Company Number: 2746616

Reed Elsevier Group plc

Annual Report and Financial Statements

For the year ended 31 December 2005

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DIRECTORS' REPORT

BOARD OF DIRECTORS

J Hommen *	- Chairman	appointed 27 April 2005
M Tabaksblat *	- Chairman	retired 27 April 2005
Sir Crispin Davis	- Chief Executive Officer	
M H Armour	- Chief Financial Officer	
G J A van de Aast		
J F Brock*		resigned 27 April 2005
M W Elliott*		
E Engstrom		
C J A van Lede*		
A Prozes		
D E Reid*		
Lord Sharman of Redlynch OBE*		
R W H Stomberg*		
P J Tierney		
S Zelnick*		appointed 27 April 2005

*Indicates non-executive director

DIRECTORS' REPORT

The directors present their report and the audited accounts for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The company is a holding company and through its subsidiary undertakings is primarily engaged in publishing and providing information, principally in North America and Europe.

The company is jointly owned and controlled by Reed Elsevier PLC and Reed Elsevier NV.

BUSINESS REVIEW AND FUTURE DEVELOPMENTS

Results and dividends

Revenue for the year was £5,116 million (2004 : £4,768 million) and adjusted operating profit (i.e. before acquisition integration costs, and amortisation of acquired intangible assets and grossed up for the equity share of taxes in joint ventures) was £1,119 million (2004 : £1,048 million). The adjusted operating margin was 21.9%, 0.1 percentage points lower than the prior year. Operating profit was £817 million (2004 : £749 million).

The group profit before tax of £434 million (2004 : £379 million) includes net acquisition related costs and disposals and other non operating items amounting to £19 million (2004 : £41 million) and charges for the amortisation of intangible assets of £275 million (2004 : £254 million).

The effective tax rate on profits before acquisition related costs, disposals and other non operating items and amortisation of intangible assets was 30.5% (2004 : 32.3%). The group profit for the year after taxation and minority interests, amounted to £263 million (2004 : £203 million).

During the year the company paid dividends of £169 million (2004 : £154 million) on the "R" ordinary shares, £48 million on the "E" ordinary shares (2004 : £nil), preference dividends of £7,500 (2004 : £7,500) and a subsidiary undertakings paid a further £80 million (2004 : £150 million) to Reed Elsevier NV in respect of its holding of special dividend shares in Reed Elsevier Nederland BV.

On 14 February 2006, the directors' declared a dividend of £300 million comprising £150 million each on the "R" and "E" ordinary shares.

At 31 December 2005 gross borrowings of £1,992 million (2004: £1,576 million) were partially offset by cash and cash equivalents of £244 million (2004: £160 million) and derivative financial instruments used to hedge the value of borrowings of £124 million (2004: £nil). In addition, net borrowings from shareholders and from Elsevier Reed Finance BV group amounted to £5,690 million (2004 : £5,083 million).

Operating business review

The results of businesses are reported in four segments: Elsevier, LexisNexis, Harcourt Education and Reed Business, which comprise the operations of the group. Adjusted operating profit is presented as an additional performance measure and is shown before amortisation of acquired intangible assets and acquisition integration costs and is grossed up to exclude the equity share of taxes in joint ventures. Unless otherwise stated, all prior year comparisons quoted in the following commentary refer to percentage movements at constant exchange rates, using the 2004 full year average and hedged rates, and exclude intra-affiliate transactions.

The comparative 2004 figures have been restated to conform to the IFRS accounting basis now adopted. Unallocated items comprise corporate costs, return on pension scheme assets and interest on pension scheme liabilities.

DIRECTORS' REPORT

Elsevier

Revenue and adjusted operating profits were ahead by 8% and 5% respectively at constant exchange rates including a part year contribution from the MediMedia MAP business acquired in August. Underlying revenue growth was on target at 5% and adjusted operating profits also grew 5%, with underlying margins similar to the prior year despite the significant costs of the newly launched Scopus product ahead of revenues building and other new product launches. Overall adjusted operating margins, at 31.3%, were 0.8 percentage points lower at constant currencies reflecting the lower margin of MediMedia MAP and other acquired businesses.

The Science & Technology division saw underlying revenue growth of 5% at constant exchange rates. Subscription renewals were strong at 97%, slightly higher than in the prior year, and good online growth was seen in widening distribution through ScienceDirect and in secondary databases including initial sales of Scopus. There has been continued good take up of e-only contracts which now account for over 40% of journal subscriptions by value, and ScienceDirect continues to see strong growth in usage, up over 20% year on year. The MDL software business saw only modest growth as a result of the extended sales cycle as pharmaceutical companies migrate to the new platform. The books business performed well with a strong frontlist.

The Health Sciences division saw underlying growth of 6%, with good growth in US book sales, particularly for the expanding nursing and allied healthcare sectors, and in journals and pharma communications. 2005 saw accelerating online revenue growth with new product and platform releases, and growing and attractive opportunities to expand our business online. Outside the US, strong growth was seen in continental Europe and in Asia Pacific and Latin America with the UK held back by comparison with a particularly strong prior year. Total revenue growth at constant currencies was 11% including MediMedia MAP and other smaller acquisitions.

Across Elsevier, the focus has been on execution. In Science & Technology, we have expanded content with an increase of more than 4% in the number of new research articles accepted, and new online services and features have been introduced to improve customer productivity. The Scopus database service, developed in close cooperation with the scientific community, continues to be well received in the market with well over 1,000 trial customers. We are expanding distribution of our electronic products globally in areas such as China as well as securing major new contracts and renewals, such as the contract to provide all our scientific content online to universities across the Netherlands. We are also developing more flexible customised offerings to expand further into corporate research markets and smaller and mid-sized institutions. A major reorganisation is nearing completion to move from a product-centric to a more market-focused organisation, with a real drive to improve customer relations and service levels, and to focus on under-penetrated and higher growth market segments.

Within Health Sciences, the focus has been on expanding world class content and information services, and building e-health workflow tools and applications. New online services were introduced, such as iConsult for the hospital and practitioner markets and new modules for the Evolve online platform for the US medical education market. Outside the US, we continue to build on strong positions and leverage our global network through versioning and geocloning of content and sharing electronic platforms and publishing infrastructure. In August, we acquired the MediMedia MAP business for €270m (£188m) with its leading positions in the French, Spanish and Italian medical publishing markets from which we expect strong growth from market demand and through innovation.

The outlook for Elsevier is positive. Subscription renewals are strong, book publishing is expanding, new electronic product is developing well in the market, and distribution is widening. Organic revenue growth of 5% is targeted for 2006 with underlying margin improvement from good revenue growth and further cost efficiency.

LexisNexis

Revenues and adjusted operating profits were up 13% and 17% respectively at constant exchange rates, including a full year contribution from Seisint and other recent acquisitions. Organic revenue growth excluding these acquisitions and minor disposals was 6%, against a target for the year of 5% and compares with the 4% growth achieved in the prior year, with underlying adjusted operating profits up 9%. Overall adjusted operating margins improved by 0.9 percentage points to 23.1% reflecting the good revenue growth and firm cost management.

In North America, LexisNexis saw revenue growth of 15%, or 6% underlying. In North American Legal Markets, stronger demand was seen from law firms for online information and workflow tools as the total practice solutions strategy gains traction, to deliver organic revenue growth of 5%. In Corporate and Federal Markets, organic revenue growth was 8% with continued recovery in online news and business, higher volumes for the US patent and trademark office and strong demand in risk management. Additionally, the Seisint business acquired in September 2004 achieved 20% pro-forma year on year sales growth and strong profit growth despite higher security and other costs following theunauthorised access to its databases reported earlier in the year. Adjusted operating profits for LexisNexis North America were up 20%, or 11% underlying, with a 1.1 percentage point increase in adjusted operating margins due to the strong revenue growth and the gearing in the business.

The International business outside North America saw excellent growth in demand for online information and from new publishing with particularly strong performances in Europe and Africa. Organic revenue growth was 7%, driven by a 16% increase in online revenues, with underlying adjusted operating profits up 5% after further investment in Germany, Asia Pacific and Latin America.

In LexisNexis, the focus in 2005 has been on combining content with online workflow tools to build total practice solutions, expanding online services internationally, and integrating Seisint within our risk management business. The success of our strategy is seen in the acceleration of growth in LexisNexis. There is significantly growing demand for practice solutions from law firms and businesses: Total Litigator, just launched, combines relevant research materials with advanced tools covering electronic discovery, court docket tracking, e-filing, expert identification, legal document preparation and many other litigator tasks, in one integrated online service; Totalsearch provides customers with a single interface to combine searches of their data with our materials; and client development tools help law firms identify business development opportunities and market themselves more effectively to existing and potential clients. Internationally, the roll out of the global legal platform has brought compelling functionalities to market. The integration of Seisint is well progressed, with product integration on the Seisint platform expected to be completed this year and the product development and sales and marketing activities now combined. The return on capital invested in Seisint is building quickly and is expected to get close to a 10% post tax return in only the second full year of ownership, and to continue to grow thereafter.

The outlook for LexisNexis is good. Revenue momentum is building in the business as organic and acquisition investment expands market opportunities and enhances value added and differentiated offerings. Organic revenue growth of 6–7% is targeted for 2006 and further margin improvement.

Harcourt Education

Revenues and adjusted operating profits were up 3% and 2% respectively at constant exchange rates. Organic revenue growth excluding acquisitions and disposals was 2%, against a target for the year of 9-10%, with underlying profits flat. Adjusted operating margins were only slightly lower by 0.2 percentage points to 17.9%, as the revenue shortfall was mostly mitigated by sales mix and firm cost management throughout the year.

The Harcourt US Schools & Testing business saw underlying revenues and operating profits up 2% at constant currencies, with a strong performance in the K-12 basal business undermined by a weak supplemental market and significant underperformance in the supplemental and assessment business.

The Harcourt US K-12 basal business saw strong revenue growth of 9% despite a lower than 75% implementation rate in relevant Texas adoptions due to the funding delays. Harcourt won a leading market share in new state textbook adoptions in the core curriculum subjects in which we compete, coming no.1 in Elementary with a 33% share and no. 2 in Secondary with a 23% share. Particular adoption successes were seen in Texas health and Florida social studies in Elementary and in literature and language arts and in Texas health and world languages in Secondary.

The supplemental business saw revenue decline of 11% excluding acquisitions and disposals. This resulted from sharply reduced sales of the literacy backlist titles not aligned to the approaches prompted by the No Child Left Behind Act, and tighter budgets at the school level, partly caused by funds moving to large scale intervention programmes sold at the district level. Firm remedial action has been taken: a major repositioning of the frontlist publishing programmes to fit with NCLB orientation; a new product line under development to address the more comprehensive intervention need at district level; and significant upgrading and re-staffing of the sales force. Some positive impact from this will be seen in 2006, with revenue expected to return to growth, but the major effect will be in 2007.

DIRECTORS' REPORT

Harcourt Assessment saw underlying revenue decline of 1% reflecting the failure to win a satisfactory share of significant state testing contracts, limited new clinical frontlist publishing, and an unexpected cut back on school spending on traditional catalogue product. Again, significant action is being implemented to address the issues. Changes are being made at a senior management level, a major upgrade in sales management and in programme servicing is underway, the clinical publishing frontlist is being strengthened, and a step change is targeted in margin through an extensive cost reduction and efficiency programme. We expect a meaningful impact from these initiatives in 2006, with revenue returning to growth and margin improvement. Results will also benefit from the continuing rollout of the Stanford Learning First online interim assessment product in 2006. The early modules of Stanford Learning First and the Unison platform on which it is based have both been well received in the market and the prospects look promising.

The Harcourt Education International business saw underlying revenues 1% lower, reflecting a weak UK instructional materials market as schools held back spending in the face of considerable funding uncertainties surrounding government initiatives. Adjusted operating profits were down 10% underlying, due to the revenue decline and investment in new assessment product.

Despite the disappointment of 2005, we believe the outlook for Harcourt Education is positive. Although the addressable adoption market for Harcourt in 2006 is smaller than in 2005, the early market response to the 2006 adoption programme is encouraging and, as stated above, progress is expected in restoring growth to the supplemental and assessment businesses. Overall, organic revenue growth of 2–4% is targeted for 2006, whilst adjusted operating profits are expected to be lower due to the significant sales and marketing investment ahead of 2007 adoptions. In 2007–2009, the textbook adoption cycle sees a strong growth phase. Harcourt has a strong programme in development to capitalise on this opportunity, and also expects to see improved momentum in the supplemental and assessment businesses.

Reed Business

Revenues and adjusted operating profits were up 5% and 9% respectively at constant exchange rates. Organic revenue growth was 5%, against a target for the year of 4-5% and compares with 2% in the prior year. Adjusted operating profit excluding acquisitions and disposals was 10%. The exhibitions business grew underlying revenues 11% whilst the magazines and information publishing businesses saw underlying revenue growth of 2%, which compares with a flat performance in the prior year. Adjusted operating margins increased by 0.7 percentage points to 15.7% despite the net cycling out of contribution from biennial joint venture exhibitions.

The Reed Business Information magazine and information publishing businesses saw continued strong growth in online services whilst print advertising remains variable by geography and sector, in part reflecting migration to strongly growing online services. In the US, revenues were up 1% from continuing titles, i.e. excluding the manufacturing product news titles which are currently being sold, with adjusted operating profits up 20% through continuing cost actions. The Media division continues to perform well with other divisions broadly flat as print advertising migrates online. In the UK, organic revenue growth was 7% driven by strong growth in online recruitment and paid search. The property, science, aerospace and agriculture sectors performed well with weakness in the social care market. Adjusted operating profits were 15% ahead underlying due to strong revenue growth and firm cost control. In Continental Europe, underlying revenues and adjusted operating profits were 1% and 6% lower respectively, with a continuing depressed market environment in The Netherlands in particular. Focus on new online services, market share performance and yield management largely mitigated the weakness in the advertising market. Asia Pacific saw 8% underlying revenue growth with strong performances in Japan and Singapore.

Reed Exhibitions had a very successful year, with underlying revenue growth of 11% whilst adjusted operating profits grew 7%, or 15% before the cycling out of the contribution from a number of biennial joint venture exhibitions. Good growth was seen across the business, in the US, Europe and Asia- Pacific, with strong demand, new launches and a turnaround in some underperforming sectors. Particularly strong performances were seen in Japan and in the international entertainment and property shows.

In Reed Business, the focus in 2005 has been on expanding our online services to the business communities we serve, through webzines, recruitment sites, search and subscription information and data services. Reed Business Information online revenues grew over 30% in the year to more than $300m and now account for nearly 20% of RBI revenues. This follows several years of sustained investment in online services, anticipating the shift from print to online in business market growth. The most developed territory, where we started investing first, is the UK and well illustrates the potential for our online services. Online revenues grew by over 30% in the UK in 2005 and now account for 35% of total revenues. Further continued development is underway of sector specific recruitment sites, expansion of the Kellysearch service for sourcing industrial components, and in providing more specialised search offerings. In addition to online, Reed Business has continued to invest in new titles and exhibitions and in upgrading formats. Growth is accelerating in China and other developing markets through launch and alliance, such as the exhibitions joint venture in China with Sinopharm announced in August.

DIRECTORS' REPORT

The outlook for Reed Business is positive. Exhibition demand remains good, although the exceptional growth of 2005 is not expected to be repeated in 2006, and the growing online business is delivering growth in the magazine and information publishing business. Organic revenue growth of 4–5% and further margin improvement is targeted for 2006.

Future Prospects

Looking to 2006, the market environments in which we operate are broadly encouraging, and, whilst noting that 2006 is a slower year for state textbook adoptions. The longer term outlook is promising. Reed Elsevier Group plc group has a clear consistent strategy and growing market success. The digital environment continues to expand opportunity and Reed Elsevier Group plc group is very focused on exploiting its content, brands, market positions and technology to drive sustainable long term growth.

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Reed Elsevier Group plc now prepares its consolidated financial statements under International Financial Reporting Standards (IFRS), with effect from the 2005 financial year. The 2004 consolidated financial statements have been restated under IFRS, adopting a 1 January 2004 transition date, other than in respect of IAS39 – Financial Instruments for which the transition date is 1 January 2005, as further described in note 32 to the financial statements. The required changes in Reed Elsevier Group plc accounting policies in adopting IFRS were in five major areas:

• Goodwill and intangible assets – goodwill is no longer amortised and intangible assets are generally amortised over shorter periods.

• Employee benefits – pension costs and defined benefit scheme assets and liabilities are measured based on market values; the amount of any surplus or deficit is recognised in full in the balance sheet.

• Share based remuneration – the fair value of share options, determined at date of grant, is expensed over the vesting period.

• Financial instruments – with effect from 1 January 2005, all derivative financial instruments are measured at fair value; hedge accounting is only permissible where effectiveness criteria are met.

• Deferred taxation – full provision is made for nearly all differences between the balance sheet amounts of assets and liabilities and their corresponding tax bases.

The parent company financial statements continue to be prepared under UK GAAP.

TREASURY POLICIES

The boards of Reed Elsevier PLC and Reed Elsevier NV have requested that Reed Elsevier Group plc has due regard to the best interests of Reed Elsevier PLC and Reed Elsevier NV shareholders in the formulation of treasury policies.

Financial instruments are used to finance Reed Elsevier Group plc's business and to hedge transactions. Reed Elsevier Group plc's businesses do not enter into speculative transactions. The main treasury risks faced by Reed Elsevier Group plc and its subsidiaries are liquidity risk, interest rate risk and foreign currency risk. The board of Reed Elsevier Group plc agrees overall policy guidelines for managing each of these risks. These policies are summarised below.

Liquidity

Reed Elsevier Group plc maintains a range of borrowing facilities and debt programmes to fund its requirements, at short notice and at competitive rates. The significance of Reed Elsevier Group plc's US operations means that the majority of debt is denominated in US dollars and is raised in the US debt markets. A mixture of short term and long term debt is utilised and Reed Elsevier Group plc maintains a maturity profile to facilitate refinancing. Reed Elsevier Group plc's policy is that no more than US$1,000 million of long term debt should mature in any 12-month period. In addition, minimum levels of net debt with maturities over three years and five years are specified, depending on the level of the total borrowings.

After taking account of the maturity of committed bank facilities that back short term borrowing, at 31 December 2005 and after utilising available cash resources, no third party borrowings mature in the next two years, 37% of borrowings mature in the third year, 8% in the fourth and fifth years, and 34% in the sixth to tenth years, and 21`% beyond the tenth year.

DIRECTORS' REPORT

In April 2005, Reed Elsevier Group plc and renegotiated and amended the terms of its US$3,000m committed credit facility. At 31 December 2005, Reed Elsevier Group plc had access to US$3,000m (2004: $3,000m) of committed bank facilities, of which US$115m was drawn. These facilities principally provide back up for short term debt but also security of funding for future acquisition spend in the event that commercial paper markets are not available. Of total committed facilities, US$nil expires within one year (2004: US$750m), US$3,000m within two to three years, (2004: US$nil), and US$nil within three to four years (2004: US$2,250m).

Interest rate exposure management

Reed Elsevier Group plc's interest rate exposure management policy is aimed at reducing the exposure of the business to changes in interest rates. The proportion of interest expense that is fixed on net debt is determined by reference to the level of net interest cover in Reed Elsevier Group plc, its subsidiaries and affiliates. Reed Elsevier Group plc uses fixed rate term debt, interest rate swaps, forward rate agreements and a range of interest rate options to manage the exposure. Interest rate derivatives are used only to hedge an underlying risk and no net market positions are held.

Foreign currency exposure management

Translation exposures arise on the earnings and net assets of business operations in countries other than those of Reed Elsevier Group plc. These exposures are hedged, to a significant extent, by a policy of denominating borrowings in currencies where significant translation exposures exist, most notably US dollars.

Currency exposures on transactions denominated in a foreign currency are required to be hedged using forward contracts. In addition, recurring transactions and future investment exposures may be hedged, within defined limits, in advance of becoming contractual. The precise policy differs according to the commercial situation of the individual businesses. Expected future net cash flows may be covered for sales expected for up to the next 12 months (50 months for Elsevier science and medical subscription businesses up to limits staggered by duration). Cover takes the form of foreign exchange forward contracts.

As at 31 December 2005, the amount of outstanding foreign exchange cover in respect of future transactions was £642m.

DIRECTORS

The Reed Elsevier Group plc board consists of six executive officers and seven independent non-executive directors. The directors who served during the year are shown on page 1. The board met seven times during the year. Messrs Elliot, Reid, Stomberg and Lord Sharman were each unable to attend one meeting. Mr van Lede was unable to attend two meetings, otherwise there was full attendance.

The board of Reed Elsevier Group plc comprises a balance of executive and non-executive directors who bring a wide range of skills and experience to the deliberations of the boards. All non-executive directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

All directors have full and timely access to the information required to discharge their responsibilities fully and efficiently. They have access to the services of the company secretary, other members of Reed Elsevier's management and staff, and its external advisors. Directors may take independent professional advice in the furtherance of their duties, at the relevant company's expense.

On appointment and at regular intervals, directors receive training appropriate to their level of previous experience. This includes the provision of a tailored induction programme, so as to provide newly appointed directors with information about the Reed Elsevier Group plc businesses and other relevant information to assist them in performing their duties. Non-executive directors are encouraged to visit the Reed Elsevier Group plc businesses to meet directors and senior executives.

Committees

Audit Committee

Reed Elsevier Group plc has established an Audit Committee. The Committee comprise only non-executive directors, all of whom are independent. The Committee is chaired by Lord Sharman, the other members being David Reid and Strauss Zelnick.

The Committee is responsible for reviewing matters relating to the financial affairs of the company, internal control policies and the internal and external audit programmes. This includes, for example, reviewing accounting policies, compliance with accounting standards and other statutory requirements, and matters relating to risk management and the effectiveness of internal controls. The Committee is also responsible for the selection of auditors, and making an annual assessment of the effectiveness of the audit and the auditors' independence, prior to making a recommendation to the board in respect of the reappointment of the auditors. The Committee approves the fees for the audit and pre-approves the provision of all non-audit services by the auditors. The amounts paid to the auditors, both for audit and non-audit services, together with a description of the services provided, appears in note 2 to the Accounts. The chief financial officer, group chief accountant, director of internal audit and senior representatives of the external auditors attend meetings of the Committee.

The Committee met five times during the year, and there was full attendance.

Remuneration Committee

Reed Elsevier Group plc has established a Remuneration Committee which comprises only independent non-executive directors. The Committee is chaired by Rolf Stomberg, the other members being Mark Elliott and Cees van Lede. The Committee met six times during the year. Mr van Lede was unable to attend one meeting, otherwise there was full attendance.

The Committee is responsible for recommending to the board the remuneration in all its forms of executive directors of Reed Elsevier Group plc, and provides advice to the Chief Executive Officer on the remuneration of executives at a senior level below the board. The fees of non executive directors are determined by the board of directors.

A Directors' Remuneration Report, which has been approved by the board of Reed Elsevier Group plc, appears on pages 11 to 27.

INTERNAL CONTROL

Reed Elsevier Group plc has an established framework of procedures and internal controls, and with which the management of each business is required to comply. Group businesses are required to maintain systems of internal control, which are appropriate to the nature and scale of their activities and address all significant operational and financial risks that they face. The board of Reed Elsevier Group plc has adopted a schedule of matters that are required to be brought to it for decision.

Reed Elsevier Group plc has a Code of Ethics and Business Conduct that provides a guide for achieving its business goals and requires officers and employees to behave in an open, honest, ethical and principled manner. The Code also outlines confidential procedures enabling employees to report any concerns about compliance, or about Reed Elsevier's financial reporting practice.

Each Business Group has identified and evaluated its major risks, the controls in place to manage those risks and the level of residual risk accepted. Risk management and control procedures are embedded into the operations of the business and include the monitoring of progress in areas for improvement that come to management and board attention. The major risks identified include business continuity, protection of IT systems and data, challenges to intellectual property rights, management of strategic and operational change, evaluation and integration of acquisitions, and recruitment and retention of personnel.

The major strategic risks facing the Reed Elsevier Group plc businesses are considered by the board. Litigation and other legal and regulatory matters are managed by legal directors in Europe and the United States.

The Reed Elsevier Group plc Audit Committee receives regular reports on the management of material risks and reviews these reports. The Audit Committee also receives regular reports from both internal and external auditors on internal control matters. In addition, each Business Group is required, at the end of the financial year, to review the effectiveness of its internal controls and report its findings on a detailed basis to the management of Reed Elsevier Group plc. These reports are summarised and, as part of the annual review of effectiveness, submitted to the Audit Committee of Reed Elsevier Group plc. The Chairman of the Audit Committee reports to the board on any significant internal control matters arising.

Annual Review

As part of the year end procedures, the board of Reed Elsevier Group plc has reviewed the effectiveness of the systems of internal control and risk management during the last financial year. The objective of these systems is to manage, rather than eliminate, the risk of failure to achieve business objectives. Accordingly, they can only provide reasonable, but not absolute, assurance against material misstatement or loss.

DIRECTORS' REPORT

RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The directors of Reed Elsevier Group plc are required to prepare financial statements as at the end of each financial period, which give a true and fair view of the state of affairs, and of the profit or loss, of the company and its subsidiaries, joint ventures and associates. They are responsible for maintaining proper accounting records, for safeguarding assets, and for taking reasonable steps to prevent and detect fraud and other irregularities. The directors are also responsible for selecting suitable accounting policies and applying them on a consistent basis, making judgments and estimates that are prudent and reasonable.

Applicable accounting standards have been followed and the consolidated Reed Elsevier Group plc group financial statements, which are the responsibility of the directors, are prepared using accounting policies which comply with International Financial Reporting Standards.

Reed Elsevier Group plc company financial statements, which are the responsibility of the directors, are prepared using accounting policies which comply with UK Generally Accepted Accounting Principles.

GOING CONCERN

The directors of Reed Elsevier Group plc, having made appropriate enquiries, consider that adequate resources exist for the combined businesses to continue in operational existence for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the financial statements.

FORWARD LOOKING STATEMENTS

The Annual Report and Financial Statements 2005 contain forward looking statements. These statements are subject to a number of risks and uncertainties and actual results and events could differ materially from those currently being anticipated as reflected in such forward looking statements. The terms 'expect', 'should be', 'will be', and similar expressions identify forward looking statements. Factors which may cause future outcomes to differ from those foreseen in forward looking statements include, but are not limited to: general economic conditions and business conditions in Reed Elsevier's markets; exchange rate fluctuations; customers' acceptance of its products and services; the actions of competitors; legislative, fiscal and regulatory developments; changes in law and legal interpretation affecting Reed Elsevier Group plc's intellectual property rights and internet communications; and the impact of technological change.

CORPORATE SOCIAL RESPONSIBILITY

Governance

The Corporate Responsibility (CR) Forum, chaired by CEO Sir Crispin Davis, and comprised of executives representing all major business functions, met twice to review CR policies, objectives and achievements. CR was also the focus at an RE board meeting.

Throughout the year, we received feedback on our CR activities at 43 meetings with government, non-governmental organizations, and socially responsible investors/analysts.

We reached 3,025 employees through direct and distance training to further their understanding of the RE Code of Ethics and Business Conduct. New initiatives included enhancing the policy zone for employees on our corporate intranet.

Workplace

We seek to employ a diverse workforce that reflects our customer base. In 2005, our senior management group comprised 15 nationalities, with women occupying 22% of these positions. We introduced a new Personal Development Plan to better identify employee strengths and training needs and began roll-out of a 1:1 coaching programme.

Marketplace

The RE value, Customer Focus, was expressed through development of new online products and services for customers including Elsevier's Library Services Webpages on ScienceDirect, allowing global customers to make online changes in holdings, IP-numbers and customer status, and Harcourt's Live Ink Reading Help, an e-tool providing US students with visual cues to sentence structure.

DIRECTORS' REPORT

With cross-business input we created a group editorial policy which makes explicit our journalists' editorial independence and records our "responsibility...to produce information of the highest quality, which is original, accurate, comprehensible, fair, and timely and which...makes a clear distinction between editorial and advertising or other content."

We established a new socially responsible supplier network across the group to reinforce our Supplier Code of Conduct, and developed new tools like an internal audit checklist.

Community

Our RE Cares programme expanded to new locations including China and India, and we increased group wide volunteerism by 30%, exceeding our target. Our third annual international RE Cares Month featured over 100 activities and touched thousands of employees.

We donated £2 million in charitable cash donations (including matching gift programmes) and the equivalent of nearly £2 million in gifts of products, services and staff time in 2005. This included over £1 million in tsunami, hurricane and earthquake relief efforts. Our flagship partnership with BookAid International has channelled over 500,000 of our books over the last three years to institutions in the developing world.

Environment

With the help of a new environmental coordinator we advanced environmental goals by key facilities, conducting site audits at all four divisions. These included a commitment to reduce energy usage by 1.2 million kWh across 11 main sites and further specific reductions across another 38 sites.

For World Environment Day we launched our 2005 environmental campaign, "War on Waste", and further engaged employees on environmental issues by introducing Green Teams in more than 50% of our key facilities. In the UK, our business reduced their electricity consumption by 7% and a key facility in Austin, Texas was awarded an Energy Star label by the United States Environmental Protection Agency.

Reed Elsevier is a member of FTSE4Good, the Per Cent Club, the Dow Jones Sustainability Index, and has been voted one of the Global 100 most sustainable corporations. We were awarded a highly commended certificate for our CR activities in the UK National Business Awards , and came first among commercial media companies in Business in the Community's Corporate Responsibility Index for the second consecutive year.

POLITICAL DONATIONS

In the United States, the Reed Elsevier Group plc group contributed £48,000 to political parties. There were no donations made in the European Union for political purposes.

PAYMENTS TO SUPPLIERS

The company agrees terms and conditions for business transactions with suppliers and payment is made on these terms. The average time taken to pay suppliers was between 30 and 45 days.

AUDITORS

Resolutions for the reappointment of Deloitte & Touche LLP as auditors of the company and authorising the directors to fix their remuneration will be submitted to the forthcoming Annual General Meeting.

By order of the board:

Stephen J Cowden
Secretary
15 February 2006

Registered Office
1-3, Strand
London, WC2N 5JR

DIRECTORS' REMUNERATION REPORT

This report provides Reed Elsevier's statement of how it has applied the principles of good governance relating to Directors' remuneration and communicates its policies and practices on executive remuneration to shareholders. It has been prepared by the Remuneration Committee (the Committee) of Reed Elsevier Group plc and approved by the boards of Reed Elsevier Group plc, Reed Elsevier PLC and Reed Elsevier NV.

In accordance with UK Directors' Remuneration Report Regulations 2002 (the UK Regulations) and the Dutch Corporate Governance Code issued in December 2003 (the Dutch Code), resolutions will be submitted to the respective Annual General Meetings of Reed Elsevier PLC and Reed Elsevier NV to approve this report and the remuneration policy as set out below.

Membership of the Remuneration Committee
Throughout 2005, the Committee consisted wholly of independent non-executive directors; Rolf Stomberg (Chairman), Mark Elliott and Cees van Lede. At the invitation of the Chairman, the Chief Executive Officer attends the meetings of the Committee except when his own remuneration is under consideration.

The contents of this report
For greater clarity, the main body of this report is focused on pay policy and practice for executive directors (pages 11 to 16) and non-executive directors (page 16). Pages 17 to 27 forming part of this report deal with the auditable disclosures and other regulatory requirements. The contents of the report are as follows:

A. Executive directors
 a. Remuneration policy and objectives
 b. Remuneration in practice
 c. 2005 payments
 d. 2005 awards
 e. Shareholding requirement
 f. Service contracts
 g. Policy on external appointments

B. Non-executive directors
 a. Policy
 b. Fee levels

C. Statutory disclosures

A. Executive directors

(a) Remuneration policy and objectives
Our remuneration policy has been designed to meet the needs of a group of global business divisions, each of which operates internationally by line of business. In order to support this business structure, it is essential to have a remuneration policy which:

- aids the attraction and retention of the best executive talent from anywhere in the world; and
- underpins Reed Elsevier's demanding performance standards.

The challenges and demands created by the need for global market competitiveness as well as for internal consistency have led the Committee to apply a more global approach to the design and operation of its incentive plans.

The Committee believes that in order to meet its remuneration objectives, the remuneration of executive directors should comprise a balance between fixed and variable (performance-related) pay elements with the greater proportion of potential reward being linked to performance. For superior performance, some 60% of total target remuneration is performance-related.

The Committee constantly reviews remuneration policy to ensure that it is sufficiently flexible to take account both of future changes in Reed Elsevier's business operations and environment and of key developments in remuneration practice. Consequently, the policy set out in this report has applied during 2005 and will apply in 2006 subject to any necessary changes. Any changes will be described in full in future reports.

Remuneration objectives
The principal objectives of the policy are to attract and motivate executives of the highest calibre and experience needed to shape and execute strategy and deliver shareholder value in an ever more competitive and increasingly global employment market. The Committee believes that this requires the following:

- A pay and benefits package which is competitive with packages offered by other leading multinational companies operating in global markets, and is capable of providing upper quartile total remuneration for the sustained delivery of the clearly superior levels of performance required by our challenging business objectives.
- A reward structure that links individual performance, company performance and share price performance so as to align the interests of the directors with those of Reed Elsevier and the shareholders of the parent companies.
- An approach to performance management that stimulates enhanced performance by directors, recognises their individual contribution to the attainment of our short term and longer term results and also encourages the teamwork which is essential to achieve the long term strategic objectives.

Base salary and the annual incentive plan (AIP) aim to position the executive within the relevant market for executive talent and to provide a focus on the delivery of our shorter term strategic objectives.

The Executive Share Option (ESOS) and Long Term Incentive Scheme (LTIS) encourage a focus on longer term earnings growth and increases executives' alignment with shareholders' interests.

The Committee believes that the primary engine for the creation of long term shareholder value is sustained growth in profitability. In relation to shareholders, the primary measure of profitability is growth in adjusted earnings per share which is supported, at an operational level, by the measures of revenue growth, profitability and cash generation. Accordingly, these measures are integrated into our reward structure. In all cases payments are made against a sliding scale of performance achievement because this is the fairest and simplest way to relate incentives to business targets. Recognising shareholder preference for longer term incentive arrangements to include a performance measure based on shareholder return, it is proposed that a secondary measure of total shareholder return relative to a focused peer group will apply to awards made under the LTIS from 2006.

(b) Remuneration in practice
The Committee's practice is to review the market competitiveness of base salary on the following basis:

- UK-based directors against FTSE 50 companies (excluding financial services); and
- US-based directors (or directors on US-market based reward packages) against US Media Industry companies.

Benefits, including medical and retirement benefits, are positioned to reflect local country practice. UK directors are eligible to participate in the all-employee SAYE (savings related) share option scheme.

Recognising the more global approach to the design of its incentive plans, referred to earlier, the annual and longer term incentive plans for executive directors are operated with common incentive opportunity levels, irrespective of geographical location.

In relation to long term incentives, the performance measures are tested once at the end of the specific performance period and are not subsequently re-tested; (i.e. there is no re-testing of any performance condition).

This overall approach is set out in greater detail below with reference to the individual elements of the reward package for executive directors:

Base salary
- Salaries are reviewed annually to take account of two factors, Firstly, market movement and individual performance during the previous year. Secondly, the increased and sustainable contribution of the individual to the group which may position the individual at a higher value relative to the market.

Annual Incentive Plan (AIP)
- Based on achievement of financial performance targets set against the critical measures of revenue growth, profit, cash generation and Key Performance Objectives (KPOs).
- Targets are approved by the Committee at the beginning of the year and are aligned with the annual budget and strategic business objectives.
- Payment against each financial performance measure is only made if a threshold of 94% of the target is achieved.
- Up to 90% of salary is payable for the achievement of highly stretching financial targets which align with the Company's double digit adjusted EPS growth objective. This 90% bonus opportunity is allocated as follows, as a percentage of salary:

Revenue	27%
Profit	27%
Cash Flow Conversion Rate	9%
KPOs	27%

  The four elements are measured separately, such that there could be a pay-out on one element and not on others.

- A maximum of 110% of salary could be paid for exceptional performance. (This degree of upside potential in our AIP is low by market standards and it reflects the demanding nature of the initial targets).

Bonus Investment Plan (BIP)
- Designed to encourage increased personal shareholding by the participant.
- Directors and other designated key senior executives may invest up to half of any payment they receive under the AIP in shares of Reed Elsevier PLC or Reed Elsevier NV.
- Subject to continued employment, and to their retaining these investment shares during a three-year performance period, they will be awarded an equivalent number of matching shares.
- The award of matching shares is wholly dependent on the achievement of a performance condition. In 2005, this was the achievement of at least 6% per annum compound growth in the average of Reed Elsevier PLC and Reed Elsevier NV adjusted EPS – measured at constant exchange rates (adjusted EPS) over the three year vesting period.

Executive Share Options (ESOS)
- Annual grants of options are made over shares in Reed Elsevier PLC and Reed Elsevier NV at the market price at date of grant.
- The level of option grant and the performance conditions are determined and reviewed by the Committee annually.

- The standard performance condition, which governs the size of grant for all participants, relates to the compound annual growth in adjusted EPS over the three years prior to grant. The Target Grant Pool for all participants is defined with reference to share usage during the base year of 2003, as follows:

Adjusted EPS Growth per annum	Target Grant Pool **(as a % of 2003 Grant)**
Less than 6%	50%
6% or more	75%
8% or more	100%
10% or more	125%
12% or more	150%

- The awards made to executive directors are subject to an annual maximum of up to three times base salary. The awards are subject to the following three performance criteria:
  - **On grant**
    – corporate performance as measured by adjusted EPS growth in accordance with the criteria above, and
    – individual performance over the three year period prior to grant;
  - **On vesting**
    -a further performance condition such that the compound growth in adjusted EPS during the three years following grant must be at least 6% per annum. There is no retesting of the performance condition.
- The combination of the above tests requires sustained high level profit growth over a continuous six year period in respect of each individual grant to executive directors.
- Options are normally exercisable between three and ten years from the date of grant.

Long term Incentive (LTIS) – 2004–2006 cycle

- For the current performance period 2004-06, awards to Directors under the LTIS were made in February 2004 over 5.5 times salary in conventional market price options and 2.5 times salary in performance shares.
- The awards will vest at the end of the 2004-06 performance period, to the extent that the performance condition has been achieved:
  - at 8% compound annual growth in adjusted EPS, 25% of the awards will vest;
  - at 10%, 100% will vest;
  - at 12%, 125% of the award will vest; and
  - awards will vest on a straight line basis between each of these points. There is no retesting of the performance condition.
- Even if the adjusted EPS target is met, the Remuneration Committee retains full discretion to reduce or cancel awards under the Plan based on its assessment as to whether the adjusted EPS growth achieved is a fair reflection of the progress of the business having regard to underlying revenue growth, cash generation, return on capital and any significant changes in inflation as well as on individual performance.
- Acceptance of an award under the LTIS (for the 2004-06 cycle) by any individual automatically terminated their award under the previous Senior Executive Long Term Incentive Plan introduced in 2000. No payments were therefore made under the 2000 Plan.

Long term Incentive (LTIS) – 2006 and future cycles

The Committee has reviewed the operation of the LTIS in line with its commitment to shareholders and is proposing the following changes to the operation of the LTIS with effect from 2006:

- **Grants will be made annually:** from 2006, all executive directors will be eligible to receive an annual grant of performance shares with a target value of around 135% of salary. (Lower levels of grant will apply to other senior executives invited to participate in the LTIS).
- **Awards will consist solely of performance shares** (rather than a mix of performance shares and conventional market price options).
- **Relative Total Shareholder Return (TSR) will be introduced as a performance measure in addition to the EPS target**. From 2006, in addition to achieving a demanding EPS performance target over a three year performance period, an additional TSR performance target over the same three year period will also be taken into account.

  The threshold level of compound adjusted EPS growth will continue to be 8% per annum, with maximum vesting being achieved for growth of 12% per annum. Any award earned through EPS performance may then be increased in line with Reed Elsevier's TSR performance against a comparator group over the three year period, to a maximum of around 270% of salary (depending on dividend payments). No increase will be applied for TSR performance which is below median, and the maximum increase will be applied at upper quartile or higher levels of TSR achievement. No award will be made to participants if Reed Elsevier fails to achieve the adjusted EPS growth threshold irrespective of the associated TSR performance.

  The effect of this revised structure is that the vesting levels based on adjusted EPS growth will, in isolation, generate a lower reward than currently. However, in combination with strong relative TSR performance, there will be scope for better reward. The Committee considers the proposed mechanism to be tougher than normal UK practice because the TSR element can improve the reward to participants if, but only if, the adjusted EPS test has first been achieved.

- Reed Elsevier's TSR will be tested against a selected international group of competitor companies over a three year period. For awards in 2006, it is proposed that these companies will be as follows:

The Thomson Corporation	United Business Media
McGraw Hill	Fair Isaac
Reuters Group	John Wiley & Sons
Pearson	DMGT
VNU	Dow Jones
Wolters Kluwer	Lagardere
ChoicePoint	Dun & Bradstreet
EMAP	WPP
Informa	Taylor Nelson

- **Any shares which vest will be treated as attracting dividends during the performance period.** The value of awards granted to participants will be reduced to take into account a reasonable expectation of the value of dividends over the performance period.
- As currently, the Committee will have full discretion to reduce or cancel awards granted to participants in 2006 and thereafter based on its assessment as to whether the EPS and TSR performance fairly reflects the progress of the business having regard to underlying revenue growth, cash generation, return on capital and any significant changes in currency and inflation as well as individual performance.

These changes require the approval of shareholders, and further information is contained in the circular dated 10 March 2006, which contains the notices of Annual General Meeting for Reed Elsevier PLC and Reed Elsevier NV, respectively.

Retirement benefits

- The Committee reviews retirement benefit provision in the context of the total remuneration package for each director, bearing in mind their age and service and against the background of evolving legislation and practice in the group's major countries of operation.
- Base salary is the only pensionable element of remuneration.
- The three UK-based executive directors are provided with conventional UK defined benefit pension arrangements targeting two thirds (Sir Crispin Davis 45%) of salary at a normal retirement age of 60.
- The Committee has considered the Government changes to UK taxation of pension schemes introduced from 6 April 2006 ("A" Day). The Committee currently intends to continue its existing practice of providing the targeted pension through a combination of:
  - –the main UK Reed Elsevier Pension Scheme for salary restricted to a cap, determined annually on the same basis as the pre-April 2006 Inland Revenue earnings cap, and
  - –Reed Elsevier's unfunded unapproved pension arrangement for salary above the cap.
- P Tierney and A Prozes are covered by a mix of defined benefit and defined contribution arrangements. Reed Elsevier pays a contribution of 19.5% of salary to E Engstrom's personal pension plan. In accordance with US legislation, these directors have no defined retirement age.

  These arrangements are set out in further detail in pages 18 and 19.

(c) 2005 payments

In this section, we set out the payments made to executive directors and any gains which they have made during 2005 under any of the long term incentive plans.

(i) Base Salary for 2005

The annual salary increases made to executive directors with effect from 1 January 2005 were consistent with UK and US norms, respectively, for increases paid to senior executives during 2005. The increases to UK-based executives were in a range from 4.9% to 6.2%, and to US-based executives were at 4%.

Because of the many countries in which we operate, there is no practical basis on which to compare directors' pay increases with those of other employees. However, the same factors, in terms of market, personal contribution and performance determine the level of increase across all employee populations globally.

	Annual Salary 2005	Annual Salary 2004
G J A van de Aast	**£430,000**	£405,900
M H Armour	**£535,000**	£503,970
Sir Crispin Davis	**£1,040,000**	£991,725
E Engstrom	**$1,040,000**	$1,000,000(i)
A Prozes	**$1,040,000**	$997,500
P Tierney	**$1,040,000**	$997,500

(i) Mr Engstrom joined in August 2004 and the salary shown for 2004 was pro-rated.

(ii) Annual Incentive Plan Payments for 2005

	Payments made in 2006 (in respect of 2005)	% of salary
G J A van de Aast	£408,741	95.1%
M H Armour	£474,989	88.8%
Sir Crispin Davis	£923,343	88.8%
E Engstrom	$846,404	81.4%
A Prozes	$1,013,958	97.5%
P Tierney	$312,021	30.0%

In setting the levels of payments under the AIP for directors, the Committee took into account a number of factors including; strong organic revenue growth in the majority of the businesses, continued improvement in underlying operating margin, overall improvement in capital efficiency and strong cash generation when compared to stretching internal targets. Harcourt Education's disappointing performance in supplemental and assessment was considered against the strong basal performance. In addition, the directors were generally assessed as performing well against their KPOs, resulting in positive business momentum and an overall promising business outlook.

(iii) Gains made under Long term Incentive Plans during 2005

The first cycle under the current Long term Incentive Scheme (LTIS) was launched for the performance period 2004–06 and the first grant does not therefore vest until early 2007, subject to the performance condition.

Similarly, the first cycle under the Bonus Investment Plan (BIP) was launched in 2003 and therefore, subject to the performance condition, the first matching shares do not vest until 2006.

The following gains were made by Executive Directors in relation to share incentives during 2005:

Mr Armour made a gain of £50,985 in respect of executive share options awarded in 1995.

Sir Crispin Davis made a gain of £9,576 under the UK Save-As-You-Earn (SAYE) Scheme granted in 2000.

Mr Engstrom made a gain of £410,921 on vesting of restricted shares awarded to him in 2004 as part of his initial recruitment arrangements, which were disclosed in the Annual Reports and Financial Statements 2004.

These gains are set out in further detail on pages 21 to 26.

(d) 2005 awards

In this section, we set out the awards made to executive directors during 2005 under the terms of our long term incentive plans.

LTIS awards – 2005 was the second year of the 2004–06 performance cycle under the LTIS, for which a single block grant was made in 2004.

ESOS grants made in the year and executive directors' elections under the Bonus Investment Plan (BIP) are shown in the following table:

		Share Options		BIP Matching Shares
	Share Type	No. of Shares	Option Price	No. of shares
G J A van de Aast	PLC	120,900	533.50p	Nil
	NV	82,478	€11.31	26,347
M H Armour	PLC	150,422	533.50p	21,861
	NV	102,618	€11.31	15,098
Sir Crispin Davis	PLC	292,409	533.50p	86,042
	NV	199,481	€11.31	Nil
E Engstrom	PLC	154,517	533.50p	14,020
	NV	105,412	€11.31	Nil
A Prozes	PLC	154,517	533.50p	23,756
	NV	105,412	€11.31	16,522
P Tierney	PLC	154,517	533.50p	24,156
	NV	105,412	€11.31	16,800

(e) Shareholding requirement

Participants in the LTIS are required to build up a significant personal shareholding in Reed Elsevier PLC and/or Reed Elsevier NV. At executive director level, the current requirement is that they should own shares equivalent to 1.5 times salary and that this shareholding should be acquired prior to any payout being made under the LTIS in February 2007.

Under the proposed terms of the revised LTIS, the shareholding requirement for the Group Chief Executive Officer will (subject to shareholders' approval) increase from 1.5 times to three times salary and for other Executive Directors from 1.5 times to two times salary (the revised shareholding requirements to be met by February 2009).

Details of directors' shareholdings, as at 31 December 2005, are set out on page 27.

(f) Service contracts
Executive directors are employed under service contracts which generally provide for one year's notice and neither specify severance payments nor contain specific provisions in respect of change in control.

The service contracts for executive directors (and for approximately 130 other senior executives) contain the following provisions:

- covenants which prevent them from working with specified competitors, recruiting Reed Elsevier employees and soliciting Reed Elsevier customers for a period of 12 months after leaving employment;
- in the event of their resigning, they will immediately lose all rights to any awards under the LTIS, ESOS and BIP granted from 2004 onwards, whether or not such awards have vested; and
- in the event that they join a specified competitor within 12 months of termination, any gains made in the six months prior to termination on the exercise of an LTIS, ESOS and BIP award made from 2004 onwards shall be repayable.

(g) Policy on external appointments
The Committee believes that the experience gained by allowing executive directors to serve as non-executive directors on the boards of other organisations is of benefit to Reed Elsevier. Accordingly, executive directors may, subject to the approval of the Chairman and the Chief Executive Officer, serve as non-executive directors on the boards of up to two non-associated companies (of which only one may be to the board of a major company) and they may retain remuneration arising from such appointments.

- Sir Crispin Davis is a non-executive director of GlaxoSmithKline plc and received a fee of £70,000 during 2005.
- Erik Engstrom is a non-executive director of Eniro AB and received a fee of £22,108 during 2005.
- Andrew Prozes is a non-executive director of the Cott Corporation and received a fee of £27,377 during 2005.

B. Non-executive directors
(a) Policy
Reed Elsevier seeks to recruit non-executive directors with the experience to contribute to the board of a dual-listed global business and with a balance of personal skills which will make a major contribution to the boards and their committee structures.

With the exception of G J de Boer-Kruyt, who serves only on the supervisory board of Reed Elsevier NV, non-executive directors, including the Chairman, are appointed to the boards of Reed Elsevier Group plc, Reed Elsevier PLC and the supervisory board of Reed Elsevier NV.

Non-executive directors' remuneration is determined by the three boards as appropriate to the director concerned. The primary source for comparative market data is the practice of FTSE50 companies, although reference is also made to AEX companies.

Non-executive directors, including the Chairman, serve under letters of appointment, do not have contracts of service and are not entitled to notice of, or payments following, termination.

During the year the Reed Elsevier Group plc board introduced a charity donation matching programme for non-executive directors. Under the policy, where a non-executive director donates all or part of their fees to a registered charity, the company may, at its sole discretion, make a matching donation to any charity, provided the charity's objectives are judged to be appropriate and are not political or religious in nature. Messrs Reid and Zelnick each donated a proportion of their fees in respect of 2005 to charity and, in accordance with the programme the company made matching charitable donations of £22,500 and £30,000, respectively.

(b) Fee levels
Non-executive directors receive one annual fee in respect of their memberships of the boards of Reed Elsevier PLC, Reed Elsevier NV and Reed Elsevier Group plc. The fee paid to G J de Boer-Kruyt, who serves only on the supervisory board of Reed Elsevier NV, reflects her time commitment to that company and to other companies within the Reed Elsevier combined businesses. Non-executive directors are reimbursed for expenses incurred in attending meetings. They do not receive any performance related bonuses, pension provisions, share options or other forms of benefit. Fees may be reviewed annually, although in practice they have changed on a less frequent basis and were last reviewed with effect from 1 May 2003. The fee for Mrs de Boer-Kruyt was last reviewed with effect from 1 January 2004.

Annual fee rates applicable to non-executive directors and to the Chairman are set out in the following table:

	Annual fee 2005	Annual fee 2004
Chairman		
J Hommen (from April 2005)	**€350,000(i)**	–
M Tabaksblat (until April 2005)	**€280,000(i)**	€280,000
Non-executive directors	**£45,000/€65,000**	£45,000/€65,000
Chairman of:		
• Audit Committee	**£7,000/€12,000**	£7,000/€12,000
• Remuneration Committee	**£7,000/€12,000**	£7,000/€12,000

i) Mr Hommen was appointed in April 2005, when Mr Tabaksblat retired. Their fees for 2005 were pro-rated.

C. Statutory disclosures

(a) Report authorship

This report has been prepared by the Remuneration Committee of Reed Elsevier Group plc. It has been prepared in accordance with the UK Regulations and the Dutch Code issued in December 2003 in order to meet the requirements of the UK Combined Code of Corporate Governance issued in July 2003, the Dutch Code and the Netherlands Civil code.

(b) Remuneration committee constitution and terms of reference

The Committee is responsible for:

- recommending to the boards the remuneration (in all its forms) of the Chairman and the executive directors, including terms of service contracts and all other terms and conditions of employment;
- providing advice to the Board and to the Chief Executive Officer on major policy issues affecting the remuneration of executives at a senior level below the board; and
- the operation of all share-based plans.

A copy of the Terms of Reference of the Committee can be found on the Reed Elsevier website www.reedelsevier.com.

The Remuneration Committee met six times during the year. Mr van Lede was unable to attend one meeting, otherwise there was full attendance.

(c) Advisors

The Committee has appointed Towers Perrin, an external consultancy which has wide experience of executive remuneration in multinational companies, to advise in developing its performance-related remuneration policy. Towers Perrin also provide actuarial and other Human Resources consultancy services directly to some Reed Elsevier companies.

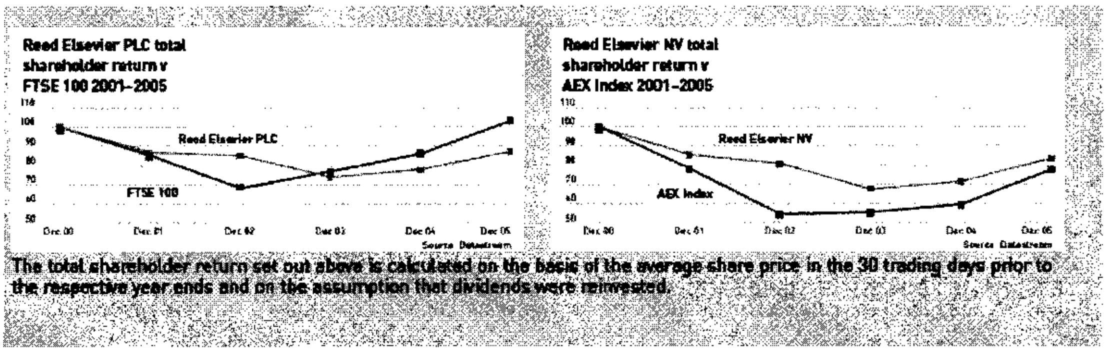
The following individuals also provided material advice or services to the Committee during the year:

- Sir Crispin Davis (Chief Executive Officer);
- Ian Fraser (Group HR Director); and
- Philip Wills (Director, Compensation and Benefits).

(d) Total Shareholder Return (TSR)

As required by the Directors' Remuneration Report Regulations 2002, the following graphs show the Reed Elsevier PLC and Reed Elsevier NV total shareholder return performance, assuming dividends were reinvested. They compare the Reed Elsevier PLC performance with that achieved by the FTSE 100, and the Reed Elsevier NV performance with the performance achieved by the Euronext Amsterdam (AEX) Index, over the five year period from 2001–2005.

For the five year period since 1 January 2001, the TSR for Reed Elsevier PLC was a negative 13%, against a FTSE 100 return of 4%. For Reed Elsevier NV during the same period, TSR was a negative 16%, against an AEX Index return of negative 22%. As Reed Elsevier PLC and Reed Elsevier NV are members of the FTSE 100 and AEX Index respectively, the Committee considers these indices to be appropriate for comparison purposes.



The total shareholder return set out above is calculated on the basis of the average share price in the 30 trading days prior to the respective year ends and on the assumption that dividends were reinvested.

(e) Service contracts

Each of the executive directors has a service contract, as summarised below:

	Contract Date	Expiry date (subject to notice period)	Notice period	Subject to:
G J A van de Aast(i)	15 November 2000	17 July 2017	12 months	English law
M H Armour(i)	7 October 1996	29 July 2014	12 months	English law
Sir Crispin Davis(i)	19 July 1999	19 March 2009	12 months	English law
E Engstrom(i)	25 June 2004	14 June 2025	12 months	English law
A Prozes(ii)	5 July 2000	Indefinite	12 months base salary payable for termination without cause	New York law
P Tierney(ii)	19 November 2002	Indefinite	12 months base salary payable for termination without cause	New York law

(i) Employed by Reed Elsevier Group plc
(ii) Employed by Reed Elsevier Inc

The Committee believes that as a general rule, notice periods should be twelve months and that the directors should, subject to practice within their base country, be required to mitigate their damages in the event of termination. The Committee will, however, note local market conditions so as to ensure that the terms offered are appropriate to attract and retain top executives operating in global businesses.

No loans, advances or guarantees have been provided on behalf of any director.

(f) Auditable disclosures

(i) Pensions in more detail

The target pension for Sir Crispin Davis at normal retirement age of 60 is 45% of base salary in the 12 months prior to retirement. Other executive directors based in the UK are provided with pension benefits at a normal retirement age of 60, equivalent to two thirds of base salary in the 12 months prior to retirement, provided they have completed 20 years service with Reed Elsevier or at an accrual rate of 1/30th of pensionable salary per annum if employment is for less than 20 years.

The target pension for A Prozes, a US-based director, is US$300,000 per annum, which becomes payable on retirement only if he completes a minimum of seven years service. The pension will be reduced in amount by the value of any other retirement benefits payable by Reed Elsevier or which become payable by any former employer, other than those attributable to employee contributions. The target pension for P Tierney, a US-based director, after completion of five years pensionable service is US$440,000 per annum, inclusive of any other retirement benefits from any former employer. In the event of termination of employment before completion of five years pensionable service, the pension payable will be reduced proportionately. As US employees Messrs Prozes and Tierney also are eligible to participate in Reed Elsevier's 401k plan, to which Reed Elsevier contributed £3,588 and £4,031, respectively for the year.

The pension arrangements for the above directors include life assurance cover whilst in employment, an entitlement to a pension in the event of ill health or disability and a spouse's and/or dependents' pension on death.

E Engstrom is not a member of a company pension scheme and Reed Elsevier made a contribution to Mr Engstrom's designated retirement account of £111,429, equivalent to 19.5% of his annual salary. In addition, Mr Engstrom is provided with life assurance cover whilst in employment.

DIRECTORS' REMUNERATION REPORT

The increase in the transfer value of the directors' pensions, after deduction of contributions, is shown below:

£	Age 31 December 2005	Directors' contributions	Transfer value of accrued pension 31 December 2004	Transfer value of accrued pension 31 December 2005	Increase in transfer value during the period (net of directors' contributions)	Accrued annual pension 31 December 2005	Increase in accrued annual pension during the period	Increase in accrued annual pension during the period (net of inflation)	Transfer value of increase in accrued annual pension during the period (net of inflation and directors' contributions)
G J A van de Aast	48	4,980	510,134	721,552	206,437	72,884	17,615	15,680	150,257
M H Armour	51	4,980	1,722,165	2,259,816	532,670	194,644	28,090	22,272	253,598
Sir Crispin Davis	56	4,980	3,961,740	5,563,704	1,596,984	310,475	61,152	52,425	934,483
A Prozes	59	–	–	–	–	–	–	–	–
P Tierney	60	–	1,556,726	1,938,541	381,816	170,308	25,500	25,500	288,412

Transfer values have been calculated in accordance with the guidance note GN11 published by the UK Institute of Actuaries and Faculty of Actuaries.

The transfer value in respect of individual directors represents a liability in respect of directors' pensions entitlement, and is not an amount paid or payable to the director.

(ii) Aggregate emoluments
The emoluments of the directors of Reed Elsevier PLC and Reed Elsevier NV (including any entitlement to fees or emoluments from either Reed Elsevier Group plc or Elsevier Reed Finance BV) were as follows:

Aggregate emoluments

	2005 £000	2004 £000
Salaries and fees	**4,234**	3,684
Benefits	**111**	475
Annual performance-related bonuses	**3,001**	3,027
Pension contributions	**135**	54
Pension to former director	**223**	190
Payment to former director	**10**	10
Total	**7,714**	7,440

No compensation payments have been made for loss of office or termination in 2004 and 2005.

Details of share options exercised by the directors over shares in Reed Elsevier PLC and Reed Elsevier NV during the year are shown on pages 21 to 26. The aggregate notional pre-tax gain made by the directors on the exercise of share options during the year was £471,482 (2004: £2,001).

(iii) Individual emoluments of executive directors

£	Salary	Benefits	Bonus	**Total 2005**	Total 2004
G J A van de Aast	430,000	16,462	408,741	**855,203**	835,222
M H Armour	535,000	19,372	474,989	**1,029,361**	998,402
Sir Crispin Davis	1,040,000	28,173	923,343	**1,991,516**	1,949,435
E Engstrom (from 23 August 2004)	571,429	13,950	465,057	**1,050,436**	739,732
A Prozes	571,429	19,891	557,120	**1,148,440**	1,080,352
P Tierney	571,429	13,009	171.44(	**755,878**	1,087,071
Total	3,719,287	110,857	3,000,690	**6,830,834**	6,690,214

Benefits principally comprise the provision of a company car, medical insurance and life assurance.

Sir Crispin Davis was the highest paid director in 2005. He exercised a SAYE share option during 2005 over 5,019 Reed Elsevier PLC ordinary shares, at an option price of 336.2p. The notional gain on the exercise amounted to £9,576.

DIRECTORS' REMUNERATION REPORT

(iv) Individual emoluments of non-executive directors

£	2005	2004
G J de Boer-Kruyt *	**23,151**	22,993
J F Brock (until 28 April 2005)	**11,130**	44,218
M W Elliott	**45,000**	45,000
C J A van Lede	**44,521**	44,218
J Hommen (from 27 April 2005)	**159,817**	–
D E Reid	**45,000**	45,000
Lord Sharman	**52,000**	52,000
R W H Stomberg	**52,740**	52,381
M Tabaksblat (until 28 April 2005)	**47,945**	190,476
S Zelnick (from 27 April 2005)	**33,750**	–
Total	**515,054**	496,286

* G J de Boer-Kruyt is not a director of Reed Elsevier Group plc

R J Nelissen, a former director of Reed Elsevier PLC, Reed Elsevier NV and Reed Elsevier Group plc served as Chairman of the Supervisory Board of Elsevier Reed Finance BV throughout 2005. During the period he received fees of £10,274 in such capacity.

(v) Share Options and Interests in Shares

Details of options and restricted shares held by directors in Reed Elsevier PLC and Reed Elsevier NV during the period are shown below. There have been no changes in the options or restricted shares held by directors since 31 December 2005.

(a) Options in Reed Elsevier PLC

		1 January 2005	Granted during the year	Option price	Exercised during the year	Market price at exercise date	31 December 2005	Exercisable from	Exercisable until
G J A van de Aast									
	– ESOS	50,940		638.00p			50,940	1 Dec 2003	1 Dec 2010
		49,317		659.00p			49,317	23 Feb 2004	23 Feb 2011
		58,000		600.00p			58,000	22 Feb 2005	22 Feb 2012
		81,728		451.50p			81,728	21 Feb 2006	21 Feb 2013
		124,956		487.25p			124,956	19 Feb 2007	19 Feb 2014
			120,900	533.50p			120,900	17 Feb 2008	17 Feb 2015
	– BIP	31,217		Nil			31,217	26 Mar 2007	26 Mar 2007
	– LTIS (options)	229,087		487.25p			229,087	19 Feb 2007	19 Feb 2014
	– LTIS (shares)	104,130		Nil			104,130	19 Feb 2007	19 Feb 2007
Total		729,375	120,900				850,275		
M H Armour									
	– ESOS	39,600		400.75p	39,600(i)	529.50p	–		
		30,000		585.25p			30,000	23 Apr 1999	23 Apr 2006
		52,000		565.75p			52,000	21 Apr 2000	21 Apr 2007
		66,900		523.00p			66,900	17 Aug 2001	17 Aug 2008
		33,600		537.50p			33,600	21 Feb 2003	19 Apr 2009
		88,202		436.50p			88,202	2 May 2003	2 May 2010
		62,974		659.00p			62,974	23 Feb 2004	23 Feb 2011
		74,000		600.00p			74,000	22 Feb 2005	22 Feb 2012
		104,319		451.50p			104,319	21 Feb 2006	21 Feb 2013
		155,147		487.25p			155,147	19 Feb 2007	19 Feb 2014
			150,422	533.50p			150,422	17 Feb 2008	17 Feb 2015
	– BIP	11,327		Nil			11,327	21 Mar 2006	21 Mar 2006
		19,225		Nil			19,225	26 Mar 2007	26 Mar 2007
			21,861	Nil			21,861	14 Apr 2008	14 Apr 2008
	– LTIS (options)	284,437		487.25p			284,437	19 Feb 2007	19 Feb 2014
	– LTIS (shares)	129,289		Nil			129,289	19 Feb 2007	19 Feb 2007
	– SAYE	4,329		377.60p			4,329	1 Aug 2009	31 Jan 2010
Total		1,155,349	172,283		39,600		1,288,032		

(a) Options in Reed Elsevier PLC continued

		1 January 2005	Granted during the year	Option price	Exercised during the year	Market price at exercise date	31 December 2005	Exercisable from	Exercisable until
Sir Crispin Davis									
	– ESOS	160,599		467.00p			160,599	21 Feb 2003	1 Sept 2009
		80,300		467.00p			80,300	1 Sept 2003	1 Sept 2009
		80,300		467.00p			80,300	1 Sept 2004	1 Sept 2009
		171,821		436.50p			171,821	2 May 2003	2 May 2010
		122,914		659.00p			122,914	23 Feb 2004	23 Feb 2011
		148,500		600.00p			148,500	22 Feb 2005	22 Feb 2012
		209,192		451.50p			209,192	21 Feb 2006	21 Feb 2013
		305,303		487.25p			305,303	19 Feb 2007	19 Feb 2014
			292,409	533.50p			292,409	17 Feb 2008	17 Feb 2015
	– BIP	22,731		Nil			22,731	21 Mar 2006	21 Mar 2006
		39,554		Nil			39,554	26 Mar 2007	26 Apr 2007
			86,042	Nil			86,042	14 Apr 2008	14 Apr 2008
	– LTIS (options)	559,722		487.25p			559,722	19 Feb 2007	19 Feb 2014
	– LTIS (shares)	254,419		Nil			254,419	19 Feb 2007	19 Feb 2007
	– SAYE	5,019		336.20p	5,019(i)	527.00p	–		
Total		2,160,374	378,451		5,019		2,533,806		
E Engstrom									
	– ESOS	63,460		478.00p			63,460	23 Aug 2007	23 Aug 2014
			154,517	533.50p			154,517	17 Feb 2008	17 Feb 2015
	– BIP		14,020	Nil			14,020	14 Apr 2008	14 Apr 2008
	– LTIS (options)	318,398		478.00p			318,398	23 Aug 2007	23 Aug 2014
	– LTIS (shares)	144,726		Nil			144,726	23 Aug 2007	23 Aug 2007
	– Restricted share	115,781		Nil	38,595(ii)	524.50p	77,186	23 Aug 2005	23 Aug 2007
Total		642,365	168,537		38,595		772,307		
A Prozes									
	– ESOS	188,281		566.00p			188,281	9 Aug 2003	9 Aug 2010
		83,785		659.00p			83,785	23 Feb 2004	23 Feb 2011
		103,722		600.00p			103,722	22 Feb 2005	22 Feb 2012
		132,142		451.50p			132,142	21 Feb 2006	21 Feb 2013
		162,666		487.25p			162,666	19 Feb 2007	19 Feb 2014
			154,517	533.50p			154,517	17 Feb 2008	17 Feb 2015
	– BIP	20,040		Nil			20,040	21 Mar 2006	21 Mar 2006
		20,104		Nil			20,104	26 Mar 2007	26 Mar 2007
			23,756	Nil			23,756	14 Apr 2008	14 Apr 2008
	– LTIS (options)	298,221		487.25p			298,221	19 Feb 2007	19 Feb 2014
	– LTIS (shares)	135,555		Nil			135,555	19 Feb 2007	19 Feb 2007
Total		1,144,516	178,273				1,322,789		

(a) Options in Reed Elsevier PLC continued

		1 January 2005	Granted during the year	Option price	Exercised during the year	Market price at exercise date	31 December 2005	Exercisable from	Exercisable until
P Tierney									
	– ESOS	396,426		451.50p			396,426	21 Feb 2006	21 Feb 2013
		162,666		487.25p			162,666	19 Feb 2007	19 Feb 2014
			154,517	533.50p			154,517	17 Feb 2008	17 Feb 2015
	– BIP	19,572		Nil			19,572	26 Mar 2007	26 Mar 2007
			24,156	Nil			24,156	14 Apr 2008	14 Apr 2008
	– LTIS (options)	298,221		487.25p			298,221	19 Feb 2007	19 Feb 2014
	– LTIS (shares)	135,555		Nil			135,555	19 Feb 2007	19 Feb 2007
Total		1,012,440	178,673				1,191,113		

(i) Retained an interest in all of the shares
(ii) Retained an interest in 10,169 shares

Awards granted under ESOS and BIP which become exercisable from 2007 onwards are subject to post-grant performance conditions.

The proportion of the award that may vest under LTIS is subject to the annual growth in adjusted EPS during the performance period. The numbers of LTIS options and shares included in the above table are calculated by reference to an assumed annual growth rate of 10%, which would result in 100% of the award vesting. Depending on actual adjusted EPS growth, the proportion of the award that may vest could be lower or higher.

Options under the SAYE scheme, in which all eligible UK employees are invited to participate, are granted at a maximum discount of 20% to the market price at time of grant. They are normally exercisable after the expiry of 3 to 5 years from the date of grant. No performance targets are attached to this scheme as it is an all-employee scheme.

The middle market price of a Reed Elsevier PLC ordinary share on the date of the 2005 award under BIP was 536.50p.

The middle market price of a Reed Elsevier PLC ordinary share during the year was in the range 474.50p to 553.50p and at 31 December 2005 was 546.00p.

(b) Options in Reed Elsevier NV

	1 January 2005	Granted during the year	Option price	Exercised during the year	Market price at exercise date	31 December 2005	Exercisable from	Exercisable until
G J A van de Aast								
– ESOS	35,866		€14.87			35,866	1 Dec 2003	1 Dec 2010
	35,148		€14.75			35,148	23 Feb 2004	23 Feb 2011
	40,699		€13.94			40,699	22 Feb 2005	22 Feb 2012
	58,191		€9.34			58,191	21 Feb 2006	21 Feb 2013
	85,805		€10.57			85,805	19 Feb 2007	19 Feb 2014
		82,478	€11.31			82,478	17 Feb 2008	17 Feb 2015
– BIP	12,057		Nil			12,057	21 Mar 2006	21 Mar 2006
		26,347	Nil			26,347	14 Apr 2008	14 Apr 2008
– LTIS (options)	157,309		€10.57			157,309	19 Feb 2007	19 Feb 2014
– LTIS (shares)	71,504		Nil			71,504	19 Feb 2007	19 Feb 2007
Total	*496,579*	*108,825*				605,404		
M H Armour								
– ESOS	20,244		€13.55			20,244	21 Feb 2003	19 Apr 2009
	61,726		€10.73			61,726	2 May 2003	2 May 2010
	44,882		€14.75			44,882	23 Feb 2004	23 Feb 2011
	51,926		€13.94			51,926	22 Feb 2005	22 Feb 2012
	74,276		€9.34			74,276	21 Feb 2006	21 Feb 2013
	106,536		€10.57			106,536	19 Feb 2007	19 Feb 2014
		102,618	€11.31			102,618	17 Feb 2008	17 Feb 2015
– BIP	8,030		Nil			8,030	21 Mar 2006	21 Mar 2006
	12,842		Nil			12,842	26 Mar 2007	26 Mar 2007
		15,098	Nil			15,098	14 Apr 2008	14 Apr 2008
– LTIS (options)	195,317		€10.57			195,317	19 Feb 2007	19 Feb 2014
– LTIS (shares)	88,780		Nil			88,780	19 Feb 2007	19 Feb 2007
Total	664,559	117,716				782,275		

DIRECTORS' REMUNERATION REPORT

(b) Options in Reed Elsevier NV continued

	1 January 2005	Granted during the year	Option price	Exercised during the year	Market price at exercise date	31 December 2005	Exercisable from	Exercisable until
Sir Crispin Davis								
– ESOS	95,774		€12.00			95,774	21 Feb 2003	1 Sept 2009
	47,888		€12.00			47,888	1 Sept 2003	1 Sept 2009
	47,888		€12.00			47,888	1 Sept 2004	1 Sept 2009
	120,245		€10.73			120,245	2 May 2003	2 May 2010
	87,601		€14.75			87,601	23 Feb 2004	23 Feb 2011
	104,204		€13.94			104,204	22 Feb 2005	22 Feb 2012
	148,946		€9.34			148,946	21 Feb 2006	21 Feb 2013
	209,645		€10.57			209,645	19 Feb 2007	19 Feb 2014
		199,481	€11.31			199,481	17 Feb 2008	17 Feb 2015
– BIP	16,115		Nil			16,115	21 Mar 2006	21 Mar 2006
	26,421		Nil			26,421	26 Mar 2007	26 Mar 2007
– LTIS (options)	384,349		€10.57			384,349	19 Feb 2007	19 Feb 2014
– LTIS (shares)	174,704		Nil			174,704	19 Feb 2007	19 Feb 2007
Total	1,463,780	199,481				1,663,261		
E Engstrom								
– ESOS	43,866		€10.30			43,866	23 Aug 2007	23 Aug 2014
		105,412	€11.31			105,412	17 Feb 2008	17 Feb 2015
– LTIS (options)	220,090		€10.30			220,090	23 Aug 2007	23 Aug 2014
– LTIS (shares)	100,040		Nil			100,040	23 Aug 2007	23 Aug 2007
– Restricted shares	80,032		Nil	26,678(i)	€11.41	53,354	23 Aug 2005	23 Aug 2007
Total	444,028	105,412		26,678		522,762		

(b) Options in Reed Elsevier NV continued

	1 January 2005	Granted during the year	Option price	Exercised during the year	Market price at exercise date	31 December 2005	Exercisable from	Exercisable until
A Prozes								
– ESOS	131,062		€13.60			131,062	9 Aug 2003	9 Aug 2010
	59,714		€14.75			59,714	23 Feb 2004	23 Feb 2011
	72,783		€13.94			72,783	22 Feb 2005	22 Feb 2012
	94,086		€9.34			94,086	21 Feb 2006	21 Feb 2013
	111,699		€10.57			111,699	19 Feb 2007	19 Feb 2014
		105,412	€11.31			105,412	17 Feb 2008	17 Feb 2015
– BIP	14,552		Nil			14,552	21 Mar 2006	21 Mar 2006
	13,612		Nil			13,612	26 Mar 2007	26 Mar 2007
		16,522	Nil			16,522	14 Apr 2008	14 Apr 2008
– LTIS (options)	204,782		€10.57			204,782	19 Feb 2007	19 Feb 2014
– LTIS (shares)	93,083		Nil			93,083	19 Feb 2007	19 Feb 2007
Total	795,373	121,934				917,307		
P Tierney								
– ESOS	282,258		€9.34			282,258	21 Feb 2006	21 Feb 2013
	111,699		€10.57			111,699	19 Feb 2007	19 Feb 2014
		105,412	€11.31			105,412	17 Feb 2008	17 Feb 2015
– BIP	13,252		Nil			13,252	26 Mar 2007	26 Mar 2007
		16,800	Nil			16,800	14 Apr 2008	14 Apr 2008
– LTIS (options)	204,782		€10.57			204,782	19 Feb 2007	19 Feb 2014
– LTIS (shares)	93,083		Nil			93,083	19 Feb 2007	19 Feb 2007
Total	705,074	122,212				827,286		

(i) Retained an interest in all of the shares

Awards granted under ESOS and BIP which become exercisable from 2007 onwards are subject to post-grant performance conditions.

The proportion of the award that may vest under LTIS is subject to the annual growth in adjusted EPS during the performance period. The numbers of LTIS options and shares included in the above table are calculated by reference to an assumed annual growth rate of 10%, which would result in 100% of the award vesting. Depending on actual adjusted EPS growth, the proportion of the award that may vest could be lower or higher, as outlined on page 13.

The market price of a Reed Elsevier NV ordinary share on the date of the 2005 award under BIP was €11.35.

The market price of a Reed Elsevier NV ordinary share during the year was in the range €10.09 to €11.91 and at 31 December 2005 was €11.80.

DIRECTORS' REMUNERATION REPORT

(c) Shareholdings in Reed Elsevier PLC and Reed Elsevier NV

	Reed Elsevier PLC ordinary shares		Reed Elsevier NV ordinary shares	
	1 January 2005(i)	31 December 2005	1 January 2005(i)	31 December 2005
G J A van de Aast	18,600	18,600	19,684	35,445
M H Armour	46,926	99,321	29,846	38,727
G J de Boer-Kruyt *	–	–	–	–
Sir Crispin Davis	473,467	528,847	298,261	298,261
M W Elliott	–	–	–	–
E Engstrom	–	19,253	–	26,678
J Hommen	–	–	–	–
C J A van Lede	–	–	11,100	11,100
A Prozes	76,808	91,444	63,454	73,632
D E Reid	–	–	–	–
Lord Sharman	–	–	–	–
R W H Stomberg	–	–	–	–
P Tierney	26,692	42,440	17,952	28,902
S Zelnick	–	–	–	–

* G J de Boer-Kruyt is not a director of Reed Elsevier Group plc
(i) Or date of appointment as a director, if subsequent to 1 January 2005

Any ordinary shares required to fulfil entitlements under nil cost restricted share awards are provided by the Employee Benefit Trust (EBT) from market purchases. As a potential beneficiary under the EBT in the same way as other employees of Reed Elsevier, each executive director is deemed to be interested in all the shares held by the EBT which, at 31 December 2005, amounted to 10,780,776 Reed Elsevier PLC ordinary shares and 5,539,922 Reed Elsevier NV ordinary shares.

Approved by the board of Reed Elsevier Group plc on 15 February 2006

Signed on behalf of the Remuneration Committee by Stephen J Cowden, Company Secretary

INDEPENDENT AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

To the members of Reed Elsevier Group plc

We have audited the consolidated financial statements of Reed Elsevier Group plc for the year ended 31 December 2005 ("the consolidated financial statements"), which comprise the group accounting policies, the consolidated income statement, the consolidated cash flow statement, the consolidated balance sheet, the consolidated statement of recognised income and expenses, the reconciliation of shareholders' equity and the related notes 1 to 33. These consolidated financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for preparing the consolidated financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards ("IFRS"), as adopted for use in the European Union.

Our responsibility is to audit the consolidated financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the consolidated financial statements give a true and fair view in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you if, in our opinion, the directors' report is not consistent with the consolidated financial statements. We also report to you if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company and other members of the group is not disclosed.

We read the directors' report and the other information contained in the annual report for the above year as described in the contents section and we consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view in accordance with IFRS, as adopted for use in the European Union, of the state of the group's affairs as at 31 December 2005 and of its profit for the year then ended; and
- the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

Deloitte & Touche LLP

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

London

15 February 2006

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Revenue	1	**5,116**	4,768
Cost of sales		**(1,877)**	(1,721)
Gross profit		**3,239**	3,047
Selling and distribution costs		**(1,117)**	(1,060)
Administration and other expenses		**(1,321)**	(1,255)
Operating profit before joint ventures		**801**	732
Share of results of joint ventures		**16**	17
Operating profit	1	**817**	749
Finance income	6	**30**	23
Finance costs	6	**(415)**	(390)
Net finance costs		**(385)**	(367)
Disposals and other non operating items	7	**2**	(3)
Profit before tax	2	**434**	379
Taxation	8	**(171)**	(176)
Net profit for the year		**263**	203
Attributable to:			
Parent company's shareholders		**261**	201
Minority interests		**2**	2
Net profit for the year		**263**	203

The historical cost profits and losses are not materially different from the results disclosed above.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Cash flow from operating activities			
Cash generated from operations	10	**1,202**	1,140
Interest received		**9**	15
Interest paid		**(96)**	(85)
Net interest paid to Reed Elsevier PLC		**(6)**	(1)
Net interest paid to the Elsevier Reed Finance BV group		**(292)**	(290)
Tax paid		**(162)**	(199)
Net cash from operating activities		**655**	580
Cash flows from investing activities			
Acquisitions	10	**(317)**	(647)
Purchases of property, plant and equipment		**(92)**	(82)
Expenditure on internally developed intangible assets		**(102)**	(110)
Purchases of investments		**(3)**	(13)
Purchases of shares in Reed Elsevier PLC and Reed Elsevier NV		**(27)**	(29)
Proceeds on disposal of property, plant and equipment		**7**	4
Proceeds from other disposals		**36**	12
Dividends received from joint ventures		**16**	17
Net cash used in investing activities		**(482)**	(848)
Cash flows from financing activities			
Dividends paid to shareholders of the parent company		**(297)**	(304)
Increase in net borrowings from shareholders and Elsevier Finance BV group		**113**	349
Increase/(decrease) in other borrowings		**91**	(134)
Net cash used in financing activities		**(93)**	(89)
Increase/(decrease) in cash and cash equivalents		**80**	(357)
Movement in cash and cash equivalents			
At start of year		**160**	521
Increase/(decrease) in cash and cash equivalents		**80**	(357)
Exchange translation differences		**4**	(4)
At end of year		**244**	160

CONSOLIDATED BALANCE SHEET

As at 31 December 2005

	Note	2005 £m	2004 £m
Non-current assets			
Goodwill	13	**3,032**	2,614
Intangible assets	14	**2,977**	2,832
Investments	15	**208**	176
Property, plant and equipment	16	**313**	291
Deferred tax assets	18	**264**	222
		6,794	6,135
Current assets			
Inventories and pre-publication costs	19	**627**	540
Trade and other receivables	20	**1,363**	1,082
Amounts owed by Reed Elsevier PLC		**39**	36
Amounts owed by the Elsevier Reed Finance BV group		**168**	346
Cash and cash equivalents		**244**	160
		2,441	2,164
Assets held for sale	21	**60**	-
Total assets		**9,295**	8,299
Current liabilities			
Trade and other payables	22	**(1,974)**	(1,795)
Borrowings	23	**(460)**	(381)
Amounts owed to Reed Elsevier PLC		**(607)**	(555)
Amounts owed to the Elsevier Reed Finance BV group		**(613)**	(778)
Taxation		**(258)**	(245)
		(3,912)	(3,754)
Non-current liabilities			
Borrowings	23	**(1,532)**	(1,195)
Amounts owed to Reed Elsevier PLC		**-**	(40)
Amounts owed to the Elsevier Reed Finance BV group		**(4,677)**	(4,092)
Taxation		**(244)**	(191)
Deferred tax liabilities	18	**(926)**	(858)
Net pension obligations	4	**(405)**	(321)
Provisions	25	**(44)**	(52)
		(7,828)	(6,749)
Liabilities associated with assets held for sale	21	**(11)**	-
Total liabilities		**(11,751)**	(10,503)
Net liabilities		**(2,456)**	(2,204)
Capital and reserves			
Share capital	27	**-**	-
Share premium	28	**324**	324
Translation reserve	29	**(122)**	107
Other reserves	30	**(2,673)**	(2,648)
Consolidated shareholders' equity		**(2,471)**	(2,217)
Minority interests		**15**	13
Total equity		**(2,456)**	(2,204)

Approved by the board of Reed Elsevier Group plc, 15 February 2006.

M H Armour
Chief Financial Officer

CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

For the year ended 31 December 2005

	2005 £m	2004 £m
Net profit for the year	**263**	203
Exchange difference on translation of foreign operations	**(232)**	107
Actuarial losses on defined benefit pension schemes	**(37)**	(74)
Fair value movements on available for sale investments	**3**	-
Fair value movements on cash flow hedges	**(18)**	-
Tax on actuarial losses on defined benefit pension schemes	**10**	12
Tax on fair value movements on cash flow hedges	**(13)**	-
Net (expense)/income recognised directly in equity	**(287)**	45
Transfer to net profit from hedge reserve	**(26)**	-
Total recognised income and expense for the year	**(50)**	248
Attributable to:		
Parent company's shareholders	**(52)**	246
Minority interests	**2**	2
Total recognised income and expense for the year	**(50)**	248

CONSOLIDATED SHAREHOLDERS' EQUITY RECONCILIATION

For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Total recognised net (expense)/income attributable to parent company's shareholders		**(52)**	246
Dividends paid	12	**(297)**	(304)
Recognition of share based remuneration		**57**	59
Net (decrease)/increase in consolidated shareholders' equity		**(292)**	1
Consolidated shareholders' equity at start of year		**(2,217)**	(2,218)
Transition adjustment on adoption of IAS39		**38**	-
Consolidated shareholders' equity at end of year		**(2,471)**	(2,217)
Transition adjustment on adoption of IAS39 attributable to:			
Parent company's shareholders		**38**	-
Minority interests		**-**	-
		38	-

ACCOUNTING POLICIES

Under a regulation adopted by the European Parliament, the Reed Elsevier Group plc financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) with effect from the 2005 financial year.

The transition date for the application of IFRS is 1 January 2004 and the comparative figures for the year ended 31 December 2004 have been restated accordingly. Reconciliations of net income and equity for the comparative period from previously applied UK GAAP to IFRS are presented in note 33. IAS39 – Financial Instruments: Recognition and Measurement is applicable from the 2005 financial year with a transition date of 1 January 2005 and accordingly no restatement of prior period comparatives has been made in respect of IAS39.

The Reed Elsevier Group plc combined financial statements are prepared under IFRS as endorsed by the European Union, including the early adoption of an amendment to IAS19 – Employee Benefits which allows actuarial gains and losses to be recognised in full in the statement of recognized income and expense in the period in which they occur.

Basis of preparation

The Reed Elsevier Group plc accounting policies under IFRS are set out below.

In addition to the figures required to be reported by applicable accounting standards, adjusted profit figures have been presented as an additional performance measure. Adjusted figures are shown before the amortisation of acquired intangible assets, acquisition integration costs, disposals and other non operating items. Adjusted operating profits are also grossed up to exclude the equity share of taxes in joint ventures.

Foreign exchange translation

Transactions in foreign currencies are recorded at the rate of exchange prevailing on the date of the transaction. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rate prevailing on the balance sheet date. Exchange differences arising are recorded in the income statement other than where hedge accounting applied (see Financial Instruments).

Assets and liabilities of foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items of foreign operations are translated at the average exchange rate for the period. Exchange differences arising are classified as equity and transferred to the translation reserve. When operations are disposed of, the related cumulative translation differences are recognized within the income statement in the period.

As permitted under the transition rules of IFRS1 – First Time Adoption of International Financial Reporting Standards, cumulative translation differences in respect of foreign operations have been deemed to be nil at the date of transition to IFRS.

Reed Elsevier uses derivative financial instruments, primarily forward contracts, to hedge its exposure to certain foreign exchange risks. Details of Reed Elsevier Group plc's accounting policies in respect of derivative financial instruments are set out below.

Revenue

Revenue represents the invoiced value of sales less anticipated returns on transactions completed by performance, excluding customer sales taxes and sales between the combined businesses.

Revenues are recognised for the various categories of turnover as follows: subscriptions – on periodic dispatch of subscribed product or rateably over the period of the subscription where performance is not measurable by despatch; circulation – on despatch; advertising – on publication or over the period of online display; exhibitions – on occurrence of the exhibition; educational testing contracts – over the term of the contract on percentage completed against contract milestones.

Where sales consist of two or more independent components, revenue is recognised on each component, as it is completed by performance, based on attribution of relative value.

Employee benefits

The expense of defined benefit pension schemes and other post-retirement employee benefits is determined using the projected unit credit method and charged in the income statement as an operating expense, based on actuarial assumptions reflecting market conditions at the beginning of the financial year. Actuarial gains and losses are recognized in full in the statement of recognised income and expense in the period in which they occur. Past service costs are recognised immediately to the extent that benefits have vested, or, if not vested, on a straight line basis over the period until the benefits vest.

Net pension obligations in respect of defined benefit schemes are included in the balance sheet at the present value of scheme liabilities, less the fair value of scheme assets. Where assets exceed liabilities, any net pension asset is limited to the extent that the asset is not recoverable through reductions in future contributions.

The expense of defined contribution pension schemes and other employee benefits is charged in the income statement as incurred.

Share based remuneration

The fair value of share based remuneration is determined at the date of grant and recognised as an expense in the income statement on a straight line basis over the vesting period, taking account of the estimated number of shares that are expected to vest. Market based performance criteria are taken into account when determining the fair value at the date of grant. Non-market based performance criteria are taken into account when estimating the number of shares expected to vest. The fair value of share based remuneration is determined by use of a binomial model. All Reed Elsevier Group plc group's share based remuneration is equity settled by the ultimate holding companies, Reed Elsevier PLC and Reed Elsevier NV and is accounted for as equity settled in Reed Elsevier Group plc..

In accordance with the transitional provisions of IFRS2 – Share Based Payment, the expense recognised in the income statement relates to grants made during the financial period and all grants made before the transition date that had not fully vested at that date.

Borrowing costs

All borrowing costs are expensed as incurred unless hedge accounting applies (see Financial Instruments).

Taxation

The tax expense represents the sum of the tax payable on the current year taxable profits and the movements on deferred tax that are recognised in the income statement.

The tax payable on current year taxable profits is calculated using the applicable tax rates that have been enacted, or substantively enacted, by the balance sheet date.

Deferred tax is the tax arising on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax is not recognised on temporary differences arising in respect of goodwill that is not deductible for tax purposes.

Deferred tax is calculated using tax rates that are expected to apply in the period when the liability is expected to be settled or the asset realised. Full provision is made for deferred tax which would become payable on the distribution of retained profits from foreign subsidiaries, associates or joint ventures.

Movements in deferred tax are charged or credited in the income statement, except when they relate to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

ACCOUNTING POLICIES

Goodwill

On the acquisition of a subsidiary or business, the purchase consideration is allocated between the net tangible and intangible assets on a fair value basis, with any excess purchase consideration representing goodwill. Goodwill arising on acquisitions also includes amounts corresponding to deferred tax liabilities recognised in respect of acquired intangible assets.

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

On disposal of a subsidiary or business, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

In accordance with the IFRS transition rules, goodwill arising on acquisitions before the 1 January 2004 date of transition to IFRS is included in the balance sheet at the net book amount previously stated under UK GAAP. An impairment review was carried out as at the transition date and no impairment identified. Deferred tax liabilities recognised in respect of acquired intangible assets acquired prior to the transition date were taken directly to equity on transition.

Intangible assets

Intangible assets acquired as part of a business combination are stated in the balance sheet at their fair value as at the date of acquisition, less accumulated amortisation. Internally generated intangible assets are stated in the balance sheet at the directly attributable cost of creation of the asset, less accumulated amortisation.

Intangible assets acquired as part of business combinations comprise: market related assets (e.g. trade marks, imprints, brands); customer related assets (e.g. subscription bases, customer lists, customer relationships); editorial content; software and systems (e.g. application infrastructure, product delivery platforms, in-process research and development); contract based assets (e.g. publishing rights, exhibition rights, supply contracts); and other intangible assets. Internally generated intangible assets typically comprise software and systems development where an identifiable asset is created that is probable to generate future economic benefits. All other development expenditure is recognised as an expense in the period in which it is incurred.

Intangible assets, other than brands and imprints determined to have indefinite lives, are amortised systematically over their estimated useful lives. The estimated useful lives of intangible assets with finite lives are as follows: market related assets – 3 to 40 years; customer related assets – 3 to 16 years; content, software and other acquired intangible assets – 3 to 20 years; and internally developed intangible assets – 3 to 10 years. Brands and imprints determined to have indefinite lives are not amortised and are subject to impairment review at least annually.

Intangible assets recognised on acquisitions made before the 1 January 2004 date of transition to IFRS have been included in the balance sheet at their previously stated UK GAAP cost less amortisation as at that date. An impairment review was carried out as at the transition date and no impairment identified.

Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation. No depreciation is provided on freehold land. Freehold buildings and long leases are depreciated over their estimated useful lives up to a maximum of 50 years. Short leases are written off over the duration of the lease. Depreciation is provided on other assets on a straight line basis over their estimated useful lives as follows: leasehold improvements – shorter of life of lease and 10 years; plant – 3 to 20 years; office furniture, fixtures and fittings – 5 to 10 years; computer systems, communication networks and equipment – 3 to 7 years.

Investments

Investments, other than investments in joint ventures and associates and of shares of the holding companies Reed Elsevier PLC and Reed Elsevier NV, are stated in the balance sheet at fair value. Investments held as part of the venture capital portfolio are classified as held for trading, with changes in fair value reported through the income statement. All other investments are classified as available for sale with changes in fair value recognised directly in equity until the investment is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is brought into the net profit or loss for the period. All items recognised in the income statement related to investments, other than investments in joint ventures and associates, are reported as non operating items.

Available for sale investments and venture capital investments held for trading represent investments in listed and unlisted securities. The fair value of listed securities is determined based on quoted market prices, and of unlisted securities on management's estimate of fair value based on standard valuation techniques.

Investments in joint ventures and associates are accounted for under the equity method and stated in the balance sheet at cost as adjusted for post-acquisition changes in Reed Elsevier Group plc's share of net assets, less any impairment in value.

Shares in Reed Elsevier PLC and Reed Elsevier, held by the Employee Benefit Trust are stated at cost.

Impairment

At each balance sheet date, reviews are carried out of the carrying amounts of tangible and intangible assets and goodwill to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent, if any, of the impairment loss. Where the asset does not generate cash flows that are independent from other assets, estimates are made based on the cash flows of the cash generating unit to which the asset belongs. Intangible assets with an indefinite useful life are tested for impairment at least annually and whenever there is any indication that the asset may be impaired.

Recoverable amount is the higher of fair value, less costs to sell, and value in use. In assessing value in use, estimated future cash flows are discounted to their present value using a discount rate appropriate to the specific asset or cash generating unit. Pre-tax discount rates of 10–12% have been applied. Estimated future cashflows are based on latest forecasts and estimates for the next five years, and a long term growth rate of 3% is assumed thereafter.

If the recoverable amount of an asset or cash generating unit is estimated to be less than its net carrying amount, the net carrying amount of the asset or cash generating unit is reduced to its recoverable amount. Impairment losses are recognised immediately in the income statement.

Inventories and pre-publication costs

Inventories and pre-publication costs are stated at the lower of cost, including appropriate attributable overhead, and estimated net realisable value. Pre-publication costs, representing costs incurred in the origination of content prior to publication, are expensed systematically reflecting the expected sales profile over the estimated economic lives of the related products, generally up to five years.

Leases

Assets held under leases which confer rights and obligations similar to those attaching to owned assets are classified as assets held under finance leases and capitalised within property, plant and equipment and the corresponding liability to pay rentals is shown net of interest in the balance sheet as obligations under finance leases. The capitalised value of the assets is depreciated on a straight line basis over the shorter of the periods of the leases or the useful lives of the assets concerned. The interest element of the lease payments is allocated so as to produce a constant periodic rate of charge.

Operating lease rentals are charged to the income statement on a straight line basis over the period of the leases. Rental income from operating leases is recognised on a straight line basis over the term of the relevant lease.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and other short term highly liquid investments and are held in the balance sheet at fair value.

Assets held for sale

Assets of businesses that are held for sale, rather than for continuing use by Reed Elsevier Group plc group, are classified as assets held for sale. Such assets are carried at the lower of amortised cost and fair value less costs to sell. Similarly, liabilities of businesses held for sale are also separately classified on the balance sheet.

Financial instruments

Financial instruments comprise investments (other than investments in joint ventures or associates), trade receivables, and cash equivalents, payables and accruals, borrowings and derivative financial instruments. Financial instruments that are classified as held to maturity are recorded in the balance sheet at amortised cost. Investments are classified as either held for trading or available for sale, as described above. Other financial instruments that are classified as held for trading are recorded in the balance sheet at fair value, with changes in fair value reported through the income statement.

In accordance with the transitional provisions of IFRS1 – First Time Adoption of International Financial Reporting Standards, financial instruments have been accounted for and presented on the UK GAAP basis for the year ended 31 December 2004. Under IAS39 – Financial Instruments, with effect from 1 January 2005, financial instruments are stated in the balance sheet at fair value.

Derivative financial instruments are used to hedge interest rate and foreign exchange risks. Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity in the hedge reserve. If a hedged firm commitment or forecasted transaction results in the recognition of a non financial asset or liability, then, at the time that the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects net profit or loss. Any ineffective portion of hedges is recognised immediately in the income statement.

Where an effective hedge is in place against changes in the fair value of fixed rate borrowings, the hedged borrowings are adjusted for changes in fair value attributable to the risk being hedged with a corresponding income or expense included in the income statement. The offsetting gains or losses from remeasuring the fair value of the related derivatives are also recognised in the income statement.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Hedge accounting is discontinued when a hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is either retained in equity until the firm commitment or forecasted transaction occurs, or, where a hedged transaction is no longer expected to occur, is immediately credited or expensed in the income statement.

As at 1 January 2005, adjustments have been made either to the carrying value of hedged items or to equity, as appropriate, to reflect the differences between the UK GAAP carrying values of financial instruments and their carrying values required to be reported under IAS39. Any transition gains or losses on financial instruments that qualify for hedge accounting and are reflected in equity will remain in equity until either the forecasted transaction occurs or is no longer expected to occur.

Critical judgements and key sources of estimation uncertainty

The most significant accounting policies in determining the financial condition and results of the group, and those requiring the most subjective or complex judgement, relate to the valuation of goodwill and intangible assets, share based remuneration, pensions and taxation.

Revenue recognition policies, while an area of management focus, are generally straightforward in application as the timing of product or service delivery and customer acceptance for the various revenue types can be readily determined. Allowances for product returns are deducted from revenues based on historical return rates. Where sales consist of two or more components that operate independently, revenue is recognised as each component is completed by performance, based on attribution of relative value.

Pre-publication costs incurred in the creation of content prior to production and publication are deferred and expensed over their estimated useful lives based on sales profiles. Such costs typically comprise direct internal labour costs and externally commissioned editorial and other fees. Estimated useful lives generally do not exceed five years. Annual reviews are carried out to assess the recoverability of carrying amounts.

Development spend embraces investment in new product and other initiatives, ranging from the building of new online delivery platforms, to launch costs of new services, to building new infrastructure applications. Launch costs and other operating expenses of new products and services are expensed as incurred. The costs of building product applications and infrastructure are capitalised as intangible fixed assets and amortised over their estimated useful lives. Impairment reviews are carried out annually.

Goodwill and intangible assets

Reed Elsevier Group plc's accounting policy is that, on acquisition of a subsidiary or business, the purchase consideration is allocated between the net tangible and intangible assets other than goodwill on a fair value basis, with any excess purchase consideration representing goodwill. The valuation of intangible assets represents the estimated economic value in use, using standard valuation methodologies, including as appropriate, discounted cash flow, relief from royalty and comparable market transactions. Acquired intangible assets are capitalised and amortised systematically over their estimated useful lives, subject to annual impairment review. Appropriate amortisation periods are selected based on assessments of the longevity of the brands and imprints, the market positions of the acquired assets and the technological and competitive risks that they face. Certain intangible assets, more particularly in relation to acquired science and medical publishing businesses, have been determined to have indefinite lives. The longevity of these assets is evidenced by their long established and well regarded brands and imprints, and their characteristically stable market positions.

The carrying amounts of goodwill and intangible assets are regularly reviewed, at least twice a year. The carrying amounts of goodwill and intangible assets, including amounts arising on all significant acquisitions, on all acquisitions made in the previous financial year, and on any acquisitions for which there are indications of possible impairment, are compared with estimated values in use based on latest management cash flow projections. Key areas of judgement in estimating the values in use of businesses are the forecast long term growth rates and the appropriate discount rates to be applied to forecast cash flows. Based on the latest value in use calculations, no goodwill or intangible assets were impaired as at 31 December 2005.

Share based remuneration

Share based remuneration is accounted for in accordance with IFRS 2 – Share Based Payment and is determined based on the fair value of an award at the date of grant, and is spread over the vesting period on a straight line basis, taking into account the number of shares that are expected to vest. The fair value of awards is determined at the date of grant by use of a binomial model, which requires judgements to be made regarding share price volatility, dividend yield, risk free rate of return and expected option lives. The number of awards that are expected to vest requires judgements to be made regarding forfeiture rates and the extent to which performance conditions will be met. These assumptions are determined in conjunction with independent actuaries based on historical data and trends.

Pensions

Pension costs are accounted for in accordance with IAS19 – Employee Benefits.

Accounting for defined benefit pension schemes involves judgement about uncertain events, including the life expectancy of the members, salary and pension increases, inflation, the return on scheme assets and the rate at which the future pension payments are discounted. Estimates for all of these factors are used in determining the pension cost and liabilities reported in the financial statements. These best estimates of future developments are made in conjunction with independent actuaries. Each scheme is subject to a periodic review by the independent actuaries. For defined contribution schemes, the net cost represents contributions payable.

Taxation

Reed Elsevier Group plc seeks to organize its affairs in a tax efficient manner, taking account of the jurisdictions in which it operates. Reed Elsevier Group plc's policy is to make prudent provision for tax uncertainties.

Reed Elsevier Group plc's policy in respect of deferred taxation is to provide in full for all taxable temporary differences using the balance sheet liability method. Deferred tax assets are only recognised to the extent that they are considered recoverable based on forecasts of available taxable profits against which they can be utilised over the near term.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

1. SEGMENT ANALYSIS

Reed Elsevier Group plc is a publisher and information provider organised to serve four business segments: Elsevier comprising scientific, technical and medical publishing and communication businesses; LexisNexis providing legal, tax, regulatory and business information to professional, business and government customers; Harcourt Education publishing school textbooks and related instructional and assessment materials; and Reed Business providing information and marketing solutions to business professionals. Internal reporting is consistent with this organisational structure

Adjusted operating profit figures are presented as an additional performance measure. They are stated before the amortisation of acquired intangible assets and acquisition integration costs and are grossed up to exclude the equity share of taxes in joint ventures. Adjusted operating profit is reconciled to operating profit in note 9.

	Revenue		Operating profit		Adjusted operating profit	
	2005	2004	2005	2004	2005	2004
	£m	£m	£m	£m	£m	£m
Business segment						
Elsevier	**1,386**	1,319	**373**	385	**425**	427
LexisNexis	**1,466**	1,292	**218**	188	**338**	287
Harcourt Education	**902**	868	**87**	67	**161**	158
Reed Business	**1,362**	1,289	**158**	126	**214**	194
Subtotal	**5,116**	4,768	**836**	766	**1,138**	1,066
Corporate costs			**(31)**	(29)	**(31)**	(30)
Unallocated net pension credit			**12**	12	**12**	12
Total	**5,116**	4,768	**817**	749	**1,119**	1,048
Geographical origin						
North America	**2,888**	2,655	**362**	318	**594**	539
United Kingdom	**862**	846	**158**	129	**186**	159
The Netherlands	**500**	503	**158**	180	**162**	187
Rest of Europe	**568**	508	**90**	85	**126**	122
Rest of world	**298**	256	**49**	37	**51**	41
Total	**5,116**	4,768	**817**	749	**1,119**	1,048

Revenue is analysed before the £91m (2004 : £94m) share of joint ventures' revenue, of which £20m (2004 : £19m) relates to LexisNexis, principally to Giuffre, and £71m (2004 : £75m) relates to Reed Business, principally to exhibition joint ventures.

Share of post tax results of joint ventures of £16m (2004 : £17m) included in operating profit comprises £3m (2004 : £3m) relating to LexisNexis and £13m (2004 : £14m) relating to Reed Business.

The unallocated net pension credit of £12m (2004 : £12m) comprises the expected return on pension scheme assets of £149m (2004 : £139m) less interest on pension scheme liabilities of £137m (2004 : £127m).

1. SEGMENT ANALYSIS (CONTINUED)

	2005 £m	2004 £m
Analysis of revenue by geographical market		
North America	**2,959**	2,774
United Kingdom	**566**	544
The Netherlands	**200**	202
Rest of Europe	**786**	708
Rest of world	**605**	540
Total	**5,116**	4,768

	Acquired intangible assets		Capital expenditure		Amortisation of acquired intangible assets		Depreciation and other amortisation	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m
Business segment								
Elsevier	**97**	3	**60**	65	**49**	39	**38**	28
LexisNexis	**27**	215	**95**	93	**102**	82	**65**	57
Harcourt Education	**3**	72	**22**	27	**73**	74	**14**	12
Reed Business	**22**	20	**27**	27	**51**	59	**25**	25
Subtotal	**149**	310	**204**	212	**275**	254	**142**	122
Corporate	**-**	-	**3**	4	**-**	-	**2**	4
Total	**149**	310	**207**	216	**275**	254	**144**	126

Capital expenditure comprises additions to property, plant and equipment and internally developed intangible assets. In addition to the depreciation and amortisation above, other non cash items relate to the recognition of share based remuneration and comprise £11m (2004 : £9m) in Elsevier, £16m (2004 : £15m) in LexisNexis, £9m (2004: £9m) in Harcourt Education, £14m (2004 : £17m) in Reed Business and £7m (2004 : £9m) in Corporate.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

1. SEGMENT ANALYSIS (CONTINUED)

	Total assets		Total liabilities		Net assets/(liabilities)	
	2005	2004	2005	2004	2005	2004
	£m	£m	£m	£m	£m	£m
Business segment						
Elsevier	**2,524**	2,081	**(739)**	(684)	**1,785**	1,397
LexisNexis	**2,881**	2,616	**(386)**	(329)	**2,495**	2,287
Harcourt Education	**1,667**	1,542	**(181)**	(177)	**1,486**	1,365
Reed Business	**1,225**	1,194	**(544)**	(515)	**681**	679
Subtotal	**8,297**	7,433	**(1,850)**	(1,705)	**6,447**	5,728
Tax	**264**	222	**(1,428)**	(1,294)	**(1,164)**	(1,072)
Cash and borrowings	**244**	160	**(1,992)**	(1,576)	**(1,748)**	(1,416)
Balances with fellow associated undertakings	**207**	382	**(5,897)**	(5,465)	**(5,690)**	(5,083)
Retirement benefit obligation	**-**	-	**(405)**	(321)	**(405)**	(321)
Other assets and liabilities	**283**	102	**(179)**	(142)	**104**	(40)
Total	**9,295**	8,299	**(11,751)**	(10,503)	**(2,456)**	(2,204)
Geographical location						
North America	**6,439**	5,620	**(8,768)**	(7,755)	**(2,329)**	(2,135)
United Kingdom	**1,112**	1,276	**(1,207)**	(1,203)	**(95)**	73
The Netherlands	**544**	448	**(643)**	(597)	**(99)**	(149)
Rest of Europe	**996**	799	**(975)**	(812)	**21**	(13)
Rest of world	**204**	156	**(158)**	(136)	**46**	20
Total	**9,295**	8,299	**(11,751)**	(10,503)	**(2,456)**	(2,204)

Investments in joint ventures of £71m (2004 : £60m) included in segment assets above comprise £28m (2004 : £26m) relating to LexisNexis and £43m (2004 : £34m) relating to Reed Business.

	Goodwill		Intangible assets	
	2005	2004	2005	2004
	£m	£m	£m	£m
Business segment				
Elsevier	**821**	630	**1,050**	919
LexisNexis	**1,304**	1,147	**924**	886
Harcourt Education	**467**	415	**632**	629
Reed Business	**440**	422	**371**	398
Total	**3,032**	2,614	**2,977**	2,832

Included in intangible assets within the Elsevier segment are £333m (2004: £298m) of intangible assets which have been determined to have indefinite lives.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

2. OPERATING PROFIT

Operating profit is stated after charging/(crediting) the following:

	Note	2005 £m	2004 £m
Staff costs			
Wages and salaries		**1,309**	1,208
Social security costs		**134**	123
Pensions	4	**100**	89
Share based remuneration	5	**57**	59
Total staff costs		**1,600**	1,479
Depreciation and amortisation			
Amortisation of acquired intangible assets	14	**275**	254
Amortisation of internally developed intangible assets	14	**57**	55
Depreciation of property, plant and equipment	16	**87**	71
Total depreciation and amortisation		**419**	380
Auditors' remuneration			
For audit services		**(3.0)**	(2.9)
For non audit services		**(1.6)**	(1.2)
Total auditors' remuneration		**(4.6)**	(4.1)
Other expenses and income			
Prepublication costs, inventory expenses and other cost of sales		**1,877**	1,721
Royalties payable to the Elsevier Reed Finance BV group		**6**	5
Operating lease rentals expense		**114**	105
Operating lease rentals income		**(14)**	(12)

Depreciation and amortisation charges are included within administration and other expenses

Auditors' remuneration for non audit services comprises: £0.4m (2004 : £0.4m) for audit related services, £0.4m (2004 : £0.2m) for due diligence and other transaction related services, £0.7m (2004 : £0.6m) for tax compliances and advisory work and £0.1m (2004 : £nil) for other audit services.

3. PERSONNEL

Number of people employed	At 31 December 2005	At 31 December 2004	Average during the year 2005	Average during the year 2004
Business segment				
Elsevier	**7,100**	6,500	**6,900**	6,400
LexisNexis	**13,400**	13,100	**13,200**	12,800
Harcourt Education	**5,400**	5,400	**5,400**	5,300
Reed Business	**10,200**	10,100	**10,200**	10,100
Subtotal	**36,100**	35,100	**35,700**	34,600
Corporate	**200**	200	**200**	200
Total	**36,300**	35,300	**35,900**	34,800

Number of people employed	At 31 December 2005	At 31 December 2004	Average during the year 2005	Average during the year 2004
Geographical location				
North America	**20,200**	20,000	**20,100**	19,800
United Kingdom	**5,800**	5,700	**5,900**	5,700
The Netherlands	**2,500**	2,600	**2,600**	2,600
Rest of Europe	**4,500**	3,900	**4,100**	3,800
Rest of world	**3,300**	3,100	**3,200**	2,900
Total	**36,300**	35,300	**35,900**	34,800

4. PENSION SCHEMES

A number of pension schemes are operated around the world. The major schemes are of the defined benefit type with assets held in separate trustee administered funds. The two largest schemes, which cover the majority of employees, are in the UK, the US and the Netherlands. Under these plans, employees are entitled to retirement benefits normally dependent on the number of years service.

The principal assumptions used for the purpose of valuation under IAS19:Employee Benefits are presented below as the weighted average of the various defined benefit pension schemes.

	2005	2004
Discount rate	**4.9%**	5.4%
Expected return on scheme assets	**7.0%**	6.8%
Expected rate of salary increases	**4.0%**	4.4%
Future pension increases	**2.8%**	2.8%

The expected rates of return on individual categories of scheme assets are determined by reference to relevant market indices. The overall expected rate of return on scheme assets is based on the weighted average of each asset category.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

4. PENSION SCHEMES (CONTINUED)

The defined benefit pension cost, recognised within operating expenses in the income statement, comprises:

	2005 £m	2004 £m
Service cost	**(91)**	(83)
Interest on pension scheme liabilities	**(137)**	(127)
Expected return on scheme assets	**149**	139
Net defined benefit pension cost	**(79)**	(71)

A total of £21m (2004 : £18m) was recognised as an expense in relation to defined contribution pension schemes.

The amount recognised in the balance sheet in respect of defined benefit pension schemes at the start and end of the year and the movements during the year were as follows:

	2005			2004		
	Defined benefit obligation £m	Fair value of scheme assets £m	Net pension obligation £m	Defined benefit obligation £m	Fair value of scheme assets £m	Net pension obligation £m
At start of year	**(2,525)**	**2,204**	**(321)**	(2,281)	2,030	(251)
Service cost	**(91)**		**(91)**	(83)	-	(83)
Interest on pension scheme liabilities	**(137)**		**(137)**	(127)	-	(127)
Expected return on scheme assets	**-**	**149**	**149**	-	139	139
Actuarial (loss)/gain	**(267)**	**230**	**(37)**	(140)	66	(74)
Contributions by employer		**47**	**47**	-	68	68
Contributions by employees	**(13)**	**13**	**-**	(10)	10	-
Benefits paid	**94**	**(94)**	**-**	89	(89)	-
Exchange translation differences	**(41)**	**26**	**(15)**	27	(20)	7
At the end of the year	**(2,980)**	**2,575**	**(405)**	(2,525)	2,204	(321)

The proportion of scheme assets held as equities, bonds and other assets is shown below:

	2005	2004
Equities	**66%**	64%
Bonds	**30%**	32%
Other	**4%**	4%
Total fair value of assets	**100%**	100%

The actual return on scheme assets for the year ended 31 December 2005 was £379m (2004 : £205m).

As at 31 December 2005 the defined benefit obligations comprise £2,890m (2004: £2,458m) in relation to funded schemes and £90m (2004: £67m) in relation to unfunded schemes. Deferred tax assets of the £133m (2004 : £109m) are recognised in respect of the net pension obligations.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

4. PENSION SCHEMES (CONTINUED)

As at 31 December 2005 the net cumulative actuarial losses recognised in the statement of recognised income and expense, since transition to IFRS effective from 1 January 2004 was £111m, comprising:

	2005	2004
	£m	£m
Experience losses on scheme liabilities	**(25)**	(18)
Experience gains on scheme assets	**230**	66
Actuarial losses arising on the present value of scheme liabilities due to changes in:		
- discount rates	**(217)**	(113)
- other actuarial assumptions	**(25)**	(9)
Total actuarial losses charged directly to equity	**(37)**	(74)

The Reed Elsevier Group plc group expects to contribute approximately £70m to its defined benefit pension schemes in 2006.

5. SHARE BASED REMUNERATION

The Reed Elsevier Group plc group offers a number of share based remuneration schemes to directors and employees. The principal share based remuneration schemes comprise share options, under the Executive Share Option Scheme (ESOS) and the Long Term Incentive Scheme (LTIS), and conditional shares under LTIS, the Retention Share Plan (RSP) and the Bonus Investment Plan (BIP), in relation to Reed Elsevier PLC and Reed Elsevier NV ordinary shares. Share options granted under ESOS and LTIS are exercisable after three years and up to ten years from the date of grant at a price equivalent to the market value of the respective shares at the date of grant. Conditional shares granted under LTIS, RSP and BIP are exercisable after three years for nil consideration.

All share based remuneration awards are subject to the condition that the employee remains in employment at the time of exercise. Share options and conditional shares granted under LTIS, RSP, certain ESOS and BIP are further subject to the achievement of growth targets of Reed Elsevier PLC and Reed Elsevier NV adjusted earnings per share measured at constant exchange rates.

The estimated fair value of grants made in the year ended 31 December 2005 and prior year, and the main assumptions used, which have been established with advice from and data provided by independent actuaries, are set out below. The fair value of grants made in any year is recognised in the income statement over the vesting period, typically three years.

	In respect of Reed Elsevier PLC ordinary shares			In respect of Reed Elsevier NV ordinary shares				
	Number of shares	Weighted average fair value per award	Fair value	Number of shares	Weighted average fair value per award	Fair value	Total fair value	
	'000	£	£m	'000	€	€m	£m	€m
2005 grants								
Share options	**11,520**	**1.05**	**12**	**7,471**	**1.91**	**14**	**22**	**32**
Conditional shares	**951**	**4.87**	**5**	**406**	**10.27**	**4**	**8**	**11**
			17			**18**	**30**	**43**

5. SHARE BASED REMUNERATION (CONTINUED)

	In respect of Reed Elsevier PLC ordinary shares			In respect of Reed Elsevier NV ordinary shares				
	Number of shares	Weighted average fair value per award	Fair value	Number of shares	Weighted average fair value per award	Fair value	Total fair value	
	'000	£	£m	'000	€	€m	£m	€m
2004 grants								
Share options	22,532	1.35	30	15,235	2.63	40	57	84
Conditional shares	5,141	4.59	24	3,391	9.96	34	47	69
Total			54			74	104	153

	In respect of Reed Elsevier PLC ordinary shares		In respect of Reed Elsevier NV ordinary shares	
Assumptions for grants made during the year	2005	2004	2005	2004
Share options				
Weighted average share price at date of grant	**£5.24**	£4.86	**€11.30**	€10.57
Expected volatility	**22%**	32%	**22%**	32%
Expected option life	**4 years**	4 years	**4 years**	4 years
Expected dividend yield	**2.6%**	2.0%	**2.6%**	2.0%
Risk free interest rate	**5.1%**	5.1%	**3.4%**	3.4%
Expected lapse rate	**3-5%**	3-5%	**3-5%**	3-5%
Conditional shares				
Weighted average share price at date of grant	**£5.26**	£4.87	**€11.05**	€10.57
Expected dividend yield	**2.6%**	2.0%	**2.6%**	2.0%
Risk free interest rate	**5.1%**	5.1%	**3.4%**	3.4%
Expected lapse rate	**3%**	3%	**3%**	3%

Expected volatility has been estimated based on relevant historic data in respect of the Reed Elsevier PLC and Reed Elsevier NV ordinary share prices.

5. SHARE BASED REMUNERATION (CONTINUED)

The share based remuneration awards outstanding at 31 December 2005, in respect to both Reed Elsevier PLC and Reed Elsevier NV ordinary shares are set out below.

	In respect of Reed Elsevier PLC ordinary shares				In respect of Reed Elsevier NV ordinary shares			
	2005	2005	2004	2004	2005	2005	2004	2004
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Share options	'000	(pence)	'000	(pence)	'000	(€)	'000	(€)
Outstanding at start of year	**63,655**	**500p**	63,780	501p	**42,103**	**€11.30**	41,966	€11.67
Granted	**11,520**	**524p**	22,532	482p	**7,471**	**€11.30**	15,235	€10.57
Exercised	**(3,629)**	**426p**	(2,913)	428p	**(1,892)**	**€10.37**	(1,377)	€10.19
Forfeited	**(4,915)**	**519p**	(19,446)	494p	**(2,812)**	**€11.85**	(13,448)	€11.65
Expired	**(92)**	**439p**	(298)	494p	**(111)**	**€10.16**	(273)	€17.07
Outstanding at end of year	**66,539**	**507p**	63,655	500p	**44,759**	**€11.30**	42,103	€11.30
Exercisable at end of year	**22,747**	**552p**	19,660	525p	**16,557**	**€12.81**	13,873	€12.37

The weighted average share price at the date of exercise of share options during 2005 was 533p (2004: 513p) for Reed Elsevier PLC ordinary shares and €11.31 (2004: €11.31) for Reed Elsevier NV ordinary shares.

	In respect of Reed Elsevier PLC ordinary shares		In respect of Reed Elsevier NV ordinary shares	
	2005	2004	2005	2004
	Number of shares	Number of shares	Number of shares	Number of shares
Conditional shares	'000	'000	'000	'000
Outstanding at start of year	**5,341**	232	**3,483**	109
Granted	**951**	5,141	**406**	3,391
Exercised	**(51)**	-	**(32)**	-
Forfeited	**(317)**	(32)	**(222)**	(17)
Outstanding at end of year	**5,924**	5,341	**3,635**	3,483

5. SHARE BASED REMUNERATION (CONTINUED)

Range of exercise prices for outstanding share options	2005 Number of share options outstanding '000	2005 Weighted average remaining contractual period till expiry (years)	2004 Number of share options outstanding '000	2004 Weighted average remaining contractual period till expiry (years)
Reed Elsevier PLC ordinary shares (pence)				
301-350	**38**	**0.1**	578	1.1
351-400	**2,161**	**2.3**	2,516	3.3
401-450	**6,110**	**4.0**	7,357	4.7
451-500	**31,858**	**6.6**	34,920	7.6
501-550	**12,981**	**8.1**	3,147	5.0
551-600	**8,283**	**5.2**	9,518	6.2
601-650	**1,019**	**3.6**	1,133	4.6
651-700	**4,089**	**5.1**	4,486	6.1
Total	**66,539**	**6.2**	63,655	6.5
Reed Elsevier NV ordinary shares (euro)				
8.01-9.00	**9**	**7.2**	9	8.2
9.01-10.00	**8,034**	**7.0**	9,084	7.9
10.01-11.00	**17,919**	**5.9**	19,917	6.8
11.01-12.00	**8,774**	**8.0**	1,845	5.0
12.01-13.00	**356**	**3.3**	407	4.0
13.01-14.00	**5,808**	**5.4**	6,619	6.4
14.01-15.00	**3,223**	**4.7**	3,530	5.7
15.01-16.00	**636**	**2.6**	692	3.4
Total	**44,759**	**6.3**	42,103	6.7

Share options are expected, upon exercise, to be met principally by the issue of new ordinary shares of Reed Elsevier PLC and Reed Elsevier NV but may also be met by the issue of shares held by the Reed Elsevier Group plc Employee Benefit Trust (EBT) (see note 15). Conditional shares will be met by the issue of shares held by the EBT.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

6. NET FINANCE COSTS

	2005 £m	2004 £m
Interest on bank loans, overdrafts and commercial paper	**(13)**	(4)
Interest on other loans	**(85)**	(83)
Interest payable to Reed Elsevier PLC	**(5)**	(7)
Interest payable to the Elsevier Reed Finance BV group	**(296)**	(295)
Interest on obligations under finance leases	**(1)**	(1)
Total borrowing costs	**(400)**	(390)
Losses on derivatives not designated as hedges	**(12)**	-
Fair value losses on interest rate derivatives formerly designated as cash flow hedges transferred from equity	**(2)**	-
Fair value losses on loans and receivables designated as fair value hedges	**(1)**	-
Finance costs	**(415)**	(390)
Gains on loans and derivatives not designated as hedges	**12**	-
Interest on bank deposits	**7**	14
Interest receivable from Reed Elsevier PLC	**4**	4
Interest receivable from the Elsevier Reed Finance BV group	**7**	5
Finance income	**30**	23
Net finance costs	**(385)**	(367)

7. DISPOSALS AND OTHER NON OPERATING ITEMS

	2005 £m	2004 £m
Revaluation of held for trading investments	**3**	-
Loss on disposal of businesses and other assets	**(1)**	(3)
Net gain/(loss) on disposals and other non operating items	**2**	(3)

8. TAX

	2005 £m	2004 £m
Current tax		
United Kingdom	**78**	68
The Netherlands	**51**	51
Rest of world	**85**	60
Total current tax	**214**	179
Deferred tax		
Origination and reversal of timing differences	**(43)**	(3)
Total	**171**	176

A reconciliation of the notional tax charge based on average applicable rates of tax (weighted in proportion to accounting profits) to the actual tax charge is set out below:

	2005 £m	2004 £m
Profit before tax	**434**	379
Tax at average applicable rates	**135**	122
Tax included in share of results of joint ventures	**(6)**	(7)
Non deductible amounts and other items	**42**	61
Tax expense	**171**	176
Tax expense as a percentage of profit before tax	**39%**	46%

A net deferred tax charge of £3m (2004: £12m credit) has been recognised in equity during year in relation to income or expense recognised directly in equity.

UK corporation tax has been provided at 30% (2004 : 30%).

9. ADJUSTED PROFIT

The Reed Elsevier Group plc group uses adjusted profit as a key performance measure. Adjusted profit figures are stated before amortisation of acquired intangible assets and acquisition integration costs, and are grossed up to exclude the equity share of taxes in joint ventures.

	2005 £m	2004 £m
Operating profit	**817**	**749**
Adjustments:		
Amortisation of acquired intangible assets	**275**	254
Acquisition integration and related costs	**21**	38
Reclassification of tax on joint ventures	**6**	7
Adjusted operating profit	**1,119**	1,048

10. CASH FLOW STATEMENT

Reconciliation of operating profit before joint ventures to cash generated from operations

	2005 £m	2004 £m
Operating profit before joint ventures	**801**	732
Amortisation of acquired intangible assets	**275**	254
Amortisation of internally developed intangible assets	**57**	55
Depreciation of property, plant and equipment	**87**	71
Share based remuneration	**57**	59
Total non cash items	**476**	439
Increase in inventories and pre-publication costs	**(55)**	(39)
Increase in receivables	**(91)**	(63)
Increase in payables	**71**	71
Movement in working capital	**(75)**	(31)
Cash generated from operations	**1,202**	1,140

Cash flow on acquisitions

	Note	2005 £m	2004 £m
Purchase of businesses	11	**(293)**	(640)
Investment in joint ventures		**(15)**	-
Deferred payments relating to prior acquisitions		**(9)**	(7)
Total		**(317)**	(647)

Reconciliation of net borrowings

	Cash & cash equivalents £m	Borrowings £m	Related derivative financial instruments £m	Net borrowings from shareholders and the Elsevier Reed Finance BV group £m	2005 £m	2004 £m
At start of year	**160**	**(1,576)**	**-**	**(5,083)**	**(6,499)**	(6,360)
Transition adjustments on adoption of IAS39	-	**(165)**	**158**	-	**(7)**	-
At start of year as restated	**160**	**(1,741)**	**158**	**(5,083)**	**(6,506)**	(6,360)
Increase/(decrease) in cash and cash equivalents	**79**	-	-	-	**79**	(357)
Net movement in bank loans overdrafts and commerical paper	-	**190**	-	-	**190**	113
Issuance of other loans	-	**(384)**	-	-	**(384)**	-
Repayment of other loans	-	**90**	-	-	**90**	2
Repayment of finance leases	-	**13**	-	-	**13**	19
Net movement in borrowings from shareholders and the Elsevier Reed Finance BV group	-	-	-	**(113)**	**(113)**	(349)
Change in net borrowings resulting from cash flows	**79**	**(91)**	-	**(113)**	**(125)**	(572)
Borrowings in acquired businesses	-	-	-	-	-	(2)
Inception of finance leases	-	**(10)**	-	-	**(10)**	(11)
Fair value adjustments to borrowings and related derivatives	-	**54**	**(50)**	-	**4**	-
Exchange translation differences	**5**	**(204)**	**16**	**(494)**	**(677)**	446
At end of year	**244**	**(1,992)**	**124**	**(5,690)**	**(7,314)**	(6,499)

Net borrowings comprise cash and cash equivalents, loan capital, finance leases, promissory notes, bank and other loans, and those derivative financial instruments that are used to hedge the fair value of fixed rate borrowings.

11. ACQUISITIONS

During the year a number of acquisitions were made for a total consideration amounting to £307m, after taking account of net cash acquired of £8m.

The net assets of the businesses acquired are incorporated at their fair value to the group's businesses. The fair values of the consideration given and the assets and liabilities acquired are summarised below.

	Book value on acquisition £m	Fair value adjustments £m	Fair value £m
Goodwill	-	182	182
Intangible fixed assets	12	137	149
Property, plant and equipment	3	(1)	2
Current assets	36	(4)	32
Current liabilities	(46)	(1)	(47)
Deferred tax	-	(11)	(11)
Net assets acquired	5	302	307
Consideration (after taking account of £8m net cash acquired)			307
Less: deferred to future years			(14)
Net cash flow			293

The fair value adjustments in relation to the acquisitions made in 2005 relate principally to the valuation of publishing rights and inventories. Goodwill represents the excess of the consideration over the net tangible and intangible assets acquired.

The businesses acquired in 2005 contributed £52m to revenue, £7m to adjusted operating profit, reduced net profit by £4m, and contributed £8m to net cash inflow from operating activities for the part year under Reed Elsevier Group plc ownership. Had the businesses been acquired at the beginning of the year, on a proforma basis, the Reed Elsevier Group plc group's revenue and net profit for the year would have been £5,180m and £263m respectively.

12. EQUITY DIVIDENDS

Dividends declared during the year

	£ per share		£ million	
	2005	2004	2005	2004
Dividends declared by subsidiary undertakings to Reed Elsevier NV			**80**	150
Dividends declared by Reed Elsevier Goup plc				
Interim to "E" ordinary shareholders	**4,800**	-	**48**	-
Interim to "R" ordinary shareholders	**16,870**	15,370	**169**	154
Total			**297**	304

The dividends paid by subsidiary undertakings relate to Reed Elsevier NV's holding of special dividend shares in Reed Elsevier Nederland BV and Reed Elsevier Overseas BV. These shares do not carry any capital rights beyond the right to repayment of their nominal value.

The dividends to be paid by the company are regulated by the equalisation arrangements between Reed Elsevier PLC and Reed Elsevier NV, the company's shareholders. The arrangements have the effect of requiring dividends to be paid by the company according to the respective requirements of the shareholders to enable them to pay dividends on their ordinary shares on an equalised basis. Accordingly, the proportion in which dividends are paid on either class of share will vary from one dividend payment to another.

13. GOODWILL

	2005	2004
	£m	£m
At start of year	**2,614**	2,440
Acquisitions	**182**	345
Disposals/transfers	**(15)**	-
Exchange translation differences	**251**	(171)
At end of year	**3,032**	2,614

14. INTANGIBLE ASSETS

	Market and customer related	Content, software and other	Total acquired intangible assets	Internally developed intangible assets	Total
	£m	£m	£m	£m	£m
Cost					
At 1 January 2004	1,208	2,831	4,039	417	4,456
Acquisitions	144	166	310	-	310
Additions	-	-	-	110	110
Disposals	-	(13)	(13)	-	(13)
Exchange translation differences	(100)	(130)	(230)	(17)	(247)
At 1 January 2005	**1,252**	**2,854**	**4,106**	**510**	**4,616**
Acquisitions	**88**	**61**	**149**	-	**149**
Additions	-	-	-	**102**	**102**
Disposals/transfers	-	**(29)**	**(29)**	-	**(29)**
Exchange translation differences	**149**	**186**	**335**	**33**	**368**
At 31 December 2005	**1,489**	**3,072**	**4,561**	**645**	**5,206**
Amortisation					
At 1 January 2004	35	1,292	1,327	227	1,554
Charge for the year	71	183	254	55	309
Disposals/write off on acquisitions	-	(13)	(13)	10	(3)
Exchange translation differences	(6)	(61)	(67)	(9)	(76)
At 1 January 2005	**100**	**1,401**	**1,501**	**283**	**1,784**
Charge for the year	**85**	**190**	**275**	**57**	**332**
Disposals/transfers	-	**(9)**	**(9)**	-	**(9)**
Exchange translation differences	**16**	**91**	**107**	**15**	**122**
At 31 December 2005	**201**	**1,673**	**1,874**	**355**	**2,229**
Net book amount					
At 31 December 2004	1,152	1,453	2,605	227	2,832
At 31 December 2005	**1,288**	**1,399**	**2,687**	**290**	**2,977**

Intangible assets acquired as a part of business combinations comprise: market related assets (e.g. trademarks, imprints, brands); customer related assets (e.g. subscription bases, customer lists, customer relationships);and content, software and other intangible assets (e.g. editorial content, software and product delivery systems, other publishing rights, exhibition rights and supply contracts). Included in content, software and other acquired intangible assets are certain assets with net book value of £1,154m (£1,240m) that arose on acquisitions completed prior to the transition to IFRS with effect from 1 January 2004 that have not been allocated to specific categories of intangible assets. Internally developed intangible assets typically comprise software and systems development where an identifiable asset is created that is probable to generate future economic benefits.

Included in market and customer related intangible assets are £333m (2004 ; £298m) of brands and imprints with indefinite lives. These assets are determined to have an indefinite life based on an assessment of their historical longevity and stable market positions.

15. INVESTMENTS

	2005 £m	2004 £m
Investments in joint ventures	**71**	60
Available for sale investments	**22**	32
Shares in Reed Elsevier NV and Reed Elsevier PLC (i)	**93**	66
Venture capital investments held for trading	**22**	18
Total	**208**	176

(i) At 31 December 2005, the Reed Elsevier Group plc Employee Benefit Trust ("EBT") held 10,780,776 (2004 : 8,313,746) Reed Elsevier PLC ordinary shares and 5,539,922 (2004 : 3,708,599) Reed Elsevier NV ordinary shares at a book amount of £93m (2004 : £66m). The aggregate market value at 31 December 2005 was £104m (2004 : £66m). The EBT purchases Reed Elsevier PLC and Reed Elsevier NV shares which, at the Trustee's discretion, can be used in respect of the exercise of share options and to meet commitments under conditional share awards. Details of the share option schemes are set out in the Directors' Remuneration Report.

An analysis of changes in the carrying value of investments in joint ventures is given below.

	2005 £m	2004 £m
At start of year	**60**	60
Share of results of joint ventures	**16**	17
Dividends received from joint ventures	**(16)**	(17)
Additions	**15**	-
Transfers	**(3)**	-
Exchange translation differences	**(1)**	-
At end of year	**71**	60

The principal joint venture at 31 December 2005 is Giuffrè (an Italian legal publisher in which Reed Elsevier Group plc has a 40% shareholding). In addition there are a number of exhibition joint ventures within Reed Business.

Summarised information showing total amounts in respect of joint ventures and the group's share is set out below.

		Total joint ventures		Reed Elsevier Group plc share	
		2005	2004	2005	2004
	Note	£m	£m	£m	£m
Revenue		**194**	209	**91**	94
Net profit for the period		**33**	37	**16**	17
Total assets		**220**	199	**103**	98
Total liabilities		**(137)**	(112)	**(63)**	(57)
Net assets		**83**	87	**40**	41
Goodwill				**31**	19
Total				**71**	60

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

16. PROPERTY, PLANT AND EQUIPMENT

	2005			2004		
	Land and buildings	Fixtures and equipment	Total	Land and buildings	Fixtures and equipment	Total
	£m	£m	£m	£m	£m	£m
Cost						
At start of year	**182**	**622**	**804**	185	642	827
Acquisitions	**-**	**6**	**6**	7	11	18
Capital expenditure	**5**	**98**	**103**	14	79	93
Disposals	**(10)**	**(85)**	**(95)**	(13)	(71)	(84)
Exchange translation differences	**15**	**49**	**64**	(11)	(39)	(50)
At end of year	**192**	**690**	**882**	182	622	804
Accumulated depreciation						
At start of year	**72**	**441**	**513**	72	474	546
Acquisitions	**-**	**4**	**4**	1	4	5
Disposals	**(3)**	**(76)**	**(79)**	(3)	(70)	(73)
Charge for the year	**8**	**79**	**87**	7	64	71
Exchange translation differences	**7**	**37**	**44**	(5)	(31)	(36)
At end of year	**84**	**485**	**569**	72	441	513
Net book amount	**108**	**205**	**313**	110	181	291

No depreciation was provided on freehold land. The net book amount of property, plant and equipment at 31 December 2005 includes £20m (2004: £19m) in respect of assets held under finance leases relating to fixtures and equipment.

17. FINANCIAL INSTRUMENTS

Details of the objectives, policies and strategies pursued by the Reed Elsevier Group plc group in relation to financial instruments are set out on pages 6 and 7. The main financial risks faced by the Reed Elsevier Group plc group are liquidity risk and market risk - comprising interest rate risk and foreign exchange risk. Financial instruments are used to finance the group's businesses and to hedge interest rate and foreign exchange risks. The group's businesses do not enter into speculative derivative transactions. Details of financial instruments subject to liquidity, market and credit risks are described below.

Liquidity risk

Fixed and floating rate borrowings analysed by maturity are summarised below. Borrowings are shown after taking account of related interest rate derivatives in designated hedging relationships.

	2005			2004		
	Fixed rate borrowings	Floating rate borrowings	Total	Fixed rate borrowings	Floating rate borrowings	Total
	£m	£m	£m	£m	£m	£m
Within 1 year	**938**	**742**	**1,680**	1,032	683	1,715
Within 1 to 2 years	**857**	**-**	**857**	599	-	599
Within 2 to 3 years	**697**	**254**	**951**	819	-	819
Within 3 to 4 years	**1,289**	**-**	**1,289**	630	228	858
Within 4 to 5 years	**588**	**145**	**733**	1,159	-	1,159
After 5 years	**1,968**	**287**	**2,255**	1,635	256	1,891
Total	**6,337**	**1,428**	**7,765**	5,874	1,167	7,041

At 31 December 2005, £290m of borrowings were designated in fair value hedging relationships whereby the interest payments are fixed for the next one to three years and swapped to floating thereafter. These borrowings have been included above as floating rate borrowings due after 5 years.

At 31 December 2005, the group had access to £1,739m (2004 : £1,555m) of committed bank facilities that expire in two to three years, of which £67m (2004 : £41m) was drawn. These facilities principally provide back up for short term borrowings.

After taking account of the maturity of committed bank facilities that back short term borrowings at 31 December 2005, and after utilising available cash resources, no third party borrowings mature in the next two years (2004 : nil); 37% of borrowings mature in the third year (2004 : nil); 8% in the fourth and fifth years (2004 : 58%), 34% in the sixth to tenth years (2004 : 20%), and 21% beyond the tenth year (2004 : 22%).

Market Risks

The Reed Elsevier Group plc group's primary market risk exposures are to interest rate fluctuations and exchange rate movements. Derivatives are used to hedge or reduce the risks of interest rate or exchange rate movements and are not entered into unless such risks exist. Derivatives used by the group for hedging a particular risk, are not specialised and are generally available from numerous sources.

The fair values of interest rate swaps, interest rate options, forward rate agreements and forward foreign exchange contracts set out below represent the replacement cost calculated using market rates of interest at 31 December 2005. The fair value of long term borrowings has been calculated by discounting expected future cash flows at market rates.

17. FINANCIAL INSTRUMENTS (CONTINUED)

Interest rate risk

The Reed Elsevier Group plc group's interest rate exposure management policy is aimed at reducing the exposure of its businesses to changes in interest rates.

The following sensitivity analysis of borrowings and derivative financial instruments to interest movements assumes an immediate 100 basis point change in interest rates for all currencies and maturities from their levels at 31 December 2005, with all other variables held constant. The range of changes represents the group's view of the changes that are reasonably possible over a one year period based on these assumptions.

At 31 December 2005, the majority of net borrowings are either fixed rate or have been fixed through the use of interest rate swaps. A 100 basis point reduction in interest rates would result in an estimated decrease in net interest expense of £6m, based on the composition of financial instruments including cash, cash equivalents, bank loans and commercial paper borrowings at 31 December 2005. A 100 basis point rise in interest rates would result in an estimated increase in net interest expense by £6m. The sensitivity of the fair value of the financial instruments of the group at 31 December 2005 to changes in interest rates is set out in the table below.

			Fair value change	
	Carrying value	Fair value	+100 basis points	-100 basis points
	£m	£m	£m	£m
Amounts owed by Reed Elsevier PLC	**39**	43	(1)	1
Short term borrowings	**(127)**	(127)	-	-
Long term borrowings (including current portion)	**(1,865)**	(1,922)	43	(48)
Amounts owed to the Elsevier Reed Finance BV group (including current portion)	**(5,290)**	(5,332)	92	(97)
Interest rate swaps (swapping fixed rate debt to floating)	**125**	125	(38)	44
Interest rate swaps (swapping floating rate debt to fixed)	**-**	-	5	(5)

Short term borrowings comprise bank loans, overdrafts and commercial paper due within one year. Long term borrowings (including current portion) comprise other loans and finance leases.

A 100 basis point change in interest rates would not result in a material change to the fair value of any other financial instrument.

Foreign exchange rate risk

Translation exposures arise on the earnings and net assets of business operations in countries with currencies other than that of the parent company, most particularly in respect of the US businesses. These exposures are hedged, to a significant extent, by a policy of denominating borrowings in currencies where significant translation exposures exist, most notably US dollars (see note 23).

17. FINANCIAL INSTRUMENTS (CONTINUED)

The following sensitivity analysis of net borrowings and derivative financial instruments to foreign exchange rate movements assumes an immediate 10% change in all foreign exchange rates against sterling from their levels at 31 December 2005, with all other variables held constant. A positive 10% change indicates a strengthening of the currency against sterling and a negative 10% change indicates a weakening of the currency against sterling. The range of changes represents the group's view of the changes that are reasonably possible over a one year period based on these assumptions.

	Carrying value	Fair value	Fair value change +10%	Fair value change -10%
	£m	£m	£m	£m
Cash and cash equivalents	**244**	244	15	(13)
Amounts owed by the Elsevier Reed Finance BV group	**168**	168	10	(8)
Short term borrowings	**(127)**	(127)	(13)	12
Long term borrowings (including current portion)	**(1,865)**	(1,922)	(214)	175
Amounts owed to the Elsevier Reed Finance BV group (including current portion)	**(5,290)**	(5,332)	(592)	485
Interest rate swaps	**125**	125	14	(11)
Forward foreign exchange contracts	**5**	5	(33)	33

A 10% change in foreign currency exchange rates would not result in a material change to the fair value of any other financial instrument.

Credit risk

The Reed Elsevier Group plc group seeks to limit interest rate and foreign exchange risks described above by the use of financial instruments and as a result, has a credit risk from the potential non-performance by the counter parties to these financial instruments, which are unsecured. The amount of this credit risk is normally restricted to the amounts of any hedge gain and not the principal amount being hedged. The group also has a credit exposure to counterparties for the full principal amount of cash and cash equivalents. Credit risks are controlled by monitoring the credit quality of these counterparties, principally licensed commercial banks and investment banks with strong long term credit ratings, and of the amounts outstanding with each of them.

The Reed Elsevier Group plc group has treasury policies in place which do not allow concentrations of risk with individual counterparties and do not allow significant treasury exposures with counterparties which are rated lower than A by Standard and Poor's, Moody's or Fitch.

Transition to IAS39 – Financial Instruments

The Reed Elsevier Group plc group adopted IAS39 – Financial Instruments with effect from 1 January 2005. On adoption of IAS39, all derivatives and fixed rate debt in hedging relationships were recorded at fair value. Borrowings and related hedging derivatives were grossed up by £165m, leaving net debt broadly unchanged. The fair value of derivatives used to hedge forecasted transactions (such as forward exchange contracts and floating-to-fixed interest rate swaps) was recorded in the balance sheet and the corresponding net gain of £54m deferred within the hedge reserve. The fair value of derivatives used to swap fixed rate debt to floating rate was recognised in the balance sheet and, together with differences on restatement at spot rates of certain foreign currency working capital balances which were reported under previous GAAP at hedged rates and other working capital restatements, the corresponding net gain recorded directly in other reserves. Including related deferred tax, other reserves were accordingly reduced by £17m. Taken together with the hedge reserve of £54m, shareholders' equity at 1 January 2005 was increased by a net IAS39 transition adjustment of £37m.

17. FINANCIAL INSTRUMENTS (CONTINUED)

In respect of currency risk, Reed Elsevier Group plc group hedges cross border transactions in foreign currencies, the most significant of which relate to the Elsevier global scientific journals business. Hedge accounting treatment continues to be applied to these transactions under IAS39. However, whereas under previous GAAP hedge accounting applied to both revenues and costs where the net exchange risk is hedged in the market, under IAS39 there is no grossing up of the hedge for the foreign currency revenues and the offsetting costs and a portion of the revenues and the costs are therefore treated as if unhedged and reported at spot rates.

Hedge accounting

The hedging relationships that are designated under IAS39 – Financial Instruments, effective from 1 January 2005 are described below:

Fair value hedges

The Reed Elsevier Group plc group has entered into interest rate swaps and cross currency interest rate swaps to hedge the exposure to changes in the fair value of fixed rate borrowings due to interest rate and foreign currency movements which could affect the income statement.

Interest rate derivatives (including cross currency interest rate swaps) with a principal amount of £545m, were in place at 31 December 2005 swapping fixed rate term debt issues denominated in United States dollars (USD) and euros to floating rate USD debt for the whole or part of their term.

The gains and losses on the borrowings and derivatives designated as fair value hedges for the year ended 31 December 2005 which are included in the income statement were:

	1 January 2005 £m	Fair value movement gain/(loss) £m	Exchange gain/(loss) £m	31 December 2005 £m
USD interest rate swaps	**6**	12	1	19
USD debt	**(6)**	(13)	(1)	(20)
	-	**(1)**	**-**	**(1)**
Euro to USD cross-currency interest rate swaps	**152**	(62)	15	105
Euro debt	**(151)**	62	(15)	(104)
	1	**-**	**-**	**1**
Total	**1**	**(1)**	**-**	**-**

All fair value hedges were highly effective throughout the year ended 31 December 2005.

At 31 December 2005 there were fair value losses of £3m (on transition to IAS39 at 1 January 2005 : £8m losses) included within borrowings, which relate to debt de-designated from a fair value hedge relationship. During 2005, £5m of the fair value loss recognised on transition to IAS39 was included in finance income.

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

17. FINANCIAL INSTRUMENTS (CONTINUED)

Cash flow hedges

The Reed Elsevier Group plc group enters into foreign exchange derivatives which fix the exchange rate on a portion of future foreign currency subscription revenues forecast by the Elsevier science and medical business for up to 50 months.

Movements in the hedging reserve in 2005, including gains and losses on cash flow hedging instruments were as follows:

	Transition loss	Foreign exchange hedges	Total hedge reserve
	£m	£m	£m
Hedge reserve at start of year:gains/(losses) deferred	**(6)**	60	54
Losses arising in 2005	-	(18)	(18)
Amounts recognised in income statement	2	(27)	(25)
Exchange translation differences	-	(3)	(3)
Hedge reserve at end of year:gains/(losses) deferred	**(4)**	**12**	**8**

All cash flow hedges were highly effective throughout the year ended 31 December 2005.

The transition loss relates to interest rate derivatives held on January 2005, which were treated as hedging instruments under UK GAAP but which are not designated as such under IAS39.

The deferred gains and losses on cash flow hedges at 31 December 2005 are currently expected to be recognised in the income statement in future years as follows:

	Transition loss	Foreign exchange hedges	Total hedge reserve
	£m	£m	£m
2006	**(2)**	12	10
2007	**(1)**	2	1
2008	**(1)**	(2)	(3)
Gains/(losses) deferred in hedge reserve at end of year	**(4)**	**12**	**8**

The cash flows for these hedges are expected to occur in line with the recognition of the gains and losses in the income statement, other than in respect of certain forward foreign exchange hedges on subscriptions, where the cash flows may be expected to occur in advance of the subscription year.

18. DEFERRED TAX

Movements in deferred tax liabilities and assets are summarised below.

	2005 £m	2004 £m
Deferred tax assets	**264**	222
Deferred tax liabilities	**(926)**	(858)
Total	**(662)**	(636)

	Excess of tax allowances over amortisation £m	Acquired intangible assets £m	Other temporary differences - liabilities £m	Tax losses carried forward £m	Pensions £m	Other temporary differences - assets £m	Total £m
Deferred tax asset/(liability) at 1 January 2004	(43)	(830)	(6)	18	84	108	(669)
(Charge)/credit to profit	(33)	62	1	(27)	13	(13)	3
Credit to equity	-	-	-	-	12	-	12
Transfers	-	-	3	34	-	(22)	15
Acquisitions	-	(68)	-	25	-	-	(43)
Exchange translation differences	5	51	-	(3)	-	(7)	46
Deferred tax asset/(liablitity) at 1 January 2005	**(71)**	**(785)**	**(2)**	**47**	**109**	**66**	**(636)**
Transition adjustment on adoption of IAS39	-	-	-	-	-	**6**	**6**
(Charge)/credit to profit	**(34)**	**65**	**(1)**	**6**	**8**	**(1)**	**43**
Credit to equity	-	-	-	-	**10**	**(13)**	**(3)**
Transfers	-	-	**(5)**	-	-	**13**	**8**
Acquisitions	-	**(11)**	**(3)**	-	-	**3**	**(11)**
Exchange translation differences	**(10)**	**(68)**	**(1)**	**1**	**6**	**3**	**(69)**
Deferred tax asset/(liablitity) at 31 December 2005	**(115)**	**(799)**	**(12)**	**54**	**133**	**77**	**(662)**

At 31 December 2005, potential deferred tax assets not recognised due to uncertainties over availability and timing of relevant taxable income amounted to £211m (2004 : £168m) in relation to tax deductions carried forward of £538m (2004: £419m). No time limitation currently applies on utilisation of the tax deductions.

19. INVENTORIES AND PRE-PUBLICATION COSTS

	2005 £m	2004 £m
Raw materials	**12**	12
Pre-publication costs	**393**	340
Finished goods	**222**	188
Total	**627**	540

20. TRADE AND OTHER RECEIVABLES

	Note	2005 £m	2004 £m
Trade and other receivables		**1,070**	963
Prepayments and accrued income		**152**	119
Derivative financial instruments	17	**141**	-
Total		**1,363**	1,082

21. ASSETS AND LIABILITIES HELD FOR SALE

The major classes of assets and liabilities of operations classified as held for sale are as follows:

	2005 £m	2004 £m
Goodwill	**16**	-
Intangible assets	**14**	-
Investments in joint ventures	**3**	-
Inventories and pre-publication costs	**19**	-
Trade and other receivables	**8**	-
Total assets held for sale	**60**	-
Trade and other payables	**11**	-
Total liabilities associated with assets held for sale	**11**	-

22. TRADE AND OTHER PAYABLES

	Note	2005 £m	2004 £m
Payables and accruals		**998**	865
Deferred income		**965**	930
Derivative financial instruments	17	**11**	-
Total		**1,974**	1,795

23. BORROWINGS

Analysis by year of repayment

	2005				2004			
	Bank loans, overdrafts and commercial paper	Other loans	Finance leases	Total	Bank loans, overdrafts and commercial paper	Other loans	Finance leases	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Within 1 year	**127**	**322**	**11**	**460**	296	77	8	381
Within 1 to 2 years	-	**74**	**3**	**77**	-	285	6	291
Within 2 to 3 years	-	**359**	-	**359**	-	74	2	76
Within 3 to 4 years	-	-	-	-	-	228	-	228
Within 4 to 5 years	-	**144**	**1**	**145**	-	-	-	-
Thereafter	-	**951**	-	**951**	-	600	-	600
	-	**1,528**	**4**	**1,532**	-	1,187	8	1,195
Total	**127**	**1,850**	**15**	**1,992**	296	1,264	16	1,576

Analysis by currency

	2005				2004			
	Bank loans, overdrafts and commercial paper	Other loans	Finance leases	Total	Bank loans, overdrafts and commercial paper	Other loans	Finance leases	Total
	£m	£m	£m	£m	£m	£m	£m	£m
US Dollars	**52**	**1,850**	**15**	**1,917**	243	1,264	15	1,522
Euro	**1**	-	-	**1**	-	-	-	-
Other	**74**	-	-	**74**	53	-	1	54
Total	**127**	**1,850**	**15**	**1,992**	296	1,264	16	1,576

Included in the US dollar amount for other loans above is £359m of debt denominated in euros (€500m), that was swapped into US dollars on issuance and against which there are related derivative financial instruments included within trade and other receivables, which, as at 31 December 2005, had a fair value of £105m.

24. LEASE ARRANGEMENTS

Finance leases

At 31 December 2005 future finance lease obligations fall due as follows:

	2005 £m	2004 £m
Within one year	**11**	9
In the second to fifth years inclusive	**5**	8
	16	17
Less future finance charges	**(1)**	(1)
Total	**15**	16
Present value of future finance lease obligations payable		
Within one year	**11**	8
In the second to fifth years inclusive	**4**	8
Total	**15**	16

Operating leases

At 31 December 2005 outstanding commitments under non-cancellable operating leases fall due as follows:

	2005 £m	2004 £m
Within one year	**113**	104
In the second to fifth years inclusive	**334**	328
After five years	**350**	365
Total	**797**	797

Of the above outstanding commitments, £780m (2004 : £781m) relate to land and buildings.

The Reed Elsevier Group plc group has a number of leased properties that are sub-leased. The future lease receivables contracted with sub-tenants fall as follows:

	2005 £m	2004 £m
Within one year	**12**	11
In the second to fifth years inclusive	**39**	38
After five years	**21**	22
Total	**72**	71

NOTES TO THE ACCOUNTS

For the year ended 31 December 2005

25. PROVISIONS

	£m
At start of year	52
Utilised	(13)
Exchange translation differences	5
At end of year	**44**

The provisions are for property lease obligations which relate to estimated sub-lease shortfall and guarantees given by Harcourt General, Inc. in favour of a former subsidiary for certain property leases for various periods up to 2016.

26. CONTINGENT LIABILITIES

There are contingent liabilities amounting to £46m (2004: £57m) in respect of property lease guarantees given by Harcourt General, Inc in favour of a former subsidiary.

The company has accepted, in accordance with clause 403 Book 2 of the Dutch Civil Code, responsibility for the liabilities, including trade creditors and external borrowings totalling £72m (2004 : £70m), of subsidiary undertakings registered in the Netherlands.

27. SHARE CAPITAL

	Authorised	Called up, issued and fully paid
£ and no. shares	At 31 Dec 2004 and 2005	At 31 Dec 2004 and 2005
Preference shares (cumulative) of £1 each		
Irredeemable 7.50%	100,000	100,000
Ordinary shares of £1 each		
"R" ordinary shares	10,000	10,000
"E" ordinary shares	10,000	10,000
Total	*120,000*	*120,000*

28. SHARE PREMIUM

	2005 £m	2004 £m
At 1 January and 31 December	**324**	324

29. TRANSLATION RESERVE

	2005 £m	2004 £m
At 1 January	**107**	-
Exchange translation differences of forign operations	**(232)**	107
Other exchange transaltion differences	**3**	-
At 31 December	**(122)**	107

30. OTHER RESERVES

	Hedge reserve 2005 £m	Other reserves 2005 £m	Total 2005 £m	Total 2004 £m
At 1 January	**-**	**(2,648)**	**(2,648)**	(2,542)
Transition adjustment on adoption of IAS39	**54**	**(17)**	**37**	-
At 1 January as restated	**54**	**(2,665)**	**(2,611)**	(2,542)
Profit attributable to parent companies shareholders	**-**	**261**	**261**	201
Actuarial losses on defined benefit pension schemes	**-**	**(37)**	**(37)**	(74)
Fair value movements on available for sale investments	**-**	**3**	**3**	-
Dividends paid	**-**	**(297)**	**(297)**	(304)
Tax on actuarial losses on defined benefit pension schemes	**-**	**10**	**10**	12
Recognition of share based remuneration reserve	**-**	**57**	**57**	59
Tax on fair value movements on cash flow hedges	**-**	**(13)**	**(13)**	-
Fair value movements on cash flow hedges	**(18)**	**-**	**(18)**	
Transfer to net profit	**(25)**	**-**	**(25)**	
Exchange translation differences on other reserves	**(3)**	**-**	**(3)**	-
At 31 December	**8**	**(2,681)**	**(2,673)**	(2,648)

31. RELATED PARTY TRANSACTIONS

The company is jointly owned and controlled by Reed Elsevier PLC and Reed Elsevier NV.

There were no material transactions during the year between the Reed Elsevier Group plc group and its fellow joint ventures, other than those disclosed in these accounts.

The group's fellow joint ventures are Elsevier Reed Finance BV and its subsidiaries. Elsevier Reed Finance BV is incorporated in the Netherlands and owned by Reed Elsevier PLC and Reed Elsevier NV. The Elsevier Reed Finance BV group provides a range of treasury services and funding to the Reed Elsevier Group plc group.

Foreign exchange contracts entered into during 2005 by Reed Elsevier Group plc and its subsidiaries with its fellow joint ventures amounted to £849m (2004 : £758m).

31. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions between the Reed Elsevier Group plc group's businesses have been eliminated within the financial statements. Transactions with joint ventures were made on normal market terms of trading and comprise sales of £6m (2004 : £6m). As at 31 December 2005, amounts owed by joint ventures were £3m (2004 : £2m).

Transactions with key management personnel, being the directors, relate to remuneration which is disclosed in the Directors' Remuneration Report

32. RECONCILIATION TO UK GAAP

Profit reconciliation

	Note	UK GAAP 2004 £m	Adjust-ments £m	IFRS 2004 £m
Revenue		4,768	-	4,768
Cost of sales		(1,721)	-	(1,721)
Gross profit		3,047	-	3,047
Selling and distribution costs		(1,060)	-	(1,060)
Administration and other expenses	(i)	(1,330)	75	(1,255)
Operating profit before joint ventures		657	75	732
Share of result of joint ventures	(ii)	22	(5)	17
Operating profit		679	70	749
Finance income		23	-	23
Finance costs		(390)	-	(390)
Net finance costs		(367)	-	(367)
Disposals and other non operating items		(3)	-	(3)
Profit before tax		309	70	379
Tax	(iii)	(230)	54	(176)
Net profit for the year		79	124	203
Attributable to:				
Parent companies' shareholders		77	124	201
Minority interests		2	-	2
Net profit for the year		79	124	203

32. RECONCILIATION TO UK GAAP (CONTINUED)

Balance sheet reconciliation

	Note	UK GAAP 2004 £m	Adjust-ments 2005 £m	IFRS 2004 £m
Non-current assets				
Goodwill	(iv)	2,352	262	2,614
Intangible assets	(v)	2,653	179	2,832
Investments	(vi)	162	14	176
Property, plant and equipment	(vii)	518	(227)	291
Deferred tax assets	(viii)	85	137	222
		5,770	365	6,135
Current assets				
Inventories and pre-publication costs		540	-	540
Trade and other receivables	(ix)	1,220	(138)	1,082
Amounts owed by Reed Elsevier PLC		36	-	36
Amounts owed by the Elsevier Reed Finance BV group		346	-	346
Cash and cash equivalents		160	-	160
		2,302	(138)	2,164
Total assets		8,072	227	8,299
Current liabilities				
Trade and other payables	(x)	(1,832)	37	(1,795)
Borrowings		(381)	-	(381)
Amounts owed to Reed Elsevier PLC		(555)	-	(555)
Amounts owed to the Elsevier Reed Finance BV group		(778)	-	(778)
Taxation		(245)	-	(245)
		(3,791)	37	(3,754)
Non-current liabilities				
Borrowings		(1,195)	-	(1,195)
Amounts owed to Reed Elsevier PLC		(40)	-	(40)
Amounts owed to the Elsevier Reed Finance BV group		(4,092)	-	(4,092)
Taxation		(191)	-	(191)
Deferred tax liabilities	(xi)	(76)	(782)	(858)
Retirement benefit obligations	(xii)	-	(321)	(321)
Provisions		(52)	-	(52)
		(5,646)	(1,103)	(6,749)
Total liabilities		(9,437)	(1,066)	(10,503)
Net assets		(1,365)	(839)	(2,204)
Capital and reserves				
Share capital		-	-	-
Share premium		324	-	324
Translation reserve	(xiii)	-	107	107
Other reserves		(1,702)	(946)	(2,648)
Consolidated shareholders' equity		(1,378)	(839)	(2,217)
Minority interests		13	-	13
Total equity		(1,365)	(839)	(2,204)

32. RECONCILIATION TO UK GAAP (CONTINUED)

Notes on the IFRS adjustments

(i) Administration and other expenses: non-amortisation of goodwill of £204m offset by higher amortisation of intangible assets of £54m, additional pension expense of £27m and share option expense of £48m.

(ii) Share of result in joint ventures: joint ventures tax reclassification of £7m offset by non-amortisation of goodwill of £2m.

(iii) Tax: reduced deferred tax charge of £47m and joint ventures tax reclassification of £7m.

(iv) Goodwill: non-amortisation of goodwill of £204m and grossing up for deferred tax liabilities of £68m offset by exchange of £10m (differences between average rates and year end balance sheet rates on profit and loss adjustments).

(v) Intangible assets: reclassification of capitalised software of £227m and exchange £6m offset by higher amortisation of £54m.

(vi) Investments: non-amortisation of goodwill in joint ventures of £2m and revaluation of shares held in Reed Elsevier PLC and Reed Elsevier NV £12m.

(vii) Property, plant and equipment: reclassification of capitalised software of £227m.

(viii) Deferred tax assets: additional deferred tax assets principally in relation to net pension obligations of £137m.

(ix) Trade and other receivables: reversal of the pension prepayment of £137m and other of £1m.

(x) Trade and other payables: reversal of unfunded defined benefit pension liability of £53m offset by other of £16m.

(xi) Deferred tax liabilities: principally relating to acquired intangible assets of £781m and other of £1m.

(xii) Employee benefit obligations: net pension obligations of £321m.

(xiii) Translation reserve: exchange differences on translation of foreign operations of £85m and translation effects of IFRS adjustments of £22m.

33. POST BALANCE SHEET EVENT

On 14 February 2006, the company declared a dividend of £300m comprising £150m in respect of the "R" shares and £150m in respect of the "E" shares.

PARENT COMPANY FINANCIAL STATEMENTS

For the year ended 31 December 2005

PARENT COMPANY BALANCE SHEET

As at 31 December 2005

	2005 £m	2004 £m
Fixed assets		
Investments		
Shares in subsidiary undertakings		
Cost	**897**	897
Provided	**(4)**	(4)
Net book amount	**893**	893
Joint ventures	**29**	29
	922	922
Current assets		
Amounts owed by Reed Elsevier PLC	**2**	1
Amounts owed by subsidiary undertakings	**226**	467
	228	468
Total assets	**1,150**	1,390
Current liabilities		
Creditors: amounts falling due within one year	**(1)**	-
Net assets	**1,149**	1,390
Capital and reserves		
Capital and reserves		
Called up share capital	-	-
Share premium account	**324**	324
Revenue reserves	**825**	1,066
Shareholders' funds	**1,149**	1,390

Approved by the board of Reed Elsevier Group plc, 15 February 2006.

M H Armour

Chief Financial Officer

PARENT COMPANY FINANCIAL STATEMENTS

For the year ended 31 December 2005

PARENT COMPANY RECONCILIATION OF SHAREHOLDERS' FUNDS
For the year ended 31 December 2005

	Share capital	Share premium	Profit and loss reserve	Total
	£m	£m	£m	£m
At 1 January 2004	-	324	652	976
Profit attributable to ordinary shareholders	-	-	568	568
Ordinary dividends paid	-	-	(154)	(154)
At 1 January 2005	-	324	1,066	1,390
Loss attributable to ordinary shareholders	-	-	(25)	(25)
Ordinary dividends paid	-	-	(216)	(216)
At 31 December 2005	-	324	825	1,149

ACCOUNTING POLICIES

Basis of preparation

The parent company financial statements have been prepared under the historical cost convention in accordance with UK Generally Accepted Accounting Principles (UK GAAP). Unless otherwise indicated, all amounts in the financial statements are in millions of pounds. As permitted by Section 230 of the Companies Act 1985, the company has not presented its own profit and loss account. The Reed Elsevier Group plc accounting policies under UK GAAP are set out below.

Investments

Fixed asset investments in the combined businesses are stated at cost, less provision, if appropriate, for any impairment in value.

Principal joint ventures and subsidiaries are set out in the supplementary information on page 74.

Foreign exchange translation

Transactions entered into in foreign currencies are recorded at the exchange rates applicable at the time of the transaction.

Taxation

Deferred taxation is provided in full for timing differences using the liability method. Deferred tax assets are only recognised to the extent that they are considered recoverable in the short term. Deferred taxation balances are not discounted.

INDEPENDENT AUDITORS' REPORT ON THE PARENT COMPANY FINANCIAL STATEMENTS

To the members of Reed Elsevier Group plc

We have audited the individual parent company financial statements of Reed Elsevier Group plc for the year ended 31 December 2005 ("the company financial statements") which comprise the parent company balance sheet, the parent company reconciliation of shareholders' funds and the parent company accounting policies. These company financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the company financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice. Our responsibility is to audit the company financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the company financial statements give a true and fair view in accordance with the Companies Act 1985. We report to you if, in our opinion, the directors' report is not consistent with the company financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read the directors' report and the other information contained in the annual report for the above year and described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the company financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the company financial statements and the part of the Remuneration Report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion, the company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2005.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London

15 February 2006

SUPPLEMENTARY INFORMATION

Principal Subsidiary Undertakings at 31 December 2005

Holding Companies	
Reed Elsevier (UK) Limited [1][7]	
Reed Elsevier Holdings B.V.[7]	(The Netherlands)
Reed Elsevier Nederland B.V.	(The Netherlands)
Reed Elsevier Overseas B.V.	(The Netherlands)
Reed Elsevier US Holdings Inc	(USA)
Reed Elsevier Inc. [1]	(USA)
Reed Elsevier Capital Inc.	(USA)
Harcourt, Inc. [1]	(USA)
Reed Elsevier Properties Inc.	(USA)
Science & Medical	
Elsevier Limited	
Elsevier B.V.	(The Netherlands)
Excerpta Medica Medical Communications B.V.	(The Netherlands)
Elsevier Inc.	(USA)
Excerpta Medica, Inc	(USA)
Academic Press [2]	(USA)
Elsevier Health Sciences [2]	(USA)
Mosby, Inc.	(USA)
MDL Information Systems, Inc.	(USA)
Endeavor Information Systems, Inc.	(USA)
MDL Information Systems GmbH	(Germany)
MC Strategies Inc	(USA)
Legal	
LexisNexis Butterworths Tolley [3]	
LexisNexis [4]	(USA)
Matthew Bender and Company, Inc.	(USA)
Martindale-Hubbell [4]	(USA)
LexisNexis Risk Management Inc	(USA)
Seisint, Inc	(USA)
Editions du Juris-Classeur SA	(France)
Butterworths Australia [5]	(Australia)
Education	
Harcourt Education Limited	
Harcourt School Publishers [6]	(USA)
Holt, Rinehart and Winston [6]	(USA)
Harcourt Achieve Inc.	(USA)
Harcourt Assessment, Inc.	(USA)
Business	
Reed Business Information Limited	
Reed Exhibitions Limited	
Reed Business Information B.V.	(The Netherlands)
Reed Business Information US [4]	(USA)
Reed Construction Data Inc.	(USA)
Reed Exhibitions [4]	(USA)
Reed Expositions France SA	(France)
Reed Midem Organisation SA	(France)
Groupe Strategies SA	(France)
Reed Exhibitions Japan Limited	(Japan)

All are wholly owned subsidiary undertakings registered and operating in England and Wales unless otherwise stated.

(1) Holding company, but also trades through one or more operating divisions
(2) Division of Elsevier Inc.
(3) Division of Reed Elsevier (UK) Limited
(4) Division of Reed Elsevier Inc.
(5) Division of Reed International Books Australia Pty Ltd
(6) Division of Harcourt, Inc.
(7) Direct subsidiary undertaking of Reed Elsevier Group plc

Principal joint ventures at 31 December 2005

Operating in		*Principal place of business*
Dott. A. Giuffrè Editore Spa	40%	Italy, Via Busto Arsizio, Milan