares do not include any shares vested but held pending release under a restricted share plan.



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 2012, stock awards to be satisfied by new-issue equity granted in the last ten years under all Pearson share plans amounted to 1.7% of the company's issued share capital. No stock awards granted in the last ten years under executive or discretionary share plans will be satisfied by new-issue equity.

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 2012 amounted to 1.2% of the company's issued share capital.

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

Headroom	2012	2011	2010
All Pearson plans	8.3%	8.3%	7.6%
Executive or discretionary plans	5.0%	5.0%	4.1%
Shares held in trust	3.8%	3.2%	3.3%

Report on directors' remuneration continued

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	$31,750
Rona Fairhead	HSBC Holdings plc	£200,000

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

Shareholder engagement

The voting results for prior reports on directors' remuneration over the previous five years are presented below:

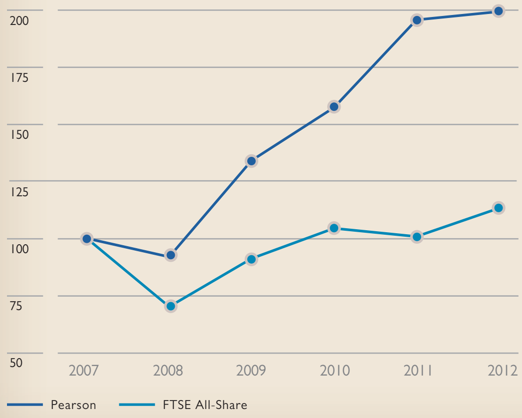
Year	Date of AGM	Votes for	Votes against
2011	27 April 2012	89.20%	4.99%
2010	28 April 2011	94.07%	3.40%
2009	30 April 2010	92.37%	4.97%
2008	1 May 2009	66.32%	23.36%
2007	25 April 2008	75.31%	10.42%

This table expresses as a percentage the votes cast, ignoring any formal instructions to withhold.

Total shareholder return performance

In compliance with current regulations, we set out below Pearson's total shareholder return performance relative to the FTSE All-Share index on an annual basis over the five-year period 2007 to 2012.

Total shareholder return: 5 years to 31 Dec 2012



Approved by the board and signed on its behalf by

David Arculus Director

7 March 2013

Financial statements: contents

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 2012. 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. In addition, we read all the financial and non-financial information in the annual report and accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2012 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 UK Corporate Governance 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 2013

Consolidated income statement
Year ended 31 December 2012

All figures in £ millions	Notes	2012	2011
Sales	2	5,059	4,817
Cost of goods sold	4	(2,224)	(2,072)
Gross profit		2,835	2,745
Operating expenses	4	(2,216)	(2,072)
Profit on sale of associate	12	–	412
Loss on closure of subsidiary		(113)	–
Share of results of joint ventures and associates	12	9	33
Operating profit	2	515	1,118
Finance costs	6	(113)	(96)
Finance income	6	32	25
Profit before tax		434	1,047
Income tax	7	(148)	(162)
Profit for the year from continuing operations		286	885
Profit for the year from discontinued operations	3	43	71
Profit for the year		329	956
Attributable to:			
Equity holders of the company		326	957
Non-controlling interest		3	(1)
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	40.5p	119.6p
– diluted	8	40.5p	119.3p
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	35.2p	110.7p
– diluted	8	35.1p	110.5p

Consolidated statement of comprehensive income
Year ended 31 December 2012

All figures in £ millions	Notes	2012	2011
Profit for the year		329	956
Net exchange differences on translation of foreign operations		(238)	(44)
Actuarial losses on retirement benefit obligations – Group	25	(119)	(56)
Actuarial losses on retirement benefit obligations – associate	12	(3)	(8)
Tax on items recognised in other comprehensive income	7	55	3
Other comprehensive expense for the year		(305)	(105)
Total comprehensive income for the year		24	851
Attributable to:			
Equity holders of the company		23	858
Non-controlling interest		1	(7)

Consolidated balance sheet

As at 31 December 2012

All figures in £ millions	Notes	2012	2011
Assets			
Non-current assets			
Property, plant and equipment	10	327	383
Intangible assets	11	6,218	6,342
Investments in joint ventures and associates	12	15	32
Deferred income tax assets	13	229	287
Financial assets – Derivative financial instruments	16	174	177
Retirement benefit assets	25	–	25
Other financial assets	15	31	26
Trade and other receivables	22	79	151
		7,073	7,423
Current assets			
Intangible assets – Pre-publication	20	666	650
Inventories	21	261	407
Trade and other receivables	22	1,104	1,386
Financial assets – Derivative financial instruments	16	4	–
Financial assets – Marketable securities	14	6	9
Cash and cash equivalents (excluding overdrafts)	17	1,062	1,369
		3,103	3,821
Assets classified as held for sale	32	1,172	–
Total assets		11,348	11,244
Liabilities			
Non-current liabilities			
Financial liabilities – Borrowings	18	(2,010)	(1,964)
Financial liabilities – Derivative financial instruments	16	–	(2)
Deferred income tax liabilities	13	(601)	(620)
Retirement benefit obligations	25	(172)	(166)
Provisions for other liabilities and charges	23	(110)	(115)
Other liabilities	24	(282)	(325)
		(3,175)	(3,192)
Current liabilities			
Trade and other liabilities	24	(1,556)	(1,741)
Financial liabilities – Borrowings	18	(262)	(87)
Financial liabilities – Derivative financial instruments	16	–	(1)
Current income tax liabilities		(291)	(213)
Provisions for other liabilities and charges	23	(38)	(48)
		(2,147)	(2,090)
Liabilities directly associated with assets classified as held for sale	32	(316)	–
Total liabilities		(5,638)	(5,282)
Net assets		5,710	5,962

All figures in £ millions	Notes	2012	2011
Equity			
Share capital	27	204	204
Share premium	27	2,555	2,544
Treasury shares	28	(103)	(149)
Translation reserve		128	364
Retained earnings		2,902	2,980
Total equity attributable to equity holders of the company		5,686	5,943
Non-controlling interest		24	19
Total equity		5,710	5,962

These financial statements have been approved for issue by the board of directors on 7 March 2013 and signed on its behalf by

Robin Freestone Chief financial officer

Consolidated statement of changes in equity

Year ended 31 December 2012

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 2012	204	2,544	(149)	364	2,980	5,943	19	5,962
Profit for the year	–	–	–	–	326	326	3	329
Other comprehensive expense	–	–	–	(236)	(67)	(303)	(2)	(305)
Equity-settled transactions	–	–	–	–	32	32	–	32
Tax on equity-settled transactions	–	–	–	–	(6)	(6)	–	(6)
Issue of ordinary shares under share option schemes	–	11	–	–	–	11	–	11
Purchase of treasury shares	–	–	–	–	–	–	–	–
Release of treasury shares	–	–	46	–	(46)	–	–	–
Put options over non-controlling interest	–	–	–	–	39	39	–	39
Changes in non-controlling interest	–	–	–	–	(10)	(10)	6	(4)
Dividends	–	–	–	–	(346)	(346)	(2)	(348)
At 31 December 2012	204	2,555	(103)	128	2,902	5,686	24	5,710

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 2011	203	2,524	(137)	402	2,546	5,538	67	5,605
Profit for the year	–	–	–	–	957	957	(1)	956
Other comprehensive expense	–	–	–	(38)	(61)	(99)	(6)	(105)
Equity-settled transactions	–	–	–	–	40	40	–	40
Tax on equity-settled transactions	–	–	–	–	3	3	–	3
Issue of ordinary shares under share option schemes	1	20	–	–	–	21	–	21
Purchase of treasury shares	–	–	(60)	–	–	(60)	–	(60)
Release of treasury shares	–	–	48	–	(48)	–	–	–
Put options over non-controlling interest	–	–	–	–	(63)	(63)	–	(63)
Changes in non-controlling interest	–	–	–	–	(76)	(76)	(40)	(116)
Dividends	–	–	–	–	(318)	(318)	(1)	(319)
At 31 December 2011	204	2,544	(149)	364	2,980	5,943	19	5,962

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 2012

All figures in £ millions	Notes	2012	2011
Cash flows from operating activities			
Net cash generated from operations	34	916	1,093
Interest paid		(75)	(70)
Tax paid		(65)	(151)
Net cash generated from operating activities		776	872
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	30	(716)	(779)
Acquisition of joint ventures and associates		(39)	(9)
Purchase of investments		(10)	(12)
Purchase of property, plant and equipment		(78)	(67)
Purchase of intangible assets		(73)	(77)
Disposal of subsidiaries, net of cash disposed	31	(11)	(6)
Proceeds from sale of associates	12	–	428
Proceeds from sale of investments		–	75
Proceeds from sale of property, plant & equipment	34	1	9
Proceeds from sale of intangible assets		3	3
Proceeds from the sale of liquid resources		23	–
Investment in liquid resources		(19)	–
Interest received		9	10
Dividends received from joint ventures and associates		27	30
Net cash used in investing activities		(883)	(395)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	11	21
Purchase of treasury shares	28	–	(60)
Proceeds from borrowings		327	–
Proceeds from the sale of liquid resources		–	2
Liquid resources acquired		(1)	–
Repayment of borrowings		–	(318)
Finance lease principal payments		(8)	(8)
Dividends paid to company's shareholders	9	(346)	(318)
Dividends paid to non-controlling interest		(2)	(1)
Transactions with non-controlling interest	33	(4)	(108)
Net cash used in financing activities		(23)	(790)
Effects of exchange rate changes on cash and cash equivalents		(24)	(60)
Net decrease in cash and cash equivalents		(154)	(373)
Cash and cash equivalents at beginning of year		1,291	1,664
Cash and cash equivalents at end of year	17	1,137	1,291

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

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 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 2013.

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 IFRS Interpretations Committee 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.

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 through profit or loss.

1. Interpretations and amendments to published standards effective 2012

The following amendments and interpretations were adopted in 2012 and have not had an impact on the Group financial statements:

- Amendments to IFRS 7 ‘Financial Instruments: Disclosures’.
- Amendments to IFRS 1 ‘First-time Adoption’.
- Amendments to IAS 12 ‘Income Taxes’.

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 19 ‘Employee Benefits (2011)’, effective for annual reporting periods beginning on or after 1 January 2013. The amendments include the elimination of the corridor approach, changes to the calculation of the net interest and service cost components and changes to disclosure. If the 2012 accounts had been prepared using IAS 19 (2011) the service cost would have been £4m higher and the net interest income would have been £15m lower.
- IFRS 9 ‘Financial Instruments’, effective for annual reporting periods beginning on or after 1 January 2015. The new standard details the requirements for the classification and measurement of financial assets and liabilities.
- The IASB issued a ‘package of five’ new and amended standards together. IFRS 10 ‘Consolidated Financial Statements’, IFRS 11 ‘Joint Arrangements’ and IFRS 12 ‘Disclosures of Involvement with Other Entities’ have been issued. IAS 27 ‘Separate Financial Statements’ (Revised 2011) has been amended following the issuance of IFRS 10 and retains the guidance for separate financial statements, IAS 28 ‘Investments in Associates and Joint Ventures’ (Revised 2011) has been amended following the issuance of IFRS 10 and IFRS 11. All three new standards and two amended standards are effective for annual reporting periods beginning on or after 1 January 2013.
- IFRS 13 ‘Fair Value Measurement’, effective for annual reporting periods beginning on or after 1 January 2013. The standard defines fair value and provides guidance on its determination, and introduces disclosure requirements on fair value measurements.
- Amendments to IAS 1 ‘Presentation of Financial Statements’ – Presentation of Items and Other Comprehensive Income, effective for annual reporting periods beginning on or after 1 July 2012. The amendments require the grouping of items in other comprehensive income into those that may be reclassified to profit or loss in subsequent periods, and those that will not.

With the exception of IAS 19 ‘Employee Benefits (2011)’, the changes in new pronouncements applicable from 1 January 2013 are not expected to have a material impact on the consolidated financial statements.

1. Accounting policies continued

a. Basis of preparation continued

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

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 in the operating expenses line of the income statement.

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.

Notes to the consolidated financial statements continued

1. Accounting policies continued

b. Consolidation continued

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.

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.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.59 (2011: \$1.60) and the year end rate was \$1.63 (2011: \$1.55).

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

1. Accounting policies continued

e. Intangible assets continued

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.

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.

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 34).

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.

Notes to the consolidated financial statements continued

1. Accounting policies continued

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.

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 where these amounts are used to offset the borrowings of the Group or as cash flows from investing activities where these amounts are held to generate an investment return.

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).

1. Accounting policies continued

m. Derivative financial instruments continued

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.

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.

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.

Notes to the consolidated financial statements continued

1. Accounting policies continued

o. Employee benefits continued

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.

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 at fair value.

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.

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.

1. Accounting policies continued

q. Revenue recognition continued

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. 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 the following business segments:

Continuing operations:

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;

Discontinued operations:

Penguin Consumer publisher with brand imprints such as Penguin, Putnam, Berkley, Viking and Dorling Kindersley.

Notes to the consolidated financial statements continued

2. Segment information continued

In October 2012, Pearson and Bertelsmann announced an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction is expected to complete in 2013 and, at that point, Pearson will no longer control the Penguin group of companies but will equity account for its 47% associate interest. The loss of control results in the Penguin business being classified as held for sale in the Pearson balance sheet at December 2012 and the results for both 2011 and 2012 have been included in discontinued operations.

For more detail on the services and products included in each business segment refer to the business review.

								2012
All figures in £ millions	Notes	North American Education	International Education	Professional	FT Group	Corporate	Discontinued operations	Group
Continuing operations								
Sales (external)		2,658	1,568	390	443	–	–	5,059
Sales (inter-segment)		5	1	12	–	–	–	18
Adjusted operating profit		536	216	37	49	–	–	838
Intangible charges		(66)	(73)	(37)	(4)	–	–	(180)
Acquisition costs		(7)	(8)	(1)	(4)	–	–	(20)
Other net gains and losses		–	–	(123)	–	–	–	(123)
Operating profit		463	135	(124)	41	–	–	515
Finance costs	6							(113)
Finance income	6							32
Profit before tax								434
Income tax	7							(148)
Profit for the year from continuing operations								286
Segment assets		5,449	2,390	631	445	1,246	1,145	11,306
Joint ventures	12	–	7	–	1	–	–	8
Associates	12	1	4	–	2	–	27	34
Total assets		5,450	2,401	631	448	1,246	1,172	11,348
Other segment items								
Share of results of joint ventures and associates	12	–	(3)	(11)	23	–	–	9
Capital expenditure	10, 11	66	33	16	26	–	11	152
Pre-publication investment	20	250	76	7	–	–	31	364
Depreciation	10	41	16	8	8	–	7	80
Amortisation	11, 20	311	142	45	16	–	39	553

2. Segment information continued

All figures in £ millions	Notes	North American Education	International Education	Professional	FT Group	Corporate	Discontinued operations	Group
								2011
Continuing operations								
Sales (external)		2,584	1,424	382	427	–	–	4,817
Sales (inter-segment)		3	–	9	–	–	–	12
Adjusted operating profit		493	196	66	76	–	–	831
Intangible charges		(57)	(60)	(11)	(8)	–	–	(136)
Acquisition costs		(2)	(9)	–	(1)	–	–	(12)
Other net gains and losses		29	(6)	–	412	–	–	435
Operating profit		463	121	55	479	–	–	1,118
Finance costs	6							(96)
Finance income	6							25
Profit before tax								1,047
Income tax	7							(162)
Profit for the year from continuing operations								885
Segment assets		5,198	2,388	626	424	1,555	1,021	11,212
Joint ventures	12	–	16	–	1	–	1	18
Associates	12	1	8	–	4	–	1	14
Total assets		5,199	2,412	626	429	1,555	1,023	11,244
Other segment items								
Share of results of joint ventures and associates	12	–	(2)	1	34	–	–	33
Capital expenditure	10, 11	75	33	17	19	–	12	156
Pre-publication investment	20	237	60	2	–	–	32	331
Depreciation	10	36	14	8	4	–	8	70
Amortisation	11, 20	309	128	16	20	–	45	518

In 2012, sales from the provision of goods were £2,946m (2011: £3,009m) and sales from the provision of services were £2,113m (2011: £1,808m). 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.

Included in other net gains and losses in 2012 in the Professional segment is the loss on closure of Pearson in Practice (£113m) and an impairment loss on a joint venture (£10m). In 2011 other net gains and losses includes a gain on sale of FTSE International (£412m) in the FT Group, a gain on the sale of investments in the North American Education business (£29m) and a net loss of £6m on acquisition and disposal transactions in the International Education business.

Notes to the consolidated financial statements continued

2. Segment information continued

Corporate costs are allocated to business segments including discontinued operations 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 £296m (2011: £404m) (see note 30). 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	2012	2011	2012	2011
Continuing operations				
UK	705	713	803	1,237
Other European countries	391	394	234	225
USA	2,800	2,707	4,496	4,325
Canada	145	150	307	226
Asia Pacific	647	514	524	570
Other countries	371	339	275	325
Total continuing	5,059	4,817	6,639	6,908
Discontinued operations				
UK	160	152	–	–
Other European countries	78	77	–	–
USA	603	606	–	–
Canada	56	59	–	–
Asia Pacific	139	132	–	–
Other countries	17	19	–	–
Total discontinued	1,053	1,045	–	–
Total	6,112	5,862	6,639	6,908

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. The geographical split of non-current assets is 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.

3. Discontinued operations

Discontinued operations relate to Penguin.

An analysis of the results and cash flows of discontinued operations is as follows:

All figures in £ millions	2012 Penguin	2011 Penguin
Sales	1,053	1,045
Operating profit	62	108
Profit before tax	62	108
Attributable tax expense	(19)	(37)
Profit after tax from discontinued operations	43	71
Operating cash flows	83	107
Investing cash flows	(81)	(13)
Financing cash flows	10	(71)
Total cash flows	12	23

Included in operating profit in 2012 are costs associated with the formation of Penguin Random House of £32m, including a provision for the settlement of litigation associated with the agency arrangement for eBooks.

4. Operating expenses

All figures in £ millions	2012	2011
By function:		
Cost of goods sold	2,224	2,072
Operating expenses		
Distribution costs	177	190
Administrative and other expenses	2,111	1,999
Other income	(72)	(117)
Total net operating expenses	2,216	2,072
Total	4,440	4,144

Included in other income in 2011 is a profit of £29m on the sale of an investment and a gain of £8m on a stepped acquisition. Both these items are excluded from adjusted earnings.

Notes to the consolidated financial statements continued

4. Operating expenses continued

All figures in £ millions	Notes	2012	2011
By nature:			
Utilisation of inventory	21	512	585
Depreciation of property, plant and equipment	10	72	63
Amortisation of intangible assets – Pre-publication	20	283	292
Amortisation of intangible assets – Other	11	230	181
Acquisition costs	8	20	12
Employee benefit expense	5	1,916	1,778
Operating lease rentals		171	164
Other property costs		33	37
Royalties expensed		245	260
Advertising, promotion and marketing		247	234
Information technology costs		82	74
Other costs		701	581
Other income		(72)	(117)
Total		4,440	4,144

During the year the Group obtained the following services from the Group's auditors:

All figures in £ millions	2012	2011
The audit of parent company and consolidated financial statements	4	4
The audit of the company's subsidiaries	2	2
Total audit fees	6	6
Other assurance services	1	–
Total assurance services	1	–
Tax compliance services	1	1
Tax advisory services	1	1
Total tax services	2	2
Corporate finance services not covered above	–	1
Total non-audit services	3	3
Total	9	9

Reconciliation between audit and non-audit service fees is shown below:

All figures in £ millions	2012	2011
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	6	6
Non-audit fees	3	3
Total	9	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.

5. Employee information

All figures in £ millions	Notes	2012	2011
Employee benefit expense			
Wages and salaries (including termination benefits and restructuring costs)		1,659	1,531
Social security costs		132	126
Share-based payment costs	26	28	36
Retirement benefits – defined contribution plans	25	71	62
Retirement benefits – defined benefit plans	25	22	20
Other post-retirement benefits	25	4	3
Total		1,916	1,778

The details of the emoluments of the directors of Pearson plc are shown in the report on directors' remuneration.

Average number employed	2012	2011
Employee numbers		
North American Education	18,552	16,133
International Education	16,751	13,646
Professional	3,706	4,561
FT Group	3,088	2,765
Other	883	859
Continuing operations	42,980	37,964

The employee benefit expense relating to discontinued operations was £211m (2011: £205m) and the average number employed was 4,542 (2011: 3,557).

Notes to the consolidated financial statements continued

6. Net finance costs

All figures in £ millions	Notes	2012	2011
Interest payable		(75)	(65)
Finance cost of put options, deferred consideration associated with acquisitions and other interest charges related to transactions		(27)	(4)
Net foreign exchange losses		(8)	(22)
Other losses on financial instruments in a hedging relationship:			
– fair value hedges		(1)	–
Other losses on financial instruments not in a hedging relationship:			
– derivatives		(2)	(5)
Finance costs		(113)	(96)
Interest receivable		10	10
Net finance income in respect of retirement benefits	25	13	3
Net foreign exchange gains		9	11
Other gains on financial instruments in a hedging relationship:			
– fair value hedges		–	–
Other gains on financial instruments not in a hedging relationship:			
– amortisation of transitional adjustment on bonds		–	1
– derivatives		–	–
Finance income		32	25
Net finance costs		(81)	(71)
Analysed as:			
Net interest payable		(65)	(55)
Net finance income in respect of retirement benefits	25	13	3
Net finance costs reflected in adjusted earnings – continuing operations		(52)	(52)
Other net finance costs		(29)	(19)
Total net finance costs		(81)	(71)

The net loss of £1m on fair value hedges in 2012 (2011: £nil) comprises a gain of £7m (2011: loss of £39m) on the underlying bonds, offset by a loss of £8m (2011: gain of £39m) on the related derivative financial instruments.

7. Income tax

All figures in £ millions	Notes	2012	2011
Current tax			
Charge in respect of current year		(154)	(187)
Adjustments in respect of prior years		18	36
Total current tax charge		(136)	(151)
Deferred tax			
In respect of temporary differences		(48)	(15)
Other adjustments in respect of prior years		36	4
Total deferred tax charge	13	(12)	(11)
Total tax charge		(148)	(162)

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	2012	2011
Profit before tax	434	1,047
Tax calculated at UK rate (2012: 24.5%, 2011: 26.5%)	(106)	(277)
Effect of overseas tax rates	(51)	(27)
Joint venture and associate income reported net of tax	2	9
Net (expense)/income not subject to tax	(15)	7
(Loss)/gain on sale of businesses not subject to tax	(28)	88
Utilisation of previously unrecognised tax losses and credits	2	1
Unutilised tax losses	(6)	(3)
Adjustments in respect of prior years	54	40
Total tax charge	(148)	(162)
UK	(22)	(10)
Overseas	(126)	(152)
Total tax charge	(148)	(162)
Tax rate reflected in earnings	34.1%	15.5%

Notes to the consolidated financial statements continued

7. Income tax continued

The tax rate reflected in adjusted earnings is calculated as follows:

All figures in £ millions	2012	2011
Profit before tax	434	1,047
Adjustments:		
Other net losses/(gains)	123	(435)
Acquisition costs	20	12
Amortisation of acquired intangibles	180	136
Other net finance costs	29	19
Adjusted profit before tax – continuing operations	786	779
Adjusted profit before tax – discontinued operations	98	111
Total adjusted profit before tax	884	890
Total tax charge	(148)	(162)
Adjustments:		
Tax charge on other net gains	–	19
Tax benefit on acquisition costs	(5)	(4)
Tax benefit on amortisation of acquired intangibles	(54)	(43)
Tax benefit on other net finance income	(1)	(5)
Tax amortisation benefit on goodwill and intangibles	36	34
Adjusted income tax charge – continuing operations	(172)	(161)
Adjusted income tax charge – discontinued operations	(32)	(38)
Total adjusted income tax charge	(204)	(199)
Tax rate reflected in adjusted earnings	23.1%	22.4%

The tax benefit/(charge) recognised in other comprehensive income is as follows:

All figures in £ millions	2012	2011
Pension contributions and actuarial gains and losses	55	7
Net investment hedges and other foreign exchange gains and losses	–	(4)
	55	3

A tax benefit of £6m (2011: tax benefit £3m) relating to share-based payments has been recognised directly in equity.

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	2012	2011
Profit for the year from continuing operations		286	885
Non-controlling interest		(3)	1
Earnings from continuing operations		283	886
Profit for the year from discontinued operations	3	43	71
Non-controlling interest		–	–
Earnings		326	957
Weighted average number of shares (millions)		804.3	800.2
Effect of dilutive share options (millions)		1.3	1.7
Weighted average number of shares (millions) for diluted earnings		805.6	801.9
Earnings per share from continuing and discontinued operations			
Basic		40.5p	119.6p
Diluted		40.5p	119.3p
Earnings per share from continuing operations			
Basic		35.2p	110.7p
Diluted		35.1p	110.5p
Earnings per share from discontinued operations			
Basic		5.3p	8.9p
Diluted		5.4p	8.8p

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.

Adjusted earnings includes the results from continuing and discontinued operations.

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.

Notes to the consolidated financial statements continued

8. Earnings per share continued

Other net finance income/costs include the finance costs of put options and deferred consideration that relate to future earn outs and similar payments on acquisition, 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. In the case of acquisition related items these are excluded as they do not reflect cash expended and foreign exchange and other 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.

Following the adoption of IAS 19 revised in 2013 the Group intends to exclude the pension finance income or expense from adjusted earnings as the calculation under the new standard will not necessarily reflect the underlying economics associated with the relevant pension assets and liabilities.

Tax on the above items is excluded from adjusted earnings. Where relevant the Group also excludes 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 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.

								2012
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	515	98	123	20	180	–	–	936
Net finance costs	(81)	–	–	–	–	29	–	(52)
Profit before tax	434	98	123	20	180	29	–	884
Income tax	(148)	(32)	–	(5)	(54)	(1)	36	(204)
Profit for the year from continuing operations	286	66	123	15	126	28	36	680
Profit for the year from discontinued operations	43	(66)	20	1	2	–	–	–
Profit for the year	329	–	143	16	128	28	36	680
Non-controlling interest	(3)	–	–	–	–	–	–	(3)
Earnings	326	–	143	16	128	28	36	677
Weighted average number of shares (millions)	804.3							804.3
Adjusted earnings per share	40.5p							84.2p

8. Earnings per share continued

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/ costs	Tax amortisation benefit	Adjusted income statement
								2011
Operating profit	1,118	111	(435)	12	136	–	–	942
Net finance costs	(71)	–	–	–	–	19	–	(52)
Profit before tax	1,047	111	(435)	12	136	19	–	890
Income tax	(162)	(38)	19	(4)	(43)	(5)	34	(199)
Profit for the year from continuing operations	885	73	(416)	8	93	14	34	691
Profit for the year from discontinued operations	71	(73)	–	–	2	–	–	–
Profit for the year	956	–	(416)	8	95	14	34	691
Non-controlling interest	1	–	–	–	–	–	–	1
Earnings	957	–	(416)	8	95	14	34	692
Weighted average number of shares (millions)	800.2							800.2
Adjusted earnings per share	119.6p							86.5p

9. Dividends

All figures in £ millions	2012	2011
Final paid in respect of prior year 28.0p (2011: 25.7p)	225	206
Interim paid in respect of current year 15.0p (2011: 14.0p)	121	112
	346	318

The directors are proposing a final dividend in respect of the financial year ended 31 December 2012 of 30.0p per share which will absorb an estimated £245m of shareholders' funds. It will be paid on 3 May 2013 to shareholders who are on the register of members on 5 April 2013. These financial statements do not reflect this dividend.

Notes to the consolidated financial statements continued

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 2011	336	669	11	1,016
Exchange differences	2	(2)	–	–
Additions	15	51	13	79
Disposals	(13)	(31)	–	(44)
Acquisition through business combination	11	21	–	32
Disposal through business disposal	–	(2)	–	(2)
Reclassifications	12	–	(12)	–
At 31 December 2011	363	706	12	1,081
Exchange differences	(9)	(23)	–	(32)
Additions	12	51	15	78
Disposals	(2)	(20)	–	(22)
Acquisition through business combination	4	13	–	17
Disposal through business disposal	(1)	(4)	–	(5)
Reclassifications	8	–	(8)	–
Transfer from/(to) software	9	(27)	–	(18)
Transfer from pre-publication	–	3	–	3
Transfer to assets held for sale	(32)	(102)	(1)	(135)
At 31 December 2012	352	597	18	967

10. Property, plant and equipment continued

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2011	(166)	(484)	–	(650)
Exchange differences	(1)	1	–	–
Charge for the year	(16)	(54)	–	(70)
Disposals	2	29	–	31
Acquisition through business combination	(1)	(10)	–	(11)
Disposal through business disposal	–	2	–	2
Reclassifications	(5)	5	–	–
At 31 December 2011	(187)	(511)	–	(698)
Exchange differences	6	17	–	23
Charge for the year	(21)	(59)	–	(80)
Disposals	2	19	–	21
Acquisition through business combination	(1)	(6)	–	(7)
Disposal through business disposal	–	2	–	2
Reclassifications	(8)	8	–	–
Transfer (from)/to software	(3)	7	–	4
Transfer to assets held for sale	17	78	–	95
At 31 December 2012	(195)	(445)	–	(640)
Carrying amounts				
At 1 January 2011	170	185	11	366
At 31 December 2011	176	195	12	383
At 31 December 2012	157	152	18	327

Notes to the consolidated financial statements continued

10. Property, plant and equipment continued

Depreciation expense of £19m (2011: £15m) has been included in the income statement in cost of goods sold, £9m (2011: £10m) in distribution expenses and £52m (2011: £45m) in administrative and other expenses. In 2012 £7m (2011: £8m) 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 £17m (2011: £18m).

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 2011	4,568	352	431	186	230	306	6,073
Exchange differences	15	(1)	1	(1)	(12)	(1)	1
Additions – internal development	–	49	–	–	–	–	49
Additions – purchased	–	28	–	–	–	–	28
Disposals	–	(9)	–	–	–	–	(9)
Acquisition through business combination	620	9	200	68	–	100	997
Disposal through business disposal	(4)	–	–	–	(5)	–	(9)
At 31 December 2011	5,199	428	632	253	213	405	7,130
Exchange differences	(213)	(13)	(22)	(11)	(9)	(22)	(290)
Additions – internal development	–	38	–	–	–	–	38
Additions – purchased	–	36	–	–	–	–	36
Disposals	–	(11)	–	–	–	–	(11)
Acquisition through business combination	505	12	128	27	10	110	792
Disposal through business disposal	(50)	–	(89)	(2)	–	–	(141)
Transfer from PPE	–	18	–	–	–	–	18
Transfer to assets held for sale	(364)	(42)	(14)	(9)	(7)	(5)	(441)
At 31 December 2012	5,077	466	635	258	207	488	7,131

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 2011	–	(250)	(103)	(41)	(111)	(101)	(606)
Exchange differences	–	(2)	1	–	4	(3)	–
Charge for the year	–	(48)	(55)	(22)	(22)	(40)	(187)
Disposals	–	6	–	–	–	–	6
Acquisition through business combination	–	(2)	–	–	–	–	(2)
Disposal through business disposal	–	–	–	–	1	–	1
At 31 December 2011	–	(296)	(157)	(63)	(128)	(144)	(788)
Exchange differences	–	9	7	3	5	8	32
Charge for the year	–	(54)	(85)	(27)	(20)	(51)	(237)
Disposals	–	8	–	–	–	–	8
Acquisition through business combination	–	(7)	–	–	–	–	(7)
Disposal through business disposal	–	–	45	1	–	–	46
Transfer from PPE	–	(4)	–	–	–	–	(4)
Transfer to assets held for sale	–	32	1	–	4	–	37
At 31 December 2012	–	(312)	(189)	(86)	(139)	(187)	(913)
Carrying amounts							
At 1 January 2011	4,568	102	328	145	119	205	5,467
At 31 December 2011	5,199	132	475	190	85	261	6,342
At 31 December 2012	5,077	154	446	172	68	301	6,218

Goodwill

The goodwill carrying value of £5,077m 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. 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.

Intangible assets are valued separately for each acquisition and the primary method of valuation used is the discounted cash flow method. The majority of acquired intangibles are amortised using the unit of production method which is based on the pattern of benefits embodied in the asset.

Amortisation of £10m (2011: £10m) is included in the income statement in cost of goods sold and £205m (2011: £177m) in administrative and other expenses. Also included in the amortisation charge for the year in 2012 is an impairment of £21m relating to Pearson in Practice which is included in the income statement in administrative and other expenses. In 2012 £7m (2011: £6m) of amortisation relates to discontinued operations.

Notes to the consolidated financial statements continued

11. Intangible assets continued

The range of useful economic lives for each major class of intangible asset (excluding goodwill and software) is shown below:

Class of intangible asset	2012 Useful economic life
Acquired customer lists and relationships	5–20 years
Acquired trademarks and brands	5–20 years
Acquired publishing rights	5–20 years
Other intangibles acquired	2–20 years

The expected amortisation profile of acquired intangible assets is shown below:

All figures in £ millions	2012 One to five years	Six to ten years	More than ten years	Total
Class of intangible asset				
Acquired customer lists and relationships	263	132	51	446
Acquired trademarks and brands	89	49	34	172
Acquired publishing rights	59	8	1	68
Other intangibles acquired	231	63	7	301

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, and monitored at the level of, 10 aggregated cash-generating units (CGUs) within the business segments as follows:

All figures in £ millions	2012	2011
US Education Publishing	2,384	2,127
US School Assessment and Information	773	792
Canada	188	192
International – Emerging Markets	463	508
International – UK	450	460
International – Rest Of World	267	228
Professional Publishing	15	13
Professional Assessment and Training	334	377
Pearson Education total	4,874	4,697
Financial Times	51	49
Mergermarket	152	138
FT Group total	203	187
Continuing operations	5,077	4,884

Goodwill in respect of discontinued operations is £364m (2011: £315m).

11. Intangible assets continued

Impairment tests for cash-generating units containing goodwill continued

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.

In 2011, following a reorganisation within the International Education business the CGUs were re-analysed into Emerging Markets, UK and Rest Of World to align with the management and reporting structure. The goodwill was reallocated accordingly using a relative value approach except where goodwill is directly attributable to one of the new CGUs, in which case the goodwill was specifically allocated to the relevant CGU.

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 9.8% to 12.7% for the Pearson Education businesses (2011: 10.7% to 13.3%) and 11.5% to 18.4% for the FT Group businesses (2011: 11.6% to 17.9%).

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 2012 (2011: 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	2012	2011
At beginning of year	18	18
Exchange differences	–	(3)
Share of loss after tax	(4)	(2)
Dividends	(2)	(2)
Additions and further investment	6	7
Goodwill impairment	(10)	–
At end of year	8	18

The goodwill impairment charge relates to the write down of the Group's investment in a joint venture in India.

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 2012 was £1m (2011: £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	2012	2011
Assets		
Non-current assets	5	15
Current assets	19	17
Liabilities		
Non-current liabilities	(2)	(1)
Current liabilities	(14)	(13)
Net assets	8	18
Income	24	22
Expenses	(28)	(24)
Loss after tax	(4)	(2)

Associates

All figures in £ millions	2012	2011
At beginning of year	14	53
Exchange differences	(8)	(3)
Share of profit after tax	23	35
Dividends	(24)	(30)
Additions	32	2
Disposals	–	(15)
Actuarial losses on retirement benefit obligations	(3)	(8)
Transfer to subsidiary	–	(20)
Transfer to assets held for sale	(27)	–
At end of year	7	14

In addition to the amounts disclosed above, FTSE International Ltd paid royalties of £13m to the FT Group during 2011. This royalty payment ceased upon the disposal of FTSE International Ltd.

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 2012 was £20m (2011: £nil). This has been transferred to assets held for sale as it relates to an investment made by Penguin.

The Group's interests in its associates, all of which are unlisted, are as follows:

	2012					
All figures in £ millions	Country of incorporation	% interest held	Assets	Liabilities	Revenues	Profit
The Economist Newspaper Ltd	England	50	140	(140)	174	23
Other continuing operations			14	(7)	17	1
Discontinued operations			29	(2)	9	(1)
Total			183	(149)	200	23

12. Investments in joint ventures and associates continued

All figures in £ millions	Country of incorporation	% interest held	Assets 2011	Liabilities 2011	Revenues 2011	Profit 2011
The Economist Newspaper Ltd	England	50	140	(140)	179	27
FTSE International Ltd *	England	50	–	–	31	7
Other			16	(2)	15	1
Total			156	(142)	225	35

* FTSE International Ltd included to date of disposal

The interests held in associates are equivalent to voting rights.

On 16 December 2011 the Group sold its 50% interest in FTSE International Ltd.

Gain on sale of FTSE International Ltd

All figures in £ millions	2011
Proceeds	428
Disposal costs	(1)
Net assets disposed	(15)
Gain on sale	412

13. Deferred income tax

All figures in £ millions	2012	2011
Deferred income tax assets	229	287
Deferred income tax liabilities	(601)	(620)
Net deferred income tax	(372)	(333)

Substantially all of the deferred tax assets are expected to be recovered after more than one year.

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 £13m at 31 December 2012 (2011: £13m) in respect of UK losses, and approximately £30m (2011: £15m) 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	2012	2011
At beginning of year		(333)	(195)
Exchange differences		14	(5)
Income statement charge	7	(17)	(37)
Acquisition through business combination	30	(67)	(96)
Disposal through business disposal	31	11	1
Tax charge to other comprehensive income or equity		38	(1)
Transfer to assets held for sale		(18)	–
At end of year		(372)	(333)

Included in the income statement charge above for 2012 is a £5m charge (2011: £26m charge) relating to discontinued operations.

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 2011	5	4	96	6	165	276
Exchange differences	–	–	1	–	2	3
Acquisition through business combination	8	–	–	–	1	9
Income statement benefit/(charge)	1	(4)	(8)	19	(6)	2
Tax (charge)/benefit to other comprehensive income or equity	–	–	–	(6)	3	(3)
At 31 December 2011	14	–	89	19	165	287
Exchange differences	–	–	(3)	(1)	(5)	(9)
Acquisition through business combination	19	–	–	–	–	19
Income statement charge	(13)	–	(16)	(5)	(33)	(67)
Tax benefit/(charge) to other comprehensive income or equity	–	–	–	43	(6)	37
Transfer to assets held for sale	(2)	–	(25)	(9)	(2)	(38)
At 31 December 2012	18	–	45	47	119	229

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 2011	(334)	(137)	(471)
Exchange differences	(6)	(2)	(8)
Acquisition through business combination	(102)	(3)	(105)
Disposal through business disposal	–	1	1
Income statement benefit	(22)	(17)	(39)
Tax benefit to other comprehensive income or equity	–	2	2
At 31 December 2011	(464)	(156)	(620)
Exchange differences	18	5	23
Acquisition through business combination	(65)	(21)	(86)
Disposal through business disposal	11	–	11
Income statement charge	15	35	50
Tax benefit to other comprehensive income or equity	–	1	1
Transfer to assets held for sale	10	10	20
At 31 December 2012	(475)	(126)	(601)

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:

		2012							
					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 – continuing operations	15	31	–	–	–	–	–	31	31
Investments in unlisted securities classified within assets held for sale	32	1	–	–	–	–	–	1	1
Cash and cash equivalents – continuing operations	17	–	–	–	–	1,062	–	1,062	1,062
Cash and cash equivalents classified within assets held for sale	32	–	–	–	–	115	–	115	115
Marketable securities		6	–	–	–	–	–	6	6
Derivative financial instruments	16	–	1	177	–	–	–	178	178
Trade receivables – continuing operations	22	–	–	–	–	883	–	883	883
Trade receivables classified within assets held for sale		–	–	–	–	249	–	249	249
Total financial assets		38	1	177	–	2,309	–	2,525	2,525
Trade payables – continuing operations	24	–	–	–	–	–	(337)	(337)	(337)
Trade payables classified within liabilities held for sale		–	–	–	–	–	(148)	(148)	(148)
Other financial liabilities – put options over non-controlling interest	24	–	–	–	(68)	–	–	(68)	(68)
Bank loans and overdrafts – continuing operations	18	–	–	–	–	–	(55)	(55)	(55)
Bank loans and overdrafts classified within liabilities held for sale	32	–	–	–	–	–	(7)	(7)	(7)
Borrowings due within one year	18	–	–	–	–	–	(229)	(229)	(228)
Borrowings due after more than one year	18	–	–	–	–	–	(1,988)	(1,988)	(2,043)
Total financial liabilities		–	–	–	(68)	–	(2,764)	(2,832)	(2,886)

Notes to the consolidated financial statements continued

14. Classification of financial instruments continued

All figures in £ millions	Notes	Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Fair value: Other liabilities	Amortised cost: Loans and receivables	Amortised cost: Other liabilities	Total carrying value	Total market value
									2011
Investments in unlisted securities	15	26	–	–	–	–	–	26	26
Cash and cash equivalents	17	–	–	–	–	1,369	–	1,369	1,369
Marketable securities		9	–	–	–	–	–	9	9
Derivative financial instruments	16	–	3	174	–	–	–	177	177
Trade receivables	22	–	–	–	–	1,061	–	1,061	1,061
Total financial assets		35	3	174	–	2,430	–	2,642	2,642
Derivative financial instruments	16	–	(1)	(2)	–	–	–	(3)	(3)
Trade payables	24	–	–	–	–	–	(483)	(483)	(483)
Other financial liabilities – put options over non-controlling interest	24	–	–	–	(86)	–	–	(86)	(86)
Bank loans and overdrafts	18	–	–	–	–	–	(78)	(78)	(78)
Borrowings due within one year	18	–	–	–	–	–	(9)	(9)	(9)
Borrowings due after more than one year	18	–	–	–	–	–	(1,964)	(1,964)	(2,000)
Total financial liabilities		–	(1)	(2)	(86)	–	(2,534)	(2,623)	(2,659)

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	2012	2011
At beginning of year	26	58
Exchange differences	(2)	–
Acquisition of investments	10	12
Disposal of investments	(2)	(44)
Transfer to assets held for sale	(1)	–
At end of year	31	26

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:

	2012			2011		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,465	143	–	1,208	151	–
Interest rate derivatives – not in a hedge relationship	61	1	–	65	3	(1)
Cross-currency rate derivatives – in a net investment hedge relationship	220	34	–	220	23	(2)
Total	1,746	178	–	1,493	177	(3)
Analysed as expiring:						
In less than one year	215	4	–	–	–	(1)
Later than one year and not later than five years	701	69	–	946	81	(2)
Later than five years	830	105	–	547	96	–
Total	1,746	178	–	1,493	177	(3)

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 2012, 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 £(59)m, sterling £257m and South African rand £(20)m (2011: US dollar £(66)m, sterling £263m and South African rand £(23)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2012 range from 3.65% to 9.28% (2011: 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	2012	2011
Cash at bank and in hand	372	864
Short-term bank deposits	690	505
Continuing operations	1,062	1,369
Cash at bank and in hand classified within assets held for sale	115	–
	1,177	1,369

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2012 the currency split of cash and cash equivalents was US dollar 47% (2011: 31%), sterling 25% (2011: 38%), euro 3% (2011: 8%) and other 25% (2011: 23%).

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	2012	2011
Cash and cash equivalents – continuing operations	1,062	1,369
Cash at bank and in hand classified within assets held for sale	115	–
Bank overdrafts – continuing operations	(33)	(78)
Bank overdrafts classified within liabilities held for sale	(7)	–
	1,137	1,291

18. Financial liabilities – Borrowings

The Group's current and non-current borrowings are as follows:

All figures in £ millions	2012	2011
Non-current		
5.5% Global Dollar Bonds 2013 (nominal amount $350m)	–	233
5.7% US Dollar Bonds 2014 (nominal amount $400m)	264	286
7.0% Sterling Bonds 2014 (nominal amount £250m)	256	257
6.0% Sterling Bonds 2015 (nominal amount £300m)	298	298
4.0% US Dollar Notes 2016 (nominal amount $350m)	229	238
6.25% Global Dollar Bonds 2018 (nominal amount $550m)	402	419
4.625% US Dollar Notes 2018 (nominal amount $300m)	217	224
3.75% US Dollar Notes 2022 (nominal amount $500m)	315	–
Bank loans and overdrafts	22	–
Finance lease liabilities	7	9
	2,010	1,964
Current		
Due within one year or on-demand:		
5.5% Global Dollar Bonds 2013 (nominal amount $350m)	219	–
Bank loans and overdrafts	33	78
Finance lease liabilities	10	9
	262	87
Total borrowings – continuing operations	2,272	2,051
Bank overdrafts classified within liabilities held for sale	7	–
Total borrowings	2,279	2,051

Included in the non-current borrowings above is £11m of accrued interest (2011: £12m). Included in the current borrowings above is £2m of accrued interest (2011: £ nil).

The maturity of the Group's non-current borrowing is as follows:

All figures in £ millions	2012	2011
Between one and two years	524	241
Between two and five years	552	1,080
Over five years	934	643
	2,010	1,964

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			2012		2011
	Effective interest rate	Carrying value	Market value	Carrying value	Market value
Bank loans and overdrafts	n/a	55	55	78	78
5.5% Global Dollar Bonds 2013	5.76%	219	218	233	237
5.7% US Dollar Bonds 2014	5.88%	264	260	286	280
7.0% Sterling Bonds 2014	7.20%	256	274	257	282
6.0% Sterling Bonds 2015	6.27%	298	337	298	340
4.0% US Dollar Notes 2016	4.26%	229	233	238	237
6.25% Global Dollar Bonds 2018	6.46%	402	410	419	409
4.625% US Dollar Notes 2018	4.69%	217	209	224	206
3.75% US Dollar Notes 2022	3.94%	315	313	–	–
Finance lease liabilities	n/a	17	17	18	18
Continuing operations		2,272	2,326		
Bank overdrafts classified within liabilities held for sale	n/a	7	7	–	–
		2,279	2,333	2,051	2,087

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	2012	2011
US dollar	1,684	1,488
Sterling	573	563
Other	22	–
	2,279	2,051

The Group has the following undrawn capacity on its committed borrowing facilities as at 31 December:

All figures in £ millions	2012	2011
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,077	1,126
	1,077	1,126

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	2012	2011
Finance lease liabilities – minimum lease payments		
Not later than one year	10	9
Later than one year and not later than two years	4	8
Later than two years and not later than three years	3	1
Later than three years and not later than four years	–	–
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	17	18

The present value of finance lease liabilities is as follows:

All figures in £ millions	2012	2011
Not later than one year	10	9
Later than one year and not later than five years	7	9
Later than five years	–	–
	17	18

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 of its financial instruments 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 overleaf. All the treasury policies remained unchanged throughout, except for revisions to the Group's bank counterparty risk limits and related approval processes and minor amendments to reflect the consolidation of the Group's treasury operations into one location.

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 2012 the fixed to floating hedging ratio, on the above basis, was approximately 55%. A simultaneous 1% change on 1 January 2013 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £6m 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 2012 the average maturity of gross borrowings was 3.9 years (2011: 4.0 years) of which bonds represented 97% (2011: 95%) 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 2012 the committed facilities amounted to £1,077m and their weighted average maturity was 2.9 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	2012	2011
Cash and cash equivalents	1,062	1,369
Marketable securities	6	9
Derivative financial instruments	178	174
Bank loans, overdrafts and loan notes	(55)	(78)
Bonds	(2,200)	(1,955)
Finance lease liabilities	(17)	(18)
Continuing operations	(1,026)	(499)
Cash & cash equivalents classified within assets held for sale	115	–
Bank loans, overdrafts and loan notes classified within liabilities held for sale	(7)	–
Net debt	(918)	(499)

The split of net debt between fixed and floating rate, stated after the impact of rate derivatives, is as follows:

All figures in £ millions	2012	2011
Fixed rate	499	510
Floating rate	419	(11)
Total	918	499

Gross borrowings, after the impact of cross-currency rate derivatives, analysed by currency are as follows:

All figures in £ millions	2012	2011
US dollar	1,905	1,687
Sterling	353	343
Other	21	21
Total	2,279	2,051

As at 31 December 2012 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	291	1,054	934	2,279
Effect of rate derivatives	1,311	(480)	(831)	–
Total	1,602	574	103	2,279

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:

				2012
All figures in £ millions	USD	GBP	Other	Total
Not later than one year	489	126	142	757
Later than one year and not later than five years	726	357	21	1,104
Later than five years	863	–	–	863
Total	2,078	483	163	2,724
Analysed as:				
Bonds	1,837	639	–	2,476
Rate derivatives – inflows	(326)	(264)	–	(590)
Rate derivatives – outflows	328	3	22	353
Trade payables	239	105	141	485
Total	2,078	483	163	2,724

				2011
All figures in £ millions	USD	GBP	Other	Total
Not later than one year	261	124	156	541
Later than one year and not later than five years	984	378	25	1,387
Later than five years	563	–	–	563
Total	1,808	502	181	2,491
Analysed as:				
Bonds	1,553	675	–	2,228
Rate derivatives – inflows	(292)	(281)	–	(573)
Rate derivatives – outflows	321	5	27	353
Trade payables	226	103	154	483
Total	1,808	502	181	2,491

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 £1,354m, sterling £58m and South African rand £(17)m.

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	2012 Level 1	2012 Level 2	2012 Level 3	2012 Total	2011 Level 1	2011 Level 2	2011 Level 3	2011 Total
Financial assets at fair value								
Derivative financial assets	–	178	–	178	–	177	–	177
Marketable securities	–	6	–	6	–	9	–	9
Available for sale financial assets								
Investments in unlisted securities – continuing operations	–	–	30	30	–	–	26	26
Investments in unlisted securities classified within assets held for sale	–	–	1	1	–	–	–	–
Financial liabilities at fair value								
Derivative financial liabilities	–	–	–	–	–	(3)	–	(3)
Other financial liabilities – put options over non-controlling interest	–	–	(68)	(68)	–	–	(86)	(86)
Total	–	184	(37)	147	–	183	(60)	123

The following table analyses the movements in level 3 fair value measurements:

All figures in £ millions	2012 Investments in unlisted securities	2012 Other financial liabilities	2011 Investments in unlisted securities	2011 Other financial liabilities
At beginning of year	26	(86)	58	(25)
Exchange differences	(2)	5	–	3
Additions	10	–	13	(63)
Fair value movements	–	(25)	–	(1)
Transfer to assets classified as held for sale	(1)	–	–	–
Disposals	(2)	38	(45)	–
At end of year	31	(68)	26	(86)

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.

19. Financial risk management continued

Financial instruments – sensitivity analysis

As at 31 December 2012 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 – continuing operations	31	–	–	(3)	4
Investments in unlisted securities classified within assets held for sale	1	–	–	–	–
Cash and cash equivalents – continuing operations	1,062	–	–	(75)	92
Cash and cash equivalents classified within assets held for sale	115	–	–	(4)	4
Marketable securities	6	–	–	–	–
Derivative financial instruments	178	(66)	65	7	(9)
Bonds	(2,200)	64	(63)	149	(183)
Other borrowings – continuing operations	(72)	–	–	5	(6)
Other borrowings classified within liabilities held for sale	(7)	–	–	1	(1)
Put options over non-controlling interest	(68)	–	–	7	(7)
Other net financial assets – continuing operations	546	–	–	(43)	52
Other net financial assets classified within assets and liabilities held for sale	101	–	–	(10)	12
Total financial instruments	(307)	(2)	2	34	(42)

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, due to the location and functional currency of the entities 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.

Notes to the consolidated financial statements continued

20. Intangible assets – Pre-publication

All figures in £ millions	2012	2011
Cost		
At beginning of year	1,965	1,863
Exchange differences	(74)	6
Additions	364	331
Disposals	(188)	(249)
Acquisition through business combination	14	14
Transfer to property, plant and equipment	(3)	–
Transfer to assets classified as held for sale	(202)	–
At end of year	1,876	1,965
Amortisation		
At beginning of year	(1,315)	(1,216)
Exchange differences	55	(11)
Charge for the year	(316)	(331)
Disposals	188	249
Acquisition through business combination	(8)	(6)
Transfer to assets classified as held for sale	186	–
At end of year	(1,210)	(1,315)
Carrying amounts		
At end of year	666	650

Included in the above are pre-publication assets amounting to £431m (2011: £413m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold. In 2012 £33m (2011: £39m) relates to discontinued operations.

21. Inventories

All figures in £ millions	2012	2011
Raw materials	13	24
Work in progress	11	20
Finished goods	237	363
	261	407

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 £512m (2011: £585m). In 2012 £71m (2011: £63m) 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	2012	2011
Current		
Trade receivables	868	1,048
Royalty advances	16	107
Prepayments and accrued income	81	90
Other receivables	139	141
	1,104	1,386
Non-current		
Trade receivables	15	13
Royalty advances	13	88
Prepayments and accrued income	33	34
Other receivables	18	16
	79	151

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	2012	2011
At beginning of year	(102)	(83)
Exchange differences	4	1
Income statement movements	(21)	(31)
Utilised	53	17
Acquisition through business combination	(1)	(8)
Disposal through business disposal	–	2
Transfer to assets classified as held for sale	12	–
At end of year	(55)	(102)

Concentrations of credit risk with respect to trade receivables are limited due to the Group's large number of customers, who are internationally dispersed.

The ageing of the Group's trade receivables is as follows:

All figures in £ millions	2012	2011
Within due date	774	1,079
Up to three months past due date	231	289
Three to six months past due date	43	37
Six to nine months past due date	10	4
Nine to 12 months past due date	7	3
More than 12 months past due date	5	–
Total trade receivables	1,070	1,412
Less: provision for sales returns	(187)	(351)
Net trade receivables	883	1,061

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.

Notes to the consolidated financial statements continued

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Legal and other	Total
At 1 January 2012	97	17	49	163
Exchange differences	(3)	–	(4)	(7)
Charged to income statement	–	12	45	57
Released to income statement	–	(1)	(2)	(3)
Deferred consideration on acquisition	6	–	–	6
Acquisition through business combination	(3)	–	4	1
Utilised	(31)	(1)	(8)	(40)
Transfer to liabilities held for sale	(2)	(1)	(26)	(29)
At 31 December 2012	64	26	58	148

Analysis of provisions:

All figures in £ millions	Deferred consideration	Property	Legal and other	Total
				2012
Current	6	12	20	38
Non-current	58	14	38	110
	64	26	58	148
				2011
Current	32	5	11	48
Non-current	65	12	38	115
	97	17	49	163

Deferred consideration primarily relates to the formation of a venture in the US Professional business in 2011.

Legal and other includes provisions in relation to legal claims, contract disputes and potential contract losses.

24. Trade and other liabilities

All figures in £ millions	2012	2011
Trade payables	337	483
Social security and other taxes	30	25
Accruals	440	544
Deferred income	714	678
Interest payable	21	18
Put options over non-controlling interest	68	86
Other liabilities	228	232
	1,838	2,066
Less: non-current portion		
Accruals	18	25
Deferred income	147	147
Put options over non-controlling interest	25	62
Interest payable	13	6
Other liabilities	79	85
	282	325
Current portion	1,556	1,741

The carrying value of the Group's trade and other liabilities approximates its fair value.

24. Trade and other liabilities continued

The deferred income balance comprises principally: multi-year obligations to deliver workbooks to adoption customers in school businesses; advance payments in assessment, testing and teaching businesses; subscription income in school and newspaper businesses; and obligations to deliver digital content in future periods.

The put options over non-controlling interest are the fair value of options held by the non-controlling interests in the Group's Southern African and Indian businesses.

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.

At 31 December 2012 the UK Group plan has approximately 27,000 members, analysed in the following table:

%	Active	Deferred	Pensioners	Total
Defined benefit	3	26	32	61
Defined contribution	18	21	–	39
Total	21	47	32	100

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.

			2012			2011
%	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.0	2.5	2.5	3.0	2.5	2.5
Rate used to discount plan liabilities	4.4	3.6	3.6	4.9	4.2	4.2
Expected return on assets	5.8	5.5	–	5.7	6.4	–
Expected rate of increase in salaries	3.5	3.9	–	4.0	4.0	–
Expected rate of increase for pensions in payment and deferred pensions	2.3 to 5.1	–	–	2.4 to 4.3	–	–
Initial rate of increase in healthcare rate	–	–	8.0	–	–	7.5
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.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

The inflation rate for the UK Group plan of 3.0% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.5% has been used.

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 3.5% for 2012 with a short-term assumption of 3.0% for three years.

For the UK plan, 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. A 1.5% improvement floor on the medium cohort is applied for males, and 1.25% for females, with tapering.

For the US plans, the RP2000 table is used, reflecting the mortality assumption most prevalent in the US. In 2010 a ten-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 Group plan and US plans is as follows:

	UK		US	
	2012	2011	2012	2011
Male	23.0	22.6	19.2	19.2
Female	24.2	23.5	21.1	21.1

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	
	2012	2011	2012	2011
Male	25.1	25.2	19.2	19.2
Female	26.1	25.6	21.1	21.1

Financial statement information

The amounts recognised in the income statement are as follows:

						2012
All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	23	3	26	78	4	108
Total operating expense	23	3	26	78	4	108
Expected return on plan assets	(111)	(8)	(119)	–	–	(119)
Interest on plan liabilities	96	7	103	–	3	106
Net finance (income)/expense	(15)	(1)	(16)	–	3	(13)
Net income statement charge	8	2	10	78	7	95
Actual return on plan assets	146	15	161	–	–	161

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
						2011
Current service cost	21	3	24	69	3	96
Total operating expense	21	3	24	69	3	96
Expected return on plan assets	(107)	(7)	(114)	–	–	(114)
Interest on plan liabilities	100	8	108	–	3	111
Net finance (income)/expense	(7)	1	(6)	–	3	(3)
Net income statement charge	14	4	18	69	6	93
Actual return on plan assets	161	5	166	–	–	166

Included within the 2012 results are discontinued operations consisting of a £4m charge (2011: £4m charge) relating to defined benefit schemes and a £7m charge (2011: £7m charge) relating to defined contribution schemes.

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2012 UK Group plan	2012 Other funded plans	2012 Other unfunded plans	2012 Total	2011 UK Group plan	2011 Other funded plans	2011 Other unfunded plans	2011 Total
Fair value of plan assets	2,162	165	–	2,327	2,008	149	–	2,157
Present value of defined benefit obligation	(2,181)	(196)	(24)	(2,401)	(1,983)	(173)	(24)	(2,180)
Net pension asset/(liability)	(19)	(31)	(24)	(74)	25	(24)	(24)	(23)
Other post-retirement medical benefit obligation				(89)				(85)
Other pension accruals				(35)				(33)
Net retirement benefit obligations				(198)				(141)
Analysed as:								
Retirement benefit assets				–				25
Retirement benefit obligations				(198)				(166)

Included within the 2012 retirement benefit obligation is a liability of £26m which relates to Penguin and is classified as held for sale.

The following losses have been recognised in other comprehensive income:

All figures in £ millions	2012	2011
Amounts recognised for defined benefit plans	(114)	(47)
Amounts recognised for post-retirement medical benefit plans	(5)	(9)
Total recognised in year	(119)	(56)
Cumulative amounts recognised	(351)	(232)

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:

	2012			2011		
%	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
Equities	32	2	34	27	3	30
Bonds	38	3	41	48	3	51
Properties	9	1	10	3	–	3
Other	14	1	15	15	1	16

The plan assets do not include any of the Group's own financial instruments, or any property occupied by the Group.

The table below further disaggregates the UK Group plan assets into additional categories and those assets which have a quoted market price in an active market and those that do not:

	2012		2011	
%	Quoted market price	No quoted market price	Quoted market price	No quoted market price
UK equities	6	1	1	1
Non-UK equities	25	3	23	3
Fixed-interest securities	21	–	29	–
Index-linked securities	19	–	23	–
Property	–	10	–	3
Other	1	14	1	16
Total	72	28	77	23

The liquidity profile of the UK Group plan assets is as follows:

%	2012	2011
Liquid – call <1 month	73	78
Less liquid – call 1– 3 months	2	6
Illiquid – call > 3 months	25	16

25. Retirement benefit and other post-retirement obligations continued

Changes in the values of plan assets and liabilities of the retirement benefit plans are as follows:

All figures in £ millions	2012 UK Group plan	2012 Other plans	2012 Total	2011 UK Group plan	2011 Other plans	2011 Total
Fair value of plan assets						
Opening fair value of plan assets	2,008	149	2,157	1,847	135	1,982
Exchange differences	–	(5)	(5)	–	1	1
Expected return on plan assets	111	8	119	107	7	114
Actuarial gains/(losses)	35	7	42	54	(2)	52
Contributions by employer	72	2	74	71	18	89
Contributions by employee	2	–	2	3	–	3
Benefits paid	(78)	(11)	(89)	(74)	(10)	(84)
Acquisition through business combination	12	15	27	–	–	–
Closing fair value of plan assets	2,162	165	2,327	2,008	149	2,157
Present value of defined benefit obligation						
Opening defined benefit obligation	(1,983)	(197)	(2,180)	(1,852)	(178)	(2,030)
Exchange differences	–	7	7	–	–	–
Current service cost	(23)	(3)	(26)	(21)	(3)	(24)
Interest cost	(96)	(7)	(103)	(100)	(8)	(108)
Actuarial losses	(144)	(12)	(156)	(81)	(18)	(99)
Contributions by employee	(2)	–	(2)	(3)	–	(3)
Benefits paid	78	11	89	74	10	84
Acquisition through business combination	(11)	(19)	(30)	–	–	–
Closing defined benefit obligation	(2,181)	(220)	(2,401)	(1,983)	(197)	(2,180)

Changes in the value of the US PRMB are as follows:

All figures in £ millions	2012	2011
Opening defined benefit obligation	(85)	(72)
Exchange differences	4	(2)
Current service cost	(4)	(3)
Interest cost	(3)	(3)
Actuarial losses	(5)	(9)
Benefits paid	4	4
Closing defined benefit obligation	(89)	(85)

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

The history of the defined benefit plans is as follows:

All figures in £ millions	2012	2011	2010	2009	2008
Fair value of plan assets	2,327	2,157	1,982	1,727	1,578
Present value of defined benefit obligation	(2,401)	(2,180)	(2,030)	(1,967)	(1,594)
Net pension (liability)/asset	(74)	(23)	(48)	(240)	(16)
Experience adjustments on plan assets	42	52	90	56	(268)
Experience adjustments on plan liabilities	(156)	(99)	(15)	(351)	194

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 2012 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by June 2017. In 2012 the Group contributed £48m (2011: £48m) towards the funding shortfall. Following the completion of the triennial funding valuation the Group has agreed to contribute £41m per annum until 2017 in excess of regular contributions. In addition, a mechanism has been agreed for the Group to make supplementary payments up to a maximum of £15m per annum. If such payments are made they are expected to accelerate the end date for extinguishing the deficit. Regular contributions to the plan are estimated to be £23m for 2013.

The Group expects to contribute $80m in 2013 and $84m in 2014 to its US pension plans.

Future benefit payments

The following table shows the expected benefit payments from the defined benefit plans over the next ten years. These use actuarial assumptions as at 31 December 2012. These represent payments from the pension funds to pensioners and others entitled to benefits, and are not an indication of payments from the company. For company funding requirements, refer to the prior section.

All figures in £ millions	UK Group plan	Defined benefit other	Total
Expected future benefit payments:			
2013	77	27	104
2014	80	24	104
2015	85	22	107
2016	87	23	110
2017	91	18	109
2018 to 2022 combined	503	76	579

25. Retirement benefit and other post-retirement obligations continued

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:

All figures in £ millions	2012 1% increase	2012 1% decrease
Effect on:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(311.7)	388.1
Decrease of aggregate of service cost and interest cost – UK Group plan	(0.1)	(1.2)
(Decrease)/increase in defined benefit obligation – US plan	(11.6)	13.9

The effect of members living one year more or one year less on the defined benefit obligation is as follows:

All figures in £ millions	2012 1 year increase	2012 1 year decrease
Effect on:		
Increase/(decrease) in defined benefit obligation – UK Group plan	76.7	(73.9)
Increase/(decrease) in defined benefit obligation – US plan	2.1	(2.1)

The effect of a one percentage point increase and decrease in the assumed medical cost trend rates is as follows:

All figures in £ millions	2012 1% increase	2012 1% decrease
Effect on:		
Increase/(decrease) in post-retirement medical benefit obligation	2.9	(2.6)
Increase/(decrease) of aggregate of service cost and interest cost	0.1	(0.1)

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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	2012	2011
Pearson plans	28	36

Share-based payment charges included in discontinued operations amounted to £4m (2011: £4m).

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 first introduced in 2001, renewed in 2006 and again in 2011. The plan consists of restricted shares.

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 May 2011 and May 2012 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 2011 and 2012 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 of up to one matching share for every invested share 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.

The number and weighted average exercise prices of share options granted under the Group's plans are as follows:

	2012		2011	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	3,203	7.15	8,878	10.20
Granted during the year	1,321	9.09	1,157	8.92
Exercised during the year	(840)	5.59	(2,323)	7.27
Forfeited during the year	(294)	7.84	(457)	8.54
Expired during the year	(17)	5.60	(4,052)	14.12
Outstanding at end of year	3,373	8.24	3,203	7.15
Options exercisable at end of year	106	5.58	64	5.54

Options were exercised regularly throughout the year. The weighted average share price during the year was £12.01 (2011: £11.14). 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.

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:

Range of exercise prices £	2012 Number of share options 000s	2012 Weighted average contractual life Years	2011 Number of share options 000s	2011 Weighted average contractual life Years
0 – 5	–	–	–	–
5 – 10	3,373	2.56	3,203	2.51
>10	–	–	–	–
	3,373	2.56	3,203	2.51

In 2012 and 2011 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:

	2012 Weighted average	2011 Weighted average
Fair value	£2.38	£2.97
Weighted average share price	£11.51	£11.47
Weighted average exercise price	£9.09	£8.92
Expected volatility	23.62%	27.50%
Expected life	3.8 years	4.0 years
Risk free rate	0.74%	1.91%
Expected dividend yield	3.65%	3.37%
Forfeiture rate	3.3%	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.

The following shares were granted under restricted share arrangements:

	2012 Number of shares 000s	2012 Weighted average fair value £	2011 Number of shares 000s	2011 Weighted average fair value £
Long-Term Incentive Plan	4,503	11.56	4,854	10.44
Annual Bonus Share Matching Plan	237	11.52	285	11.29

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. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Participants under both plans are entitled 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 are taken into consideration by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

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27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2011	812,677	203	2,524
Issue of ordinary shares – share option schemes	2,949	1	20
At 31 December 2011	815,626	204	2,544
Issue of ordinary shares – share option schemes	1,417	–	11
At 31 December 2012	817,043	204	2,555

The ordinary shares have a par value of 25p per share (2011: 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.

28. Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2011	14,009	137
Purchase of treasury shares	5,387	60
Release of treasury shares	(4,731)	(48)
At 31 December 2011	14,665	149
Purchase of treasury shares	–	–
Release of treasury shares	(4,563)	(46)
At 31 December 2012	10,102	103

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.2% (2011: 1.8%) 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 £2.5m (2011: £3.7m).

At 31 December 2012 the market value of Pearson plc treasury shares was £120.0m (2011: £177.4m).

29. Other comprehensive income

All figures in £ millions	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
	2012				
	Attributable to equity holders of the Company				
Net exchange differences on translation of foreign operations	(236)	–	(236)	(2)	(238)
Actuarial losses on retirement benefit obligations – Group	–	(119)	(119)	–	(119)
Actuarial losses on retirement benefit obligations – associate	–	(3)	(3)	–	(3)
Tax on items recognised in other comprehensive income	–	55	55	–	55
Total other comprehensive expense for the year	(236)	(67)	(303)	(2)	(305)

All figures in £ millions	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
	2011				
	Attributable to equity holders of the Company				
Net exchange differences on translation of foreign operations	(38)	–	(38)	(6)	(44)
Actuarial gains on retirement benefit obligations – Group	–	(56)	(56)	–	(56)
Actuarial gains on retirement benefit obligations – associate	–	(8)	(8)	–	(8)
Tax on items recognised in other comprehensive income	–	3	3	–	3
Total other comprehensive expense for the year	(38)	(61)	(99)	(6)	(105)

30. Business combinations

On 16 May 2012 the Professional business acquired Certiport, Inc. Certiport is based in the US and is a leading provider of certification and assessment programmes in IT and digital literacy. On 5 July 2012 the International Education business completed the purchase of GlobalEnglish Corporation, a leading provider of cloud-based, on-demand business English learning, assessment and performance support software. On 19 July 2012 Penguin announced the acquisition of Author Solutions, Inc., the world's leading provider of professional self-publishing services and on 21 November 2012 the North American Education business acquired EmbanetCompass, a leading provider of technology enabled online learning solutions. The Group acquired a 100% interest in all of the investments noted above.

Notes to the consolidated financial statements continued

30. Business combinations continued

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:

All figures in £ millions	Notes	Certiport fair value	Author Solutions fair value	Global English fair value	Embanet Compass fair value	Other fair value	2012 Total fair value	2011 Total fair value
Property, plant and equipment	10	–	1	–	3	6	10	21
Intangible assets	11	49	35	36	74	86	280	375
Intangible assets – Pre-publication	20	5	–	1	–	–	6	8
Inventories		–	–	–	–	1	1	2
Trade and other receivables		5	8	8	13	–	34	58
Cash and cash equivalents (excluding overdrafts)		2	–	8	18	6	34	151
Financial liabilities – Borrowings		–	–	–	–	–	–	(9)
Net deferred income tax liabilities	13	(20)	(3)	(13)	(21)	(10)	(67)	(96)
Retirement benefit obligations		–	–	–	–	(2)	(2)	(4)
Provisions for other liabilities and charges	23	–	–	–	–	(1)	(1)	(78)
Trade and other liabilities		(11)	(28)	(22)	(26)	(24)	(111)	(115)
Current income tax liabilities		–	–	(1)	–	–	(1)	(2)
Non-controlling interest		–	–	–	–	–	–	(1)
Net assets acquired at fair value		30	13	17	61	62	183	310
Goodwill	11	58	56	46	350	(5)	505	620
Fair value of previously held interest arising on stepped acquisition		–	–	–	–	–	–	(15)
Total		88	69	63	411	57	688	915
Satisfied by:								
Cash		(88)	(69)	(63)	(411)	(51)	(682)	(913)
Deferred consideration		–	–	–	–	(6)	(6)	–
Net prior year adjustments		–	–	–	–	–	–	(2)
Total consideration		(88)	(69)	(63)	(411)	(57)	(688)	(915)

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.

Intangible assets in other acquisitions includes £69m relating to prior year acquisitions.

The fair value of trade and other receivables is £34m and includes trade receivables with a fair value of £26m. The gross contractual amount for trade receivables due is £27m of which £1m is expected to be uncollectable.

A provisional value of £nil of goodwill arising on 2012 acquisitions is expected to be deductible for tax purposes (2011: £1m).

Intangible assets acquired in 2012 have the following useful economic lives: Certiport: customer lists and relationships 3-20 years; Author Solutions: customer lists and relationships 5 years, trademarks and brands 20 years, other intangibles 7-20 years; Global English: other intangibles 10 years. As EmbanetCompass was acquired in late 2012 the useful economic lives of intangible assets acquired are provisional and not yet finalised. Intangible assets acquired with all other acquisitions have useful economic lives of 2-20 years.

30. Business combinations continued

All figures in £ millions	2012	2011
Cash flow on acquisitions		
Cash – Current year acquisitions	(682)	(913)
Deferred payments for prior year acquisitions and other items	(31)	(5)
Cash and cash equivalents acquired	34	151
Acquisition costs and other acquisition liabilities paid	(37)	(12)
Net cash outflow	(716)	(779)

Acquisitions in 2012 contributed £45m to sales and £5m to operating profit before acquisition costs and amortisation of acquired intangibles from the date of acquisition to the balance sheet date. Of these amounts, Certiport contributed £20m of sales and a profit of £4m, Global English contributed £14m of sales and £2m of profit and EmbanetCompass contributed £7m of sales and £1m of profit.

If the acquisitions had completed on 1 January 2012, the Group estimates that sales for the period would have been £5,168m and profit before tax would have been £444m.

31. Disposals including business closures

All figures in £ millions	Notes	2012	2011
Disposal of subsidiaries			
Property, plant and equipment	10	(3)	–
Intangible assets	11	(45)	(4)
Inventories		–	(7)
Trade and other receivables		–	(5)
Cash and cash equivalents (excluding overdrafts)		–	(6)
Net deferred income tax liabilities	13	11	1
Retirement benefit obligations		–	1
Trade and other liabilities		–	2
Current income tax liabilities		–	1
Non-controlling interest		–	7
Attributable goodwill	11	(50)	(4)
Net assets disposed		(87)	(14)
Costs		(26)	–
Loss on disposal		(113)	(14)

All figures in £ millions	2012	2011
Cash flow from disposals		
Cash and cash equivalents disposed	–	(6)
Costs paid	(11)	–
Net cash outflow	(11)	(6)

The disposal in 2012 includes the write down of assets resulting from the closure of Pearson in Practice. The disposal in 2011 relates to Longman Nigeria.

Notes to the consolidated financial statements continued

32. Held for sale

Assets classified as held for sale relate to Penguin as a result of the announcement by Pearson and Bertelsmann to combine Penguin and Random House.

All figures in £ millions	Notes	2012	2011
Property, plant and equipment	10	40	–
Intangible assets	11	404	–
Investments in joint ventures and associates	12	27	–
Deferred income tax assets	13	38	–
Other financial assets	15	1	–
Trade and other receivables		451	–
Intangible assets – Pre-publication	20	16	–
Inventories		80	–
Cash and cash equivalents (excluding overdrafts)	17	115	–
Assets classified as held for sale		1,172	–
Financial liabilities – Borrowings	18	(7)	
Deferred income tax liabilities	13	(20)	–
Retirement benefit obligations	25	(26)	–
Provisions for other liabilities and charges	23	(29)	–
Trade and other liabilities		(234)	–
Liabilities directly associated with assets classified as held for sale		(316)	–
Net assets classified as held for sale		856	–

33. Transactions with non-controlling interest

In 2012 the Group increased its investments in its subsidiaries in China at a cost of £4m. In 2011 the remaining non-controlling interest in Sistema Educacional Brasileiro was acquired for £108m.

34. Cash generated from operations

All figures in £ millions	Notes	2012	2011
Profit		329	956
Adjustments for:			
Income tax		167	199
Depreciation	10	80	70
Intangible charges	11	183	139
Amortisation of other intangible assets	11	54	48
Net finance costs	6	81	71
Share of results of joint ventures and associates	12	(9)	(33)
Loss/(profit) on disposals		113	(435)
Acquisition costs		21	12
Costs on formation of Penguin Random House		32	–
Net foreign exchange adjustment from transactions		(21)	24
Share-based payment costs	26	32	40
Pre-publication		(55)	2
Inventories		49	15
Trade and other receivables		(94)	(9)
Trade and other liabilities		–	31
Retirement benefit obligations		(41)	(65)
Provisions for other liabilities and charges		(5)	28
Net cash generated from operations		916	1,093
Dividends from joint ventures and associates		27	30
Purchase of property, plant and equipment		(78)	(67)
Purchase of intangible assets		(73)	(77)
Proceeds from sale of property, plant and equipment		1	9
Proceeds from sale of intangible assets		3	3
Finance lease principal payments		(8)	(8)
Operating cash flow		788	983
Operating tax paid		(65)	(151)
Net operating finance costs paid		(66)	(60)
Free cash flow		657	772
Dividends paid (including to non-controlling interests)		(348)	(319)
Net movement of funds from operations		309	453
Acquisitions and disposals (net of tax)		(780)	(420)
Purchase of treasury shares		–	(60)
New equity		11	21
Other movements on financial instruments		–	(8)
Net movement of funds		(460)	(14)
Exchange movements on net debt		41	(55)
Total movement in net debt		(419)	(69)

Notes to the consolidated financial statements continued

34. 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	2012	2011
Net book amount	1	9
Loss on sale of property, plant and equipment	–	–
Proceeds from sale of property, plant and equipment	1	9

The principal other non-cash transactions are movements in finance lease obligations of £nil (2011: £10m).

35. 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, contract disputes, royalties, copyright fees, permissions and other rights. None of these claims are expected to result in a material gain or loss to the group.

36. 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	2012	2011
Not later than one year	186	179
Later than one year and not later than two years	174	164
Later than two years and not later than three years	158	149
Later than three years and not later than four years	137	134
Later than four years and not later than five years	124	119
Later than five years	899	980
	1,678	1,725

37. 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. In December 2011, the Group disposed of its 50% interest in FTSE International Ltd and details of this transaction are also shown in note 12.

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.

38. Events after the balance sheet date

In January 2013, the Group completed the purchase of a 5% equity investment in NOOK Media, LLC for $89.5m. NOOK Media is a new company consisting of Barnes & Noble's digital businesses including its NOOK e-reader and tablets, the NOOK digital bookstore and its 674 college bookstores across America.

In February 2013 the Group completed the purchase of the remaining minority interest in Tutorvista, the Bangalore based tutoring services company, for £17m.

Notes to the consolidated financial statements continued

39. Accounts and audit exemptions

Following a change in legislation in 2012 the Pearson plc subsidiary companies listed below are exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479A.

	Company number
Aldwych Finance Ltd	04720439
ASET Ltd	04231636
ASET Group Ltd	03964551
ASET Management Ltd	03139404
ASET Solutions Ltd	03849880
Blue Wharf Ltd	04344573
Burmedia Investments Ltd	03060487
Edexcel Ltd	04496750
Education Development International plc	03914767
Embankment Finance Ltd	04460625
eNVQ Ltd	03985948
EQL Assessment Ltd	05224778
Financial Times Group Ltd	00879531
Fronter UK Ltd	05737591
FT Business Information Ltd	00758738
FT Labs Ltd	04701650
FT Personal Finance Ltd	03855520
Goal Ltd	03566588
Green Wharf Ltd	07009228
Hoxton Holdings Ltd	05052993
Icodeon Ltd	05068195
Inframation Ltd	04581107
Joint Examining Board Ltd	03278422
Longman Group (Overseas Holdings) Ltd	00690236
MergerID Ltd	07031999
Midlands Educational Technology Ltd	01448842
Pearson Amsterdam Finance Ltd	03041245
Pearson Australia Finance Unltd	05578463
Pearson BOP Investments Ltd	08038068
Pearson Canada Finance Unltd	05578491
Pearson College Ltd	07967446

	Company number
Pearson Education Ltd	00872828
Pearson Education Holdings Ltd	00210859
Pearson Heinemann Ltd	03099304
Pearson in Practice ATA Ltd	07679091
Pearson in Practice Holdings Ltd	06337129
Pearson in Practice Skills Based Learning Ltd	03755464
Pearson in Practice Technology Ltd	03786989
Pearson International Finance Ltd	02496206
Pearson Loan Finance Unltd	05144467
Pearson Loan Finance No. 2 Unltd	05632021
Pearson Luxembourg Holdings Ltd	05052661
Pearson Luxembourg Holdings No. 2 Ltd	02635107
Pearson Management Services Ltd	00096263
Pearson Overseas Holdings Ltd	00145205
Pearson Professional Holdings Ltd	00149375
Pearson Services Ltd	01341060
Pearson Shared Services Ltd	04623186
Peter Honey Publications Ltd	03754757
Sector Training Ltd	05342448
St Clements Press (1988) Ltd	02174119
Testchange Ltd	02496240
The Coaching Space Ltd	05333023
The Financial Times (Benelux) Ltd	01613899
The Financial Times (France) Ltd	00867316
The Financial Times (Japan) Ltd.	01613900
The Financial Times (M-M UK) Ltd	01398449
The Financial Times (SCP) Ltd	00519261
The Financial Times (Spain) Ltd	01214411
TQ Catalis Ltd	07307943
TQ Clapham Ltd	07307925

39. Accounts and audit exemptions continued

Following a change in legislation in 2012 the Pearson plc subsidiary companies listed below are exempt from the requirements of the Companies Act 2006 to prepare individual accounts by virtue of section 394A.

	Company number
Exec-Appointments Ltd	04010964
FDI Intelligence Ltd	N1040129
Financial Times Business Ltd	00202281
Financial Times Electronic Publishing Ltd	02749250
Financial Times Investor Ltd	04005565
Fundex Ltd	00931507

	Company number
Mandatewire Ltd	03855296
The Financial News Ltd	00607228
The Financial Times (Switzerland) Ltd	01613901
The Financial Times (Zhongwen) Ltd	01900030
Throgmorton Publications Ltd	00905696

Company balance sheet
As at 31 December 2012

All figures in £ millions	Notes	2012	2011
Assets			
Non-current assets			
Investments in subsidiaries	2	9,108	9,056
Amounts due from subsidiaries		2,021	318
Financial assets – Derivative financial instruments	6	174	177
		11,303	9,551
Current assets			
Amounts due from subsidiaries		578	2,944
Prepayments		4	4
Financial assets – Derivative financial instruments	6	4	–
Cash and cash equivalents (excluding overdrafts)	4	643	469
		1,229	3,417
Total assets		12,532	12,968
Liabilities			
Non-current liabilities			
Amounts due to subsidiaries		(4,227)	(1,370)
Financial liabilities – Borrowings	5	(473)	(481)
Financial liabilities – Derivative financial instruments	6	–	(2)
		(4,700)	(1,853)
Current liabilities			
Amounts due to subsidiaries		(1,953)	(5,850)
Current income tax liabilities		(13)	(10)
Financial liabilities – Borrowings	5	(618)	(703)
Financial liabilities – Derivative financial instruments	6	–	(1)
		(2,584)	(6,564)
Total liabilities		(7,284)	(8,417)
Net assets		5,248	4,551
Equity			
Share capital	7	204	204
Share premium	7	2,555	2,544
Treasury shares	8	(27)	(94)
Special reserve		447	447
Retained earnings		2,069	1,450
Total equity attributable to equity holders of the company		5,248	4,551

These financial statements have been approved for issue by the board of directors on 7 March 2013 and signed on its behalf by

Robin Freestone Chief financial officer
7 March 2013

Company statement of changes in equity
Year ended 31 December 2012

	Equity attributable to equity holders of the company					
All figures in £ millions	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2012	204	2,544	(94)	447	1,450	4,551
Profit for the year	–	–	–	–	1,011	1,011
Issue of ordinary shares under share option schemes*	–	11	–	–	–	11
Contributions from subsidiaries for treasury shares	–	–	21	–	–	21
Release of treasury shares	–	–	46	–	(46)	–
Dividends	–	–	–	–	(346)	(346)
At 31 December 2012	204	2,555	(27)	447	2,069	5,248

	Equity attributable to equity holders of the company					
All figures in £ millions	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2011	203	2,524	(82)	447	727	3,819
Profit for the year	–	–	–	–	1,089	1,089
Issue of ordinary shares under share option schemes*	1	20	–	–	–	21
Purchase of treasury shares	–	–	(60)	–	–	(60)
Release of treasury shares	–	–	48	–	(48)	–
Dividends	–	–	–	–	(318)	(318)
At 31 December 2011	204	2,544	(94)	447	1,450	4,551

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 (2011: £131m) relating to profit on intra-group disposals that is not distributable.

* Full details of the share-based payment plans are disclosed in note 26 to the consolidated financial statements.

Company cash flow statement
Year ended 31 December 2012

All figures in £ millions	Notes	2012	2011
Cash flows from operating activities			
Net profit		1,011	1,089
Adjustments for:			
Income tax		(39)	(39)
Net finance costs		103	85
Amounts due to subsidiaries		(427)	(917)
Net cash generated from operations		648	218
Interest paid		(93)	(112)
Tax received		43	57
Net cash generated from operating activities		598	163
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired		–	(114)
Interest received		1	–
Net cash received from /(used in) investing activities		1	(114)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	7	11	21
Net purchase of treasury shares		–	(60)
Repayment of borrowings		(1)	(307)
Dividends paid to company's shareholders		(346)	(318)
Net cash used in financing activities		(336)	(664)
Effects of exchange rate changes on cash and cash equivalents		(4)	(29)
Net increase/(decrease) in cash and cash equivalents		259	(644)
Cash and cash equivalents at beginning of year		(234)	410
Cash and cash equivalents at end of year	4	25	(234)

Notes to the company financial statements

1. Accounting policies

The financial statements on pages 166 to 174 comprise the separate financial statements of Pearson plc. As permitted by section 408 of the Companies Act 2006, only the consolidated 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 consolidated 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	2012	2011
At beginning of year	9,056	9,180
Subscription for share capital in subsidiaries	110	279
Disposals/liquidations	–	(413)
Currency revaluations	(58)	10
At end of year	9,108	9,056

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 consolidated 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 £55m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £54m 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 £126m, while a 10% decrease in the value of sterling would increase the carrying value by £154m. 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%.

Notes to the company financial statements continued

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:

All figures in £ millions	USD	GBP	Other	Total
				2012
Not later than one year	(26)	3	1	(22)
Later than one year and not later than five years	105	21	21	147
Later than five years	155	–	–	155
Total	234	24	22	280
Analysed as:				
Bonds	232	285	–	517
Rate derivatives – inflows	(326)	(264)	–	(590)
Rate derivatives – outflows	328	3	22	353
Total	234	24	22	280

All figures in £ millions	USD	GBP	Other	Total
				2011
Not later than one year	(24)	3	2	(19)
Later than one year and not later than five years	128	24	25	177
Later than five years	176	–	–	176
Total	280	27	27	334
Analysed as:				
Bonds	251	303	–	554
Rate derivatives – inflows	(292)	(281)	–	(573)
Rate derivatives – outflows	321	5	27	353
Total	280	27	27	334

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.

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.

4. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2012	2011
Cash at bank and in hand	1	–
Short-term bank deposits	642	469
	643	469

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2012 the currency split of cash and cash equivalents was US dollar 63% (2011: 2%) and sterling 37% (2011: 98%).

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	2012	2011
Cash and cash equivalents	643	469
Bank overdrafts	(618)	(703)
	25	(234)

5. Financial liabilities – Borrowings

All figures in £ millions	2012	2011
Non-current		
7.0% Sterling Bonds 2014 (nominal amount £250m)	256	257
4.625% US Dollar Notes 2018 (nominal amount $300m)	217	224
	473	481
Current		
Due within one year or on-demand:		
Bank loans and overdrafts	618	703
	618	703
Total borrowings	1,091	1,184

Included in non-current borrowings above is £3m of accrued interest (2011: £4m). Included in current borrowings above is £nil of accrued interest (2011: £nil).

Notes to the company financial statements continued

5. Financial liabilities – Borrowings continued

The maturity of the company's non-current borrowings is as follows:

All figures in £ millions	2012	2011
Between one and two years	256	–
Between two and five years	–	257
Over five years	217	224
	473	481

As at 31 December 2012 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	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	618	256	217	1,091
Amounts due to subsidiaries	1,953	3,286	941	6,180
Effect of rate derivatives	1,311	(480)	(831)	–
	3,882	3,062	327	7,271

The carrying amounts and market values of borrowings are as follows:

		2012		2011	
All figures in £ millions	Effective interest rate	Carrying amount	Market value	Carrying amount	Market value
Bank loans and overdrafts	n/a	618	618	703	703
7.0% Sterling Bonds 2014	7.20%	256	274	257	282
4.625% US Dollar notes 2018	4.69%	217	209	224	206
		1,091	1,101	1,184	1,191

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	2012	2011
US dollar	255	373
Sterling	826	802
Euro	10	9
	1,091	1,184

6. Derivative financial instruments

The company's outstanding derivative financial instruments are as follows:

All figures in £ millions	2012 Gross notional amounts	2012 Assets	2012 Liabilities	2011 Gross notional amounts	2011 Assets	2011 Liabilities
Interest rate derivatives – in a fair value hedge relationship	234	35	–	243	35	–
Interest rate derivatives – not in a hedge relationship	1,292	109	–	1,030	119	–
Cross-currency derivatives	220	34	–	220	23	(3)
Total	1,746	178	–	1,493	177	(3)
Analysed as expiring:						
In less than one year	215	4	–	–	–	(1)
Later than one year and not later than five years	701	69	–	946	81	(2)
Later than five years	830	105	–	547	96	–
Total	1,746	178	–	1,493	177	(3)

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 2011	812,677	203	2,524
Issue of ordinary shares – share option schemes	2,949	1	20
At 31 December 2011	815,626	204	2,544
Issue of ordinary shares – share option schemes	1,417	–	11
At 31 December 2012	817,043	204	2,555

The ordinary shares have a par value of 25p per share (2011: 25p per share). All issued shares are fully paid. All shares have the same rights.

Notes to the company financial statements continued

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2011	14,009	82
Purchase of treasury shares	5,387	60
Contribution from subsidiaries	–	–
Release of treasury shares	(4,731)	(48)
At 31 December 2011	14,665	94
Purchase of treasury shares	–	–
Contribution from subsidiaries	–	(21)
Release of treasury shares	(4,563)	(46)
At 31 December 2012	10,102	27

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 £2.5m (2011: £3.7m). At 31 December 2012 the market value of the company's treasury shares was £120.0m (2011: £177.4m).

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 (2011: £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 £171m (2011: £176m) and interest receivable from subsidiaries for the year of £64m (2011: £54m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £47m (2011: £17m). Dividends received from subsidiaries were £1,124m (2011: £1,471m).

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 report on directors' remuneration in the consolidated financial statements.

There were no other material related party transactions.

Principal subsidiaries

The principal operating subsidiaries at 31 December 2012 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
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 Company Ltd	England
Dorling Kindersley Holdings Ltd**	England

* The Penguin Group companies have been included in discontinued operations.

** 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	2008	2009	2010	2011	2012
Sales					
North American Education	2,002	2,470	2,640	2,584	2,658
International Education	866	1,035	1,234	1,424	1,568
Professional	244	275	333	382	390
Education	3,112	3,780	4,207	4,390	4,616
FT Group	390	358	403	427	443
Continuing	3,502	4,138	4,610	4,817	5,059
Discontinued	1,317	1,486	1,349	1,045	1,053
Total sales	4,819	5,624	5,959	5,862	6,112
Adjusted operating profit					
North American Education	303	403	469	493	536
International Education	135	141	171	196	216
Professional	36	43	51	66	37
Education	474	587	691	755	789
FT Group	74	39	60	76	49
Continuing	548	626	751	831	838
Discontinued	214	232	187	111	98
Total adjusted operating profit	762	858	938	942	936
Operating margin – continuing	15.6%	15.1%	16.3%	17.3%	16.6%
Adjusted earnings					
Total adjusted operating profit	762	858	938	942	936
Net finance costs	(88)	(97)	(85)	(52)	(52)
Income tax	(178)	(194)	(215)	(199)	(204)
Non-controlling interest	(36)	(44)	(17)	1	(3)
Adjusted earnings	460	523	621	692	677
Weighted average number of shares (millions)	797.0	799.3	801.2	800.2	804.3
Adjusted earnings per share	57.7p	65.4p	77.5p	86.5p	84.2p

All figures in £ millions	2008	2009	2010	2011	2012
Cash flow					
Operating cash flow	796	913	1,057	983	788
Operating cash conversion	104%	106%	113%	104%	84%
Operating free cash flow	631	723	904	772	657
Operating free cash flow per share	79.2p	90.5p	112.8p	96.5p	81.7p
Total free cash flow	631	723	904	772	657
Total free cash flow per share	79.2p	90.5p	112.8p	96.5p	81.7p
Net assets	5,024	4,636	5,605	5,962	5,710
Net debt	1,460	1,092	430	499	918
Return on invested capital (gross basis)					
Total adjusted operating profit	762	858	938	942	936
Cash tax paid	(89)	(103)	(85)	(151)	(65)
Return	673	755	853	791	871
Average invested capital	7,337	8,504	8,315	8,731	9,578
Return on invested capital	9.2%	8.9%	10.3%	9.1%	9.1%
Dividend per share	33.8p	35.5p	38.7p	42.0p	45.0p

Corporate and operating measures

Pearson's corporate and operating measures include the results of Penguin throughout 2012 as the business was wholly owned during that period.

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	2012
Underlying decrease	(41)
Portfolio changes	318
Exchange differences	(27)
Total sales increase	250
Underlying decrease	(1)%
Constant exchange rate increase	5%

Adjusted income statement

Reconciliation of the consolidated income statement to the adjusted numbers presented as non-GAAP measures in the financial statements.

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/ costs	Tax amortisation benefit	Adjusted income statement
	2012							
Operating profit	515	98	123	20	180	–	–	936
Net finance costs	(81)	–	–	–	–	29	–	(52)
Profit before tax	434	98	123	20	180	29	–	884
Income tax	(148)	(32)	–	(5)	(54)	(1)	36	(204)
Profit for the year from continuing operations	286	66	123	15	126	28	36	680
Profit for the year from discontinued operations	43	(66)	20	1	2	–	–	–
Profit for the year	329	–	143	16	128	28	36	680
Non-controlling interest	(3)	–	–	–	–	–	–	(3)
Earnings	326	–	143	16	128	28	36	677

Adjusted income statement continued

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/ costs	Tax amortisation benefit	Adjusted income statement
								2011
Operating profit	1,118	111	(435)	12	136	–	–	942
Net finance costs	(71)	–	–	–	–	19	–	(52)
Profit before tax	1,047	111	(435)	12	136	19	–	890
Income tax	(162)	(38)	19	(4)	(43)	(5)	34	(199)
Profit for the year from continuing operations	885	73	(416)	8	93	14	34	691
Profit for the year from discontinued operations	71	(73)	–	–	2	–	–	–
Profit for the year	956	–	(416)	8	95	14	34	691
Non-controlling interest	1	–	–	–	–	–	–	1
Earnings	957	–	(416)	8	95	14	34	692

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	2012
Underlying decrease	(14)
Portfolio changes	19
Exchange differences	(11)
Total adjusted operating profit increase	(6)
Underlying decrease	(2)%
Constant exchange rate increase	1%

Corporate and operating measures continued

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	2012	2011
Adjusted operating profit	936	942
Cash conversion	84%	104%
Operating cash flow	788	983
Operating tax paid	(65)	(151)
Net operating finance costs paid	(66)	(60)
Total operating free cash flow	657	772
Non operating tax paid	–	–
Total free cash flow	657	772
Weighted average number of shares in issue (millions)	804.3	800.2
Operating free cash flow per share	81.7p	96.5p
Total free cash flow per share	81.7p	96.5p

Return on invested capital

	Net invested capital		Gross invested capital	
All figures in £ millions	2012	2011	2012	2011
Total adjusted operating profit	936	942	936	942
Intangible charges	(183)	(139)	–	–
Operating tax paid	(65)	(151)	(65)	(151)
Return	688	652	871	791
Average goodwill and other intangibles	6,371	5,680	8,550	7,684
Average net operating assets	1,028	1,047	1,028	1,047
Average invested capital	7,399	6,727	9,578	8,731
Return on invested capital	9.3%	9.7%	9.1%	9.1%

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.

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/investors 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 at www.pearson.com/investors/announcements/email-alerts

Shareholder information online

Shareholder information can be found on our website www.pearson.com/investors/shareholder-information.

Our registrar, Equiniti also 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.

2012 Dividends

	Payment date	Amount per share
Interim	14 September 2012	15 pence
Final	3 May 2013	30 pence

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 their telephone dealing helpline on 08456 037 037 (weekdays only) or, for online dealing, log on to www.shareview.co.uk/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 The Bank of New York Mellon, PO Box 43006, Providence, RI 02940-3006, 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 plus network extras. Lines open 8.30am to 5.30pm Monday to Friday.

Shareholder information continued

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.

For more information, please log on to our website at www.pearson.com/investors/shareholder-information/managing-your-shares and www.pearson.com/shareholderfaqs

Tips on protecting your shares

- Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation
- Inform our registrar, Equiniti 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

2013 Financial calendar

Ex-dividend date	3 April
Record date	5 April
Last date for dividend reinvestment election	12 April
Annual General Meeting	26 April
Payment date for dividend and share purchase date for dividend reinvestment	3 May
Interim results	26 July
Payment date for interim dividend	13 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
F +44 (0)20 7190 5700
firstname.lastname@pearson.com
www.pearson.com

Financial Times Group (UK)
Number One Southwark Bridge,
London SE1 9HL, UK
T +44 (0)20 7873 3000
F +44 (0)20 7873 3922
firstname.lastname@ft.com
www.ft.com

The Penguin Group (UK)
80 Strand,
London WC2R 0RL, UK
T +44 (0)20 7010 3000
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)

Notes

Reliance on this document

Our Business Review on pages 02 to 43 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.-

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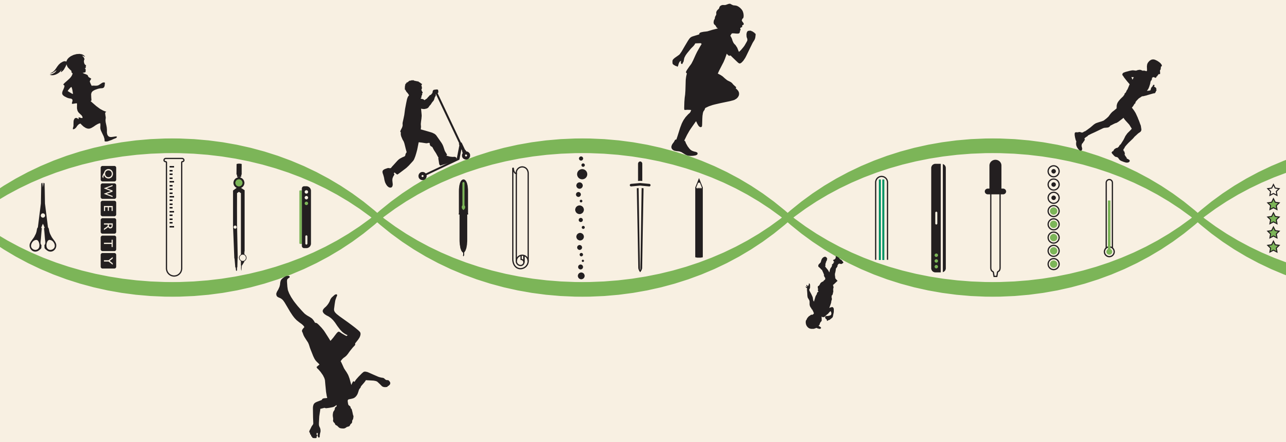
Learn more at www.pearson.com



Pearson plc
80 Strand
London
WC2R 0RL
T +44 (0)20 7010 2000
F +44 (0)20 7010 6060