

To be filed with the financial statements for  
Peter Honey Publications Ltd, company number  
3754757

# Pearson plc

## Annual Report and Accounts 2014



80 Strand  
London WC2R 0RL


Registered Number 53723 (England)

# Transforming learning together

IMAGE REMOVED

# Pearson at a glance

Financial highlights

 To read about our KPIs go to p14

## Sales

£4.9bn  
+2%

IMAGE REMOVED

IMAGE REMOVED

## Adjusted operating profit (excluding Merger market)

£720m  
+8%

IMAGE REMOVED

IMAGE REMOVED

## Average annual growth in headline terms 2009–2014

Adjusted earnings per share

+0.4%

IMAGE REMOVED

IMAGE REMOVED

Operating cash flow

-6.6%

Dividend

+7.5%

Throughout this report growth rates are stated on a constant exchange rate (CER) basis unless otherwise stated. Where quoted, underlying growth rates exclude both currency movements and portfolio changes. Unless otherwise stated, sales exclude Penguin and Merger market while adjusted operating profits include Penguin, Penguin Random House and Merger market. Continuing operations exclude both Penguin and Merger market.

## About Pearson

Pearson is the world's leading learning company, with 40,000 employees in over 70 countries working to help people of all ages to make measurable progress in their lives through all kinds of learning.

We provide learning materials, technologies, assessments and services to teachers and students in order to help people everywhere aim higher and fulfil their potential.

We put the learner at the centre of everything we do.

Responding to new recommendations and best practice, every effort has been made to ensure this report is fair, balanced and understandable. Notably, our 'Responsible business' section has been reshaped around our 'Social impact', to reflect a new and broader commitment to making a positive contribution to society.

Together with 'Our business' and 'Our performance', these three sections of this document (p2-56) form our strategic report, which was approved for issue by the board on 9 March 2015 and signed on its behalf by

IMAGE REMOVED

Robin Freestone Chief financial officer

## Strategic report

## Our business

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OUR BUSINESS

OUR PERFORMANCE

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## Chairman's introduction

IMAGE REMOVED

Glen Moenno  
Chairman

"The most difficult phase of our transformation has now been completed... one which has laid the foundations to strengthen our position as the world's largest education company."

Share price performance

**+32.0%**

FTSE 100 +2.0%

FTSE All Share +2.3%

Performance over 12 months to announcement of preliminary results (close of 27 February 2015)

Source: Datastream

Read our full Governance section	p57-112 ➔
LEADERSHIP & EFFECTIVENESS	p60-69 ➔
ACCOUNTABILITY	p70-77 ➔
ENGAGEMENT	p78-81 ➔
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ADDITIONAL DISCLOSURES	p107-112 ➔

Dear shareholders,

We continue to make this report as helpful as possible to our shareholders and everyone interested in our company. We are guided by the IIRC and FRC's principles, and wherever possible, we will continue to move towards those over the next few years. Our ambition this year is to tell a more transparent, concise and joined-up story of the journey we are on to create value.

In 2013 we made a series of commitments designed to measure and increase the company's impact on learning outcomes around the world. In 2014, John Fallon and his leadership team have embedded efficacy – the idea that each product or service we invest in is judged by the outcomes it helps learners achieve – as the defining principle around which Pearson is organised. We also, as an organisation, reaffirmed the values that we stand for, which John talks about in more depth on page 4. This report is the story of how these commitments will result in a more sustainable and profitable company.

Read more about this in our Chief executive's strategic overview on p4-9, and our Efficacy section on p38-43.

### Transforming for long-term success

The most difficult phase of our transformation has now been completed. This has been one of the most significant restructures in our long and varied history, one which has laid the foundations to strengthen our position as the world's largest education company. The benefits of this restructure are already being felt as Pearson becomes more digital, more service driven, and more capable of improving education in the world's great economies. They are also visible in the way we are organised, the strategies behind which we are marshalled, and our emerging culture. This is explained and exemplified throughout this report.

Transformations of this scale cannot succeed without the commitment of all our stakeholders, and I am very grateful to our shareholders and employees for the confidence and patience they have placed in our long-term vision. Although in 2014 our share price saw some volatility at the time I write this (having just announced our preliminary results) it has recovered significantly, rising 32% over the last 12 months. Over the ten years to December 2014 it had almost doubled (89.3%), during which time the total shareholder return has increased by 182.6%. Moreover, I'm delighted that, for the 23rd consecutive year we've been able to increase our dividend per share. We have confidence that these trends will continue, thanks to the steps we have taken in the last two years.

### Share price performance

IMAGES REMOVED

Source: Datastream to 31 December 2014

### Total shareholder return (TSR)

IMAGES REMOVED

Source: Datastream to 31 December 2014

TSR is one of our KPIs

More on p14 ➔

### Building a balanced and strong team

Though our immediate transformation has been completed, we will, of course, continue to adapt and improve to ensure our ongoing success. We continue to build a balanced, experienced team, welcoming Elizabeth Corley and Tim Score to the board, and a number of highly regarded industry specialists to the executive management team.

This year we have also held our triennial external board review, and alongside that we have established a process for long-term succession planning, which we'll undertake annually. I would like to take this opportunity to thank our chief financial officer, Robin Freestone, for his enormous contribution to Pearson over the last ten years. We look forward to Coram Williams joining us in that role on 1 August 2015. Read more about our board on page 60, and the executive team on page 9.

### Looking forward

These are exciting times for everyone involved at Pearson, as we begin to see the opportunities created by two years of very substantial transformation. It has been a challenging journey at times, but worth it. We now move into our next chapter, better prepared than ever to help people all over the world progress in their lives through learning, and in so doing create a growing sustainable company for the benefit of our shareholders.

IMAGE REMOVED

Glen Moreno, Chairman

OUR BUSINESS

OUR PERFORMANCE

OUR SOCIAL IMPACT

GOVERNANCE

FINANCIAL STATEMENTS

## Chief executive's strategic overview

IMAGE REMOVED

John Fallon  
Chief executive

"For education to really work it needs to not only provide access, but ensure progress... by standing at the intersection of new technology and good teaching practices, we can help to make learning more accessible and more relevant for more people around the world."

Dear shareholders,

Pearson's purpose is to empower people to progress in their lives through learning, and that means we put the learner at the heart of everything we do. Through this review, you'll see five stories from students that illustrate how we've been doing over the last year.

Each story demonstrates the commitment and ability of the young woman involved, each a great source of inspiration to all of us. Each showcases one of Pearson's most commercially successful products (MGI, BTEC, Connections, Wall Street English, MyLabs) of recent years. And they all illustrate that the bigger Pearson's social impact – in improving access to good quality education and ensuring that translates into meaningful learning outcomes for far more people – the more we can create a faster growing and more profitable company, and do so in a sustainable manner.

Last October Malala Yousafzai accepted her Nobel Peace Prize on behalf of the 66 million girls around the world who don't go to school. In this same spirit, I've chosen five stories that are about the achievements of young women around the world. You'll find more stories reflecting the full diversity of what we do at [www.pearson.com](http://www.pearson.com).

### Positioned to make a greater impact

The transformation programme we launched in February of 2013 is now complete. Over the course of two years we carried out as much restructuring, in terms of activity and costs incurred, as we'd carried out in the previous six

### Short stories of impact

#### Rozanna's story

IMAGE REMOVED

IMAGE  
REMOVED

Rozanna has beaten overwhelming odds. Born into a family in Zimbabwe in which neither parent had taken A-levels, let alone attended university, she was not a typical candidate for higher education. Insecurity, lack of access to technology and fear about personal safety were some of the barriers she faced. But her thirst for education led her to enrol in Pearson's Midrand Graduate Institute (MGI) in South Africa. Rozanna is now a third-year psychology major with a drive for achievement that has inspired us all at Pearson. She praises her lecturers and credits much of her success with the personalised learning technology she uses at MGI.

That programme has been all about setting Pearson up to be able to demonstrate the impact of what we do in education around the world. It is about enabling us to do right across Pearson the thing that we have done increasingly well in many parts of the company, and which our stories of people learning all help to demonstrate. That is, we stand at the intersection of new technology (with its ability to engage, personalise and diagnose) and new, more effective, ways of teaching. This position allows us to develop products and services that enable the benefits of richer, deeper learning to be more widely felt.

We've had to conduct this accelerated programme of change whilst dealing with cyclical and policy related forces in our biggest markets, which I described in last year's report, and which continued to hurt us in 2014. In spite of these challenges, I'm pleased to report that we did meet the financial expectations that we set publicly for the company at the start of the year. Overall, at a time of much internal disruption and upheaval, we put in a generally good competitive performance. There were a couple of areas of under-performance, too, and we're working hard to do better in these activities in 2015. It wasn't just Pearson's education related businesses that performed well through this period of change. Penguin Random House, the company we own with Bertelsmann, turned in a best-selling performance whilst integrating the two companies. And the *Financial Times*, now part of our professional education business, continued to deliver the world's best news and information to its audiences whilst accelerating its own digital transition.

In 2015, we expect Pearson's profits to start to grow again, as the forces that have been working against us over the last two years start to ease, and as we benefit from the cost savings achieved by our restructuring and the revenues generated by our new investments.

#### A growing global demand

We'll be working hard with our customers to tackle what we think is one of the most important challenges in the world today. For globalisation and the disruptive powers of technology mean we live in a 'Second Machine Age' in which, as my colleague, Lionel Barber (editor of the *Financial Times*) puts it, "leverage in the workplace is best achieved through knowledge." This means that equipping every global citizen with what are sometimes described as '21st century skills' is more important than ever. In other words, for education to really work, it needs to not only provide access, but ensure progress.

To prosper in career and college, all young people need to leave school literate and numerate, with good knowledge of science, technology and the liberal arts – and being able to apply that knowledge to solve real world problems. They also need to be proficient in the kinds of less tangible skills that will help them succeed in the workplace – critical thinking, adaptability, team-working, and digital fluency.

They need the grit, resilience and determination to persevere and succeed – and, most of all, they need the capacity to carry on learning throughout their lives. These are all things that can be taught.

#### Short stories of impact

##### Bethany's story

IMAGE REMOVED

IMAGE  
REMOVED

Bethany is a UK student who did not take A-levels, but instead went after a BTEC qualification. She, like so many recent BTEC applicants, applied to university with a different skillset, but not with any less determination or ability. Her hard work and credentials were recognised when she was accepted to study Psychology and Linguistics at Oxford University. Bethany's story highlights that a skills-based qualification like a BTEC is not a 'lesser' credential, but one that can set a student up for success in higher education and a career.



## Chief executive's strategic overview continued

## Meeting the need

For the two billion people learning English as a foreign language, or the 300-400 million more people enrolling in higher education over the next 30 years, and all the other students of all ages around the world, the need for effective and relevant teaching and learning will continue to grow.

Of course, there are challenges to meeting this need. Fragmented and siloed approaches to education, changes in government policy and regulations, and widely diverse economic and social conditions, make our work – and that of educators worldwide, much more complex. But we are confident that by standing at the intersection of new technology and good teaching practices, we can help to make learning more accessible and more relevant for more people around the world.

In 2015, five priorities, outlined here, are guiding our work.




IMAGE REMOVED

## 2015 priorities

A business model focused on helping more people achieve better learning outcomes

Our efficacy initiative, first outlined in last year's report, is no longer just a framework. Efficacy is now at the centre of our business model and a major part of how we create value. This year, we'll embed it even more deeply into the fabric of everything we do so that it reaches more products, influences more people and transforms more processes. As our customers become ever more focused on achieving better returns on education related spending, Pearson is at the forefront of a great global growth opportunity. And it enables us to put our social impact at the very heart of our business. This applies to our Project Literacy campaign (page 54) and the renewed investment in our Pearson Affordable Learning Fund (page 56) just as it does to the research and development of new products and services and the way we engage with our customers each day. It is the means by which we ensure that education is more accessible, impactful and affordable, and delivers those outcomes to people regardless of location.

## Our business model

Our efficacy programme assessing and improving the impact of our products is central to our value creation model.



IMAGE REMOVED

## Short stories of impact

## Zuriel's story



IMAGE REMOVED



IMAGE REMOVED

Zuriel is an ambitious 12-year old documentary filmmaker, originally from Nigeria, who now lives in California. She is enrolled in Pearson's entirely online Connections Academy, which she says allows her to "do extracurricular activities even when travelling overseas, creating documentaries, and interviewing African leaders," without missing important schoolwork. Zuriel recently launched the "Speak Up, Stand Up" project to inspire girls on the African continent to 'stay in school, get a good education, and also to accomplish their dreams.' We can safely say she is leading by example.

## 2 New digital products

To further this work, we'll be launching new global products to meet the need for much better learning outcomes. They connect content with assessment and feedback. They use analytics and big data to personalise learning – making it a far more collaborative and effective experience for students and teachers. They all draw on world-class research into the science of teaching and learning. In the end they'll all be mobile first and device neutral. And they are all designed to take full account of just how 'messy' education can be, how important it is to deliver large and complex projects, and how to deal with 'last mile' issues. Our customers all know that the real problem in education is not finding a great teacher or a really good school, but being able to replicate that excellence at scale. All our new digital products are focused on meeting that need.

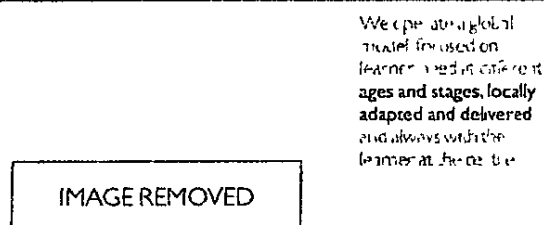
### Our priorities

School	Higher Ed	Professional
Blended and virtual schools (e.g. Connections Education)	Blended and virtual higher education learning (e.g. CTL)	Blended and virtual English language learning (e.g. Wall Street English)
Sistemas (e.g. COC)	Online programme management (e.g. our partnership with Arizona State University - ASU Online)	Pearson VUE
Large scale assessment services (e.g. TestNav)		Global Scale of English and Progress
World class qualifications (e.g. Edexcel BTEC)		Next generation courseware (e.g. MyEnglishLab, ELT World, Top Notch)
Digital clinical portfolio (e.g. Q Interactiv)	Next generation courseware (e.g. REVEL)	
Next generation courseware (e.g. enVisionMATH, Pearson System of Courses, Realizeit)		

## 3 A more focused company

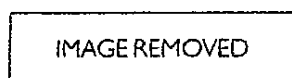
We're building these products in a modular and scalable way, and deploying them on a smaller number of global platforms. This improves the customer experience, makes it much easier to share assets and resources across the whole company, and is also much more cost effective. It is one example of how we are simplifying our company. We've already reduced the number of applications and systems used across the company by 10%, and we will continue that work this year. We have already sold a number of businesses where either we lacked scale or we saw limited scope for us to have a more direct impact on learning outcomes. This work will continue, as we focus our resources and energy on the biggest education challenges we see around the world. It is where we can make the biggest impact, and where, by running Pearson as one company, we see the biggest opportunity.

### Our operating structure



### Short stories of impact

#### Julia's story



Julia is learning English at one of Pearson's Wall Street English centres in Shanghai. I met with her during my visit there and was inspired by her drive. She now lives far from her parents' farm in south China, and far from the norms of rural life. Julia's decision to leave home to continue in higher education might have come as a shock to her family, but she is determined to improve her English language capabilities in order to further her career prospects and, one day, find work with a global company. She likes to engage on social media with friends she's met virtually around the world – and she wants to use her English language skills to spread the word that, as she puts it, "there's more to my country than air pollution."

## Chief executive's strategic overview continued

100% of our business is now in education

## 4 A more consistently high performing culture

At its best, Pearson has always championed high performance, we're now taking a whole series of actions (including how we recruit, appraise and reward everyone who works for Pearson) to make this a feature of everything we do. We've reaffirmed, and amplified, our long held values of 'brave, imaginative and decent', which are particularly important at a time of great change (Of the top 100 executives in the company, 70 are in the last two years, new to their roles or to the company). We've also added 'accountable' as a fourth core value. This is important to ensure that, in our new more 'matrix' style organisation, we all actively help each other to achieve our collective goals. It also recognises how important it is to be accountable to the public trust for all we do in education around the world.

IMAGE REMOVED

## 5 A stronger brand

This accountability extends to our willingness to engage in the public debate. Education is one of the most important areas of public life and evokes strong emotions and opinions in a field where data and evidence as to 'what works' can be difficult to come by. Our focus on educational impact and learning outcomes – and our openness and transparency in holding ourselves to account in achieving these goals – is vital to address these concerns. Today, public awareness of Pearson as the world's leading learning company, is still relatively limited. If we are going to achieve our full potential, we need to build Pearson, as a global education brand that is known for our work in empowering more people to progress in their lives through learning. This means, for example, that we need to be much less muted in our engagement in the circa 78 million-voice strong 'global conversation' that our research tells us is currently taking place around the topics of 'education' and 'learning'. And we also need to organise our product marketing so that we position Pearson, especially online and through social media in a much more coherent way.

### Short stories of impact

#### Taylor's story

IMAGE REMOVED

IMAGE REMOVED

Taylor is a student at the University of North Texas who was not thrilled that Statistics was a required course for her major. She lacked confidence in math and nearly let that fear cause her to change course and quit her degree programme altogether. 'I thought I didn't have the ability to do maths,' she told us. Taylor was then introduced to Pearson's MyStatsLab and decided to push through her fear. Instead of failure, she found success through using the tool to reinforce learning and practice in difficult areas. She completed her Statistics class with the highest possible grade.

### Looking ahead

In accepting her Nobel Peace Prize, Malala Yousafzai said 'I am many. I am not raising my voice, it is the voice of those 66 million girls.' At the same event, her fellow recipient, Kailash Satyarthi, set us all the task of 'universalising knowledge'.

All 40,000 Pearson colleagues are tackling these priorities in that spirit of 'I am many,' working with each other and with the millions of students, teachers and schools we serve. We'll grow by helping more of our fellow citizens to grow, by universalising the knowledge (and the skills) they'll need to succeed in this increasingly human capital driven world. Working with the communities in which we operate, we'll combine new technology and new teaching to enable the world to earn a far greater return on the \$5 trillion and more that is spent on education each year. As we succeed, we'll grow our market opportunity and help many more people make progress in their lives through learning. As a result, we'll start to grow again in 2015, and more importantly, it will set us up to be a faster growing, leaner, more profitable and cash-generative company for years to come. We'll be a company deploying less capital and capable of earning higher returns.

I thank all my colleagues for their hard work and commitment. And I thank our shareholders for their support and patience. We are already better placed to help more learners around the world to achieve their own personal aspirations.

IMAGE REMOVED

John Fallon Chief executive

### My executive team

#### Lines of Business

Doug Kubach, President, School  
Tim Bozk, President, Higher Education  
John Ridding, President, Professional

#### Geographies

Don Kilburn, President, North America  
Rod Bristow, President, Core  
Tamara Minick-Scolafo, President, Growth

#### Enabling functions

Robin Freestone, Chief financial officer  
*Coram Williams, Chief financial officer from 1st August 2015*  
Michael Barber, Chief education adviser  
Kate James, Chief corporate affairs officer  
Luyen Chou, Chief product officer  
Albert Hitchcock, Chief information officer  
Melinda Wolfe, Chief human resources officer  
Phil Hoffman, Chief corporate finance & strategic development officer

## Financial overview

IMAGE REMOVED

Robin Freestone Chief financial officer

Sales (at CER)

+2%

Adjusted earnings per share

-5%

Operating cash flow

+10%

Dividend per share

+6%

"In 2014, revenues were up 2% at constant exchange rates to £4.9bn, and level in underlying terms, but declined 4% in headline terms due to the negative impact of exchange rates."

Business performance	2014 £m	2013 £m	HEADLINE GROWTH	CER GROWTH	UNDERLYING GROWTH
Sales	4,874	5,069	(4)%	2%	0%
Adjusted operating profit (excluding Mergermarket)	720	710	1%	8%	5%
Adjusted operating profit	722	736	(2)%	5%	5%
Adjusted earnings per share	66.7p	70.1p	(5)%		
Operating cash flow	649	588	10%		
Free cash flow	413	269	54%		
Free cash flow per share	50.9p	33.3p	53%		
Return on invested capital	5.6%	5.4%	0.2pts		
Net debt	1,639	1,379	(19)%		

### Statutory results

Sales	4,874	5,069	(4)%
Operating profit	398	458	(13)%
Profit before tax	305	382	(20)%
Basic earnings per share	58.1p	66.6p	(13)%
Cash generated in operations	704	684	3%
Dividend per share	51.0p	48.0p	6%

### Note

- a) Growth rates are stated on a constant exchange rate (CER) basis unless otherwise stated. Where quoted, underlying growth rates exclude both currency movements and portfolio changes. Unless otherwise stated, sales exclude Penguin and Mergermarket while adjusted operating profits include Penguin, Penguin Random House and Mergermarket. Continuing operations exclude both Penguin and Mergermarket.
- b) The business performance measures are non-GAAP measures and reconcile to the equivalent statutory heading under IFRS are included in notes to the consolidated financial statements 2, 6, 7, 8 and 34 and the corporate and operating measures.
- c) For comparability purposes we have included an additional adjusted operating profit measure that excludes the results of Mergermarket but includes those of Penguin. In 2014 Mergermarket contributed only one month of profit (£2m) whilst it contributed a full year in 2013 (£26m). Although Penguin is a diversified business the results are not effectively included within our associate share of PPH.

### Profit & loss statement

In 2014, Pearson sales declined £195m, 4% in headline terms, to £4.9bn. Total adjusted operating profit fell £14m, 2% in headline terms, to £722m after £44m of net restructuring charges (2013: £135m).

Currency movements, primarily from the strength of Sterling relative to the US Dollar during the year, reduced sales by £272m and operating profits by £49m. At constant exchange rates (ie stripping out the impact of those currency movements), our sales and adjusted operating profit grew 2% and 5%, respectively.

Acquisitions and disposals contributed £79m to sales and a net zero to operating profits at constant exchange rates. This includes integration costs and investments related to our newly-acquired companies, which we expense. Penguin Random House was reported post-tax for the full year in 2014, compared to only the second half in 2013 following the combination of Penguin with Random House on 1 July 2013, and resulted in a £7m reduction in the contribution to operating income with an equal benefit to our tax charge.

Stripping out the impact of portfolio changes, Penguin Random House and the impact of currency movements, revenues were level in underlying terms while adjusted operating profit (excluding Mergermarket) grew by 5%.

Net interest payable in 2014 was £64m compared to £72m in 2013. This decrease is mainly due to the impact of foreign exchange translation and additional interest receivable on cash balances held overseas which offset the effect of higher average net debt levels in the period.

Our tax rate in 2014 was 17.9% compared to 14.6% in 2013 reflecting tax settlements in 2013.

Adjusted earnings per share were 66.7p (2013: 70.1p).

### Restructuring

Net restructuring charges were £44m (2013: £135m) and included portfolio, title, marketing and technology rationalisation in North America; the consolidation and integration of our operations in certain Growth markets and a move to a distributor model in South Korea; the exit of non-strategic business lines in certain Core and Growth markets; and, across all of our businesses, technology platform and operations simplification and the ongoing transformation of our supply chain and customer contact operations. Gross restructuring costs were £84m in 2014 (2013: £176m) offset by estimated net benefits in-year of £40m (2013: £41m).

### Cash generation

Headline operating cash flow increased by £61m to £649m benefiting from improved working capital from deferred revenue growth and an increased dividend from Penguin Random House, partly offset by increased investment levels and ongoing restructuring charges. Free cash flow increased by £144m to £413m, additionally reflecting lower tax payments. Our average working capital to sales ratio improved by a further 1.1 percentage points to 12.3% helped by lower inventory levels and the absence of Penguin.

### Return on invested capital

Our return on average invested capital was 5.6% (2013: 5.4%). Despite lower reported profit, ROIC benefited from lower cash tax paid. We expect ROIC to start to improve again in 2015.

## Financial overview continued

## Statutory results

In 2014, our statutory operating profit was £398m after a £77m write down of the balance sheet value of intangibles in our Indian business, a £38m loss on disposal of our stake in Nook Media and a £40m gain on the disposal of our stake in Safari Books Online and CourseSmart. Our statutory earnings were £470m, including a £198m gain from the disposal of Mergermarket and a £29m adjustment to the Penguin disposal, primarily in relation to pensions.

In 2013, our statutory operating profit was £458m. Our statutory earnings were £539m, including a £217m gain from the disposal of Penguin.

## Balance sheet

Our net debt increased to £1,639m (£1,379m in 2013) primarily reflecting the strengthening of the US dollar relative to Sterling and the acquisition of Grupo Multi, partly offset by the disposal of Mergermarket, fewer restructuring charges, improved working capital, the growth in deferred revenue and an increased dividend from Penguin Random House. Pearson's net debt/EBITDA ratio increased from 1.6x in 2013 to 1.9x in 2014 and our interest cover increased from 10.2x to 11.3x.

## Dividend

The board is proposing a dividend increase of 6% to 51.0p, subject to shareholder approval. 2014 will be Pearson's 23rd straight year of increasing our dividend above the rate of inflation. Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning more than £2.9bn to shareholders. We have a progressive dividend policy: we intend to build our dividend cover to around 2.0x over the long term, increasing our dividend more in line with earnings growth from then.

## 2015 outlook

In 2014, we completed the major restructuring and product investment programme, initiated in 2013, designed to accelerate Pearson's shift towards significant growth opportunities in digital, services and fast-growing economies. We believe this will provide Pearson with a significantly larger market opportunity, a sharper focus on the fastest-growing markets and stronger financial returns. In 2015, we are returning to more normal levels of restructuring expenditure.

Based on 21 January 2015 exchange rates, we expect to report adjusted earnings per share of between 75p and 80p in 2015. The major factors behind this guidance are as follows:

## Trading conditions

We continue to expect that cyclical and policy related factors stabilise in 2015.

In North America, our largest market, we expect growth in online higher education services and VUE and, with more stable college enrolments and a slower new edition year, learning services to be broadly level. In school, while the possibility of further policy related disruption remains, we expect greater stability in learning services and assessments with growth in virtual schools.

In our Core markets (which include the UK, Italy and Australia), we expect trading conditions to stabilise in the UK, growth in inside services to broadly offset declines in learning services in Australia, and sustained share in Italy following share gains in 2014. We expect the *Financial Times* to continue to benefit from, and invest in, its digital transition.

In our Growth markets (which include Brazil, China, India and South Africa), we expect good growth in China in our English Language Learning adult and test preparation businesses and continued stability in learning services, in Brazil, we expect a better year in our Sisternas business and good growth in our English Language Learning franchises, and in South Africa we expect a more stable year in learning services with modest growth in higher education direct delivery

#### Portfolio changes

We benefited for many years from the synergies created by integrating Penguin into our shared services operations. Following the transition of Penguin from Pearson services during 2014, some shared services costs remain with Pearson without associated revenues. We estimate these shared services costs at approximately £30m. We can reduce this somewhat over time which will be captured in our normal levels of restructuring.

Pearson has initiated a process to explore a possible sale of PowerSchool and our other Student Information Systems businesses including PowerSchool SMS Gradespeed, and eSIS Forms. This process is at an early stage and there is no certainty that it will lead to a transaction. In 2014, PowerSchool contributed \$97m of revenues and \$20m of operating income. Our guidance assumes ownership of PowerSchool for all of 2015. Pearson has appointed Evercore to advise on the process.

#### Currency movements

Pearson generates approximately 60% of its sales in the US. A five cent move in the average £/\$ exchange rate for the full year (which in 2014 was £1/\$1.65) has an impact of approximately 13p on adjusted earnings per share.

The benefit from the weakening of Sterling against the US dollar on our reported operating income will be partly offset by the strength of Sterling against a range of non-US dollar currencies, including the euro, Australian dollar and certain emerging markets currencies, and a higher interest charge as Sterling weakness against the US dollar increases the Sterling value of our US dollar denominated debt and interest payments.

#### Restructuring

We will benefit from the absence of £44m of exceptional net restructuring charges expensed in 2014 and we still expect to generate £45m of incremental cost savings in 2015.

These benefits will be partly offset by normal levels of net restructuring of approximately £30m in 2015.

#### Interest and tax

We expect our interest charge to be higher than 2014, reflecting higher average net debt levels, primarily as a result of the strength of the US dollar against Sterling. We expect a tax rate of approximately 17% on our total profit before tax (which includes the post-tax contribution from Penguin Random House).



## Key performance indicators

### Five-year performance

Financial objectives	KPI	Performance
Maintain long-term growth	<b>Sales</b> Sales rose 2% at CER in 2014 and have grown over the last five years at an average annual rate of over 3%, reflecting good long-term growth in digital and services businesses and acquisitions in the global education market partially offset by a shift to subscription revenues, recent cyclical and policy factors and adverse exchange rate movements	<b>+3.7%</b>  <a href="#">Learn more about link to remuneration on p86</a>
	<b>Total adjusted operating profit</b> Total adjusted operating profit rose 5% in 2014 at CER and has fallen at a compound annual rate of 3.4% since 2009, reflecting good long-term growth in digital & services offset by the sale of businesses, exceptional restructuring costs in 2014, recent cyclical and policy factors and adverse exchange rate movements	<b>-3.4%</b>
Deliver sustainable returns	<b>Total adjusted earnings</b> Total adjusted earnings per share is down 5% year on year in 2014, reflecting portfolio changes, exchange rate movements and a higher tax rate. Over five years EPS has grown at an average annual rate of 0.4% reflecting good long-term growth in our digital and services businesses offset by declines in print portfolio changes, recent exceptional restructuring costs, cyclical and policy factors and adverse exchange rate movements	<b>+0.4%</b>  <a href="#">Learn more about link to remuneration on p86</a>
	<b>Return on invested capital</b> ROIC grew 0.2% to 5.6% in 2014 and was affected by lower reported profit and a higher tax charge. ROIC has fallen from 8.9% in 2009. We expect ROIC to start to improve again in 2015	<b>-3.3</b> percentage points <a href="#">Learn more about link to remuneration on p86</a>
	<b>Total shareholder return</b> TSR in 2014 was -7% which compares to a 1% return on the FTSE 100 Index of large UK listed companies. Over five years, Pearson has returned approximately 62%, well ahead of the return on the FTSE 100 Index of 45% over the same period	<b>+61.9%</b>  <a href="#">Learn more about link to remuneration on p86</a>
	<b>Dividends per share</b> We increased dividends in respect of 2014 by 6% to 51p, our 23rd straight year of increasing our dividend above the rate of inflation	<b>+7.5%</b>
Manage our cash position effectively	<b>Operating cash flow</b> Operating cash flow rose to £649m in 2014, up more than 10% benefiting from lower restructuring charges, improved working capital, deferred revenue growth and an increased dividend from Penguin Random House, partly offset by increased investment levels. Over five years operating cash flow has declined at an average annual rate of over 6% per annum, reflecting good long-term growth in our digital and services businesses offset by declines in print portfolio changes, recent exceptional restructuring costs, cyclical and policy factors and adverse exchange rate movements	<b>-6.6%</b>  <a href="#">Learn more about link to remuneration on p86</a>

## Data/Progress

IMAGE REMOVED

## Strategic objectives

Transform  
to digital and  
services

## Data/Progress

Revenue share

2010 - 46.5%

£2.1bn

2014 - 62.1%

£3.0bn

IMAGE REMOVED

Grow  
presence in  
emerging  
markets

Revenue share

2010 - 10.9%

£496m

2014 - 16.3%

£794m

IMAGE REMOVED

## Non financial measures

Deliver  
measurable  
impact  
(Efficacy)

✓ Review programme on track  
✓ Plans to report first pilot impact  
results in 2016 on target

Efficacy reviews  
completed

200

IMAGE REMOVED

Deliver  
gender  
balance

Gender diversity

	MEN		WOMEN	
Board	7	70%	3	30%
Senior managers (excl executive board directors)	64	65%	35	35%
All employees	17,064	+2%	23,470	58%

IMAGE REMOVED

Reduce our  
carbon  
footprint

Global GHG emissions  
Metric tonnes CO<sub>2</sub>e

2014

129,742 -11%

2013

145,718

IMAGE REMOVED

Maintain  
community  
investment

IMAGE REMOVED

IMAGE REMOVED

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# Operating performance overview

## Developing for access, delivering for outcomes

Our strategy centres on a significant and exciting long-term opportunity: the sustained and growing global demand for greater affordability, access, and achievement in education. We can meet this demand by accelerating our shift to digital, to services and to fast-growing economies; and committing to deliver measurably improved learning outcomes through our efficacy framework.

Our primary segments for management reporting are Geographies (North America, Core and Growth) as this is how we drive business performance. This is how we reach learners, through content and digital services in individual classrooms: through broad partnerships with public and private education institutions and, in certain markets, by directly expanding capacity through our own schools and colleges.

This geographical structure is wholly dependent upon a parallel product development strategy, in which we organise by learning ages and stages – School, Higher Education and Professional.

By focusing our product development around the needs of the learner, we are able to centre evidence and expertise where it can be best applied to improving outcomes for people.

IMAGE REMOVED

Operating performance continued

Geography

# North America

Sales

£3.0bn

Adjusted operating profit

£464m

IMAGE REMOVED

Revenues declined 3% in headline terms, due to the strengthening of sterling against the US dollar, but increased by 2% at both CER and in underlying terms. Revenue growth in Connections Education, VUE, Clinical and Higher Education was partially offset by declines in School learning services and State Assessments. Adjusted operating profits declined 2% in headline terms due to currency movements, but grew 5% at both CER and underlying, reflecting revenue mix, lower returns provision, reduced US pension costs and lower restructuring charges.

In our statutory results, we recognised a £38m loss on disposal of our 5% stake in Nook Media and a £40m gain on the disposal of our stakes in Safari Books Online and CourseSmart.

IMAGE REMOVED

Our new operating and reporting structure

North America. Our largest market, accounting for 65% of revenues in 2014.

Learn more about Our operating structure on p7 ➔

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## Operating performance continued

North America  
continued

## School

In School, good growth in Connections Education, our virtual schools business, was offset by declines in our State Assessments business due to the impact of legislative changes in Texas and California, and in learning services, due to some loss of market share (as reported at the half year), revenue deferral on blended programmes and softness in the Open Territories

Connections Education served over 62,000 Full Time Equivalent students during 2014 through full-time virtual and blended programmes, up more than 15% from 2013. Three new full-time virtual public schools were launched in 2014 and an additional one will launch in 2015. At full-time virtual schools supported by Connections Education, students consistently outperform their virtual school peers on state standardised tests. Students at College Park Academy, a blended school in Maryland using the Connections Education curriculum, scored significantly higher than their in-state peers in reading and math in the Maryland School Assessment (MSA) for 6th and 7th Grades.

In State and National Assessments, high stakes online test volumes grew strongly, up 40% on 2013 to 11 million, as customers transitioned to computer-based testing. Paper-based high stakes test volumes declined 17% to 32 million, in part due to the growth of computer-based testing, but

also the impact of legislative changes in Texas and California. We were awarded contracts to administer Partnership for Assessment of Readiness for College and Careers (PARCC) assessments in 11 states and extended our contracts to administer Virginia Standards of Learning (SOL) Assessments and the Maryland High School Assessment. We will continue to administer the Florida Comprehensive Assessment Test (FCAT) until summer 2016.

Clinical Assessment grew strongly, benefiting from the launch of the fifth edition of the Wechsler Intelligence Scale for Children (WISC-V) and strong growth in Q-Interactive, where early studies are showing good improvements in mental health professional productivity and student engagement levels.

PowerSchool supported almost 13 million students (in more than 70 countries), broadly level with 2013, while licensed Schoolnet student counts rose more than 10% to over 10 million. In New Jersey we launched Schoolnet in 27 school districts, with 14 more implementations in progress, and have delivered over 400,000 assessments since launch.

Learning services revenues declined due to the impact of revenue deferrals from blended digital programmes and a loss of market share, with a weaker performance in Grades 6-8 Science and Math in Texas, and Grades 6-12 Literature and Grades 6-8 Math in Florida, only partly offset by a stronger performance in K-6 Math in Texas, Grades 6-12 Social Studies in Tennessee and Grades K-6 Math in California. We won an estimated 25% of the total new adoptions market (of \$910m in 2014) enVisionMATH, which now has the largest installed base of elementary students in the US, continues to drive significant improvements in student computation and problem solving.

IMAGE REMOVED

Connections Education served over 62,000 (+15%) full time equivalent students during 2014 through full-time virtual and blended programmes. At full time virtual schools supported by Connections Education, students consistently outperform their virtual school peers on state standardised tests.

Learn more at [connectionseducation.com](http://connectionseducation.com)

IMAGE REMOVED

### Higher Education

In Higher Education, total college enrolments fell, as expected, by 1.3%. Career enrolments in two-year public (community) and four-year for-profit colleges declined 3%, with rising employment rates and regulatory change affecting the for-profit and developmental learning sectors.

Learning services grew modestly, primarily due to market share gains, continued growth in digital courseware registrations, a stronger new edition cycle and less pronounced seasonality. MyLab registrations in North America grew 3% to almost 11 million. Lecturer generated case studies indicate that the use of MyLab programmes, as part of a broader course redesign, can support improvements in student test scores (<http://pearson/IZxLE>). We launched REVEL, which combines trusted content with interactive videos, quizzes, a mobile user interface, study tools, assignment calendar and performance dashboard for 17 humanities and social sciences subjects. The launch of REVEL is the first of numerous product lines taking advantage of our new cloud-based, mobile-ready, and data analytics capabilities. New editions launched in 2014 included *Tro: The Structures and Properties of Chemistry*, Acemoglu, Laibson and List, *Economics*, and *Pearson Writer*, an application built for mobile devices that helps students in developing writing skills. We published a range of digital titles for The Boy Scouts of America and implemented a new digital curriculum incorporating enhanced Merit Badge programmes in subjects including Robotics, Digital Technology and First Aid for the organisation's 2.7 million youth members.

IMAGE REMOVED

In 2014, we launched REVEL combining trusted content with rich interactivity and content across 17 humanities and social sciences subjects. REVEL is the first of our product lines taking full advantage of our new cloud-based, mobile-ready and data analytics capabilities.

Learn more at [pearsonhighered.com/revel](http://pearsonhighered.com/revel)

Pearson On Line Services, where we run fully online undergraduate and graduate learning programmes and earn certain revenues based on the success of the students and the institution, grew course enrolments by 22% during the year with continued strong growth in programmes at Arizona State University Online and University of Florida Online. We signed new programmes with Bradley University, to create five online graduate degree programmes in nursing and counselling, and University of Texas at Austin, Dana Center where we are partnering for the web delivery of math courses for its New Mathways Project (NMP) which will become part of a state-wide reform initiative in a collaboration between Dana Center and the Texas Association of Community Colleges. We expanded our collaboration with the American Health Information Management Association (AHIMA) to administer its online education business, which serves AHIMA's 71,000 members including 10,000 higher education students each year. We now provide our learning management system hosting 100 courses based on AHIMA content, technical support, a next generation Virtual Lab Product, and are launching a Coding Basics course combining AHIMA and Pearson content.

### Professional

At VUE, global test volumes grew 9% year-on-year to almost 13 million boosted by continued growth in IT, State Regulatory and Professional certifications.

New contracts include a deal to administer the Microsoft Certified Professional (MCP) Program globally, which significantly expands our existing partnership with Microsoft through Certiport's Microsoft Office Specialist (MOS) and Microsoft Technology Associate (MTA) exams.

IMAGE REMOVED

**MyLab** registrations in North America grew 3% to almost 11 million. Lecturer generated case studies indicate that the use of MyLab programmes can support improvements in test scores.

Learn more at [pearsonmylabandmastering.com](http://pearsonmylabandmastering.com)

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IMAGE REMOVED

Operating performance continued

Geography

# Core

Sales

£1.2bn

Adjusted operating profit

£152m

Revenues declined by 8% in headline terms and by 5% at both CER and in underlying terms. Modest growth in Italy and good growth at VUE was offset by declines in UK assessment revenues, due to the impact of policy changes on our UK school qualifications business, and reduction in partner market revenues, due to divestments and a move to distributor models implemented in 2013. FT revenues were broadly level at CER, with digital content growth offset by declines in print content and advertising. Adjusted operating profit (excluding Mergermarket) increased by £32m to £152m, driven by the benefits of restructuring actions taken over the last two years in all markets and by profit growth at the FT.

IMAGE REMOVED

IMAGE REMOVED

## Our new operating and reporting structure

Core Our biggest Core markets are the UK, Australia, Germany, France, Benelux and Italy. Additionally, we have around 100 partner markets where we do not franchise ourselves, so we collaborate with others.

Learn more about Our operating structure on p7 →

OUR BUSINESS

OUR PERFORMANCE

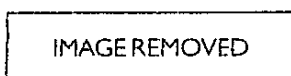
OUR SOCIAL IMPACT

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## Operating performance continued

## Core continued



We continue to invest to build Pearson College in the UK, and graduated our first 32 students during the year. Pearson College was one of only four private colleges to pass Quality Assurance Agency (QAA) review first time. Learn more at [pearsoncollege.com](http://pearsoncollege.com)

## School

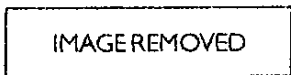
In the UK, qualifications have been impacted by government policy, where changes to accountability measures and a shift to end of course assessments in GCSE have led to a 21% decline in BTECs and 11% decline in General Qualifications in the year. We marked almost four million National Curriculum Tests, up 24% on 2013. Our contract to administer the National Curriculum Test (NCT) was extended to 2017. More than 4,600 schools, with almost 850,000 children, now subscribe to at least one of the Bug Club services, our primary school blended reading programme.

In Australia, we benefited from a stronger adoption year and the launch of the locally standardised version of the Wechsler Pre and Primary Scales of Intelligence (fourth edition). In Italy, we gained share in both primary and secondary with new titles combined with professional development and online cross-curricula support. In primary, we developed Top Secret and adapted Our Discovery Island English Language Learning programmes. In secondary, we extended our market leadership in the Humanities.

Revenues declined significantly in our partner markets due to challenging market conditions in Africa and Scandinavia and the move to a distributor model in certain markets. We disposed of our local schools lists in the Caribbean as we continue to focus on our largest global geographic opportunities.

## Higher Education

In the UK, our learning services revenues declined, primarily due to enrolment contraction following policy changes in the vocational markets. We continue to invest to build Pearson College and graduated our first



More than 4,600 schools in the UK, with almost 850,000 children, now subscribe to at least one of the Bug Club services, our primary school reading programme.

Learn more at [bugclub.co.uk](http://bugclub.co.uk)

32 students during the year. Pearson College was one of only four private colleges to pass Quality Assurance Agency (QAA) review first time.

In Australia, learning services revenues grew modestly benefiting from growth in core subjects, such as Biology, and direct-to institution sales of digital learning products offset by our exit from vocational publishing. Monash Online, our collaboration with Monash University, continues to show good growth and will launch additional courses in the second half of 2015. In addition we collaborated with another leading university in Australia to provide course development, recruitment, enrolment, and student support services for post-graduate courses.

#### Professional

At VUE, test volumes grew strongly following the successful launch of a new contract with CPA Australia to deliver Professional level exams and continued good growth in UK Driving Theory test volumes. We will continue to deliver our UK contract to administer the Driving Theory test for the DVSA until September 2016. VUE entered into ten year partnerships with the Chartered Institute of Management Accountants (CIMA) and the Association of Chartered Certified Accountants (ACCA) in the UK to transform a selection of their exams from pen and paper to computer-based testing.

The contribution from The Economist Group was lower due to a decline in advertising revenue, a weaker US dollar and lower profits at CQ Roll Call. The circulation of The Economist remains robust at 1.6 million, with an increase of 23% in digital subscriptions. The Economist's new daily app Espresso, was downloaded almost 400,000 times. The Group's content marketing services continue to grow with revenue increasing by 20% at CER.

## Financial Times Group

At the Financial Times Group, the FT grew its total circulation by 10% year-on-year to a record high of nearly 720,000 across print and online. Digital subscriptions increased 21% year-on-year to almost 504,000 and now represent 70% of the FT's total paying audience. The strong digital circulation growth offset continued structural declines in print content and advertising, where the FT continues to take market share.

Product innovation and launches, including an FT Weekend app, daily FirstFT briefing with editors' selection of essential news and comment from across the web, 'follow the author' alerts and a new FT Android App continue to result in steady growth in mobile usage and time spent on FT.com. Mobile is the fastest growing channel. We launched the FT | IE Corporate Learning Alliance, a joint venture with IE Business School, which provides premium custom learning to business leaders around the globe. The partnership connects the academic excellence of prominent business schools with the FT's award-winning journalism and insight into real world and real time business challenges.

IMAGE REMOVED

Financial Times' product innovations include the FT Weekend web app and FirstFT, a daily email briefing of must reads from its website and other sources.

Learn more at [ft.com](http://ft.com)

FT digital subscriptions increased

+21%

504,000

## Operating performance continued

## Geography

## Growth

Sales

£746m

Adjusted operating profit

£35m

IMAGE REMOVED

Revenues grew 1% in headline terms, despite the strength of sterling against key emerging market currencies, grew by 11% at CER, benefiting from the acquisition of Grupo Multi, and were down 1% in underlying terms, primarily due to the phasing of purchasing and a stronger School textbook adoption in South Africa in 2013. Growing English Language Learning enrolments in China and college enrolments in Saudi Arabia and South Africa were offset by a smaller School textbook market in South Africa, and lower revenues in Brazil from Sistemas, and ELT and Higher Education textbooks. Excluding the textbook impact in South Africa, revenues grew 4% in underlying terms. Adjusted operating profit declined by £3m to £35m reflecting a benefit from the acquisition of Grupo Multi offset by a slower adoption year in South Africa, launch costs associated with our new vocational colleges and a contract provision in Saudi Arabia, and weaker revenues and restructuring costs in Brazil.

In our statutory results, we wrote down the balance sheet value of our Indian business by £77m largely reflecting the reduced value of online tutoring which was primarily focused on the US market.

IMAGE REMOVED

## Our new operating and reporting structure

**Growth** Our growth markets are made up of Brazil, South Africa, China, India and other fast growing economies. Around one third of external employees now work in these countries.

Learn more about Our operating structure on p7 

## Operating performance continued

## Growth continued

## School

In South Africa, we performed well, competitively maintaining our market share of the School textbook market, but volumes declined significantly to more normal levels following a large adoption year, and significant share gains, in 2013

In Brazil, enrolments in our Sistemas were down 3% to 481,000 with growth in our public Sistemas (NAME) offset by declines in our private Sistemas as we combined our three sales forces into one. 72% of the municipalities that adopted NAME for lower secondary education showed improvement in their IDEB score, Brazil's federally established measure of educational quality

In India, DigiClass, our multimedia teaching solution is now installed in more than 26,000 classrooms, up more than 10% on 2013. We partnered with IBM to further accelerate our deployment across the country

## Higher Education

In South Africa, student enrolments in CTI/MGI, our private network of higher education institutions, grew by 15% to 13,400 across 13 campuses

In Mexico, our fully accredited online university partnership, UTEL, increased the number of students enrolled from under 5,000 last year to more than 9,000 in 2014 as a result of improved consumer marketing efforts and better student retention

In India, Higher Education revenues declined due to high levels of returns

IMAGE REMOVED

DigiClass, our multimedia teaching solution is now installed in more than 26,000 classrooms in India, up more than 10% on 2013

Learn more at [digiclass.in](http://digiclass.in)

## Professional

In Pearson English, good growth in direct delivery in China and inside services in Brazil due to the acquisition of Grupo Multi was partly offset by declines in learning services in Brazil and Mexico

Global student registrations for MyEnglishLab grew 15% to more than 460,000 with strong growth in Latin America

We launched the Global Scale of English (GSE), a new global standard for scoring English language proficiency on a precise, numeric, universal scale for businesses, governments and academic institutions. The scale is being embedded into all Pearson English products and services

In China, English direct delivery enrolments grew at both Wall Street English (WSE), up 2% to 66,000, and Global Education, up 7% to 117,000. To support long-term growth, we consolidated our ERP systems in China and deployed a Salesforce.com CRM system in WSE. We divested our online vocational training operations

In Brazil, we completed the acquisition of Grupo Multi, the largest provider of private language schools in Brazil. We successfully integrated the business despite challenging market conditions and disruption caused by the World Cup and Presidential elections

IMAGE REMOVED

Student enrolments in CTI/MGI, our private network of higher education institutions across South Africa, grew by 15% to 13,400 across 13 campuses

Learn more at [ctiac.za](http://ctiac.za) and [mgi.ac.za](http://mgi.ac.za)

## Penguin Random House

Pearson owns 47% of Penguin Random House, the first truly global consumer book publishing company. Penguin Random House was reported post-tax for the full year in 2014, compared to only the second half in 2013 following the combination of Penguin with Random House on 1 July 2013, which resulted in a £7m reduction in the contribution to operating income with an equal benefit to our tax charge.

Penguin Random House performed well in 2014, benefiting particularly from a strong publishing performance in Children's around the world and multi-million-copy film and television tie-ins.

The US business published 760 *New York Times* print and ebook bestsellers in 2014 (2013 full year pro forma 790), enjoying exceptional success in children's publishing with John Green's *The Fault in our Stars* (29 weeks at number one on the *New York Times* bestsellers list and nearly eight million copies sold) and four million copies of his backlist titles, tie-in titles from Disney's *Frozen* film (more than 17 million copies sold), Dasher's *The Maze Runner*, Forman's *If I Stay* and continued strong sales of LEGO® movie tie-in titles. Notable Adult titles included Grisham's *Gray Mountain*, Child's *Personal*, Monk Kidd's *The Invention of Wings*, Follett's *Edge of Eternity*, Bush's *41: A Portrait of My Father*, along with strong film and television tie-ins, such as Flynn's *Gone Girl*, Hillenbrand's *Unbroken*, and Martin's *Song of Fire and Ice* novels. The UK business

published 206 *Sunday Times* bestsellers (2013 pro forma 207), also enjoying outstanding sales of John Green along with the continued strength of Kinney's *Wimpy Kid* franchise. Key Adult titles included Brown's *Inferno*, Oliver's *Jamie's Comfort Food* and *Girl Online* by YouTube sensation Zoella, which became the fastest-selling debut UK novel ever.

Penguin Random House has a strong publishing programme for 2015, including new titles from John Grisham, Jamie Oliver, Toni Morrison, James Patterson, Sylvia Day, Lee Child, Nick Hornby, Harlan Coben, Danielle Steel, John Sandford, Janet Evanovich, Gayle Forman, Emily Giffin and Nora Roberts, as well as film tie-ins for *50 Shades of Grey*, John Green's *Paper Towns*, the sequel to James Dasher's *The Maze Runner*, and *Star Wars*.

The integration of the two businesses is progressing well and is on track to deliver net benefits in 2015 and beyond. Organisational structures have been aligned, systems integration is well underway and consolidation of North American warehousing will be completed in the first half of 2015. In March 2014, Penguin Random House acquired Santillana Ediciones Generales, a leading trade book publisher in Spain, Portugal and across Latin America, consolidating its leadership in Spanish language publishing.

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IMAGE REMOVED

We launched Global Scale of English, a new global standard for scoring English language proficiency to be embedded into all Pearson English products and services.

Learn more at [english.com/gse](http://english.com/gse)

IMAGE REMOVED

Student enrolments at Wall Street English in China grew to 66,000 (+2%).

Learn more at [wallstreetenglish.com](http://wallstreetenglish.com)

IMAGE REMOVED

We completed the acquisition of Grupo Multi, the largest provider of private language schools in Brazil.

## Other financial information

### Net finance costs

All figures in £ millions	2014	2013
Net interest payable	(64)	(72)
Finance income/(costs) in respect of employee benefit plans	1	(3)
Other net finance costs	(30)	(1)
<b>Total net finance costs</b>	<b>(93)</b>	<b>(76)</b>

Net interest payable in 2014 was £64m, compared to £72m in 2013

Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three-month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) fell by 0.1% to 0.2%. This decrease in floating market interest rates, along with the impact of foreign exchange translation and additional interest receivable on cash balances held overseas, more than offset the effect of higher levels of average net debt in the period. These factors contributed to the overall decrease in the Group's average net interest payable from 4.8% to 3.6%. The Group's average net debt rose by £260m, largely as a result of net acquisition activity and the translation of our predominantly US dollar debt.

Finance income and costs relating to retirement benefits have been excluded from our adjusted earnings as we believe the income statement presentation does not reflect the economic substance of the underlying assets and liabilities. Also included in the statutory definition of net finance costs (but not in our adjusted measure) are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. Finance costs for put options and deferred consideration are excluded from adjusted earnings as they relate to the future potential acquisition

of non-controlling interests and don't reflect cash expended. Foreign exchange and other gains and losses are excluded from adjusted earnings as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity.

In 2014, the total of these items excluded from adjusted earnings was a loss of £29m compared to a loss of £4m in 2013. Both the losses in 2014 and 2013 mainly relate to foreign exchange differences on un-hedged cash and cash equivalents and other financial instruments.

### Funding position and liquid resources

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

All figures in £ millions	2014	2013
Cash and cash equivalents	530	729
Marketable securities	16	6
Net derivative assets	40	76
Bonds	(2,173)	(2,168)
Bank loans and overdrafts	(42)	(47)
Finance leases	(10)	(11)
<b>Net debt</b>	<b>(1,639)</b>	<b>(1,415)</b>
Net cash classified as held for sale	–	36
<b>Total net debt</b>	<b>(1,639)</b>	<b>(1,379)</b>



Net acquisition activity and foreign exchange rate movements are the largest contributors to the increase in the Group's net debt. Reflecting the geographical and currency split of our business, a large proportion of our debt is denominated in US dollars (see note 19 for our policy). The strengthening of the US dollar against sterling during 2014 (from \$1.66 to \$1.56 £1) increases the sterling equivalent value of our reported net debt.

The Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. In January 2014, Moody's changed the outlook on its short-term and long-term ratings from 'Stable' to 'Negative'. In May 2014, the Group accessed the capital markets, raising €500m through the sale of notes maturing in May 2021 and bearing interest at 1.875%. The notes were swapped to floating rate in US dollars to conform with the policy described in note 19. The Group has a \$1.750m committed revolving credit facility which was refinanced in August 2014 and matures in August 2019. At 31 December 2014 this facility was undrawn. The facility is used for short-term drawings and providing refinancing capabilities, including acting as a back up for our US commercial paper programme. This programme is primarily used to finance our US working capital requirements, in particular our US educational businesses which have a peak borrowing requirement in June. At 31 December 2014, no commercial paper was outstanding. The Group also maintains other committed and uncommitted facilities to finance short-term working capital requirements in the ordinary course of business. Further details of the Group's approach to the management of financial risks are set out in note 19 to the financial statements.

### Taxation

The effective tax rate on adjusted earnings in 2014 was 17.9% as compared to an effective rate of 14.6% in 2013. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 21.5% in 2014 and 23.25% in 2013). These higher tax rates were largely offset by amortisation-related tax deductions and by adjustments arising from settlements with tax authorities. Both these items were less significant in 2014 than they had been in 2013.

The reported tax charge on a statutory basis in 2014 was £63m (20.7%) compared to a charge of £87m (22.8%) in 2013. The decrease in the statutory rate is mainly due to tax benefits arising on the increase in intangible charges, only partly offset by the factors affecting the adjusted rate as described above.

Tax paid in 2014 was £163m compared to £246m in 2013. Tax paid in 2013 was unusually high as a result of the permitted deferral of US tax payments in 2012 following Hurricane Sandy. These payments were subsequently made in 2013 and were accompanied by additional payments arising from settlements with tax authorities, including £55m relating to prior year disposals.

### Discontinued operations

In October 2012, Pearson and Bertelsmann announced an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction completed on 1 July 2013 and from that point, Pearson no longer controlled the Penguin Group of companies and has equity accounted for its 47% associate interest in the new Penguin Random House (PRH) venture.

## Other financial information continued

The loss of control resulted in the Penguin business being classified as held for sale on the Pearson balance sheet at 30 June 2013 and a subsequent gain on sale of £202m was reported in the second half of 2013. Included in the gain reported in 2013 was a provision for amounts payable to Bertelsmann upon settlement of the transfer of pension liabilities to PRH. During 2014, it was decided that this transfer would not go ahead as planned and the costs have been credited back in the £29m gain reported against the disposal in 2014.

The results for Penguin in the first half of 2013 and the gains reported in both 2013 and 2014 have been included in discontinued operations. The share of results from the associate interest in the PRH venture arising in the second half of 2013 and in 2014 has been included in operating profit in continuing operations.

Additionally, on 29 November 2013 we announced the sale of the Mergermarket Group to BC Partners. The sale was completed on 4 February 2014 and resulted in a gain of £198m after tax. The Mergermarket business was classified as held for sale on the balance sheet at 31 December 2013 and the gain and the results for both 2013 and 2014 to the date of sale have been included in discontinued operations.

### Non-controlling interest

There are non-controlling interests in the Group's businesses in South Africa, China and India although none of these are material to Group numbers. During 2013 some of the minorities in South Africa and India were bought out, further reducing the impact of these interests in 2014.

### Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The gain on translation of £175m in 2014 compares to a loss in 2013 of £217m and is principally due to movements in the US dollar. A significant proportion of the Group's operations are based in the US and the US dollar strengthened in 2014 from an opening rate of £1 \$1.66 to a closing rate at the end of 2014 of £1 \$1.56. At the end of 2013 the US dollar had weakened in comparison to the opening rate moving from £1 \$1.63 to £1 \$1.66.

Also included in other comprehensive income in 2014 is an actuarial gain of £8m (after offsetting a £15m loss in respect of associates) in relation to post-retirement plans. This gain arises from changes in the assumptions used to value the liabilities and from returns on plan assets that are in excess of the discount rate. The gain compares to an actuarial gain in 2013 of £79m.

### Dividends

The dividend accounted for in our 2014 financial statements totalling £397m represents the final dividend in respect of 2013 (32.0p) and the interim dividend for 2014 (17.0p). We are proposing a final dividend for 2014 of 34.0p, bringing the total paid and payable in respect of 2014 to 51.0p, a 6% increase on 2013. This final 2014 dividend which was approved by the board in February 2015, is subject to approval at the forthcoming Annual General Meeting and will be charged against 2015 profits. For 2014, the dividend is covered 1.3 times by adjusted earnings.

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

### Post-retirement benefits

Pearson operates a variety of pension and post retirement plans. Our UK Group pension plan has by far the largest defined benefit section. We have some smaller defined benefit sections in the US and Canada but, outside the UK, most of our companies operate defined contribution plans. In addition to pension plans we also operate post-retirement medical benefit plans (PRMBs), the most significant of which is in the US. In 2014 we amended the eligibility criteria for the US PRMB plan. This amendment resulted in a curtailment gain and a reduction in the ongoing service cost of the plan.

The charge to profit in respect of worldwide pensions and retirement benefits for continuing operations amounted to £83m in 2014 (2013 £96m) of which a charge of £84m (2013 £93m) was reported in adjusted operating profit and an income of £1m (2013 charge £3m) was reported against other net finance costs. The reduced charge in 2014 is in part due to the US PRMB curtailment gain and also to a reduction in costs relating to our defined contribution plans.

The overall surplus on the UK Group pension plan of £86m at the end of 2013 has increased to a surplus of £190m at the end of 2014. The movement has arisen principally due to continuing asset returns and deficit funding which was only partially offset by an unfavourable movement in the discount rate used to value the liabilities. In total, our worldwide deficit in respect of pensions and other post-retirement benefits decreased from a net deficit of £56m at the end of 2013 to a net asset of £27m at the end of 2014.

#### Acquisitions and disposals

The acquisition of Grupo Multi, Brazil's leading adult English language training company, for £437m (plus £49m in net debt assumed) was announced in December 2013 and completed on 11 February 2014. There were no other significant acquisitions in the year. We recorded £240m of goodwill on the Grupo Multi transaction together with £254m of intangibles relating to trade names, content, franchises and technology. In total acquisitions completed in the year contributed an additional £70m of sales and £29m of adjusted operating profit.

The sale of the Mergermarket group of companies to BC Partners for £375m was completed on 4 February 2014 and realised a profit before tax of £244m. In addition our North America business disposed of its joint venture interests in Safari Books Online and CourseSmart, realising a profit before tax of £40m and its investment in Nook Media, realising a loss before tax of £38m.

#### Return on invested capital (ROIC)

Our ROIC is calculated as total adjusted operating profit less cash tax, expressed as a percentage of average gross invested capital. ROIC increased from 5.4% in 2013 to 5.6% in 2014. Increased profit and reduced tax payments are the main reasons for the movement.

#### Related party transactions

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

#### Post balance sheet events

There were no significant post balance sheet events.

## Principal risks and uncertainties

### Identifying and assessing risk

Our principal risks and uncertainties are outlined below. These are the most significant risks that may adversely affect our business strategy, financial position or future performance. The risk assessment process evaluates the probability of the risk materialising and the financial or strategic impact of the risk. Those risks which have a higher probability and significant impact on strategy, reputation or operations, or a financial impact greater than £40m are identified as principal risks.

The risk assessment and reporting criteria are designed to provide the board with a consistent, Group-wide perspective of the key risks. The reports to the board, which are submitted twice per year, include an assessment of the probability and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness.

The identification of the principal Group risks is informed by discussions with each Line of Business, Geography and key enabling functions, identifying key risks and assessing the adequacy of mitigating controls.

The Pearson executive members have oversight of risks relevant to each of their areas of responsibility. This is now included in their goals and objectives.

The audit committee provides oversight and reassurance to the board with regard to the procedures for the identification, assessment and reporting of risk. See page 71 for the committee's risk-related activities during 2014, including deep dives into selected principal risks.

Management is responsible for considering and executing the appropriate action to mitigate these risks whenever possible. It is not possible to identify every risk that could affect our businesses, and the actions taken to mitigate the risks described below cannot provide absolute assurance that a risk will not materialise and/or adversely affect our business or financial performance.

**Risk appetite** There are certain areas where we do not have any appetite to take risks, such as complying with laws on anti-bribery and corruption or the safety and security of learners. In other areas, such as strategy and change, we recognise the importance of managed risk-taking in order to achieve business objectives and goals. During 2015, further work is being done to define risk appetite and tolerance and to embed this more formally into decision making and day-to-day business activities.

### OUR PRINCIPAL GROUP RISKS

Outlined here are the most significant risks that may affect our future. We assess the probability of the risk materialising and the financial or strategic impact of the risk. The risks with greatest potential impact are identified as principal risks.

Learn more about Principal risks and uncertainties on p36-37 ➔

STRATEGY AND CHANGE	1	Government regulation and decisions
	2	Digital and services evolution and market forces
	3	Acquisitions, divestments and joint ventures
	4	Business transformation and change
	5	Talent
OPERATIONAL RISKS	6	Customer facing systems
	7	Testing failure
	8	Safety, safeguarding and protection
FINANCIAL RISKS	9	Tax
	10	Intellectual property
	11	Data privacy and cyber security
	12	Anti-bribery and corruption
LEGAL AND COMPLIANCE RISKS		

### Our principal risks

**Risk categories** To aid in the identification of risks and development of associated mitigating actions, risks are categorised into four main areas: strategy and change, operational, financial, and legal and compliance.

**Key changes to Group risks in 2014** As set out in the 'our performance' section, 2014 was a year of considerable change across the Group. These changes provide the foundation for significant mitigation of strategic and market risks, including the shift to digital and services. But with change there can be an increase in risk in the short-term. Additional governance and oversight was put in place to mitigate these change-related risks. As the new organisation structure stabilised, there was resulting clarity in roles and responsibilities. This, together with the appointment of management and staff to key positions, assisted in mitigating risk in a number of key areas.

With the increased focus on growing our direct delivery business activities, there has been a need to improve the effective management of related operational risks. This includes the safety and security of our learners, which is reflected as a new principal risk. Specific roles have been created and filled to ensure there is expertise to deal with these areas and this will continue to be a focus area in 2015.

With the accelerating shift to digital products, we continue to look at ways that we can improve our customers' experience of our products and services. This is particularly the case for products where there are periods of peak demand on our systems, such as 'back to school' times. A dedicated cross-business task force has been put in place to ensure that root causes are addressed and improvements implemented.

Learn more about Risk Governance on [p76](#) ➔

OUR BUSINESS

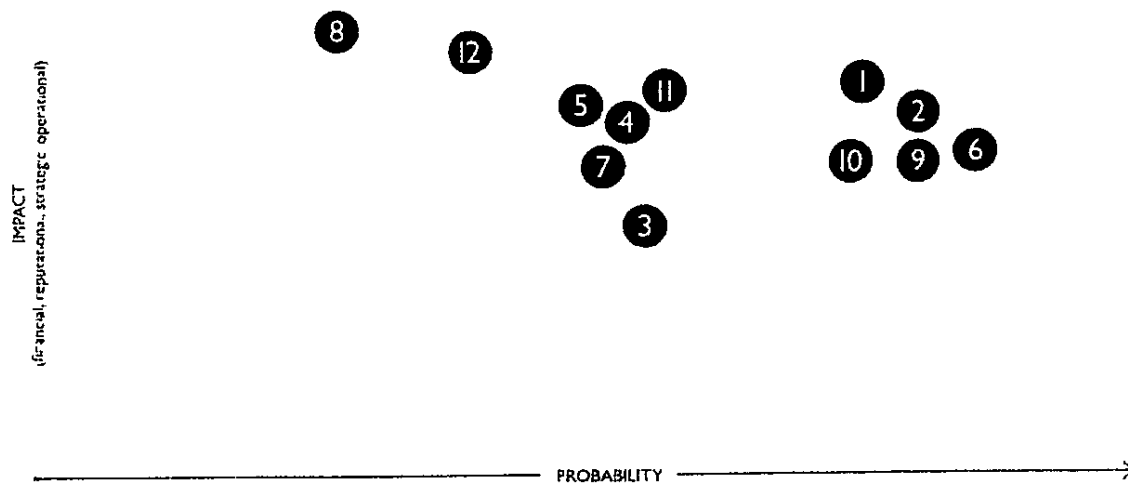
OUR PERFORMANCE

OUR SOCIAL IMPACT

GOVERNANCE

FINANCIAL STATEMENTS

### RISK ASSESSMENT



## Principal risks and uncertainties continued

STRATEGIC & CHANGE RISKS		
	Risk	Mitigation
1	Government regulation and decisions Changes in funding, policy and/or regulations impact business model and/or content decisions across all markets	<p>In the US we actively monitor changes through participation in advisory boards and representation on standard setting committees. Our customer relationship teams have detailed knowledge of each state market. We work through our own corporate affairs team and our industry trade associations including the Association of American Publishers. We are also monitoring municipal funding and the impact on our education receivables.</p> <p>In the UK we maintain relationships with those government departments and agencies that are responsible for policy and funding. We work proactively with them to ensure our programmes meet existing and new government objectives at the right quality level.</p> <p>Across all of our other markets, local management monitor and respond to potential and actual changes in regulations, supported by our global corporate affairs team. This includes Growth markets of China, India, Brazil and South Africa.</p>
2	Digital and services evolution and market forces. Failure to successfully invest in and deliver the right products and services	<p>Our global education strategy will drive a faster move to digital and services, recognising that this is a significant opportunity for Pearson, as well as a potential risk. We are transforming our products and services for the digital environment along with managing our print inventories.</p> <p>Our content is being adapted to new technologies across our businesses and is priced to drive demand. We develop new distribution channels by adapting our product offering and investing in new formats.</p> <p>As set out on page 38-43, our focus on efficacy is driving our decisions on how and where we invest in products and services.</p>
3	Acquisitions, divestments and joint ventures Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations could lead to goodwill and intangible asset impairments	<p>We perform pre-transaction due diligence and closely monitor actual performance to ensure we are meeting operational and financial targets. Any divergence from these plans will result in management action to improve performance and minimise the risk of any impairments. Executive management and the board receive regular reports on the status of acquisitions and mergers, with a formal review once per year.</p>
4	Business transformation and change The pace and scope of our business transformation initiatives increase the execution risk that benefits may not be fully realised, costs of these changes may increase, or that our business as usual activities do not perform in line with expectations	<p>As noted in the Chairman's introduction, the most difficult phase of our transformation has now been completed. There remain a number of important change initiatives in progress, such as the Enabling Programme which will deliver sustainable improvements in finance, human resources and operations. In addition to usual good practices in place for project and change management, there is enhanced governance, monitoring and reporting in place for these most significant change initiatives.</p>
5	Talent. Failure to attract, retain and develop staff, including adapting to new skill sets required to run the business	<p>Through the changes during 2013 and 2014, we have been successful in promoting our best internal talent and recruiting individuals who are global leaders in their specific field.</p> <p>As part of our transformation, we have made and continue to make improvements in a number of areas that are key to mitigating talent risk. These include: clear employee objectives and development plans; an all employee engagement survey with action plans as appropriate; succession planning and talent management; and competitive remuneration plans. See page 65 for details of the board's talent review.</p>
OPERATIONAL RISKS		
	Risk	Mitigation
6	Customer facing systems. Failure to maintain and support customer facing services, systems, and platforms including quality and timely execution of new products and enhancements	<p>Effective project management disciplines are in place to ensure that enhancements and new products meet the required standards. Real time monitoring and reporting of operational performance is used to identify any issues and direct appropriate responses.</p> <p>A Quality Task Force (QTF) is in place to oversee improvements to ensure our customers' experience is one that is expected from a digital business. This initiative has already delivered significant tactical improvements and is driving longer term, strategic improvements.</p>

OPERATIONAL RISKS		
Risk	Mitigation	
<b>7</b> Testing failure: A control breakdown or service failure in our school assessment and qualifications businesses could result in financial loss and reputational damage	We seek to minimise the risk of a breakdown in our student marking with the use of robust quality assurance procedures and controls and oversight of contract performance. Combined with our investment in technology, project management and skills development of our people	
Our professional services and school assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed	In addition to the internal business procedures and controls implemented to ensure we successfully deliver on our contractual commitments, we also seek to develop and maintain good relationships with our customers to minimise associated risks	
	We also look to diversify our portfolio to minimise reliance on any single contract	
<b>8</b> Safety, safeguarding and protection: Failure to adequately protect children and learners, particularly in our direct delivery businesses	Recognising the importance of managing evolving risks associated with our direct delivery business models, we created and filled the role of a head of safeguarding and protection. See page 49 for further details	
FINANCIAL RISKS		
Risk	Mitigation	
<b>9</b> Tax: Risk that changes in tax law or perceptions on tax planning strategies lead to higher effective tax rate or negative reputational impact	Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders in line with our broader fiduciary duties. We are committed to complying with all statutory obligations to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy	
	Oversight of tax strategy is within the remit of the audit committee, which receives a report on this topic at least once a year. All of the audit committee members are independent non-executive directors. The chief financial officer is responsible for tax strategy, the conduct of our tax affairs and the management of tax risk, all delegated to a global team of tax professionals	
LEGAL RISKS		
Risk	Mitigation	
<b>10</b> Intellectual property: If we do not adequately protect our intellectual property and proprietary rights, our competitive position and results may be adversely affected and limit our ability to grow	We seek to mitigate this type of risk through general vigilance, co-operation with other publishers and trade associations, advances in technology, as well as recourse to law as necessary. Digital rights management standards and monitoring programmes have been developed. We have a piracy task force to identify weaknesses and remediate breaches. We monitor activities and regulations in each market for developments in copyright/intellectual property law and enforcement and take legal action where necessary	
<b>11</b> Data privacy and cyber security: Failure to comply with data privacy regulations and standards or weakness in information security, including a failure to prevent or detect a malicious attack on our systems, could result in a major data privacy breach, causing reputational damage to our brands and financial loss	Through our global enterprise information security and compliance programme, we have established a governance model, security and privacy framework and policies, a global security and privacy organisational model and standard based information security and privacy controls and practices	
	We constantly test and re-evaluate our data security procedures and controls across all our businesses with the aim of ensuring personal data is secured and we comply with relevant legislation and contractual requirements. We pursue appropriate privacy accreditations, e.g. TRUSTe Privacy and Safe Harbor Seal. We regularly monitor regulation changes to assess the impact on existing processes and programmes. We have established a global security operations centre that provides ongoing monitoring of potential malicious attacks on our infrastructure and systems	
<b>12</b> Anti-bribery and corruption: Failure to effectively manage risks associated with compliance to global and local ABC legislation	Our ABC compliance programme was rolled out in 2011 to support compliance with UK Bribery Act, in line with 'adequate procedures' guidance. Our 'zero tolerance' approach is also designed to comply with all other global and local ABC laws and regulations. We have a risk-based programme of training (online and face-to-face). Our ABC policy is communicated to third parties and forms part of our contractual terms for higher risk third parties	

# Efficacy

## 1. Introduction

"A deceptively simple but incredibly powerful idea that every product we sell can be measured and judged by the outcomes it helps the learner to achieve" John Fallon, Chief executive

### Measuring outcomes

At the time of writing last year's Annual report, we had just announced a new commitment to what the company calls efficacy. The goal was simple, but also incredibly challenging: we would move to define measurable learner outcomes for Pearson products and services, and to report publicly on the learner outcomes delivered by our products in early 2018.

We were also extremely aware that efficacy in education is not a challenge we can tackle alone. We will need to share what we are finding out, and be prepared to listen to all the feedback. And we will need to be willing to learn from others as they pursue their own methods. We remain absolutely committed to this community approach.

### Review process and result

When we began, efficacy was merely a concept and a lofty goal. We had developed a framework which could evaluate the likelihood that a product or service will deliver its intended outcomes, and had designed a process to apply the framework within the Lines of Business via efficacy reviews. Since 2012, we have completed 200 reviews. This process has provided snapshots of the state of efficacy in different parts of Pearson, as well as what investments we need to make in order to move towards greater efficacy, at a product and service level.

### Reporting on efficacy progress

We are committed to reporting on learner outcomes by 2018. Published in 2013, *The incomplete guide to delivering learner outcomes* explained the programme and its transformative potential. The response was overwhelmingly positive from internal and external stakeholders, and over the past year we've made further strides. Alongside this Annual report, we are publishing *On the road to delivering learner outcomes* which reports this progress.

Read the reports online at  
efficacy.pearson.com

## 2. Making the change

### Developing our strategy

The commitment to efficacy has emerged as the central theme to Pearson's strategy and culture. Our employees are driven by the mission of helping learners make progress in their lives; it provides meaning to our work. There is also a clear business and commercial case for the learner-centric approach we are now taking to run our company. Pearson's scale means we are in the strongest position in the global market to evaluate the effectiveness of different educational products across many populations, and to develop and implement new evidence-based models. We are the first in the market to commit to reporting on product efficacy, and the first to engage outside partners who will independently validate the rigour and objectivity of our efficacy measurement. This feedback loop will make our products better and strengthen our relationships with customers and end learners, and will yield meaningful results for the business in the coming years. We also hope that through this approach we will influence the education sector more broadly.

### Embedding efficacy

Culture. We also know that our commitment to efficacy is much more than a strategy – to be truly effective it needs to become a way of working for every one of our employees. To make this happen we have put in place a global efficacy network of Pearson experts who are dedicated, most of them full-time, to embedding efficacy into the way we do business as a company. Their efforts will ensure all our employees are driven by the mission of helping learners to make progress in their lives. The team is matched to Pearson's new organisational structure: we have efficacy leaders in each global Line of Business as well as the

### Making the change in 2014

200

Efficacy reviews

20,150

Employees have engaged in efficacy training

88

Efficacy leaders across Pearson



Geographies, working cross-functionally to impact global and local product development and the way we market, sell and measure our products and services

**Training** Efficacy depends on the commitment of every employee – not only those occupying these new positions. So we have also rolled out broadscale efficacy training on the topic throughout the company. We have created an online course on efficacy, which was added to the new hire orientation package and is available to everyone in the company via our internal learning portal. Over 20,000 employees have taken the course. In addition, efficacy leaders are running workshops and trainings in person all over the world to build awareness and understanding.

**External engagement** We know that going this alone is not an option. The solutions to the efficacy challenge will emerge from many corners, from different professions, and also from different sectors. That's why we have continued our public engagements, to help play our part in this global community of changemakers. We partnered with the RSA in the UK on a series about learner outcomes, and contributed to the Shared Value Initiative's conference on the Role of Business in Education. We have emphasised efficacy in our presence at innovation events such as New School Venture Fund's annual conference and SXSWedu. Efficacy is also a central part of our commitment to the Global Partnership for Education, of which Pearson is the only corporate member; we will be offering in-kind workshops and efficacy reviews to member countries, and giving GPE members access to our growing body of research on learner outcomes.

#### LEADERSHIP: EFFICACY EXPERTS

"Efficacy is the reason why I work in education – long before I'd ever even heard of that word. As a South African, I live in one of the most wonderful but also one of the most unequal countries in the world. Everyday I am confronted with examples of how people have either benefited from a strong education or been severely disadvantaged by the lack of one. Through offering good quality education, with measurable improvement of learner outcomes, we can help bring about change."

Marion Smallbones  
Efficacy director, Schools

IMAGE REMOVED

"To me, efficacy means that we care enough about the customer experience and the trust they place in us, that we're willing to reorganise our company to make sure we deliver the outcomes we're promising. It means being personally accountable for my actions, and asking myself each day "How can I make a difference to students and teachers today?"

Karen Mullane  
Vice president, Efficacy results  
Pearson North America

IMAGE REMOVED

Learn about our operating structure on p7 ➔

"Before hearing about efficacy, I thought my job was just to drive, I thought, isn't it the same to be a truck driver who delivers books and a truck driver who delivers alcoholic drinks or tobacco?..."

IMAGE REMOVED

"... Now I realise my job has to do with education. I am a part of the educational process in my country. My children, and even my grandchildren, will be benefited by the job I do."

Juan Hernandez, a Pearson truck driver who participated in a workshop called Eficacia para todos facilitated by Veronica Valdes, Efficacy manager Latin America Hub

## Efficacy continued

### 3. Efficacy in action

Efficacy is changing the way we operate and develop our business, alongside our employees, customers, and the broader education market. We have early evidence of the impact of the products and services we deliver to customers.

#### Efficacy approach and activities

##### Define intended learner outcomes

Review products to ensure they are positioned to deliver on those outcomes, and put in place efficacy improvement programmes

Conduct research to measure the efficacy of products and feed insights back into product development

Support customers to effectively implement the products to get the best outcomes possible

##### Starting from outcomes

In 2014 we further defined the standards for these assessments of our products, creating a more detailed description of the outcomes Pearson products and services deliver as well as the relative strengths of different types of evidence used in our studies. The table opposite shows our proposed framework for the types of outcomes that customers desire

#### Efficacy review framework

Our efficacy framework examines different aspects of our product performance

1 Outcomes	2 Evidence
3 Planning and implementation	4 Capacity to deliver

Our efficacy framework is also being used by others (with our support) and their feedback has helped to refine it. View our online tool at [efficacy.pearson.com/our-path-to-efficacy/how-to-review](http://efficacy.pearson.com/our-path-to-efficacy/how-to-review)

#### Efficacy reviews, studies and implementation

Our efficacy review process provides a rigorous way to evaluate whether a given product or service is positioned to deliver learner outcomes and to identify how it should be improved. It is being used in every Line of Business (see framework below). Efficacy studies evaluate the efficacy of a product or service in the market, conducted in partnership with customers, learners, and increasingly third-party academic institutions. We are starting to work with customers to ensure that Pearson products and services are used and implemented in ways that maximise their efficacy based on this research.

#### Efficacy in the product lifecycle

Pearson products at all stages of maturity will be incorporating efficacy into their development via a formal global product lifecycle which is being rolled out across the business. New products or features will need to be justified by educational research supporting their design; products in growth mode will be gathering increasingly robust evidence that the product is improving learner outcomes and evolve accordingly. Mature products will continue to sustain and monitor efficacy evidence alongside financial metrics. Further, efficacy requirements are now incorporated into our acquisitions and investments processes, from the Pearson Affordable Learning Fund to traditional M&A.

#### Shaping Pearson products

In addition to the huge strides on culture and processes described above, we have a plan in place to quickly impact a range of Pearson products and to prepare the company to report publicly on efficacy in 2018.

#### Making the change in 2014

"We are enthusiastic supporters of the efficacy approach. In 2014 it became the way we work and plan. It's not a review process, it is a way of doing business"

IMAGE  
REMOVED

Caspar de Bono  
Managing Director, Financial Times B2B

## EFFICACY: TYPES OF OUTCOMES

Category	Level of aspiration and value	Definition	Example outcomes
<b>Access</b> The learner access and experience	Utility	The degree to which learners can access a product (e.g. access to technology and socio-economic access)  The level of learner satisfaction  The level of motivation and confidence that the learner gains	All learners can access digital learning materials from a personal computer, tablet or smart phone at anytime  Learners have a positive learning experience
<b>Completion</b> The timeliness of completion	Usage rhythm as designed	The progress that the learner makes through the course  The time taken to achieve the standard or competence	Learners complete course of work within one semester
<b>Achievement</b> The standard of achievement or level of competence	Competencies and skills achieved	Qualification gained The level of performance on a standardised test Course-specific competencies demonstrated The acquisition of specific skills	Learner earns a bachelor's degree  The learner will be able to demonstrate mastery of the English course material
<b>Progression</b> Learner progression	'Door unlocked'	Ability of learner to progress to next course of study, training or employment	Learner gets gainful employment in field of study

## Making the change in 2014

"A key client was delighted to hear about our interest in helping him focus on achieving the outcomes he had set. Although he wasn't used to having such a conversation with a publisher [his admission] he was very open about what they need to do with the various schools and programmes they manage. Through the course of our conversation, he made it clear that he wanted to build a new 'premier' partnership with us. What really struck me is how a conversation on efficacy and outcomes created an almost kid-in-a-candy-store response from such a seasoned executive."

"What really struck me is how a conversation on efficacy and outcomes created an almost kid-in-a-candy-store response."

Bruce Bergwall  
Business Development Director  
Higher Education

IMAGE  
REMOVED

## Efficacy continued

## 4. Early impact in 2014

### The first wave

In 2014 we identified a 'first wave' of products with which to initiate our work in efficacy. The list was chosen based on a set of business and efficacy criteria, including market position, product and data maturity, strategic importance, and the scale of customer base and revenue. The products and services represent a mix of geographies and target learner populations. They will be the focus of the first externally-audited efficacy report in 2018.

### Key achievements so far


We've achieved the following milestones in our timeline for impacting the full range of Pearson products and services:

All of the 'first wave' products have defined the learner outcomes they are positioned to deliver, as well as the metrics they will use to measure those outcomes.

Pearson products in all categories are steadily progressing through efficacy reviews, we are developing mechanisms for classifying and tracking products' progress on efficacy throughout the company next year.

A majority of the products which have undergone efficacy reviews are on the path to efficacy, meaning they are continually working to complete the actions identified during efficacy reviews to increase the efficacy of the product, are demonstrating progress on gathering efficacy evidence, and are refining their efficacy plans through follow-on reviews and dialogue with customers.

Each Line of Business has at least one 'first wave' product that is in a position to report on efficacy impact with a view towards external reporting in 2018. We are sharing these publicly alongside this Annual report.

Learn about our Lines of Business in our operating structure on p7 

### EFFICACY: PRODUCT PROGRESS IN 2014

As evidence of the progress we have made, we are publicly sharing details of efficacy progress for five of our products on an online site. This data is preliminary, we do not yet have fully validated evidence of outcomes with customers, because of the lead time that rigorous studies require. We are eager, however, to test early results with our customers and other stakeholders to inform the development of our research and reporting processes. We invite you to read the full reports at [efficacy.pearson.com/progress](http://efficacy.pearson.com/progress).

**enVisionmath 2.0** is a comprehensive next-generation elementary mathematics curriculum that has research-based instructional practices and is based on the highly successful enVisionMATH that reaches over six million learners. enVisionMATH users achieve significantly greater growth in math proficiency compared to other programmes as evidenced by an independent randomised control trial.

**Wall Street English** provides premium English language programmes for young professionals. In-depth efficacy reviews of operations were carried out in four countries and have led to a variety of improvements, from helping learners to better define their goals to measuring their progress against these.

**MyEnglishLab** provides learners in secondary school and higher education with interactive online practice, homework and assessments, and teachers with a range of diagnostic tools for English language blended-learning programmes. More than 450,000 new learners in 25 countries used MyEnglishLab in 2014. The efficacy review has led to a variety of improvements from UX to curriculum design. Efficacy studies were also completed with more than 25 institutions around the world.

**MasteringChemistry for General Chemistry** is an online homework tutorial and assessment programme serving up to 250,000 learners annually in the United States with 30,000 learners annually across 60 other countries. For seven years, our product team and the efficacy results team in North America have worked with educators to collect evidence about the impact of MasteringChemistry on learning and have generated 17 sets of user-generated results. In addition, several independent peer-reviewed academic articles have documented the efficacy of MasteringChemistry both in and outside the US. We are mobilising a wider set of efficacy activities in 2015 to support further product improvements and document impact on learner outcomes across a broader set of geographies.

**CTI and MGI** provide pathways for the emergent middle class to gain access to higher education in South Africa and the economic and personal advancement opportunities that this provides. Currently they serve 14,000 students across 12 CTI and 13 MGI campuses. Our efficacy efforts provide objective evidence of these opportunities to date and our ongoing efficacy programme is focused on constantly improving opportunities for our students and graduates.

## 5. Momentum

### Maintaining progress through 2015

We take the view that 2015 is a critical year for making progress on operationalising efficacy. Our priority will be on delivering efficacy in our strategic products, from end to end.

#### Key aims for 2015

1 The 'first wave' of products will continue to make demonstrable progress on the path to efficacy.

We are continually working to complete the actions identified during efficacy reviews to increase the efficacy of the product, demonstrating progress on gathering efficacy evidence, and refining their efficacy plans through follow-on reviews and dialogue with customers.

Read the first reports online at [efficacy.pearson.com/progress](http://efficacy.pearson.com/progress)

2 We will identify the next set of products to be the focus for efficacy efforts.

This will be the 'second wave', and the relevant teams will have identified clear outcomes to be delivered by their products, as well as having gone through efficacy reviews.

3 We will have evidence of increased awareness and adoption of efficacy internally.

This will cover all functions and geographies, and we will have reworked major internal processes to align with the efficacy agenda (including, for example, partnerships, acquisitions, and product strategy).

4 We will continue to increase the external awareness of efficacy.

through our ongoing work with stakeholders, and to promote the adoption of outcomes-based approaches to education in the market.

### A global research programme

A successful future for Pearson hinges on insight into – and response to – fundamental questions in education. For that reason, we are building global research capabilities. This will enable us to participate deeply in the worldwide conversation about learner outcomes, and to inform business leaders of effective educational practices.

In addition to efficacy studies and market research, which are based in business units, our new research capabilities will look into broad and global education themes, that could in turn drive specific product innovations.

The global research team will aim to uncover clear and replicable findings to eight key unanswered questions in education, ranging from the micro (how children learn) to the macro (how education systems work effectively).

Learn more at [research.pearson.com](http://research.pearson.com)

IMAGE REMOVED

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# Our social impact

The single most important contribution that Pearson can make to society is to equip people with the access and skills they need to progress. Our commitment to efficacy, (p38) is the means through which we will achieve this.

Learning empowers people, and it defines our company purpose. Acting responsibly is central to achieving this purpose and to our business strategy, and how we deliver is as important as what we achieve.

It shapes the decisions we make, the culture and values we promote and sustain, the relationships we foster, and the ways we treat our planet. Ultimately, operating responsibly helps us to better deliver outcomes for people, and to better meet the expectations of all of society.

IMAGE REMOVED

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

### Our social impact strategy

In 2014, we reviewed and redefined our social impact strategy. We have identified three organising ideas that structure our reporting.

#### Standards

Our standards work sees us continue to invest in our people and to work hard to reduce our environmental footprint.

#### Impact

We plan to make a significant contribution through campaigning and programme activity with a particular focus on literacy.

#### Innovation

Through innovation we will partner to help find solutions to some of the biggest unmet educational needs.

## Overview

Our commercial success is dependent on us operating in a responsible way. We report our approach and the progress we are making across five areas:

### Standards

1	Our responsibility	See p47 ➔
2	Our values and behaviour	See p48 ➔
3	Our relationships	See p49 ➔
4	Our planet	See p52 ➔
5	Our performance	See p53 ➔

### Also in this section

Impact Project Literacy	See p54 ➔
Social innovation	See p56 ➔

We will report on our progress in all these areas in our 2014 Social Impact report available on [pearson.com/social-impact](http://pearson.com/social-impact)

## Standards

### 1. Our responsibility

#### Definitions

Pearson has adopted a broad definition of responsible business and has established a set of commitments across a range of social, community and human rights principles to

Ensure that our products and services are inclusive, appropriate in content to the age, location and ability of the learner, and are easy and safe to use and access

Respect and protect how we use and share data entrusted to us by learners and our customers

Inform, support and equip colleagues to work collaboratively

Encourage and reward high performance, nurturing talent and creating a culture where all are able to realise their individual potential

Provide a safe and healthy workplace for our employees and the learners of all ages we directly serve

Extend our commitments on labour standards, human rights and environmental responsibility to include our suppliers and business partners

Provide opportunities for Pearson people to be good citizens and to get involved in their local communities

Deliver against our targets on our response to climate change and to make more efficient use of resources

### Responsibility at Pearson

#### Environment and supply chain

#### Climate change

#### Responsible resource use

#### Responsible procurement

Orange = part of our risk and compliance agenda  
See p71 ➔



Based on these commitments, the broad 'responsible business' issue map for Pearson is set out below. It reflects a series of priorities that are common across many sectors and individual companies. These are the issues that we focus on when thinking about responsible business.

Some of these issues are central to our business success, others may be small based on our commercial operations but have the potential to significantly affect our impact and reputation. The priorities in orange already form part of our risk and compliance agenda described on p71. The relative significance of issues varies based on country, operational, political and regulatory environments as well as learner expectations. The premise of our social impact strategy is that, in moving towards a single operating company model, this is underpinned by clear, consistent, global policies and standards across the entire responsible business agenda.

#### Governance

Corporate responsibility cannot be separated from our business and reputation. Our board of directors has ultimate responsibility for considering issues of responsibility as part of setting business strategy.

The reputation & responsibility committee, a formal committee of the board, provides ongoing oversight, scrutiny and challenge across the entire responsible business agenda. In addition, the board considered a detailed review of the corporate responsibility strategy at the June 2014 meeting. Learn more on p78 ➔

The Pearson executive drives implementation of business strategy, including our response to the key issues and opportunities we face.

This year, we established a single responsible business leadership business council to oversee the development and implementation of our overarching responsible business strategy on behalf of the board. It is chaired by our chief corporate affairs officer and comprises senior executives from across the global business.

#### Stakeholders

Public and private sector customers regularly seek information from us about how we go about our business, while many learners and employees want to understand our approach to sustainability. Socially responsible investors, and non-governmental organisations look at issues such as supply chain standards and ethics. Our approach to responsible business is informed by the priorities and views of our many stakeholders.

	People	Learners	Communities	Values and governance
	Corporate culture and values	Affordability and pricing	Active citizenship	Tax
	Diversity and inclusion	Editorial independence and integrity	Campaigns and partnerships	Ethical conduct (Code of Conduct)
	People recruitment and development	Appropriateness and accessibility of content	Political engagement	Combating corruption (Anti bribery and corruption)
	Remuneration and compensation	Safeguarding and protection		
	Health & safety	Data privacy and security		

## Standards continued

## 2. Our values and behaviour

### Pearson employee survey

In 2014, Pearson put in place a new organisational structure for the company that reflects our aim to shift from a portfolio of businesses towards a single operating model with standard systems, clear accountability, a flatter, more meritocratic culture and quicker decision-making

Change can be both exhilarating and inspiring, but also brings operational risk. We recognised this and throughout the year we continually tracked reaction to change to understand how best to support our people

Most notably, we asked colleagues to tell us how they felt about working at Pearson, and over 24,000 people completed the engagement survey. We then shared the findings. The key messages are outlined in the next column

### Code of Conduct

Our values are reinforced by our Code of Conduct that covers among other things, individual conduct, learners employees, community, the environment and our social obligations. We make sure everyone is aware of the Code and this forms part of the induction process. This year, we started a process to review the Code to make sure that it provides the level of guidance and case study support that our employees need to live by the standards we set for ourselves. The updated Code will be circulated early in 2015 to everyone working at Pearson and they will be asked to confirm they have read it, understand it and provide a check that the company complies with it

### Issues and concerns

We operate a free, confidential telephone helpline and website for anyone who wants to raise a concern and we have a clear non-retaliation policy in place to encourage people to share the issues they have. In 2014 we had 112 concerns raised through the ethics reporting process. These were investigated and where possible the outcome shared with the whistleblower. This year, as in most years, the majority of the concerns related to HR practices. Material concerns raised are reported to the Pearson audit committee

### Pearson employee survey Our people told us

1 That our purpose to empower human progress through learning was clear and compelling, and that our focus on efficacy is improving our products and services. Over 90% of our employees agreed that the work of Pearson to improve the lives of others was important to them. But, we could do more to be clearer about how we achieve that purpose and how it translates into every day planning and investment

2 That values and behaviour are critical to our success. We responded to feedback from the survey through a global programme of focus groups and consultation with the executive team to look at our current values to be brave, imaginative and decent in light of our organisational structure. Our aim was to understand how we could help our people to apply, bring alive and extend the values as the touchstone on how we behave, act and work together

3 That in this time of change, our leaders and managers could do more to communicate more often and more clearly their expectations of working together in a more joined-up way. We will set a performance goal for each Pearson executive member to improve on the results of the 2014 survey and will continue to support teams and support leaders to be role models for our values and behaviours as they embed new ways of working. Our performance assessment process has been identified as a means to embed our values and behaviours and help people create clear career paths

4 More work is needed to express how the new structure works and to challenge that it is helping deliver for learners. Consequently, we are doing more work on the Pearson brand to clarify who we are and how our products are effective at improving learning in ways that promote human progress

### 3. Our relationships

Helping learners to learn and progress is both the focus of our business strategy and the single most important contribution we can make to society.

#### Learners and customers

Our section on efficacy describes the commitments and progress we are making on our responsibilities towards the learner. A global challenge is to extend access to affordable quality education.

An important new way of working introduced this year is the Pearson product lifecycle framework for managing all Pearson products, services and platforms. This introduces a common language and vocabulary to help us take a view on investing in our products. This is part of a wider focus on product and customer experience that will allow us to better listen and respond to what our learners and customers need. As part of this approach, we introduced the Net Promoter Score system into Pearson, one of the most recognised methods for measuring customer loyalty. We used this to assess how customers viewed some of our most important products, along with a global brand survey through which we will measure ourselves annually.

As we increasingly own and operate learning institutions so we are active in serving learners of all ages including children, young people and vulnerable adults. This introduces new responsibilities to safeguard and protect

the best interests of our learners – providing a safe, supportive and age appropriate learning environment whether in a classroom or online. This year, we adopted a global policy on safeguarding and protection and appointed a new head of safeguarding to lead this important new area of work.

#### Our people

We continued our focus on our broader responsibilities as an employer. During the year:

We introduced for the first time a single global approach to performance assessment. This is designed to help our employees know what is expected of them and to incentivise people to act consistently with our values and business strategy. We cascaded goals from the top down with the executive team sharing their 2014 objectives with all employees.

We consolidated the use of Milo as our single platform to deliver training to provide access to learning and development, and to support performance assessment. This is the first time that Pearson has used a single platform for these activities.

Employees completed approximately 110,000 courses, with the new 'one Pearson – Exploring how we work' being the most popular. Through Milo we delivered a new global employee induction called 'Welcome to Pearson', popular programmes on 'Efficacy for Everyone', and a suite of management modules on performance conversations. Employees and managers also used Milo to record their individual goals, monitor their progress, and assess their performance.

#### Arizona State University – Starbucks – Pearson

In June, ASU and Starbucks announced a unique partnership to offer opportunities for the more than 100,000 Starbucks employees to access affordable higher education.

IMAGE REMOVED

ASU online offers Starbucks employees who work more than 20 hours a week affordable access to over 40 undergraduate degree programmes in a service powered by Pearson.

IMAGE REMOVED

100,000

Starbucks employees to access affordable higher education

40

Undergraduate degree programmes

## Standards continued

### 3. Our relationships continued

**2** As part of our commitment to helping our employees be safe, resilient and productive, we introduced a common global incident reporting system for health & safety. Our overall goal is to achieve zero harm to employees working hard through training and communication to prevent incidents before they occur. Our performance is reviewed by the audit committee.

**3** We made sure that our people understand how we are doing as a company, including how world and sector trends might affect them and the business. We provide comprehensive, relevant information including presentations, messages and webinars with senior executives and consult where appropriate so that we can learn and take into account the perspectives of our people. In developing our brand strategy, we opened a survey to all our employees with 13,000 sharing their views on the direction we should take.

#### Diversity and inclusion

We are committed to attracting, retaining, engaging and developing the best people. We know that creating and sustaining an inclusive work environment is critically important, offering equal opportunity from the boardroom down regardless of race, gender, gender identity or reassignment, age, disability, religion or sexual orientation.

On gender diversity, we continue to seek to support women to advance in management and senior roles. We remain an enthusiastic supporter of the 30% Club which brings together chairs and CEOs who work to

encourage a better gender balance across their companies. During 2014, we actively supported the Mentoring Programme set up by the 30% Club which provides talented mid-career women access to cross-company, cross-sector mentoring. At board level, Pearson appointed Elizabeth Corley as a non-executive director and has exceeded the target to have at least 25% female directors ahead of the 2015 timeframe set by Lord Davies.

We also supplemented the diversity toolkit launch last year by launching Women in Learning and Leadership (WILL), a global employee network in Pearson. To date, over 2,000 employees have joined as members of WILL chapters around the world. The ambition of the 12 chapters established in 2014 is to proactively drive change in support of women at Pearson.

At the end of 2014, 58% of our global workforce was female. Women represent 35% of our senior leadership team. The gender balance based on our organisational structure can be seen in the table below.

We continued to progress on supporting the Lesbian, Gay, Bisexual and Transgender (LGBT) community at Pearson. During 2014, Spectrum was launched as a global employee resource network dedicated to support the advancement of LGBT colleagues across Pearson. Pearson again received a perfect score of 100% in the 2014 Corporate Equality Index recognising excellence in corporate policies and practice in supporting LGBT employees in the US, administered by the Human Rights Campaign. In the UK, we are members of the Stonewall Diversity Champions programme.

#### Diversity performance (as at 31 December 2014)

Women in Pearson (%)	2013	2014
Board of Directors	22%	30%
Senior leadership team (two reporting lines from the CEO)	31%	35%
All employees	57%	58%

Employees by gender (number)	Men	Women
Board of Directors	7	3
Senior leadership team (two reporting lines from CEO excluding Executive Board Directors)	64	35
All employees	17,064	23,470

#### Community investment

IMAGE REMOVED

Disability forms part of our wider commitment to equal opportunity. We work to ensure that appropriate policies, procedures, training and support are available for people with disabilities to ensure fair access to career opportunities to realise their talent.

#### Supply chain and partners

Pearson purchases goods and services valued at over £2bn each year. This total includes our investment in research and development of new digital products and services as well as advances to authors. Pearson was a founder signatory to the UN Global Compact in 2000. We were clear from the outset that we would use our influence with our suppliers to improve standards for their employees and the communities in which they operate. Ever since, we have monitored our performance against both the Global Compact principles and a set of commitments we made to them, reporting annually on our progress. The scope of the UN Global Compact covers labour standards and human rights, combatting corruption as well as environmental responsibility. Specific clauses relating to these standards are an integral part of our contracts for key suppliers. These standards include the rejection of forced and compulsory labour, a respect for diversity, a minimum age to work on Pearson projects and compliance with employment laws and regulations.

#### Communities

Not for profit partners help us to extend our reach and impact helping further learning – especially for the most disadvantaged or hard to reach – in ways that are complementary to our business objectives. We therefore partner with a number of charitable organisations and for a decade, the Pearson Charitable Foundation has been the largest of these.

During 2014, we reviewed our community investment activity and concluded that we could greatly increase our impact by adopting a more integrated approach that places social impact at the heart of the business model. The Pearson board approved in June 2014 a new strategy which established increasing literacy rates worldwide as our anchor social impact campaign issue for the next five years. Our section on Project Literacy explains more about our new strategy. In 2014, our community investment was £14.4m, or 2% of pre-tax profits.

As part of this review, we assessed our existing charity partners and their fit with our new approach and strategy. A number of these, most notably, the Pearson Charitable Foundation, no longer align with our approach. Therefore, as of 2015, Pearson advised it would no longer fund the Foundation as the primary vehicle for its philanthropic and community activities. Having been informed of this change in its funding, in November the Foundation board of directors passed a resolution to wind down its operations and to close at the end of 2014. Pearson worked with the charity to ensure that new partners were found wherever possible for the Foundation programmes.

## Standards continued

## 4. Our planet

We believe that better education is crucial to building a better world. To be passionate about a better world goes further and we recognise a shared responsibility to protect the natural resources needed to deliver learning today.

### Climate change

Pearson continues to be climate neutral for our directly controlled operations, a commitment we first achieved in 2009 and have maintained ever since. We have set ambitious targets to reduce our operational emissions by the end of 2020 and we work with employees and suppliers to measure and reduce carbon emissions in our value chain – from sourcing of raw materials to the transport and distribution of our products.

We continue to maintain our commitment to climate neutrality through carbon reduction, purchase of renewable energy, renewable energy generation at our sites and the purchase of carbon offsets. We have also started working on a carbon footprint analysis of our book publishing in the US and UK to help us target the most effective reductions.

### Highlights of our activities include

Pearson retained global certification against the Carbon Trust Standard. We were the second ever organisation to secure the standard which recognises leadership in measuring, managing and reducing year-on-year carbon emissions.

We maintained our record of purchasing 100% of the electricity we use from green power. That represented over 186,000 MWh of electricity in 2014.

We opened a new solar installation at our distribution centre in South Africa. We now have invested in renewable energy generation at five sites and have 2.6 Megawatts of wind and solar assets installed.

Pearson is certified against ISO14001 in the UK and Australia. Our Hudson Street offices in New York became the latest to secure LEED certification, an internationally recognised mark of environmental excellence in facilities management. Pearson occupies 740,000 square feet in LEED certified buildings.

Pearson invests in forest-based carbon offsets for any part of our climate footprint we cannot reduce or avoid through other means. Since 2009, this programme has seen over 1,000 hectares of forest protected in Canada, Colombia, Costa Rica, the US and the UK.

Our approach to managing other materially important emissions – such as embedded carbon dioxide in purchased raw materials as well as business travel by air – are detailed in our 2014 Environment report.

### Environment highlights

↓22%

Our target was to reduce our operational emissions by 20% the end of 2015 based on a 2009 base year. We achieved a 22% reduction in 2014, in part due to the creation of Penguin Random House.

### ISO14001

Pearson is certified against ISO14001 in the UK and Australia.

### Green power

100%

We maintained our record of purchasing 100% of the electricity we use from green power.

IMAGE REMOVED

### Material use forests

As a purchaser of paper and newsprint for our books, magazines and newspapers, security and sustainability of supply are very important to us. Paper use remains a priority environmental issue and we continue to focus on sustainability sourcing and being more efficient in how we use paper. We

First adopted and publicly disclosed our paper environmental sourcing policy in 2003

Collect and map data on the forest of origin, certification systems applicable and recycled content for the papers we purchase

Talk about our guidelines with our key paper suppliers when we meet and as part of our contract discussions

Discuss our approach to paper purchasing with customers, environmental groups, investor analysts and other interested parties

Hold Forest Stewardship Council (FSC) chain of custody certification allowing books to carry the FSC label for our businesses in North America

Are members of industry bodies dedicated to responsible forest management. We have been members of the WWF forest and trade network for over a decade and are a founder member of PREPS – the publishers database for responsible environmental paper sourcing – which we use across our global business

Visit [pearson.com/environment](http://pearson.com/environment) to learn more ➔

## 5. Our performance

### Our social impact ranking

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

Index/year	2011	2012	2013	2014
Dow Jones Sustainability Indices	Global Sector leader	Gold Class	Silver Class	Bronze Class
BITC Corporate Responsibility Index	Platinum	Platinum (retained)	Platinum	Platinum (retained)
Inclusion in FTSE4Good	Yes	Yes	Yes	Yes

Pearson continues to score highly in the Dow Jones Sustainability Indices rating. For the last decade, we have been included in the DJSI World index which includes only the top 10% of companies in each industry and our bronze class rating recognises companies within 10% of the sector leader.

We welcome feedback on this aspect of the company as we do on any other. Please e-mail [peter.hughes@pearson.com](mailto:peter.hughes@pearson.com) with any questions or ideas you may have.

### Global Greenhouse Gas (GHG) emissions data (Metric tonnes of CO<sub>2</sub>e)

Emissions from	Calendar year 2013	Calendar year 2014
Combustion of fuel and operation of facilities (GHG Protocol scope 1)	30,170	25,027 -17%
Electricity, heat, steam and cooling purchased for own use (GHG Protocol scope 2)	115,548	104,715 -9%
<b>Total</b>	<b>145,718</b>	<b>129,742</b> -11%

**Carbon emissions** The scope 1 and scope 2 carbon emissions are calculated according to The Greenhouse Gas Protocol's Corporate Accounting and Reporting Standard (Revised Edition) together with the latest emission factors (this recognises 3 sources including, but not limited to DEPPA, the International Energy Agency and the US Environmental Protection Agency). No material scope 1 or scope 2 emissions have been excluded from the reported GHG emissions.

Intensity ratios	Calendar year 2013	Calendar year 2014
Scopes 1 and 2 (tonnes CO <sub>2</sub> e)/ sales revenue £ (millions)	28.1	26.6 5%
Scopes 1 and 2 (tonnes CO <sub>2</sub> e)/FTE	3.19	3.17 no change

## Impact:

Introducing our flagship campaign

### Project Literacy

Pearson is committed to maximising our impact through community investment. In 2014 we reviewed our approach and believe that we can make more of a difference by focusing and campaigning on a single issue that has the potential to transform lives.

A clear focus will allow us to inspire our people to get involved, to harness our products and expertise and to build partnerships and programmes that make a measurable difference

In June 2014, the Pearson board approved increasing literacy rates worldwide as our anchor social impact campaign issue for the next five years

#### Why literacy?

As we fight to end poverty, literacy is critical. With words we can make sense of the world around us, pursue life changing opportunities and stand up for the rights of others to do the same

Despite rapid progress in the decade prior, illiteracy rates for adults and children worldwide have hovered at around 800 million since 2000, with 781 million people illiterate today. Of those, 123 million are young people under the age of 24

We know too that basic literacy is only part of the story. The skills that individuals and economies need to progress and to prosper grow increasingly complex in the face of technology. Functional illiteracy costs the world \$1.19 trillion per year – equivalent to the GDP of South Korea or Mexico

#### Campaign goals

Project Literacy sets out to help make this the last generation to be held back by poor literacy. The new Sustainable Development Goals, due to be signed at the United Nations General Assembly in September 2015, will set ambitious goals for education for the next 15 years. We believe that it is within reach to ensure that by 2030, every child born can grow up to be a literate adult. Furthermore, achieving this will be core to the success of the other development goals

#### Pearson's contribution

Literacy is an area of need where we see clear overlap between the opportunity for impact and Pearson's products, expertise and networks. We have significant experience in providing resources to communities around the world that help improve reading and writing skills. Our longstanding heritage in publishing and the history of our community investment makes ending global illiteracy stand out for Pearson as an area in which we can contribute a mix of product, content, employee time, energy and interest to drive impact

#### Global demand for literacy

IMAGE REMOVED

60m

children are not in primary school

781m

people are illiterate today

IMAGE REMOVED

IMAGE REMOVED



We envisage Pearson's contribution in three broad categories

**1** We have a role to play in energising the debate around literacy. We will act to identify, celebrate and support good practice to scale, invest in research to uncover new opportunities and to increase the prominence of literacy in national and international policy discourse.

**2** We have a responsibility to activate our own business assets and influence towards the thematic and geographic areas where we see opportunity to improve literacy. We will place an emphasis on supporting our employees to participate and contribute to literacy initiatives around the world, with the aim of launching a number of these opportunities midway into 2015.

**3** We will invest in partnerships that pursue new innovations in literacy. Where relevant, our product development will also take account of and seek to address barriers presented by poor literacy.

#### Progress in 2014

Our Project Literacy campaign kicked off in late September with a global listening and awareness raising exercise hosted on [projectliteracy.com](http://projectliteracy.com). We invited individuals and organisations already working to improve literacy to highlight publicly on the website the programmes and projects which inspire them.

We also asked that they share issues where increased action is needed and contribute to our goals by issuing a challenge to us. To date, we've received 181 inspiring literacy submissions via the website.

These projects and challenges are fundamental to informing the new activities, investments and partnerships which we will be announcing in the course of 2015 and beyond. Over time, [projectliteracy.com](http://projectliteracy.com) will act as the one-stop shop for the campaign as a whole -- sharing research, partnerships and reporting on impact.

In late 2014 we kicked off a first partnership with GOOD is GOOD. The partnership has begun by issuing literacy related stories and engaging non-profit organisations who understand the challenges of literacy. It will also bring together Pearson employees and local communities in volunteer work.

Literacy is an issue on which many different not for profit, community and commercial organisations are already working hard to make a difference. As part of this campaign we will bring the private and public sectors together with a single ambition to accelerate progress and test new ideas.

Visit [projectliteracy.com](http://projectliteracy.com) to learn more ➔

#### Taking literacy to the next level

Our new social impact campaign – Project Literacy – builds on existing community activity.

Jumpstart's Read for the Record saw more than 2.3 million adults and children join together to read *Bunny Cakes* by bestselling author and illustrator, Rosemary Wells.

IMAGE REMOVED

IMAGE REMOVED

Read for my School doubled its participation rates on the previous year, with 212,000 pupils across England together reading 876,000 books. The competition encourages pupils to read as many books as possible in a two month period drawing from an online free library of books offered by Pearson and Penguin Random House.

IMAGE REMOVED

We helped Book Aid International support the development of libraries in schools and communities across sub-Saharan Africa. We were the largest donor, giving a third of the 1 million books supplied by the charity this year.

For 2015 we will review how we report on our community partnerships in light of our new approach.

## Social innovation

Extending access to quality education to the poorest and most marginalised families is a challenge, particularly in the most deprived countries of the world. Pearson is committed to playing our part and is active in helping shape and inform the global debate around education and learning policy. We represent the private sector and charitable foundations on the board of the Global Partnership for Education (GPE). Along with representatives from developing countries and donor governments, the GPE aims to strengthen education systems in developing countries. We also continue to champion the role of the private sector in education as a founder member of the Global Business Coalition for Education.

Learn more about these activities at

➔ [www.globalpartnership.org](http://www.globalpartnership.org)

➔ [www.gbc-education.org](http://www.gbc-education.org)

Key to our social innovation approach is our belief that commercial solutions can accelerate access to quality education. Uncovering, developing and scaling solutions, especially in places where education standards fall well behind the best in the world, can require us to challenge the way we think about our business.

Commercial solutions might involve new business models, investing in new technology, or testing innovative partnerships or distribution channels.

### Social innovation in practice – the Pearson Affordable Learning Fund

The Fund launched in 2012 with \$15 million of capital. It supports education for students from the poorest and most marginalised families and sets improvements in learning outcomes and market-based returns as conditions of continued investment. The Fund has already invested in innovative education start-ups in South Africa, Ghana, India, and the Philippines. Half of the Fund is currently invested in companies with female CEOs.

In January 2015 we announced a new \$50 million investment, through which we expect to reach millions of additional students and young people by 2020.

In addition – by providing financial backing, good governance, and operational support to education entrepreneurs – the Fund aims to foster and scale innovation throughout Africa, Asia and Latin America. It is also enabling innovation from which governments can learn, the cost per student in the schools in the Fund portfolio is generally lower than in government schools.

### Pearson Affordable Learning Fund (PALF)

In December 2013 the Pearson Affordable Learning Fund made a \$300,000 investment in Avanti. Founded in 2010, Avanti helps to prepare students from low income backgrounds in India (those with an annual family income of \$5,000 or below) for college entrance exams, focusing on the highly competitive career paths of engineering and medicine. Avanti's approach emphasises peer learning, which takes the form of small group work and concept tests. Alongside our financial investment, we have supported Avanti by reviewing their curriculum and content, teacher

training and helping to appoint a new board and implement a new governance structure. The results thus far have been extremely impressive – over 40% of Avanti's students placed in the top 1% on the IIT JEE examination in 2013 and 2014, with 100% placing in the top 20%. The IIT entrance exam is considered the world's most competitive, with over 500,000 students taking the exam each year for a university system with only 10,000 annual seats. Avanti costs are less than 25% of those traditional classes, with students charged only \$30 per month.

IMAGE REMOVED

Learn more at [avantifellows.org](http://avantifellows.org) ➔

# Governance report

OUR BUSINESS

OUR PERFORMANCE

OUR SOCIAL IMPACT

GOVERNANCE

FINANCIAL STATEMENTS

## What's in this section?

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Note: This section constitutes our directors' report as required by UK legislation

# Governance overview

from Glen Moreno, Chairman

IMAGE REMOVED

Clear board roles and governance processes offer balance and experience to our strong, focused executive team, helping to drive strategic and performance progress.

## In this Governance section

LEADERSHIP & EFFECTIVENESS	p60-69 ➔
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Dear shareholders,

As you may have already seen elsewhere in this report, 2014 was a year in which we completed the restructure of Pearson, laying the foundations to strengthen our position as the world's largest education company and embedding efficacy into all we do. I would like to take this opportunity to share with you some insights as to how our board and governance framework has operated and evolved throughout the year to complement our transformation. Learn more about our Transformation on p4-9 ➔

## Governance principles

**Our role and activities** As a board we organise our work around four major themes where we believe we can add value: governance, strategy, business performance and people. Our board calendar and agenda provide ample time to focus on these themes and we have set out some examples of the business considered by the board, as well as the governance practices to which we adhere, on the pages that follow. Learn more about Board meetings and activities on p63 ➔

**UK Corporate Governance Code** This year, as is required, we are reporting against the 2012 edition of the UK Corporate Governance Code (the Code). The board believes that during 2014 the company was in full compliance with the Code. See page 73 for our position on audit tendering and rotation. A detailed account of the provisions of the Code can be found on the FRC's website at [www.frc.org.uk](http://www.frc.org.uk) and we encourage readers to view our compliance schedule on the company website at [www.pearson.com/governance](http://www.pearson.com/governance).

## Board and management

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

**Board changes** As is best practice, we continually assess and refresh the board to ensure we maintain an appropriate balance and diversity of skills and experience. We will soon bid farewell to two trusted advisers, David Arculus and Ken Hydon, who have signalled

their intentions to stand down from the board at the upcoming Annual General Meeting (AGM) having each served the company for nine years. We will miss their wise counsel and rigour as chairmen of the remuneration and audit committees respectively, and we thank them for their service to Pearson.

During the past year we have also welcomed two new non-executive directors to our board. Elizabeth Corley joined us in May 2014 and in January 2015 we welcomed Tim Score. I am delighted to say that Elizabeth and Tim are to be appointed as our new remuneration and audit committee chairmen respectively, following the AGM in April 2015. Between them, Elizabeth and Tim bring a wealth of business, finance and technology experience to Pearson's board, and will no doubt contribute fresh perspectives to the board's deliberations. Learn more about our Board of directors on p60-61 ➔

**Board and executive structure and balance** Our board consists primarily of non-executive directors, who bring a strong independent viewpoint, complementing the executive perspectives of John Fallon and Robin Freestone. In addition, we invite the Pearson executive to attend a number of the board's sessions to bring insights and thoughts from across the business. Learn more about the Pearson executive on p9 ➔

**Board evaluation** During 2014 we undertook an externally-facilitated board evaluation process. As always, this assists us in identifying opportunities to refine our processes, but the overall findings reflected a board which functions well, is fit for purpose and which has a strong sense of collegiality and support – something which has served us well through our two-year transformation. Learn more about the Board evaluation on p67 ➔

**Accountability** See full section on p70-77 ➔

Throughout our transformation, our audit committee has played a vital role in overseeing both risk and reporting matters. Our refocused business has seen the introduction of a new financial reporting structure along the lines of our primary geographic markets, and our shift towards digital, services and emerging markets has brought new opportunities and risks – strategic, operational and financial. Learn more about our Principal risks and uncertainties on p34 ➔

**Engagement** See full section on p78-81 ➔

Engagement with shareholders and society as a whole is key to Pearson's mission to help people make progress in their lives through learning. During the year, recognising this, we formalised our reputation & responsibility committee, headed by Vivienne Cox, whose focus includes our reputation with stakeholders (including investors and the education community) and oversight of Pearson's public commitments to society. We also welcomed a number of shareholders to our Annual General Meeting which, as always, was a valuable opportunity for our board and senior management to respond to shareholders' views and questions.

**Remuneration** See full section on p82-106 ➔

Our remuneration policy was reviewed last year to align with the company's strategy and organisation and was approved by shareholders at the 2014 AGM. We continue to operate executive remuneration in line with the approved policy and at present do not anticipate seeking shareholder approval for our policy again until required to do so at the 2017 AGM.

This year's report on directors' remuneration refers to the changes we made in line with policy in 2014 to better align executive director compensation with the interests of our shareholders and, to put our report into context, contains a summary of the approved directors' remuneration policy report from 2013 which is not subject to a vote. The report also deals with the significant minority vote against the 2013 annual remuneration report which the company received at the 2014 AGM.

#### Conclusion

I hope this report clearly sets out how your company is run, and how we align governance and our board agenda with the strategic direction of Pearson. We always welcome questions or comments from shareholders, either via our website ([www.pearson.com](http://www.pearson.com)) or in person at our Annual General Meeting.

IMAGE REMOVED

Glen Moreno Chairman

# Leadership & effectiveness

## Board of directors

### Chairman

IMAGE REMOVED

**Glen Moreno** Chairman  
aged 71 appointed 1 October 2005

Chairman of the nomination committee and member of the remuneration committee

Glen has more than four decades of experience in business and finance and is currently non-executive director and chairman designate of Virgin Money Holdings (UK) plc and non-executive director of Fidelity International Limited. He is also a senior adviser to HSBC and chairman of the Global Leadership and Technology Exchange leadership board. Previously Glen was deputy chairman of The Financial Reporting Council Limited in the UK, deputy chairman and senior independent director at Lloyds Banking Group plc, senior independent director of Man Group plc and acting chairman of UK Financial Investments Limited, the company set up by HM Treasury to manage the government's shareholdings in UK banks.

### Executive Directors

IMAGE REMOVED

**John Fallon** Chief executive  
aged 52 appointed 3 October 2012

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

IMAGE REMOVED

**Robin Freestone** Chief financial officer  
aged 56 appointed 12 June 2006

Robin's experience in management and accounting includes a previous role as group financial controller of Amersham plc (now part of General Electric) and senior financial positions with ICI plc, Zeneca and Henkel UK. He was also a non-executive director and founder shareholder of eChem Limited until May 2014 when the company was sold. Robin joined Pearson in 2004 as deputy chief financial officer and became chief financial officer in June 2006. He qualified as a chartered accountant with Touche Ross (now Deloitte), and currently sits on the Advisory Group of the ICAEW's Financial Reporting Faculty and was, until December 2014, chairman of The Hundred Group of Finance Directors. He also sits on the CBI's Economic Growth board.

### Non-executive Directors

Pearson board members bring a wide range of experience, skills and backgrounds which complement our strategy.

Digital experience  
50%

IMAGE REMOVED

Emerging market experience  
25%

IMAGE REMOVED

Education/learning sector experience  
50%

IMAGE REMOVED

Note: Graphic illustrates experience of non-executive directors

IMAGE REMOVED

**Ken Hydon** Non-executive director  
aged 70 appointed 28 February 2006

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

Ken's experience in finance and business includes working in the electronics, retail, consumer products and healthcare sectors. He is non-executive director of Reckitt Benckiser Group plc, one of the world's leading branded consumer goods companies in health, hygiene and home. He is also a non-executive director of Merlin Entertainment plc, the world's second largest visitor attraction operator. From 2004 to 2013 he was a non-executive director of Tesco plc. Previously, Ken was chief financial officer of Vodafone Group plc, the multinational telecommunications company and financial director of subsidiaries of Racal Electronics.

IMAGE REMOVED

**Josh Lewis** Non-executive director  
aged 52 appointed 1 March 2011

Member of the nomination and remuneration committees

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

## Non-executive Directors

IMAGE REMOVED

David Arculus Non-executive director  
aged 68 appointed 28 February 2006

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

David has experience in banking, telecommunications and publishing in a long career in business. Currently he is chairman of Energy UK and Hassium Asset Management and is a member of council of Cranfield University. David's previous roles include the chairmanship of Aldermore Bank plc, Numis Corporation plc, O2 plc, Severn Trent plc, IPC Group and the advisory board of the British Library, as well as chief operating officer of United Business Media plc, group managing director of EMAP plc and a non-executive director of Telefonica SA. David served from 2002 to 2006 as chairman of the UK government's Better Regulation Task Force, which worked on reducing burdens on business.

IMAGE REMOVED

Elizabeth Corley, CBE Non-executive director  
aged 58 appointed 1 May 2014

Member of the nomination and remuneration  
committees

Elizabeth is chief executive officer of Allianz Global Investors, one of the world's leading investment organisations. She was previously at Merrill Lynch Investment Managers and Coopers & Lybrand. Elizabeth is a member of the board of the Investment Association, a member of the European Securities and Markets Authority's stakeholder group, an advisory council member of The CityUK and is non-executive director of the Financial Reporting Council in the UK. She is also a member of the management committee of the Forum of European Asset Managers, a member of the CFA Future of Finance Council and a member of the Committee of 200. Elizabeth was appointed Commander of the Order of the British Empire (CBE) in the 2015 New Year Honours for services to the financial sector. She is also a fellow of the Royal Society of Arts and an accomplished crime fiction author.

IMAGE REMOVED

Vivienne Cox Senior independent director  
aged 55 appointed 1 January 2012

Chairman of the reputation & responsibility  
committee and member of the audit,  
nomination and remuneration committees

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years, in Britain and Continental Europe, in posts including executive vice president and chief executive of BP's gas, power and renewables business and its alternative energy unit. She is non-executive director of Stena International and of energy company BG Group plc and chairman of the supervisory board of Vallourec, which supplies tubular systems for the energy industry. She is also lead independent director at the UK Department for International Development. Vivienne is a commissioner of the Airports Commission, which was set up by the UK government to examine any requirements for additional UK airport capacity.

IMAGE REMOVED

Linda Lorimer Non-executive director  
aged 62 appointed 1 July 2013

Member of the audit, nomination and  
reputation & responsibility committees

Linda has a deep background in education, strategy, administration and public affairs. She is vice president for Global & Strategic Initiatives at Yale University, where her duties include oversight of Yale's Office of International Affairs and Office of Digital Dissemination. Over a 30 year career in higher education, she has been responsible for many of Yale's administrative services including the university's public communications, alumni relations and Office of Sustainability. Previously, Linda served as president of Randolph Macon Woman's College in Virginia and had earlier worked at Yale in several senior roles including associate provost. She is a non-executive director of Save the Children (US) and was chair of the board of the Association of American Colleges and Universities.

IMAGE REMOVED

Hansh Manwani Non-executive director  
aged 61 appointed 1 October 2013

Member of the nomination and reputation &  
responsibility committees

Hansh has an extensive background in emerging markets and senior experience in a successful global organisation. He was previously chief operating officer of consumer products company Unilever, having joined the company in 1976 as a marketing management trainee in India, and held senior management roles around the world, including North America, Latin America, Europe, Africa and Asia. He is non-executive chairman of Hindustan Unilever Limited in India and serves on the boards of Wipro Corporation, Qualcomm Inc. and Nielsen NV. He is also on the board of the Indian School of Business and the Economic Development Board (EDB) of Singapore.

IMAGE REMOVED

Tim Score Non-executive director  
aged 54 appointed 1 January 2015

Member of the audit and nomination  
committees

Tim has been chief financial officer of ARM Holdings plc, the world's leading semiconductor IP company, for 13 years, with extensive experience of the technology sector and in both developed and emerging markets, particularly China. He is an experienced non-executive director and currently sits on the board of The British Land Company plc. He served on the board of National Express Group plc from 2005 to 2014, including time as interim chairman, and six years as the senior independent director. Earlier in his career, Tim held senior finance roles with Rebus Group, William Baird BTR plc and others.

# Leadership & effectiveness

## Board governance

### Board of directors

**Composition of the board** The board currently consists of the chairman, Glen Moreno, two executive directors including the chief executive, John Fallon, and eight independent non-executive directors. Following the 2015 AGM, the board will consist of six independent non-executive directors, following the retirement of David Arculus and Ken Hydon.

**Chairman and chief executive** There is a defined split of responsibilities between the chairman and the chief executive. The roles and responsibilities of the chairman and chief executive are clearly defined, set out in writing and reviewed and agreed by the board annually.

**Chairman's significant commitments** During the course of 2014, the chairman stepped down from his position as deputy chairman of the Financial Reporting Council, and with effect from 1 January 2015 has been appointed as a non-executive director and chairman designate of Virgin Money Holdings (UK) plc.

**Independence of directors** All of the non-executive directors who served during 2014 were considered by the board to be independent for the purposes of the Code.

The board reviews the independence of each of the non-executive directors annually. This includes reviewing their external appointments and any potential conflicts of interest as well as assessing their individual circumstances in order to ensure that there are no relationships or circumstances likely to affect their character or judgement. In addition to this review, each of the non-executive directors is asked annually to complete an independence questionnaire to satisfy requirements arising from Pearson's US listing.

The board has in particular considered the independence of David Arculus and Ken Hydon who have each now served for nine years. It is the intention of both David and Ken to retire as directors at the 2015 AGM, but nevertheless the board believes that both directors continue to provide sufficient challenge to the deliberations of the board as a whole, and that they are sufficiently independent in character and judgement to continue to serve as independent non-executive directors for the remainder of their terms.

### Key roles

ROLE	NAME	RESPONSIBILITY
Chairman	Glen Moreno	The chairman is primarily responsible for the leadership of the board and ensuring its effectiveness.
Chief executive	John Fallon	The chief executive is responsible for the operational management of the business and for the development and implementation of the company's strategy as agreed by the board and the Pearson executive.
Senior independent director	Vivienne Cox	<p>The senior independent director's role includes meeting regularly with the chairman and chief executive to discuss specific issues, as well as being available to shareholders generally if they should have concerns that have not been addressed through the normal channels.</p> <p>The senior independent director has responsibility for appraising the performance of the chairman, including in relation to the effectiveness of the nomination committee, as part of the annual board evaluation process. The senior independent director would be expected to chair the nomination committee in the event that it was considering succession to the role of chairman of the board.</p>

### Gender split of the board

■ Men	7
■ Women	3

Figures as at 31 December 2014

Following 2015 AGM, split will be 6:3

IMAGE  
REMOVED

### Length of tenure of non-executive directors

■ Under 3 years	1
■ 3 to 6 years	2
■ 7 years or more	2

Figures as at 31 December 2014

Following 2015 AGM, ratio will be 4:2:0

IMAGE  
REMOVED



**Conflicts of interest** Under the Companies Act 2006 (the Act), directors have a statutory duty to avoid conflicts of interest with the company. The company's articles of association (Articles) allow the directors to authorise conflicts of interest. The company has established a procedure to identify actual and potential conflicts of interest, including all directorships or other appointments to, or relationships with, companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Once notified to the chairman or company secretary, such potential conflicts are considered for authorisation by the board at its next

scheduled meeting. The relevant director cannot vote on an authorisation resolution, or be counted in the quorum in relation to the resolution relating to his/her conflict or potential conflict. The board reviews any authorisations granted on an annual basis.

#### Board meetings

The board held six full scheduled meetings in 2014, with discussions and debates focused on the key strategic issues facing the company. Major items covered by the board in 2014 are shown in the table below.

#### Board meetings during the year 2014

Feb 2014 London	Apr 2014 London	Jun 2014 Washington DC	Jul 2014 London	Oct 2014 London	Dec 2014 New York
ANNUAL GENERAL MEETING - 25 APRIL 2014					
<b>GOVERNANCE</b>					
<ul style="list-style-type: none"> <li>Annual review of authorised conflicts of interest</li> <li>Review of division of responsibilities between chairman and chief executive</li> </ul>	<ul style="list-style-type: none"> <li>Focus on forthcoming AGM and review of shareholder issues</li> </ul>	<ul style="list-style-type: none"> <li>Brand reputation and US government policy <a href="#">Read more on p78</a></li> </ul>		<ul style="list-style-type: none"> <li>Update on Pearson Foundation</li> </ul>	<ul style="list-style-type: none"> <li>Approval of committee terms of reference</li> <li>Enterprise risk management review</li> <li>Approval of schedule of authority limits</li> </ul>
<b>STRATEGY</b>					
<ul style="list-style-type: none"> <li>2014 operating plan</li> <li>Review of transformation to date and plans for 2014</li> </ul>	<ul style="list-style-type: none"> <li>Update on new organisational and product strategy approach</li> <li>Pearson Technology - view from new chief information officer</li> </ul>	<ul style="list-style-type: none"> <li>Overview of US business</li> </ul>	<ul style="list-style-type: none"> <li>Strategic plan update</li> <li>Systems, supply chain and procurement</li> </ul>	<ul style="list-style-type: none"> <li>Strategic offsite meeting focusing on:</li> <li>Geographies and Lines of Business strategic reviews including post acquisition reviews</li> <li>Focus sessions - Financial Times and UK education</li> <li>Technology deep dive</li> </ul>	<ul style="list-style-type: none"> <li>Penguin Random House review</li> <li>Business portfolio and transaction update</li> </ul>
<b>PERFORMANCE</b>					
<ul style="list-style-type: none"> <li>2013 report and accounts and dividend recommendation</li> </ul>	<ul style="list-style-type: none"> <li>Review of investor relations strategy and share price performance</li> <li>Trading update</li> </ul>		<ul style="list-style-type: none"> <li>Interim results and dividend approval</li> </ul>	<ul style="list-style-type: none"> <li>Trading update</li> </ul>	<ul style="list-style-type: none"> <li>Trading update and preliminary view of 2015</li> </ul>
<b>PEOPLE</b>					
<ul style="list-style-type: none"> <li>Review remuneration committee recommendations</li> </ul>		<ul style="list-style-type: none"> <li>Rising Stars breakfast <a href="#">Read more on p65</a></li> </ul>	<ul style="list-style-type: none"> <li>Organisational design and structure</li> </ul>	<ul style="list-style-type: none"> <li>Rising Stars breakfast <a href="#">Read more on p65</a></li> </ul>	<ul style="list-style-type: none"> <li>Talent review</li> </ul>

In addition to its six formal meetings, the board held one further meeting in February 2014 to approve the 2013 preliminary results and to make its determination that the 2013 Annual report was fair, balanced and understandable. The board also undertook discussions throughout the year, as required, to consider the progress and terms of corporate transactions.

## Leadership & effectiveness

### Board governance continued

#### The role and business of the board

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

A schedule of formal matters reserved for the board's decision and approval is available on our website, at [www.pearson.com/governance](http://www.pearson.com/governance).

The board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive board papers are circulated to the board and committee members at least one week in advance of each meeting and the board receives regular reports from the chief executive. In addition to meeting papers, a library of current and historic corporate information is made available to directors electronically to support the board's decision-making process. Directors can obtain independent professional advice, at the company's expense, in the performance of their duties as directors. All directors have access to the advice and services of the company secretary.

Non-executive directors meet with local senior management every time board and committee meetings are held at the locations of operating companies, such as during the board's 2014 trip to Washington, DC. This allows the non-executive directors to share their experience and expertise with senior managers as well as allowing them to better understand the abilities and motivations of senior management, which in turn will help them assess the company's prospects and plans for succession.

#### Standing committee

A standing committee of the board has been established to approve certain ordinary course of business items such as banking matters, guarantees, intra-Group transactions and routine matters relating to employee share plans.

The committee has written terms of reference, reviewed and approved each year, which clearly set out its authority and duties. These can be found on the company website at [www.pearson.com/governance](http://www.pearson.com/governance).

#### Culture and values of the board

As part of its annual evaluation, the board considered its own culture and dynamics, and how these have evolved alongside the wider transformation.

The board agreed that it has a real sense of collegiality, with an open and transparent approach where diversity of opinion and challenge are encouraged and welcomed. As a whole and at an individual level, the board feels wholly committed to Pearson's values and mission, and throughout 2014 has received regular updates on the transformation as it has progressed. Learn more about our Board evaluation on p67 ➔

#### Board attendance

The following table sets out the attendance of the company's directors at scheduled board meetings during 2014.

	Board meetings attended
Chairman	
Glen Moreno	6/6
Executive directors	
John Fallon	6/6
Robin Freestone	6/6
Non-executive directors	
David Arculus	6/6
Elizabeth Corley*	4/4
Vivienne Cox	6/6
Ken Hydon	6/6
Josh Lewis	6/6
Linda Lorimer	6/6
Harish Manwani	6/6

\* Appointed on 1 May 2014

### Succession planning

The board considers oversight of succession planning – not only at board and executive management level but for all key positions throughout the business – as one of its prime responsibilities. At board level, the primary focus in the latter part of the year has been to identify suitable candidates for the role of chief financial officer.

The company has formal contingency plans in place for temporary absence of the chief executive for health or other reasons. The matter of chief executive succession is a standing item for discussion and review by the chairman and chief executive annually. Succession planning for the board and chair are also undertaken annually.

### Talent review

The board dedicated part of its December 2014 meeting to reviewing chief executive succession and the leadership talent pipeline at Pearson. In preparation for that, the Pearson executive team undertook a rigorous talent review programme assessing performance and potential of its top 100 executives (their direct reports) as well as the strength of the succession pipeline for their own roles and their team's roles.

All members of the executive team also took part in a multi-rater feedback process (360 feedback process), receiving feedback from direct reports, colleagues and the chief executive on key leadership traits and behaviours.

At the board meeting, the board discussed chief executive succession and together they reviewed the 360 summary reports for the executives, as well as overall themes from the 2014 employee engagement survey.

This discussion was followed by a session on the broader talent process, looking into succession for each executive role, analysing diversity statistics and discussing key capabilities that will be critical for the effective delivery of our strategy (pedagogy, technology and product management).

As a result of this process, we are designing structured development plans for the top 100 executives in the organisation and starting a deeper assessment of our capabilities in the areas of pedagogy, technology and product management.

### RIISING STARS

In addition to the board's established succession planning and talent review process for senior roles throughout the business, it was decided in 2014 to initiate a series of Rising Stars sessions.

The first of these sessions took place over informal breakfasts during each of the board's offsite meetings in Washington, DC and London. The purpose of the sessions is to provide the board with the opportunity to meet a cross-section of junior or mid-level colleagues from the host country who have been identified by senior executives as showing real promise. The board's feedback on these sessions in 2014 was overwhelmingly positive – they valued the opportunity to meet and hear from colleagues from all levels, finding the sessions rich and interesting, and taking away a clearer sense of Pearson's working culture.

IMAGE REMOVED

Rising Stars  
gender split

■ Male 47%  
■ Female 53%

as at 31 December 2014

"The Rising Stars offered the directors incredible insights into the workings of the company's enterprises. These men and women are a key part of the future of the company, and we were impressed by their sagacity and by their passion for the mission of Pearson – and by their good ideas for our collective future."

Linda Lorimer Non-executive director

## Leadership & effectiveness

### Board governance continued

#### Directors' training and induction

Directors receive a significant bespoke induction programme and a range of information about Pearson when they join the board. This includes background information on Pearson and details of board procedures, directors' responsibilities and various governance related issues, including procedures for dealing in Pearson shares and their legal obligations as directors. The induction also includes a series of meetings with members of the board, the Pearson executive and senior management, presentations regarding the business from senior executives and a briefing on Pearson's investor relations programme. The induction programmes for Elizabeth Corley and Tim Score are ongoing, tailored to their specific interests, and relevant to the board committees they have joined.

All directors receive training in the form of presentations about the company's operations through board meetings held at operational locations and by encouraging the directors to visit local operations and management as and when their schedule allows including if they are travelling to a country or region on non-Pearson business. The company secretary and general counsel, in conjunction with the Group's advisers, monitor legal and governance developments and update the board on such matters as agreed with the chairman. Directors can also make use of external courses.

#### Directors' indemnities

In accordance with section 232 of the Act, the company grants an indemnity to all of its directors. The indemnity relates to costs incurred by them in defending any civil or criminal proceedings and in connection with an application for relief under sections 661(3) and (4) or sections 1157(1)-(3) of the Act, so long as monies are repaid not later than when the outcome becomes final if:

- (i) they are convicted in the proceedings
- (ii) judgment is given against them or
- (iii) the court refuses to grant the relief sought

As permitted by Pearson's articles of association, the directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by section 234 of the Act. The indemnity was in force throughout the last financial period and is currently in force.

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

#### Board committees

The board has established four formal committees: the audit committee, the nomination committee, the remuneration committee and the reputation & responsibility committee, which was formally constituted in 2014 having operated on an informal basis during 2013. The chairmen and members of these committees are appointed by the board on the recommendation (where appropriate) of the nomination committee and in consultation with each relevant committee chairman. In addition to these formal board committees, the standing committee also operates with board level input.

#### More committee information

AUDIT COMMITTEE	p70 ➔
NOMINATION COMMITTEE	p68 ➔
REMUNERATION COMMITTEE	p82 ➔
REPUTATION & RESPONSIBILITY COMMITTEE	p78 ➔
STANDING COMMITTEE	p64 ➔

The approach adopted by the board is for committees to focus on their own areas of expertise enabling the board meetings to focus on governance, strategy, performance and people, thereby making the best use of the board's time together as a whole. The committee chairmen report to the full board at each meeting immediately following their sessions, ensuring a good communication flow whilst retaining the ability to escalate items to the full board's agenda if appropriate.

#### Board committee attendance

The following table shows attendance by directors at committee meetings throughout 2014.

	Audit	Remuneration	Nomination	Reputation & responsibility
Glen Moreno	-	4/4	6/6	-
John Fallon	-	-	6/6	-
David Arculus	5/5	4/4	6/6	-
Elizabeth Corley*	-	1/1	4/4	-
Vivienne Cox	5/5	4/4	6/6	3/3
Ken Hydon	5/5	4/4	6/6	-
Josh Lewis	-	4/4	6/6	-
Linda Lorimer	5/5	-	6/6	3/3
Harish Manwani	-	-	6/6	3/3

\* Joined nomination committee on 1 May 2014 and remuneration committee on 1 August 2014.

## BOARD EVALUATION

A formal evaluation of the board, its committees and individual directors' performance was completed at the end of 2014

It is recommended by the Code that this process is facilitated by a third party every three years. This effectiveness review was conducted by external evaluator, JCA Group. In addition to facilitating this review, JCA Group provided benchmarking and due diligence services in connection with the appointment of Elizabeth Corley as a non-executive director. JCA Group has no other connection to Pearson apart from in relation to board evaluation and search consultancy services.

## EVALUATION PROCESS

On JCA Group's recommendation, the process for the evaluation was as follows:

- 1 **Initial briefing** An initial briefing on the company to provide context and insights into the strategic priorities for the business as well as any issues or concerns to address more specifically
- 2 **Discussion guideline** Development of a 'discussion guideline' which was shared with the participants ahead of one-to-one meetings, to address key topics but not limit the discussion to only these, such topics included the organisation of the board, board and chair succession, judgement of the strategy and business performance, the dynamics and composition of the board and feedback on the committees and individual directors
- 3 **One-to-one meetings** One-to-one meetings with each board member, both executive and non-executive, these conversations were conducted on a confidential, un-attributable basis
- 4 **Effectiveness report** A full report was presented to the board, containing the key findings, recommendations for actions and suggested next steps

## Conclusion and recommendations

The review concluded that overall the board and its committees remain effective in fulfilling their responsibilities appropriately. Actions agreed as a result of the evaluation included ongoing review and assessment of the strategy and its success, given the significant transformation being undertaken by the company. The frequency of board meetings was judged to be appropriate. However, building on the success of the recommendation of the chief executive's monthly letter from last year's internal board review, there was also a suggestion to introduce additional board calls in between board meetings to keep the board current on issues and progress. In addition, it was highlighted that it is essential the board pays continuing attention to ensure all directors are well informed and have a deep understanding of the issues for the business and the broader global education environment in order to provide appropriate strategic direction and challenge going forward. This might include creating ongoing opportunities for board members to visit Pearson's operations in different global venues.

## Personal objectives

In addition to the evaluation of the board as a whole, executives are also evaluated each year on their performance against personal objectives under the company's annual incentive plan. Learn more about our Annual incentive plan on p104 ➔

The non-executive directors, led by the senior independent director, also conduct a review of the chairman's performance.

## Committee evaluation

In addition to the review of the board and individual directors, the audit and remuneration committees each undergo an annual evaluation process to review their performance and effectiveness.

The process involves distribution of questionnaires to audit and remuneration committee members, as well as key stakeholders in each committee, seeking views on matters including committee roles and responsibilities, quality and timeliness of meeting materials, opportunity for discussion and debate, dialogue with management and access to independent advice. Responses are then evaluated and presented to the respective committee at a scheduled meeting, with key themes being drawn out for discussion.

## Leadership & effectiveness

### Board governance continued

#### NOMINATION COMMITTEE

Chairman  
Glen Moreno

IMAGE REMOVED

Members David Arculus, Elizabeth Corley, Vivienne Cox, Ken Hydon, Josh Lewis, Linda Lottimer, Harish Manwani, Glen Moreno and Tim Score

#### Key activities in 2014

Objectives	Actions
Identify and appoint additional non-executive directors, at least one of whom to be female	Appointment of Elizabeth Corley and Tim Score
Audit committee and remuneration committee chair succession	Appointment of Tim Score and Elizabeth Corley as respective committee chairmen
Commence search for new chief financial officer	Appointment of Coram Williams announced – to join board on 1 August 2015

For nomination committee attendance see overview table on p66 ➔

#### COMMITTEE RESPONSIBILITIES INCLUDE:

1. **Appointments** Identifying and nominating candidates for board vacancies
2. **Balance** Ensuring that the board and its committees have the appropriate balance of skills, experience, independence, diversity and knowledge to operate effectively
3. **Succession planning** Reviewing the company's leadership needs with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace

#### Nomination committee role and composition

The committee primarily monitors the composition and balance of the board and its committees, and identifies and recommends to the board the appointment of new directors and/or committee members

John Fallon stepped down from the nomination committee in December 2014, although he will continue to be available to attend committee meetings by invitation. Elizabeth Corley and Tim Score joined the nomination committee following their appointments to the board.

#### Committee meetings and appointments

The nomination committee meets at least once a year and at other times as and when required. During 2014, the committee met six times with its primary focus being to consider suitable candidates for the role of chief financial officer and for non-executive positions, including for the roles of audit and remuneration committee chairmen in preparation for the retirement from the board of Ken Hydon and David Arculus during 2015.

The non-executive search culminated in the successful appointment of Tim Score and Elizabeth Corley to the board, who also joined the audit and remuneration committees respectively and will assume the chairmanships of those committees following the AGM in April 2015.

Having considered a range of external and internal candidates, we announced on 27 February 2015 that Coram Williams would succeed Robin Freestone as chief financial officer. Coram will join Pearson as CFO designate on 1 July 2015 and will replace Robin on the board on 1 August 2015.

In addition, the committee continued to focus on the search for a non-executive director with insights into mobile and digital technology to further complement our strategy.

Pearson uses a number of leading firms in its board and executive search activities. An external search consultancy, Odgers Berndtson, was used during the recruitment process for Tim Score. Odgers Berndtson does not have any other connection to Pearson apart from as a search consultancy.

The committee identified Elizabeth Corley as a potential non-executive candidate and an external search agency, JCA Group, provided benchmarking and due diligence services in connection with Elizabeth's appointment. In addition to these services, JCA Group facilitated Pearson's board evaluation in 2014.

Learn more about the Board of directors on p60 ➔

#### Chairman role

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

#### Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website at [www.pearson.com/governance](http://www.pearson.com/governance).

#### Diversity

The board embraces the Code's underlying principles with regard to board balance and diversity, including gender diversity. The nomination committee, led by the chairman, ensures that the directors of Pearson demonstrate a broad balance of skills, experience and nationality to support Pearson's strategic development and reflect the global nature of the Group's business.

The committee and the board always take account of diversity in its broadest sense when considering board appointments whilst ensuring that appointments are made based on merit and relevant experience.

Lord Davies has called for companies to target 25% female representation on boards of FTSE 100 companies by 2015. Pearson is committed to having at least 30% female directors within Lord Davies' 2015 timeframe and currently has three female directors on its board of eleven, representing 27%. With the forthcoming retirement of David Arculus and Ken Hydon in the coming months, this figure is expected to increase to 33%.

Immediately below board level, the Pearson executive, not including the chief executive and chief financial officer who are main board directors, has three female members out of a total of 12 (representing 25%). Our senior leadership team, up to and including two reporting levels from the chief executive, shows a strong pipeline of female talent with women representing 35% of our senior leaders.

Pearson considers diversity as an important issue across the Group, not just at board level. One of the key aims of Pearson's diversity policy is to increase the number of leaders coming from a diverse background, including advancing more women into leadership positions such as through our Women in Learning and Leadership programme for employees.

Learn more about Diversity throughout Pearson on p50 ➔

IMAGE REMOVED

Glen Moreno Chairman of nomination committee

# Accountability

## AUDIT COMMITTEE

Chairman  
Ken Hydon  
(stands down at  
2015 AGM)

IMAGE REMOVED

Members David Arculus, Vivienne Cox, Ken Hydon,  
Linda Lonimer, Tim Score

In my nine years as audit committee chairman I have learned a lot about Pearson, its operations, its practices and its senior management and have enjoyed the stimulation generated by so much change and world class colleagues.

Ken Hydon Chairman of audit committee

For Audit committee meeting attendance  
see overview table on p66 ➔

### COMMITTEE RESPONSIBILITIES INCLUDE OVERSIGHT OF:

1. **Reporting** The quality and integrity of financial reporting and statements and related disclosure
2. **Policy** Group policies, including accounting policies, and practices
3. **External audit** External audit, including the appointment, qualification, independence and the performance of the external auditor
4. **Risk and internal control** Risk management systems and internal control environment including the performance of the internal audit function
5. **Compliance** Compliance with legal and regulatory requirements in relation to financial reporting and accounting matters

### Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website at [www.pearson.com/governance](http://www.pearson.com/governance) ➔

### Audit committee role

The committee has been established by the board primarily for the purpose of overseeing the accounting, financial reporting, internal control and risk management processes of the company and the audit of the financial statements of the company. As a committee, we are responsible for assisting the board's oversight of the quality and integrity of the company's external financial reporting and statements and the company's accounting policies and practices.

The Group's internal auditor has a dual reporting line to the chief financial officer and me, and external auditors have direct access to the committee to raise any matter of concern and to report on the results of work directed by the committee. I report to the full board at every board meeting immediately following a committee meeting. As a committee, we also review the independence of the external auditors, including the provision of non-audit services (further details of which can be found on page 107 and note 4 to the financial statements), ensure that there is an appropriate audit relationship and that auditor objectivity and independence are upheld.

### Audit committee changes

Linda Lonimer joined the audit committee in January 2014 and we have also recently welcomed Tim Score who joined the committee upon his appointment to the board on 1 January 2015. Following nine years with Pearson, and as chairman of the audit committee, I will step down from the board at the 2015 Annual General Meeting. Tim Score will take over the chairmanship of the committee following my retirement and I am sure Tim will bring his own challenge and rigour to the committee's deliberations as an experienced audit committee chairman.

### Fair, balanced and understandable reporting

We are mindful of the Code's revised principle C1.1 relating to fair, balanced and understandable reporting and accordingly we built in additional steps to our Annual report timetable to ensure that the full board was given sufficient opportunity to review, consider and comment on the report as it progressed. Learn more about Fair, balanced and understandable reporting on p108 ➔



### Risk assessment, assurance and integrity

A key part of the role of the committee is in providing oversight and reassurance to the board with regard to the integrity of the company's financial reporting, internal control policies, and procedures for the identification, assessment and reporting of risk. During 2014 we aligned our risk and control processes with the new organisational structure, and conducted a number of deep dives into selected principal risks.

#### Data security

We view data privacy and cyber security breach as one of our principal operational risks, and this is a regular item on the audit committee's agenda. During 2014 a new chief information officer and a chief information security officer were appointed, and the committee met with both shortly following their appointments to receive their initial assessments on Pearson's data security programme and subsequently for progress updates throughout the year. The committee learned that the key areas of focus are to ensure consistently secure applications and infrastructure across all parts of the Group, with the aim of adopting best-in-class practices for our customers and employees.

#### Anti-bribery and corruption

Given our geographic focus and profile, and a number of recent acquisitions in growth markets, anti-bribery and corruption (ABC) is a specific risk for Pearson. The committee conducted a deep dive into ABC risk in 2014, joined by legal advisers: the SVP general counsel and SVP internal audit and compliance. The focus of the deep dive included the increasingly co-ordinated approach taken by authorities in higher-risk jurisdictions in which we operate, as well as a review of recent enforcement actions elsewhere in the education sector. The committee noted that Pearson's ABC policy is updated on an ongoing basis to reflect legislative changes, and learned more about how the internal ABC training programme continues to evolve to reflect our new business models and market specific risks.

#### Health & safety

One year on from the introduction of our global health & safety policy, the committee conducted a deep dive reviewing implementation and findings to date. As well as reviewing findings of audits at Pearson sites around the world, the committee discussed the Group's health and safety priorities. A primary focus is the safeguarding and protection of our students and, to this end, a new global safeguarding officer has been appointed and a safeguarding and protection policy introduced. Our initial

focus has been on our direct delivery businesses – the areas of greatest risk – and a training course is being developed for those staff who have contact with students. We have also engaged throughout the Group to ensure that our safeguarding is robust whenever we come into contact with children, young people and vulnerable adults. Corporate security is another key area of focus, particularly in relation to the safety and security of our staff working in, or travelling to, high-risk destinations. Significant progress has been made in implementation of the new policies across our businesses, although there remains work to be done, and the committee will maintain oversight as we move forward with our health & safety and safeguarding strategies.

#### Audit committee meetings and activities

The committee met five times during the year with the following in attendance: the chief financial officer, SVP internal audit and compliance, members of the senior management team, and the external auditors. Additionally, the chief executive and chairman periodically attended committee meetings. Since the remit of the SVP internal audit and compliance expanded to include compliance, the internal audit director and the VP compliance and risk assurance have also attended meetings, so the committee has direct contact with those areas. The committee also met regularly in private with the external auditors and the SVP internal audit and compliance.

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

Finally, I would like to thank my fellow committee members, the chief financial officer and the SVP internal audit and compliance for their enthusiasm and support.

Learn more about the Key activities of the audit committee on p72 

IMAGE REMOVED

Ken Hydon Chairman of audit committee

## Accountability continued

## AUDIT COMMITTEE

## Audit committee meetings during the year

Every  
meeting

Feb 2014

Apr 2014

Jul 2014

Sep 2014

Dec 2014

## REPORTING

› Accounting and technical updates	› The 2013 Annual report and accounts preliminary announcement, financial statements and income statement	› Interim management statement	› Review of the interim results and trading announcement	› Overview of 2014 Annual report process
› Impact of legal claims and regulatory issues on financial reporting	› Form 20-F and related disclosures including the annual Sarbanes-Oxley Act section 404 attestation of financial reporting internal controls			

## POLICY

› Accounting matters and Group accounting policies		› Tax reporting process	› Annual review and approval of external auditor policy › Information security and policy update	› Annual review of treasury policy and strategy
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## EXTERNAL AUDIT

› Provision of non audit services by PwC	› Receipt of the external auditor's report on the Form 20-F and on the year end audit › Reappointment of the external auditors › Confirmation of auditor independence	› 2014 external audit plan › Remuneration and engagement letter of the external auditors › Review opinion on interim results	› Update on audit tendering requirements › Review of the effectiveness of the external auditors
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## RISK AND INTERNAL CONTROL

› Internal audit activity reports and review of key findings › Enterprise risk management › Data security	› Assessment of the effectiveness of the Group's internal control environment and risk management systems › Review of Group internal audit terms of reference	› Risk deep dive testing risk	› Annual internal audit plan › Risk deep dive business continuity planning › Risk deep dive health & safety	› Risk deep dive anti bribery and corruption › Risk deep dive tax	› 2015 internal audit plan › Crisis management and ebola preparedness › Health & safety
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## COMPLIANCE AND GOVERNANCE

› Fraud whistleblowing reports and Code of Conduct matters	› Compliance with the Code › Compliance with SEC and NYSE requirements including Sarbanes Oxley Act		› Review of the committee's terms of reference › Review of the effectiveness of the committee and the group internal audit function
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### Members

All of the audit committee members are independent non-executive directors and have financial and/or related business experience due to the senior positions they hold or have held in other listed or publicly traded companies and/or similar public organisations. Ken Hydon, current chairman of the committee, is the company's designated financial expert. He is a Fellow of the Chartered Institute of Management Accountants, the Association of Chartered Certified Accountants and the Association of Corporate Treasurers. He also serves as audit committee chairman for Reckitt Benckiser Group plc and Merlin Entertainments plc, and until 2012 for Tesco plc and Royal Berkshire NHS Foundation Trust. Tim Score, who will assume the chairmanship of the committee during 2015 is an Associate Chartered Accountant. He also serves as audit committee chairman for The Brush Land Company plc and until 2014 for National Express Group plc.

The qualifications and relevant experience of the other committee members are detailed on p60-61 ➔

### Audit committee meetings during the year 2014

During the year the matters considered by the committee included those shown on the table opposite.

In February 2015, the committee also considered the 2014 Annual report and accounts, including the preliminary announcement, financial statements, strategic report, directors' report and corporate governance compliance statement.

### External audit

Based on management's recommendations, the committee reviews the proposal on the appointment of the external auditors. The committee reviewed the effectiveness and independence of the external auditors during 2014 and remains satisfied that the auditors provide effective independent challenge to management.

The review was conducted by distributing a questionnaire to key audit stakeholders including members of the audit committee, the chief executive, chief financial officer, SVP company secretarial, SVP internal audit and compliance, SVP finance for each Geography and Line of Business and heads of corporate functions. Feedback overall was very positive, indicating an effective external audit process.

The lead audit partner explained to the committee how PwC were monitoring and reviewing each highlighted area and confirmed that they would consider how to adapt their approach in light of specific comments received.

In addition, in accordance with our external auditor policy, Group internal audit performs an annual assessment of audit fees, services and independence which forms the basis for a recommendation by the committee to the board in respect of the appointment and compensation of our external auditor. Learn more about Auditors' independence on p107 ➔

The committee will continue to review the performance of the external auditors on an annual basis and will consider their independence and objectivity, taking account of all appropriate guidelines. There are no contractual obligations restricting the committee's choice of external auditors. In any event, the external auditors are required to rotate the audit partner responsible for the Group audit every five years. The current lead audit partner rotated onto the Group's audit in 2013.

Pearson's last audit tender was in respect of the 1996 year end resulting in the appointment of Price Waterhouse as auditors. We reported last year that a tender process would commence no later than 2017 to ensure auditors have been appointed in time for the 2018 year end audit, following the end of the current lead partner's term, in line with the FRC's suggested transitional arrangements on audit tendering. Developments at an EU level regarding mandatory audit rotation for listed companies have changed the UK landscape on audit tendering and rotation and, as a result, Pearson would be required to change auditors no later than the next audit appointment after 17 June 2023. The audit committee will continue to monitor developments in this area and to consider the timing of the next tender so as to achieve the most efficient and effective outcome and expects to have concluded on its planned approach within the next year. Once the next audit tender occurs, the Group will adopt a policy of putting the audit contract out to tender at least every ten years.

### Audit committee training

The committee receives regular technical updates as well as specific or personal training as appropriate. In September 2014, as part of a deep dive into anti-bribery and corruption (ABC) risk, the committee held a session with legal advisers to better understand global ABC developments.

Committee members also meet with local management on an ongoing basis in order to gain a better understanding of how Group policies are embedded in operations.

## Accountability continued

## AUDIT COMMITTEE

## Significant issues

AREA OF FOCUS	ISSUE	ACTION TAKEN BY AUDIT COMMITTEE	OUTCOME
New organisation structure and IFRS 8	Following the introduction of the new management structure and operating model, the Group has changed its externally reported segments in 2014 in accordance with the guidance in IFRS 8 'Operating Segments'. As part of the exercise to identify new segments and restate financial reports, underlying cash generating units (CGUs) were also defined.	The committee reviewed restated financials and discussed the conclusion that the Group's primary segments were now made up of the businesses within the three regions – North America, Core and Growth. The committee confirmed that reporting for the new segments was consistent with board reporting for internal purposes. The committee also discussed the definition of CGUs and the allocation of goodwill to these CGUs for the purpose of impairment testing.	Segments and CGUs redefined.
Impairment reviews	The Group carries significant goodwill intangible asset balances. There is judgement exercised in the identification of CGUs and the process of allocating goodwill to CGUs and aggregate CGUs and in the assumptions underlying the impairment review.	The committee considered the results of the Group's annual goodwill impairment review in the light of new and aggregate CGUs. The key assumptions are considered to be the cash flows derived from strategic and operating plans, long term growth rates and the weighted average cost of capital. The committee considered the sensitivities to changes in assumptions and the related disclosures required by IAS 36 'Impairment of Assets'. In particular the committee reviewed the analysis and disclosure relating to the Growth CGUs where valuations indicated an impairment in the India business and sensitivity to assumptions was also reviewed in relation to other businesses.	Annual impairment review finalised with confirmation of an impairment in India and sufficient headroom in all other CGUs.
Revenue recognition	Pearson has a number of revenue streams where revenue recognition practices are complex and management assumptions and estimates are necessary.	The committee regularly reviews revenue recognition practice and the underlying assumptions and estimates. In addition, the committee has visibility of internal audit findings relating to revenue recognition controls and processes and routinely monitors the views of external auditors on revenue recognition issues. During the year the committee reviewed revenue recognition in respect of services provided to universities and higher education institutions to facilitate online courses and looked at significant new school testing and teacher certification contracts. The committee also discussed the impact of the new revenue recognition standard, IFRS 15 'Revenue from Contracts with Customers' and noted that although the standard would not be adopted by Pearson until 2017 the committee would need to understand the implications of the change well before that date.	Assumptions underlying revenue recognition were reviewed and challenged.
Tax	There are a number of issues in different countries where management judgements and assumptions are made as to the correct tax treatment.	The committee considered the Group's approach to tax provisioning. The Group operates in a large number of countries and, accordingly, its earnings are subject to tax in many jurisdictions. The judgement in relation to tax provisioning is a combination of the committee's assessment of the specific open tax issues and also a review of the time periods in which the Group's tax affairs are open to enquiry by local tax inspectors in jurisdictions where the Group has a larger taxable presence. The committee addressed this matter through the presentation of a management report on the Group's tax affairs by the head of group tax and through a presentation of the external auditor's assessment of the Group's tax provisioning.	The committee was satisfied with the Group's approach to tax provisioning taking account of the views of management and the assessment of the external auditors.

## Significant issues continued

AREA OF FOCUS	ISSUE	ACTION TAKEN BY AUDIT COMMITTEE	OUTCOME
Grupo Multi acquisition	Pearson acquired Grupo Multi in February 2014 for £437m. Management assumptions and estimates were necessary in establishing fair values for the assets and liabilities acquired.	The committee monitored progress on the acquisition accounting and fair value adjustments proposed with particular emphasis on tax and legal provisions and on the external valuation of intangible assets.	Acquisition accounting reviewed and significant judgements explained.
Disposal accounting	Pearson disposed of its 100% interest in Merger market, its joint venture interest in Safari Books Online, its 5% investment in Nook Media and made adjustments to the disposal of Penguin recorded in 2013.	The committee reviewed the disposal accounting and disclosure and considered the main judgements relating to tax treatments, pension accounting in relation to Penguin and contingent consideration relating to Safari. The committee also discussed the valuation of the Nook Media investment at various meetings during the year prior to its eventual disposal in December 2014.	Accounting treatments and valuations confirmed.

## Significant issues

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

At the July 2014 audit committee meeting, the committee discussed and approved the auditors' Group audit plan and reviewed the key risks of misstatement of the Group's financial statements, which were updated at the December 2014 committee meeting.

The table opposite sets out the significant issues considered by the audit committee together with details of how these items have been addressed. The committee discussed these issues with the auditors at the time of their review of the half year interim financial statements in July 2014 and again at the conclusion of their audit of the financial statements for the full year in February 2015.

All the significant issues were areas of focus for the auditors. Learn more in the Independent auditors' report on pages 114-121.

In December 2014, the committee discussed with the auditors the status of their work, focusing in particular on internal controls and Sarbanes-Oxley testing, and covering the significant issues outlined above.

As the auditors concluded their audit, they explained to the committee:

- › The work they had conducted over revenue, working alongside management to assess several complex revenue contracts.

- › The work they had done to understand the Group's tax strategy and identify business and legislative risks, to evaluate key underlying assumptions and assess the recoverability of deferred tax assets.
- › Their evaluation of the recoverability of digital platforms and pre-publication assets.
- › Their focus on segments, CGUs and goodwill impairment and the impact of the Group's transformation on those.
- › The results of their controls testing to date for Sarbanes-Oxley Act section 404 reporting purposes and in support of their financial statements audit.
- › The review of the company's 'going concern' reports. The auditors also reported to the committee the misstatements that they had found in the course of their work, which were insignificant, and the committee confirmed that there were no material items remaining unadjusted in these financial statements.

## Accountability continued

### RISK GOVERNANCE AND CONTROL

#### Internal control and risk management

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

In September 2014, the Financial Reporting Council published updated Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, which takes effect for our 2015 year end reporting. The changes were discussed by executive management and the audit committee and a plan has been developed to set a clear path to compliance with the new requirements, including ongoing robust assessment of risk and preparation of a viability statement.

An enterprise risk management (ERM) framework is in place to identify, evaluate and manage risks, including key financial reporting risks. Business areas undertake semi-annual risk reviews to identify new or potentially under-managed risks. Throughout the year, risk discussions are facilitated by the risk assurance team with Group and business area management to identify the key risks the company faces in achieving its objectives, to assess the probability and impact of those risks and to document the actions being taken to manage those risks. The Pearson Executive reviews the output of these sessions focusing on the key risks facing the business. Management has the responsibility to consider and execute appropriate action to mitigate these risks whenever possible. The results of these reviews are reported to the audit committee and the board in detail.

During 2014, the semi-annual reporting of top risks was reviewed by executive management as well as the board and audit committee. During the year, the audit committee considered the oversight of specific selected principal risks, through a series of risk 'deep dives'. This is covered in more detail in the separate report on the audit committee. The key elements and procedures that have been established to provide effective risk management and internal control systems are described below. During 2014, we aligned these procedures to the new organisation structure.

Learn more about our Principal risks and mitigating factors on p34 ➔

#### Control environment

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

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

The identification and mitigation of significant business risks is the responsibility of Group senior management and the management team for each business area – being the heads of the Lines of Business, Geographies and enabling functions. Each business area, including the corporate centre, maintains internal controls and procedures appropriate to its structure, business environment and risk assessment whilst complying with Group policies, standards and guidelines.

#### Financial management and reporting

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

We have an ongoing process to monitor the risks and effectiveness of controls in relation to the financial reporting and consolidation process including the related information systems. This includes up-to-date Group financial policies, formal requirements for finance

functions, Group consolidation reviews and analysis of material variances, Group finance technical reviews, including the use of technical specialists, and review and sign-off by senior finance managers. These processes are subject to reviews based on Group internal audit's risk-based audit programme. The Group finance function also monitors and assesses these processes, through a finance compliance function.

These controls include those over external financial reporting which are documented and tested in accordance with the requirements of section 404 of the Sarbanes-Oxley Act, which is relevant to our US listing. One key control in this area is the disclosure committee, which submits reports to the audit committee. This committee is chaired by the SVP internal audit and compliance, and members include the chief financial officer, general counsel, SVP investor relations, SVP company secretarial as well as senior members of financial management. The primary responsibility of this committee is to review Pearson's public reporting and disclosures to ensure that information provided to shareholders is complete, accurate and compliant with all applicable legislation and listing regulations.

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

#### Group internal audit

The Group internal audit function is responsible for providing independent assurance to management and the audit committee on the design and effectiveness of internal controls to mitigate strategic, financial, operational and compliance risks. The risk-based annual internal audit plan is approved by the audit committee. Management action plans to improve internal controls and to mitigate risks, or both, are agreed with each business area after each audit. Formal follow up procedures allow Group internal audit to monitor business areas' progress in implementing its recommendations and to resolve any control deficiencies. Group internal audit has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. Regular reports on the work of Group internal audit are provided to executive management and, via the audit committee, to the board.

The SVP internal audit and compliance oversees compliance with our Code of Conduct and works with senior legal and human resources personnel to investigate any reported incidents including ethical, corruption and fraud allegations. The audit committee is provided with an update of all significant matters received through our whistle-blowing reporting system, together with an annual review of the effectiveness of this system. The Pearson anti-bribery and corruption programme provides the framework to support our compliance with various anti-bribery and corruption regulations such as the UK Bribery Act 2010 and the US Foreign Corrupt Practices Act.

#### Treasury management

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

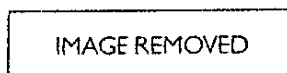
#### Insurance

Pearson purchases comprehensive insurance coverage where this is available on a cost-effective basis. Pearson's insurance subsidiary, Spear Insurance Company Limited, is used to leverage the risk retention capability of the Group and to achieve a balance between retaining insurance risk and transferring it to external insurers.

# Engagement

## REPUTATION & RESPONSIBILITY COMMITTEE

Chairman  
Vivienne Cox



Members Vivienne Cox, Linda Lorimer, Harish Manwani

As Pearson takes a more active role in education worldwide, we have a responsibility to our learners and to our shareholders to grasp new opportunities which have a positive impact on society. We are working to build our brand and to sharpen our awareness and management of anything that risks damaging it.

Vivienne Cox, Chairman of reputation & responsibility committee

### Reputation & responsibility committee role

The reputation & responsibility committee became a formal committee of the board in 2014. This reflects the board and Pearson executive's growing awareness and ambition around Pearson's corporate reputation, and our belief in the importance of fulfilling our obligations to the communities in which we work, and maximising Pearson's positive impact on society.

### Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These can be found on the company website at [www.pearson.com/governance](http://www.pearson.com/governance).

The committee's responsibilities are shown in more detail below.

For reputation & responsibility committee meeting attendance see overview table on p66.

### COMMITTEE RESPONSIBILITIES:

- 1 Reputation Pearson's reputation among major stakeholders, including governments, investors, employees, customers, learners and the education community
- 2 Strategy Communications strategies, policies and plans related to reputational issues
- 3 Social Social impact initiatives
- 4 Brand Brand and culture development
- 5 Ethics Ethical business standards
- 6 Risk Oversight of reputational risk

### BOARD VISIT TO WASHINGTON, DC

In June 2014, the board visited Washington, DC for a three-day meeting to understand the forces behind changes in the education landscape across the US and the implications for Pearson's brand and reputation in our largest, most successful market. Specifically, the presentations and discussions focused on four key areas, outlined opposite...



### Key activities in 2014

In the second year of Pearson's transformation, the committee acted to scrutinise and challenge the long-term strategy and approach throughout 2014, meeting three times and receiving presentations from business leaders across a number of key areas

In particular the committee reviewed and provided input on

- › Our long-term vision for corporate transparency and reporting, in particular adopting oversight of our political contributions policy and spending
- › The wind-down of the Pearson Charitable Foundation and our revised approach to social impact activity
- › The rationale and future strategy for the Pearson Affordable Learning Fund
- › The review of the Pearson master brand and employee values, and our approach to tracking the equity of the Pearson brand globally

### Committee aims for 2015

In 2015 the committee will continue to focus on how our strategy for managing our reputation and maximising our contribution to society is changing with the organisation. The committee will adopt oversight of health & safety management, policy and issues, reflecting its increasingly significant role in safeguarding our reputation as we become more active in the direct delivery of education to students. In particular, the committee will review progress on the integration of social impact into Pearson's business following the closure of the Pearson Charitable Foundation, the development of our reputation management approach in our newer markets, and our progress towards our 2018 efficacy commitment.

IMAGE REMOVED

Vivienne Cox Chairman of reputation & responsibility committee

1 How to increase productivity and demonstrate return on investment in our schools and colleges, and how to prepare more students to compete and succeed in a 21st century global economy

2 Increasing polarisation and politicisation of education issues and how the explosion of social media has altered the public policy landscape and the rules of the game

3 Learning to engage with new players and new issues that come from increasing private sector investment in education, particularly from venture capital and philanthropy, and the shift into new digital and services-led businesses

4 Growing public scrutiny of Pearson's role in education, in particular how our size and our success makes Pearson a target for critics and competitors and how the public demand for transparency and proof of positive social impact is posing new challenges – and opportunities – for companies

The board had a deep dive session examining how Pearson was building and executing a more robust, proactive government relations and reputation management capability

The board spent time getting a first-hand look at blended learning in action meeting educators, parents and learners during a visit to College Park Academy, an innovative charter school run by our Connections team in partnership with the University of Maryland's School of Education

There was an opportunity for the board to engage with key national opinion leaders, policymakers, reformers and innovators in education, including Melody Barnes, former domestic policy adviser to President Obama, and Ted Mitchell, US Under Secretary of Education

Finally, the board heard from the Pearson executive team about how our new operating model was helping to accelerate our shift to digital and services business across K-12 and higher education, followed by an update on the efficacy initiative

## Engagement continued

## SHAREHOLDER ENGAGEMENT

## Engaging with shareholders

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

**Shareholder outreach** In 2014, we continued with our shareholder outreach programme, seeing approximately 690 institutional and private investors at more than 420 different institutions in Australia, Brazil, Brunei, Canada, Greater China, Continental Europe, Japan, Singapore, South Korea, the UK and the US

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

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

**Consultations** During the year we also consulted with our major shareholders and with shareholder representative bodies on our directors' remuneration policy. Read about Remuneration on p82 ➔

**Seminars** We have an established programme of educational seminars for our institutional shareholders focusing on individual parts of Pearson. These seminars are available to all shareholders via webcast on [www.pearson.com](http://www.pearson.com) ➔

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

We encourage our private shareholders to become more informed investors and have provided a wealth of information on our website about managing Pearson shareholdings, see [www.pearson.com/investors/shareholder-information.html](http://www.pearson.com/investors/shareholder-information.html) for further information, or turn to page 212 of this report. We also encourage all shareholders, who have not already done so, to register their email addresses through our website and with our registrar. This enables them to receive email alerts when trading updates and other important announcements are added to our website

See additional Shareholder information on p212 ➔

AGM

24 April 2015

8 Northumberland Avenue  
London, England WC2N 5BY

690

institutional and private  
investor meetings in 2014

Our programme of educational seminars is available for institutional investors via webcast on [www.pearson.com](http://www.pearson.com) ➔

IMAGE REMOVED

### Share dealing

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

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

### Annual General Meeting

Our AGM, on 24 April 2015, is an opportunity for all shareholders to meet the board and to hear presentations about Pearson's businesses and results.

### WIDER ENGAGEMENT

#### Engaging with all stakeholders

We post all company announcements on our website, [www.pearson.com](http://www.pearson.com), as soon as they are released, and major shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes information about all of our businesses, links to their websites and details of our corporate responsibility policies and activities.

Learn more about our approach to corporate responsibility in the Social impact section on p45-56 ➔

#### Visit [pearson.com](http://pearson.com) for

Investor relations information

Company announcements and shareholder presentations, webcasts and conference calls

Past announcements and presentations

Historical financial performance

Share price data

Calendar of events

Information about our businesses and their websites

Corporate responsibility policies and activities

IMAGE REMOVED

# Report on directors' remuneration

## PART 1 – LETTER FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

Chairman  
David Arculus

IMAGE REMOVED

Members David Arculus, Elizabeth Corley, Vivienne Cox,  
Ken Hydon, Josh Lewis and Glen Moreno

The committee believes that Pearson's remuneration policy supports the company's strategy to deliver sustained performance and create long-term value in the interests of all stakeholders.

David Arculus Chairman of remuneration committee

In this remuneration section

<b>PART 1 LETTER FROM THE CHAIRMAN</b>	<b>p82</b>
<b>PART 2 REMUNERATION POLICY</b>	<b>p85</b>
<b>PART 3 REMUNERATION REPORT</b>	<b>p89</b>

### Terms of reference

The committee's full charter and terms of reference are available on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance)

### Introduction

I am pleased to present our report on directors' remuneration for 2014

The 2014 annual remuneration report will be put forward for your consideration and approval by advisory vote at the Annual General Meeting on 24 April 2015

In accordance with the UK remuneration reporting requirements, this report contains

- › A summary of the directors' remuneration policy on p85  
The full policy was approved by shareholders at the Annual General Meeting on 25 April 2014 and can be found on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance)
- › The annual remuneration report, on p89-106, describing all aspects of remuneration practice in 2014

We believe this report clearly demonstrates the link between our remuneration policy and practice, and the company's strategy and performance, as well as our commitment to shareholder engagement

### Principles of remuneration policy

The purpose of the remuneration policy is to support the company's strategy to deliver sustained performance and create long-term value in the interests of all stakeholders. This is summarised in the panel overleaf

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

## REMUNERATION POLICY PRINCIPLES

**1 Sustainability and affordability** We seek a careful and sustainable balance between market competitiveness, affordability and the long-term interests of the company and its shareholders, whilst also being mindful of pay conditions elsewhere in the Group and the wider social and economic context. The process for setting levels of executive remuneration is robust and transparent.

**2 Pay for performance** A high proportion of total remuneration is delivered as variable pay that is directly linked to both short and long-term performance of the company, through annual incentives that reward the achievement of annual strategic goals and long-term incentives that drive long-term earnings and share price growth. Performance conditions are sufficiently stretching and recognise individual contribution as well as the company's financial results.

**3 Alignment** We encourage executives to acquire and hold Pearson shares in line with shareholders' interests. Long-term incentives reward the achievement of sustainable, long-term value creation that will be beneficial to shareholders. We actively seek feedback from shareholders on all aspects of executive remuneration.

### Remuneration supporting strategy

Pearson's executive remuneration arrangements were reviewed last year to align with and support the company's new strategy. Executive remuneration decisions have been made after consultation with shareholders, careful consideration of the needs of the business, the transformation and reorganisation of the company, changes in roles and responsibilities, the pay markets in which Pearson operates and pay elsewhere in the organisation.

Pearson's strategy informs our remuneration philosophy and policy and complements our more traditional financial goals, which are to achieve sustainable growth on three key measures (earnings, cash, and return on invested capital) and to deliver reliable cash returns to our investors through healthy and growing dividends.

We believe those are, in concert, good indicators that we are building the long-term value of Pearson. These measures (or others that contribute to them) therefore form the basis of our annual budgets and strategic plans and the basis for annual and long-term incentives.

### What we did in 2014

We consulted with our major shareholders and with shareholder representatives on the directors' remuneration policy prior to its publication. However, following publication a number of shareholders expressed concern that the policy allowed the committee to exercise discretion to approve remuneration elements outside of the normal limits in exceptional and unforeseen circumstances. In response to this, prior to the Annual General Meeting, on 9 April 2014, and following further consultation, we issued a RNS statement to clarify the basis on which certain elements of the policy would apply and, in particular, to define and limit when and how remuneration arrangements outside the normal terms of the policy might be applied. The policy was approved at the Annual General Meeting on 25 April 2014.

### Performance in 2014 at a glance

In 2014, despite continuing challenging market conditions, we had a good competitive performance. Overall, we saw

- › Growth in sales of 2% and in adjusted operating profit of 5% at constant exchange rates
- › An increase in our dividend of 6% which was Pearson's 23rd straight year of increasing our dividend above the rate of inflation

Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning £2.9bn to shareholders.

### Remuneration in 2014 at a glance

Base salary	+2%
Allowances and benefits	No change in arrangements from 2013
Retirement benefits	
Annual incentives	Pay out below target
Long-term incentives	Nil vesting

Note: This reflects changes to remuneration for the chief executive and the chief financial officer, not for the rest of the Pearson executive.

## Report on directors' remuneration continued

## PART 1 – LETTER FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

Looking back to some specific aspects of policy and practice in 2014

- › We established maximum opportunities for each element of remuneration
- › We changed the weighting of the performance metrics under the Pearson long-term incentive plan from one third on each measure to half on earnings per share growth, one-third (no change) on return on invested capital and one-sixth on relative total shareholder return
- › We introduced a mandatory restriction on participants ability to dispose of the 75% of vested long-term incentive shares that are released after three years (other than to meet personal tax liability) for a further two years and for the remaining 25% of vested shares to be subject to continuing employment over the same period
- › We increased the mandatory shareholding guidelines to 300% of salary for the CEO and 200% of salary for other executive directors
- › These shareholding guidelines were also extended to other members of the Pearson executive at 100% of salary
- › We clarified the arrangements for malus and strengthened the clawback provisions
- › The annual bonus share matching plan was ceased. The last award under this plan will vest or not, subject to performance, during 2016
- › We undertook a regular periodic review of base salaries for 2014 taking into account general economic and market conditions, the level of increases made across the company as a whole, the remuneration of executives in similar positions in comparable companies, and individual performance
- › Annual incentives paid to executives for 2014 were below target, as they were in 2013, reflecting below target performance in a tough trading environment
- › There was the second consecutive nil pay-out on long-term incentives, reflecting below threshold performance for 2014 against the company's three-year targets for earnings per share growth, return on invested capital and relative total shareholder return
- › To increase alignment with shareholder interests and the long-term growth of the company we reviewed the operation of the long term incentive plan for the senior leadership population below the Pearson executive

For 2014 and beyond, awards for this group of employees will be subject to performance based on an earnings per share growth target

## What we've planned for 2015

## Looking forward, for 2015

- › We will continue to operate directors' remuneration in line with the approved remuneration policy and anticipate putting the policy to shareholder vote next at the 2017 Annual General Meeting
- › As approved in the 2013 directors' remuneration report for performance-related long-term incentive awards for 2015 and onwards, the averaging period for the calculation of relative total shareholder return will be moved to the period running up to the year end and the length of the averaging period will be increased to three months
- › On long-term incentives, we have reduced the proportion of the maximum award that vests for threshold performance from 30% to 25% in line with institutional investors' preferences
- › Based on our guidance for 2015, we will face a challenge in delivering a pay-out under the long-term incentive plan award for 2013

The committee welcomes the positive engagement with shareholders on our approach to this year's report on directors' remuneration and, specifically, on the issue of the vote against our annual remuneration report at the 2013 Annual General Meeting

The committee is committed to an ongoing dialogue with shareholders regarding executive remuneration and would therefore welcome any observations or questions that individual shareholders may wish to raise

I would like to thank my fellow members of the committee and the people who have assisted us for their contribution over the past year

Finally as I step down from the board and from chairing the committee, I look forward to handing over the reins to my successor, Elizabeth Corley

Yours sincerely

IMAGE REMOVED

David Arculus Chairman of the remuneration committee

## PART 2 – SUMMARY OF REMUNERATION POLICY

### Introduction to summary of remuneration policy

The company's policy on directors' remuneration was approved by shareholders at the Annual General Meeting on 25 April 2014. We issued an RNS statement of further information on the remuneration policy on 9 April 2014, to clarify the use of the committee's discretion over certain elements of remuneration in exceptional circumstances.

To help shareholders understand the context of remuneration practice reported in the annual remuneration report that follows, and specifically the limits applied to directors' remuneration, we have included below some key points and a summary of pertinent sections of the remuneration policy for information only. For further detail, please refer to the full remuneration policy and the clarification statement on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance).

#### Scope of policy

The policy applies to executive directors, the chairman and non-executive directors.

Reference is also made to the remuneration policy for other members of the Pearson executive (currently 12 in number) who are not directors but who fall within the committee's remit.

#### Duration of policy

The policy took effect on 25 April 2014 and is expected to last until the next binding vote on our remuneration policy which at present is planned for the 2017 AGM.

#### Use of discretion

The committee has avoided, where possible, including general discretions in the policy table. However, exceptional or genuinely unforeseen circumstances may arise in the future and in those circumstances it may be in shareholders' interests for Pearson to put in place remuneration arrangements that are outside the terms of the policy. If this happens, the committee will be permitted to implement remuneration arrangements that it considers appropriate in the circumstances. In these circumstances, Pearson would consult in advance with major shareholders before it does so and would explain the exercise of this discretion in the following year's directors' remuneration report.

As clarified in the RNS statement of further information on the remuneration policy on 9 April 2014, this discretion would only be used in the very narrow circumstances

articulated in the policy – that is, in exceptional or genuinely unforeseen circumstances. The committee considers that these circumstances would arise highly infrequently, if at all, in the lifetime of the policy. The committee would regard reliance on this discretion as a matter of utmost seriousness and, in relation to our stated obligation to consult in advance with major shareholders, would not proceed unless there was clear consensus in favour among those consulted. Further, the committee would ensure that the value of the remuneration arrangement put in place in reliance on this discretion would fall within the normal limit (as stated in the policy) for the element of remuneration to which the arrangement relates.

As part of the approved policy, the committee also has discretion to award base salary increases, allowances and benefits, and long-term incentive plan awards in excess of the normal maximum limits to current or new directors. As clarified in the RNS statement, this discretion will only be exercised in exceptional circumstances other than in the case of increases in the cost of benefits that are outside Pearson's control and changes in benefit providers. Again, Pearson would consult with major shareholders before exercising any such discretion and such exercise would be limited by reference to the safeguards described above, including only proceeding where there was clear consensus in favour among those consulted. In these circumstances, the committee would ensure that the maximum value of the remuneration arrangement put in place in reliance on this discretion did not exceed a margin of 25% over the normal maximum limit for the element in question (as stated in the policy).

#### Legacy arrangements

Given the long-term nature of some of Pearson's remuneration structures – including obligations under service contracts, incentive plans and pension arrangements – a number of pre-existing obligations remained in place at the time that the new policy became effective, including obligations that are 'grandfathered' by virtue of being in force at 27 June 2012. Pearson's policy is to honour all pre-existing obligations, commitments or other entitlements that were entered into before the effective date of this policy.

#### Summary of remuneration policy table

For more information on how remuneration is operated, please refer to the full remuneration policy on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance).

## Report on directors' remuneration continued

## PART 2 – SUMMARY OF REMUNERATION POLICY

Element of remuneration	Purpose and link to strategy	Performance conditions	Normal limit	Exceptional limit as clarified in RNS statement of 9 April 2014
Base salary	Helps to recruit, reward and retain Reflects competitive market level, role, skills, experience and individual contribution	None, although performance of both the company and the individual are taken into account when determining an appropriate level of base salary increase each year	Base salary increases are not ordinarily more than 10% per annum	Up to 25% over normal limit in specific individual situations including internal promotions and material changes to the business or the role
Allowances and benefits	Help to recruit and retain Reflect the local competitive market	None	Total value not ordinarily in excess of 15% of base salary in any year	Up to 25% over normal limit in specific individual situations including changes in individual circumstances such as health status and changes in the role such as relocation  In excess of 25% over normal limit in the case of increases in the cost of benefits that are outside of Pearson's control and changes in benefit providers
Retirement benefits	Help to recruit and retain Recognise long term commitment	None	As set out in approved remuneration policy	None
Annual incentives	Motivate achievement of annual strategic goals Focus on key financial metrics Reward individual contribution	The committee has the discretion to select the performance measures, targets and relative weightings from year to year Funded by Pearson global annual financial results and weighted 60% on adjusted earnings per share, 20% on sales, 20% on operating cash flow Payouts take into account individual performance against personal objectives	Overall limit 200% of base salary 2015 maximum opportunity is 180% for the chief executive and no more than 170% for other executive directors and members of the Pearson executive	None
Long-term incentives	Help to recruit, reward and retain Drive long term earnings, share price growth and value creation, and align interests of executives and shareholders Encourage long term shareholding and commitment to company Link management's long term reward and wealth to corporate performance in a flexible way	The committee will determine the performance measures, weightings and targets governing an award of restricted shares prior to grant to ensure continuing alignment with strategy and to ensure the targets are sufficiently stretching Awards vest subject to the following performance conditions: one-third on earnings per share growth, one-third on return on invested capital (ROIC), one-sixth on relative total shareholder return (TSR) Performance tested over three years	Maximum face value of 400% of base salary Other than in exceptional circumstances on recruitment etc, the company's normal policy not to award restricted shares to executive directors and other members of the Pearson executive without performance conditions	Up to 25% over normal limit in exceptional circumstances for example for retention purposes or to reflect particular business situations. The discretion to award restricted shares without performance conditions to executive directors will not be used other than where it is appropriate to compensate a new director on a 'like for like' basis for incentives foregone at a previous employer

Total shareholder return (TSR) is the return to shareholders from any growth in Pearson's share price and reinvested dividends over the performance period. For long term incentive awards, TSR is measured relative to the constituents of the FTSE World India Index over a three year period. Companies that drop out of the index are normally excluded, i.e. only companies in the index for the entire period are counted. Share price is averaged over three months at the start and end of the performance period. Dividends are treated as reinvested on the ex-dividend date, in line with the Datastream methodology. The vesting of shares based on relative TSR is subject to the committee satisfying itself that the recorded TSR is a genuine reflection of the underlying financial performance of the business.

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

Adjusted earnings per share (EPS) is calculated by dividing the adjusted earnings attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding any ordinary shares purchased by the company and held in trust (see note 8 of the financial statements for a detailed description of adjusted earnings per share). EPS growth is calculated using the point-to-point method. This method compares the adjusted EPS in the company's accounts for the financial year ended prior to the grant date with the adjusted EPS for the financial year ending three years later and calculates the implicit compound annual growth rate over the period.



### Non-executive directors and chairman

Non-executive director remuneration has been designed to attract and retain high calibre individuals, with appropriate experience or industry relevant skills, by offering market competitive fee levels

The structure of non-executive directors' fees with effect from 1 May 2014 is as follows

Director	Fee
Non-executive director	£70,000
Chairmanship of audit committee	£27,500
Chairmanship of remuneration committee	£22,000
Chairmanship of reputation & responsibility committee	£10,000
Membership of audit committee	£15,000
Membership of remuneration committee	£10,000
Membership of reputation & responsibility committee	£5,000
Senior independent director	£22,000

The total fees payable to the non-executive directors are subject to the limit set out in the articles of association of the company (currently £750,000) and are increased by ordinary resolution from time to time

The chairman's fees remain unchanged at £500,000 per year

For more information on non-executive directors' remuneration, please refer to the full remuneration policy on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance)

### Pay and performance scenario analysis

The remuneration policy approved by shareholders in 2014 required a scenario chart in the format set out below for 2014 remuneration. Although not required, the company has updated the scenario charts below so as to apply to 2015 remuneration

Consistent with its policy, the committee places considerable emphasis on the performance-linked elements, i.e. annual and long-term incentives

The chart below shows what each director could expect to receive in 2015 under different performance scenarios, based on the following definitions of performance

Performance scenario	Elements of remuneration and assumptions
Maximum	2015 base salary, allowances, benefits, and retirement benefits at the same percentage of base salary as in 2014, maximum individual annual incentive as per policy, maximum value of 2014 long-term incentive award
Target	2015 base salary, allowances, benefits and retirement benefits at the same percentage of base salary as in 2014, target individual annual incentive as per policy, target value of 2014 long-term incentive award (Towers Watson's independent assessment of the expected value of the award, i.e. the net present value taking into account all the conditions)
Minimum	2015 base salary, allowances, benefits, and retirement benefits at the same percentage of base salary as in 2014, no annual or long-term incentives

Note: The value of long-term incentives does not take into account dividend awards that are payable on the release of restricted shares nor any changes in share price

On this basis, the relative weighting of fixed and performance related remuneration and the absolute size of the remuneration packages for the chief executive and the chief financial officer (as represented by the current incumbent) are as follows on the next page

## Report on directors' remuneration continued

## PART 2 – SUMMARY OF REMUNERATION POLICY




IMAGE REMOVED




IMAGE REMOVED

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

**Recruitment**

The committee expects any new executive directors to be engaged on the same terms and to be awarded variable remuneration within the same normal limits and subject to the same conditions as for the current executive directors outlined in the policy. As clarified in the RNS statement of further information on the remuneration policy on 9 April 2014, this applies other than in the circumstances set out below where it is appropriate to take account of the terms of the new directors' existing employment and/or their personal circumstances

The committee recognises that it cannot always predict accurately the circumstances in which any new directors may be recruited. The committee may determine that it is in the interests of the company and shareholders to secure the services of a particular individual which may require the committee to take account of the terms of that individual's existing employment and/or their personal circumstances. Examples of circumstances in which the committee expects it might need to do this are outlined in full in the remuneration policy on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance)

In light of the various legacy pension arrangements enjoyed by the incumbent executive directors, in determining the pension arrangements for any new recruit, the committee expects to offer a defined

contribution arrangement with company contributions not exceeding those set in our approved policy on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance) but would have regard for the recruit's existing arrangements, the market norms in the home country and the existing pension vehicles available within the company

In making any decision on any aspect of the remuneration package for a new recruit, the committee would balance shareholder expectations, current best practice and the requirements of any new recruit and would strive not to pay more than is necessary to achieve the recruitment. The committee would give full details of the terms of the package of any new recruit in the next annual remuneration report

Pearson expects any new chairman or non-executive director to be engaged on terms that are consistent with the general remuneration principles outlined in the relevant sections of this policy. However, in the case of the chairman, the committee may consider it appropriate to offer a remuneration package that differs from that of the existing incumbent if that is necessary to attract the most capable candidate or to reflect the individual's expected duties

**Further information on remuneration policy**

For further information on the following aspects of the remuneration policy, please refer to the full remuneration policy and the RNS statement of further information on the remuneration policy on 9 April 2014 on the Governance page of the company's website at [www.pearson.com/governance](http://www.pearson.com/governance)

- › Selection of performance measures and target setting
- › Legacy arrangements under the annual bonus share matching plan
- › Remuneration policy for other employees
- › Service contracts and termination provisions
- › Employment conditions elsewhere in the company
- › Executive directors' non-executive directorships
- › Shareholder views

## PART 3 – ANNUAL REMUNERATION REPORT

## Annual remuneration report

The remuneration committee presents the annual remuneration report, which will be put to shareholders as an advisory (non-binding) vote at the Annual General Meeting to be held on 24 April 2015

## Remuneration compliance

This report was compiled in accordance with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and was approved by the board of directors on 9 March 2015

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

## This report comprises of a number of sections

Where required under current regulations, the tables marked \*audit have been subject to audit

The remuneration committee and its activities on page 90 to 93

Voting outcome at 2014 Annual General Meeting on page 94

Single figure of total remuneration and prior year comparison on page 95 \*audit

Remuneration paid to the chairman and non-executive directors on page 96 \*audit

Retirement benefits on page 96 \*audit

Annual incentive on page 97 \*audit

Long-term incentives on page 98 \*audit

Movements in directors' interests in share awards on page 99 \*audit

Movements in directors' interests in share options on page 100 \*audit

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Executive directors' non-executive directorships on page 102

Historical performance and remuneration on page 103

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Information on changes to remuneration for 2015 on page 104 and 105

## Report on directors' remuneration continued

**PART 3 – ANNUAL REMUNERATION REPORT****The remuneration committee and its activities****Composition**

Chairman	David Arculus	Independent non-executive director
Members	Elizabeth Corley	
	Vivienne Cox	Independent non-executive directors
	Ken Hydon	
	Josh Lewis	
	Glen Moreno	Chairman of the board
Internal advisers	John Fallon	Chief executive
	Robin Freestone	Chief financial officer
	Melinda Wolfe	Chief human resources officer
	Robert Head	VP executive reward & global share plans
	Stephen Jones	SVP company secretarial
External advisers	Towers Watson	

Glen Moreno is a member of the committee as permitted under the UK Corporate Governance Code

Internal advisers provided material assistance to the committee during the year. They attended meetings of the committee, although none of them was involved in any decisions relating to his or her own remuneration

To ensure that the committee receives independent advice, Towers Watson supplies survey data and advises on market trends, long-term incentives and other general remuneration matters. Towers Watson was selected and appointed by the committee through a formal tendering process. Towers Watson also advised the company on health and welfare benefits in the US and

provided consulting advice directly to certain Pearson operating companies. Towers Watson is a member of the Remuneration Consultants Group, the body which oversees the Code of Conduct in relation to executive remuneration consulting in the UK

During the year, Towers Watson was paid fees for advice to the committee, which were charged on a time spent basis, of £95,100. As part of its annual review of its performance and effectiveness, the committee remains satisfied that Towers Watson's advice was objective and independent and that Towers Watson's provision of other services in no way compromises its independence

**Committee performance**

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

The committee participated in a survey to review its performance and effectiveness in July 2014, looking at areas such as the clarity of roles and responsibilities, the composition of the committee, the use of time, the quality and timeliness of meeting materials, the opportunity for discussion and debate, dialogue with management and access to independent advice

The committee concluded that it is operating effectively and noted the challenges for the year ahead

The committee and its members were subject to a formal third-party external evaluation by JCA Group of the board, its committees and individual directors' performance which was completed at the end of 2014

## REMUNERATION COMMITTEE RESPONSIBILITIES

The committee's principal duties are to

- 1 Determine and review policy** Review and determine the policy for the remuneration of executive directors, the presidents of the principal geographic markets and Lines of Business and other members of the Pearson executive who report directly to the CEO (executive management). This policy includes base salary, short-term incentive, pension arrangements, any other benefits and termination of employment.
- 2 Review and approve implementation** Regularly review the implementation and operation of the remuneration policy for executive management and approve the individual remuneration packages for each of the executive directors.
- 3 Approve performance related plans** Approve and review the arrangements for any performance related plan operated by the company and any other plan to pay to any executive director.
- 4 Review long-term plans** Review the design and implementation of incentive awards that are subject to approval by the board and shareholders.
- 5 Set termination arrangements** Approve and determine severance and termination arrangements in connection with the termination of employment of executive directors.
- 6 Review targets** Review and approve corporate goals and objectives relevant to CEO remuneration and evaluate the CEO's performance in relation to those goals and objectives.
- 7 Determine chairman's remuneration** Have sole responsibility for determining the remuneration and benefits payable to the chairman of the board.
- 8 Appoint remuneration consultants** Appoint and review the independence and any remuneration consultants who advise the committee on the need for such advice.

## Report on directors' remuneration continued

## PART 3 – ANNUAL REMUNERATION REPORT

## Meetings, activities and decisions in 2014

The remuneration committee met four times during 2014, as described below

19 and 20 February  
2014

## MARKET

Noted Towers Watson's overview of the current remuneration environment and 2013/2014 market data

## PERFORMANCE

Noted management's overview of 2013 and 2014 performance and plans

## IMPLEMENTATION

Reviewed and approved the 2013 annual incentive pay-out and 2014 remuneration package for John Fallon

Reviewed chairman's remuneration which remained unchanged

Reviewed and approved 2013 annual incentive plan pay-outs

Reviewed and approved provisional 2011 long-term incentive plan pay-outs (pending confirmation of TSR performance)

Approved vesting of 2011 annual bonus share matching awards and release of shares

## GOVERNANCE

Noted the activity of the standing committee of the board in relation to the operation of the company's equity based reward programmes

Noted company's use of equity for employee share plans

## POLICY

Reviewed and approved 2013 directors' remuneration report

Reviewed and approved increases in base salaries for 2014 for the Pearson executive

Reviewed and approved 2014 Pearson annual incentive plan targets

Reviewed and approved 2014 individual annual incentive opportunities for the Pearson executive

Reviewed long-term incentive awards and associated performance conditions for the Pearson executive

23 April  
2014

## IMPLEMENTATION

Reviewed and noted total remuneration for members of the Pearson executive for 2013 and 2014

Confirmed nil pay-out under 2011 long-term incentive plan

Reviewed and approved 2014 long-term incentive awards and associated performance conditions for the Pearson executive

## GOVERNANCE

Reviewed and approved amendments to plan rules for the worldwide save for shares and long-term incentive plans

## POLICY

Considered approach to 2014 long-term incentive awards for senior leaders and managers below the Pearson executive

## DISCLOSURE

Noted shareholder feedback on 2013 directors' remuneration report and RNS statement of further information on the remuneration policy

## REMUNERATION IN ACTION

## Shareholding by executives supporting performance and strategy

Following consultation on our remuneration policy approved by shareholders in 2014, we introduced two arrangements designed to encourage shareholding by executives and support performance and strategy

First, under the long-term incentive plan, we introduced a mandatory restriction on participants' ability to dispose of the 75% of shares that vest based on performance after three

years (other than to meet personal tax liabilities) for a further two years. Furthermore, participants' rights to the release of the remaining 25% of the vested shares is subject to continued employment over the same period

Secondly, we increased our mandatory shareholding guidelines to 300% of salary for the CEO and 200% of salary for other executive directors. These shareholding

23 July  
2014

#### PERFORMANCE

Noted management's overview of 2014 performance

#### GOVERNANCE

Reviewed the committee's charter and terms of reference

Reviewed the committee's performance

#### POLICY

Noted update on 2014 long term incentive awards for senior leaders and managers below the Pearson executive

#### STAKEHOLDERS

Reviewed 2014 Annual General Meeting season, shareholder voting and engagement strategy

4 December  
2014

#### MARKET

Noted update to remuneration aspects of the UK Corporate Governance Code and principles of remuneration of the Investment Management Association

#### PERFORMANCE

Noted management's overview of 2014 performance

Noted and reviewed the status of the outstanding long term incentive awards based on the current view of likely Pearson financial performance

#### DISCLOSURE

Noted template and outline of 2014 report on directors' remuneration and considered shareholder engagement strategy

#### IMPLEMENTATION

Noted remuneration package for new appointment to the Pearson executive, effective 1 January 2015

Noted exit arrangements for a member of the Pearson executive

Reviewed operation of the 2014 annual incentive plan particularly with regard to the Pearson executive

Noted 2014 long term incentive awards for senior leaders and managers below Pearson executive

Considered matter of former CEO's double taxation in the US and UK and related issues

guidelines have also been extended to other members of the Pearson executive at 100% of salary

Together, these arrangements clearly demonstrate the commitment to sustained performance and long term value creation and alignment with shareholders' interests

**"Shareholding by senior executives demonstrates commitment to sustained performance and long-term value creation and alignment with shareholders' interests."**

David Arculus Chairman of the remuneration committee

## Report on directors' remuneration continued

**PART 3 – ANNUAL REMUNERATION REPORT****Voting outcome at 2014 Annual General Meeting**

The following table summarises the details of votes cast in respect of the resolutions on the report on directors' remuneration at the 2014 Annual General Meeting

Report	Votes for	Votes against	Total votes cast	Votes withheld (abstentions)
Remuneration policy	517,308,446 95.76% of votes cast	22,905,879 4.24% of votes cast	540,214,325 65.96% of issued share capital	6,004,239
Annual remuneration report	349,696,505 65.83% of votes cast	181,521,643 34.17% of votes cast	531,218,148 64.86% of issued share capital	15,000,416

The committee took this significant vote against the 2013 annual remuneration report very seriously and considered the voting result and shareholder engagement strategy at their April, July and December 2014 meetings.

The primary reason for the vote against was clear: investors' objection to the committee exercising its discretion to allow a portion of Rona Fairhead's 2011 LTIP award to vest without reference to performance. The committee acknowledges that the approved remuneration policy provides a comprehensive remuneration framework with clear limits and as a result issues of a similar nature will not arise in the future.

We consulted on this voting outcome and this disclosure in the 2014 annual remuneration report with our major shareholders and shareholder representative bodies, who were broadly satisfied with both the process for engagement and the explanation given.

As in previous years and as required by law, details of the voting on all resolutions at the 2015 Annual General Meeting will be announced via the RNS and posted on the Pearson website following the Annual General Meeting.



## Single total figure of remuneration and prior year comparison

Total aggregate emoluments for executive and non-executive directors were £4,206m in 2014. These emoluments are included with total employee benefit expense in note 5 to the financial statements (page 141)

## Executive directors

The remuneration received by executive directors in respect of the financial years ending 31 December 2014 and 31 December 2013 is set out below

## Executive director remuneration

Element of remuneration £000s	John Fallon		Robin Freestone		Total	
	2014	2013	2014	2013	2014	2013
Base salary	761	750	553	545	1,314	1,295
Allowances and benefits	83	43	15	14	98	57
Travel	50	15	12	12	62	27
Healthcare	2	3	2	2	4	5
Risk	31	25	1	-	32	25
Annual incentives	692	463	365	341	1,057	804
Percentage of maximum (%)	51%	34%	39%	37%	-	-
Percentage of target (%)	91%	62%	78%	74%	-	-
Percentage of salary (%)	91%	62%	66%	63%	-	-
Long-term incentives	74	141	63	181	137	322
LTIP	-	-	-	-	-	-
ABSMIP	-	-	-	-	-	-
Dividend equivalents	74	141	63	181	137	322
Retirement benefits	285	330	166	163	451	493
Defined contribution cost	-	-	23	22	23	22
Defined benefit accrual	87	135	-	-	87	135
Allowances in lieu of benefits	198	195	143	141	341	336
<b>Total remuneration</b>	<b>1,895</b>	<b>1,727</b>	<b>1,162</b>	<b>1,244</b>	<b>3,057</b>	<b>2,971</b>

Single total figure of remuneration In accordance with the regulations, we show a single total figure of remuneration which includes retirement benefits and long term incentives in addition to the other elements of remuneration that have been shown in previous reports

Base salary In accordance with policy, the committee considered a report from the chief executive and chief human resources officer on general pay trends in the market and the level of pay increases across the company as a whole. For 2014, the company had reiterated its standing principles that base compensation provides the appropriate rate of remuneration for the job taking into account relevant recruitment markets, business sectors and geographical regions and that total remuneration should reward both short and long term results, delivering competitive rewards for target performance, but higher rewards for exceptional company performance. For the US and UK, the budget guideline issued at the end of September 2013 for adjustments to base pay for 2014 was 3% although business units with an April review date operated to a 2% salary increase pool. Local inflation rates and market conditions were taken into account in particular markets.

Allowances and benefits Travel benefits comprise company car allowance and private use of a driver. Health benefits comprise healthcare, health assessment and gym subsidy. Risk benefits comprise additional life cover and long term disability insurance. In addition to the above benefits and allowances, executive directors may also participate in company benefit or policy arrangements that have no taxable value.

The increase in travel benefits for John Fallon is attributable to the first full-year of reporting of his private use of a driver based on the benefit in kind charge for the 2013/2014 tax year.

Annual incentive For more detail, see table on page 97. Annual incentives for the directors are funded by Pearson global annual financial results and pay out to take into account individual performance against personal objectives.

Long term incentives The single figure of remuneration for 2014 includes all long term incentive awards that were subject to a performance condition where the performance period ended or was substantially (but not fully) completed at 31 December 2014 and awards where the performance condition has been satisfied but where the release of shares is subject to a further holding period. The same methodology has been applied for the single figure of remuneration for 2013.

In 2014, the performance conditions for the 2012 LTIP and 2012 ABSMIP were not met so there is nothing to report in the single figure of remuneration for 2014. The executive directors both held vested shares under the 2009 LTIP that were released on 1 April 2014 at the end of the two year holding period and these shares were part of the single figure of remuneration for 2012 as reported in the 2012 report on directors' remuneration. However, the dividend equivalent shares that were awarded and released on 1 April 2014 have been included in the single figure of remuneration for 2014 as below.

Director	Date of award and release	Number of shares	Value	Share price on release
John Fallon	1 Apr 14	7,054	£73,644	1.044 Op
Robin Freestone	1 Apr 14	6,046	£63,120	1.044 Op

Retirement benefits For more detail, see table on page 96

## Report on directors' remuneration continued

**PART 3 – ANNUAL REMUNERATION REPORT****Chairman and non-executive director remuneration**

The remuneration paid to the chairman and non-executive directors in respect of the financial years ending 31 December 2014 and 31 December 2013 is as follows

Director £000s	2014						2013					
	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total
Glen Moreno	500	–	–	–	–	500	500	–	–	–	–	500
David Arculus	68	21	14	–	2	105	65	20	10	–	1	96
Elizabeth Corley (appointed 1 May 2014)	47	–	4	–	1	52	–	–	–	–	–	–
Vivienne Cox	68	7	22	21	6	124	65	–	15	20	5	105
Ken Hydon	68	27	8	–	8	111	65	25	5	–	5	100
Josh Lewis	68	–	8	–	9	85	65	–	13	–	9	87
Linda Lorimer	68	–	17	–	8	93	33	–	–	–	3	36
Harish Manwani	68	–	4	–	7	79	16	–	–	–	1	17
<b>Total</b>	<b>955</b>	<b>55</b>	<b>77</b>	<b>21</b>	<b>41</b>	<b>1,149</b>	<b>809</b>	<b>45</b>	<b>43</b>	<b>20</b>	<b>24</b>	<b>941</b>

Note: Taxable benefits refer to travel, accommodation and subsistence expenses incurred while attending board meetings during 2014 that were paid or reimbursed by the company which are deemed by HMRC to be taxable in the UK. The amounts in the table above include the grossed up cost of UK tax to be paid by the company on behalf of the directors. Total remuneration for 2013 is re-stated to include these taxable expenses. The company has made a voluntary disclosure to HMRC to settle the tax liability for taxable expenses in prior tax years.

**Retirement benefits**

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

Director	Plans	Normal retirement age	Accrued pension at 31 Dec 14 £000 <sup>1</sup>	Value of defined benefit pension over the period £000 <sup>2</sup>	Other pension costs to the company over the period £000 <sup>3</sup>	Other allowances in lieu of pension £000 <sup>4</sup>	Total annual value in 2014 £000 <sup>5</sup>
John Fallon	Pearson Group Pension Plan Accrual rate of 1/30th of pensionable salary per annum. Taxable and non-pensionable cash supplement	62	80.7	86.7	–	197.7	284.4
Robin Freestone	Money Purchase 2003 section of the Pearson Group Pension Plan. Taxable and non-pensionable cash supplement	62	–	–	22.6	143.4	166.0

Note 1: The accrued pension at 31 December 2014 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2014. For John Fallon it relates to the pension payable from the UK plan. Robin Freestone does not accrue defined benefits.

Note 2: This column comprises the increase in the directors' accrued pension over the period (net of inflation<sup>6</sup> multiplied by 20 and from which the directors' contributions are deducted).

Note 3: This column comprises contributions to defined contribution arrangements for UK benefits.

Note 4: This column represents the cash allowances paid in lieu of the previous EURBS arrangements for John Fallon and Robin Freestone.

Note 5: Total annual value is the sum of the previous three columns.

Note 6: There are no additional benefits or special arrangements under the retirement plans for directors who retire before their normal retirement date.

### Annual incentive pay-out in 2014

For 2014, annual incentives were funded by Pearson global annual financial results based on the performance measures set out below. Individual pay-outs take into account performance against personal objectives. Actual performance against the financial targets for 2014 was as follows:

Measures	Weighting	Threshold for 2014	Target for 2014	Maximum for 2014	Actual performance in 2014	Pay-out in 2014 (% of target)
Group EPS (p)	60%	57.0	68.2	79.5	66.7	86%
Group sales (£m)	20%	4,695	4,995	5,295	4,883	63%
Operating cash flow (£m)	20%	565.5	678.6	791.7	648.9	74%
<b>Total</b>	<b>100%</b>					<b>79%</b>

Note 1: Pearson's reported financial results for the relevant period were used to measure performance.

Note 2: The annual incentive plan is designed to incentivise and reward underlying performance excluding the effect of foreign exchange and portfolio changes (acquisitions and disposals) and other factors that the committee considers relevant in the performance year. Targets, thresholds and maxima are expressed at 2014 actual exchange rates (£1/\$1.6488). The targets, thresholds and maxima were originally set at plan exchange rates (£1/\$1.60) and have been adjusted to actual exchange rates for comparison against actual performance to negate the effect of exchange rate movements.

Note 3: No discretion has been exercised to adjust the resulting underlying pay-outs.

## Report on directors' remuneration continued

## PART 3 – ANNUAL REMUNERATION REPORT

## Long-term incentives

The status of outstanding awards under the long-term incentive plan (LTIP) and the legacy annual bonus share matching plan (ABSMP) and performance against the performance conditions as at 31 December 2014 are described in the table below

For each executive director, details of awards under the LTIP and ABSMP that were awarded, vested, released, lapsed or held during 2014 are summarised in the adjacent table

## Status of outstanding awards under the long-term incentive plan and annual bonus share matching in 2014

Plan	Date of award	Share price on date of award	Vesting date	Performance measures	Performance period	Pay-out at threshold	Pay-out at maximum	Actual performance	% of award vested	Status
LTIP	1 May 2014	1102 Op	1 May 2017	Relative TSR	2014 to 2017	30% at median	100% at upper quartile		-	Outstanding subject to performance
				ROIC	2016	30% for ROIC of 6.5%	100% for ROIC of 7.5%			
				EPS growth	2016 compared to 2013	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%			
LTIP	1 May 2013	1183 Op	1 May 2016	Relative TSR	2013 to 2016	30% at median	100% at upper quartile		-	Outstanding subject to performance
				ROIC	2015	0% for ROIC of 8.5%	100% for ROIC of 10.5%			
				EPS growth	2015 compared to 2012	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%			
LTIP	2 May 2012	1161 Op	2 May 2015	Relative TSR	2012 to 2015	30% at median	100% at upper quartile	19th percentile	Nil	Estimated to lapse in 2015
				ROIC	2014	0% for ROIC of 8.5%	100% for ROIC of 10.5%	5.6%	Nil	Will lapse in 2015
				EPS growth	2014 compared to 2011	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	8.3%	Nil	Will lapse in 2015
ABSMP	15 May 2013	1206 Op	15 May 2016	Real compound annual EPS growth	2012 to 2015	50% of matching award for EPS growth of 3.0%	100% of matching award for EPS growth of 5.0%	-	-	Outstanding subject to performance
ABSMP	15 May 2012	1152 Op	15 May 2015	Real compound annual EPS growth	2011 to 2014	50% of matching award for EPS growth of 3.0%	100% of matching award for EPS growth of 5.0%	10.5%	Nil	Performance condition not met. Will lapse in 2015

## Movements in directors' interests in share awards during 2014

Plan	Date of award	Vesting date	Number of shares as at 1 Jan 2014	Awarded	Released	Dividends awarded and released	Lapsed	Number of shares as at 31 Dec 2014	Status
<b>John Fallon</b>									
LTIP	1 May 2014	1 May 2017	0	274 000	-	-	-	274 000	Outstanding subject to performance
LTIP	1 May 2013	1 May 2016	250 000	-	-	-	-	250 000	Outstanding subject to performance
LTIP	2 May 2012	2 May 2015	100 000	-	-	-	100 000	0	Expected to lapse in 2015
LTIP	3 Mar 2010	3 Mar 2013	13 752	-	-	-	-	13 752	Vested and held until 3 Mar 2015 (75% vested shares released in 2013)
LTIP	3 Mar 2009	3 Mar 2012	29 887	-	29 887	7 054	-	0	Released 1 Apr 2014 (75% vested shares released in 2012)
ABSMP	15 May 2013	15 May 2016	6 083	-	-	-	-	6 083	Outstanding subject to performance
ABSMP	15 May 2012	15 May 2015	8 917	-	-	-	8 917	0	Will lapse in 2015
<b>Total</b>			<b>408 639</b>	<b>274 000</b>	<b>29 887</b>	<b>7 054</b>	<b>108 917</b>	<b>543 835</b>	

**Robin Freestone**

LTIP	1 May 2014	1 May 2017	0	162 000	-	-	-	162 000	Outstanding subject to performance
LTIP	1 May 2013	1 May 2016	150 000	-	-	-	-	150 000	Outstanding subject to performance
LTIP	2 May 2012	2 May 2015	100 000	-	-	-	100 000	0	Expected to lapse in 2015
LTIP	3 Mar 2010	3 Mar 2013	11 460	-	-	-	-	11 460	Vested and held until 3 Mar 2015 (75% vested shares released in 2013)
LTIP	3 Mar 2009	3 Mar 2012	25 617	-	25 617	6 046	-	0	Released 1 Apr 2014 (75% vested shares released in 2012)
ABSMP	15 May 2012	15 May 2015	17 833	-	-	-	17 833	0	Will lapse in 2015
<b>Total</b>			<b>304 910</b>	<b>162 000</b>	<b>25 617</b>	<b>6 046</b>	<b>117 833</b>	<b>323 460</b>	

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

Note 2 Vested means where awards are no longer subject to performance conditions. Released means where shares have been transferred to participants. Held means where awards have vested but shares are held pending release on the relevant anniversary of the award date. Outstanding means awards that have been granted but are still subject to the achievement of performance conditions. Dividends refers to dividend equivalent shares that have been added without performance conditions to vested shares under the LTIP and released immediately on a vest.

Note 3 No variations to terms and conditions of plan interests were made during the year.

Note 4 In relation to the LTIP award made on 1 May 2014, pay out is 50% of maximum for attainment of ROIC of 7%.

Note 5 The value of the LTIP awards in 2014 for the executive directors is shown below based on a share price on the date of award of £102.0p.

Director	Date of award	Vesting date	Number of shares	Face value (£)	Face value (% of 2014 salary)	Value for threshold performance (% of 2014 salary)
John Fallon	1 May 2014	1 May 2017	274 000	£3 019 480	397%	119%
Robin Freestone	1 May 2014	1 May 2017	162 000	£1 785 240	323%	97%

Note 5 For the LTIP award made on 2 May 2012 and due to vest on 2 May 2015 we have estimated the out-turn of the relative TSR performance condition based on performance as at 9 February 2015 at nil. If actual relative TSR performance is different on the date of vesting, we will set this out in the annual remuneration report for 2015.

Note 6 The single figure of remuneration for 2014 includes all awards that were subject to a performance condition where the performance period ended, or was substantially (but not fully) completed, at 31 December 2014 and awards where the performance condition has been satisfied but where the release of shares is subject to a further holding period. The same methodology has been applied for earlier periods and the single figure for earlier reporting periods has been restated where necessary.

Note 7 The value of shares included in the single figure of remuneration is the number of shares multiplied by the share price on release.

## Report on directors' remuneration continued

## PART 3 – ANNUAL REMUNERATION REPORT

## Movements in directors' interests in share options during 2014

John Fallon and Robin Freestone also hold options under the worldwide save for shares plan as follows

Director	Date of grant	Number of shares under option held as at 31 Dec 2014	Option price	Earliest exercise date	Expiry date	Value in 2014 single figure £000
John Fallon	7 May 2010	1,930	805.6p	1 Aug 15	1 Feb 16	0
	30 Apr 2014	1,109	811.2p	1 Aug 17	1 Feb 18	0
Robin Freestone	4 May 2012	990	909.0p	1 Aug 15	1 Feb 16	0
	30 Apr 2014	1,109	811.2p	1 Aug 17	1 Feb 18	0

Note 1 No share option awards were vested or were exercised in the year

Note 2 No variations to terms and conditions of share options were made during the year

Note 3 Acquisition of shares under the worldwide save for shares plan is not subject to a performance condition

Note 4 All share options that become exercisable during a year are included in the single figure of total remuneration for that year. The value included in the single figure of total remuneration is the number of options multiplied by the difference between the value on grant and the market value on the earliest exercise date. No share options were exercisable during 2014 and so there is nothing to include in the single figure of total remuneration for 2014.

Note 5 The market price on 31 December 2014 was 1,190.0p per share and the range during the year was 998.0p to 1,340.0p.

## Payments to former directors

It is the committee's intention to disclose any payments to past directors including the release of share-based awards post-departure.

The number of shares retained from the number of shares originally awarded takes into account lapses due to performance, releases prior to ceasing to be a director and pro-rating for service in the performance period (where applied).

## 2012 long-term incentive awards

As set out in the annual remuneration report for 2013, Marjorie Scardino, Rona Fairhead, John Makinson and Will Ethridge retained long-term incentive plan awards made on 2 May 2012, all subject to performance. As disclosed elsewhere in this report, these awards are expected to lapse in 2015.

## Will Ethridge

As set out in the annual remuneration report for 2013, Will Ethridge stepped down from the board on 31 December 2013. He continued to be eligible for the same base salary, annual incentive and other benefits in accordance with his service agreement with the company until he retired on 31 December 2014. No compensation for loss of office or severance was paid on his stepping down from the board, or on his retirement.

As also reported in the annual remuneration report for 2013, Will Ethridge retained 100,000 (two thirds) of the shares awarded on 1 May 2013. The committee also approved an award of 116,000 performance related shares for Will Ethridge for 2014 on the same terms as the 2014 awards for members of the Pearson executive. In accordance with policy and after having carefully considered all relevant factors, the committee further determined in its absolute discretion that on his retirement from the company on 31 December 2014, Will Ethridge would retain a pro-rata entitlement of one-third of this award (i.e. 38,666 shares) which would vest or not, subject to performance in 2017.

## Marjorie Scardino

Because of payroll processing errors during the years 2007 to 2010, taxes deducted from Marjorie Scardino's compensation were incorrectly allocated by Pearson among tax authorities in the UK and the US. This resulted in her being subject to temporary double taxation. The committee has concluded in principle that Pearson should reimburse (on an after-tax basis) certain costs incurred by Marjorie Scardino in funding a proportion of the double-tax obligation. Details of any reimbursement will be included in a subsequent annual remuneration report.

## Non-executive directors

The company's voluntary disclosure to HMRC regarding the taxable reimbursement of expenses for tax years prior to 2014 includes non-executive directors who are no longer employed by the company.

### Payments for loss of office

As announced to the stock exchange on 24 October 2014 and 27 February 2015, Robin Freestone will be stepping down from the board on 1 August 2015 and leaving the company during 2015. There will be no payment for loss of office.

At the time of writing, no further decisions have been made about whether and how the committee might exercise its discretion under Pearson's discretionary share plans. In accordance with policy, the committee will have regard to all relevant circumstances including distinguishing between different types of leaver, the circumstances at the time the award was originally made, his performance, and the circumstances in which he left employment. In the event that discretion is so exercised in Robin's favour, the details will be included in a subsequent annual remuneration report.

### Directors' interests in shares and value of shareholdings

#### Directors' interests

The share interests of the continuing directors and their connected persons are as follows:

Director	Number of ordinary shares at 31 Dec 14	Number of conditional shares at 31 Dec 14	Total number of ordinary and conditional shares at 31 Dec 14	Value (% salary)	Guideline (% salary)	Guideline met
<b>Chairman</b>						
Glen Moreno	200,000	--	--	--	--	--
<b>Executive directors</b>						
John Fallon	282,147	13,752	295,899	549%	300%	✓
Robin Freestone	504,283	11,460	515,743	1,317%	200%	✓
<b>Non-executive directors</b>						
David Arculus	17,117	--	--	--	--	--
Elizabeth Corley	468	--	--	--	--	--
Vivienne Cox	2,123	--	--	--	--	--
Ken Hydon	18,634	--	--	--	--	--
Josh Lewis	6,632	--	--	--	--	--
Linda Lorimer	1,581	--	--	--	--	--
Harish Manwani	1,392	--	--	--	--	--

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

Note 2: The current value of the executive directors' holdings of ordinary and conditional shares is based on the mid-market value of Pearson shares of 1420p on 27 February 2015 against base salaries in 2014. All executive directors comfortably exceeded the shareholding guidelines. The shareholding guidelines do not apply to the chairman and non-executive directors.

Note 3: Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals investing part of their own after-tax annual bonus in Pearson shares under the annual bonus share matching plan.

Note 4: The register of directors' interests (which is open to inspection during normal office hours) contains full details of directors' shareholdings and options to subscribe for shares. The market price on 31 December 2014 was 1,190.0p per share and the range during the year was 998.0p to 1,340.0p.

Note 5: There were no movements in ordinary shares between 1 January 2015 and a month prior to the sign-off of this report.

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

## Report on directors' remuneration continued

## PART 3 – ANNUAL REMUNERATION REPORT

## Interests of directors and value of shareholdings

IMAGE REMOVED

**Shareholding guidelines**

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership and to align further the interests of executives and shareholders. With effect from 2014, target holding is 300% of salary for the chief executive and 200% of salary for the other executive directors.

Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children plus any shares vested but held pending release under a restricted share plan. Executive directors have five years from the date of appointment to reach the guideline.

With effect from 2014, these guidelines have been extended to include all members of the Pearson executive at 100% of salary.

The shareholding guidelines do not apply to the chairman and non-executive directors. However, a minimum of 25% of the basic non-executive directors' fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

**Dilution and use of equity**

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

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

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

At 31 December 2014, stock awards to be satisfied by new-issue equity granted in the last ten years under all Pearson share plans amounted to 1.7% of the company's issued share capital. No stock awards granted in the last ten years under executive or discretionary share plans will be satisfied by new-issue equity.

In addition, for existing shares, no more than 5% of Pearson equity may be held in trust at any time. Against this limit, shares held in trust at 31 December 2014 amounted to 0.9% of the company's issued share capital.

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

Headroom	2014	2013	2012
All Pearson plans	8.3%	8.4%	8.3%
Executive or discretionary plans	5.0%	5.0%	5.0%
Shares held in trust	4.1%	3.8%	3.8%

**Executive directors' non-executive directorships**

Executive directors served as non-executive directors elsewhere but either waived or did not receive fees.



### Historical performance and remuneration

#### Total shareholder return performance

We set out below Pearson's total shareholder return (TSR) performance relative to the FTSE All-Share index on an annual basis over the six-year period 2008 to 2014. This comparison has been chosen because the FTSE All-Share represents the broad market index within which Pearson Shares are traded. TSR is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends (source: DataStream).

IMAGE REMOVED

In accordance with the reporting regulations, this section also presents Pearson's TSR performance alongside the single figure of total remuneration for the CEO over the last six years and a summary of the variable pay outcomes relative to the prevailing maximum at the time. The table below summarises the total remuneration for the CEO over the last five years and the outcomes of annual and long-term incentive plans as a proportion of maximum.

Financial year ending	2009	2010	2011	2012	2013	2014
Total remuneration – John Fallon (single figure, 000s)	–	–	–	–	1,727	1,895
Total remuneration – Marjorie Scardino (single figure, 000s)	6,370	8,466	8,340	5,330	–	–
Annual incentive – incumbent (% of maximum)	91.3%	92.1%	75.7%	24.2%	34.3%	50.5%
Long-term incentive – incumbent (% of maximum)	80.0%	97.5%	68.3%	36.7%	Nil	Nil

Annual incentive is the actual annual incentive received by the incumbent as a percentage of maximum opportunity.

Long-term incentive is the pay out of performance related restricted shares under the long-term incentive plan where the year shown is the final year of the performance period for the purposes of calculating the single total figure of remuneration.

Total remuneration – John Fallon: John Fallon's total remuneration opportunity is lower than that of the previous incumbent. Variable pay outs under the annual and long-term incentive plans reflect performance for the relevant periods.

## Report on directors' remuneration continued

## PART 3 – ANNUAL REMUNERATION REPORT

## Comparative information

The following information is intended to provide additional context regarding the total remuneration for executive directors

## Relative percentage change in remuneration for CEO

The following table sets out the change between 2013 and 2014 in three elements of remuneration for the CEO, in comparison to the average for all employees

While the committee considers the increase in base pay for the CEO relative to the broader employee population benefits are driven by local practices and eligibility is determined by level and individual circumstances which do not lend themselves to comparison

	Base salary	Allowances and benefits	Annual incentives	Total
CEO	15%	93%	49%	22%
All employees	1%	-9%	4%	0%

Note 1 The figures for all employees reflect average salaries and average employee numbers each year. Annual incentives include all plans including sales incentives

Note 2 The increase in allowances and annual incentives for John Fallon is attributable respectively to (a) the first full year of reporting of his private use of a driver based on the benefit in-kind charge for the 2013/2014 tax year and (b) the year-on-year increase in his payout under the Pearson annual incentive plan

## Relative importance of pay spend

The committee considers directors' remuneration in the context of the company's allocation and disbursement of resources to different stakeholders

In particular, we chose operating profit because this is a measure of our ability to reinvest in the company. We include dividends because these constitute an important element of our return to shareholders

£m	2014	2013	Year-on-year change	
			£m	%
Operating profit	722	736	-14	-2%
Dividends	397	372	25	7%
Total wages and salaries	1,728	1,836	-108	-6%

Note 1 Operating profit is as set out in the financial statements

Note 2 Wages and salaries include continuing operations only and exclude directors. 2013 is restated on the same basis. Average employee numbers for continuing operations for 2014 were 40,876 (2013: 47,115). Further details are set out in note 5 to the financial statements on page 141

## Information on changes to remuneration for 2015

## Executive directors' base salaries

We have undertaken a regular periodic review of base salaries for 2015, taking into account general economic and market conditions, the level of increases made across the company as a whole, the remuneration of executives in similar positions in comparable companies and individual performance

As a result of this review, the 2015 base salaries for the CEO and CFO are as follows

£000s	John Fallon	Robin Freestone
Base salary at 31 December 2014	£765	£556
Increase	£15.3	£0
	2%	0%
Base salary at 1 April 2015	£780.3	£556

## Annual incentive

The key design principles underlying the company's approach to annual incentives for 2015 are the same as for 2014, namely

- › Full alignment of annual incentives with the global education strategy to reinforce a 'one Pearson' focus
- › A clear, transparent, coherent, consistent, organisation-wide approach to incentives and performance management with a common incentive framework for Lines of Business, Geographies and enabling functions
- › The size of the overall annual incentive pay-out will be linked to overall Pearson performance

For 2015, there will be no change to the overall Pearson performance measures, namely adjusted earnings per share (60% weighting), sales (20%) and cash flow (20%)

The Pearson financial targets will be set each year as part of the normal operating plan process. The CEO and CFO will recommend the overall Pearson incentive funding metrics (including performance measures, targets and weightings) to the committee for approval in the normal way

There will be no change in individual annual incentive opportunities for the executive directors and the Pearson executive

Annual incentive pay-outs are determined according to a combination of Pearson-wide performance and individual goals. The sum of the CEO's and the Pearson executives' on-target annual incentive constitutes the incentive pool for this group which flexes up or down based on overall Pearson performance. Individual performance is assessed against goals set at the start of the year. Individual pay-outs up to individual maximum opportunities and within the total pool are recommended by the CEO (or by the chairman in the case of the CEO himself) for review and, in the case of the executive directors, for approval by the committee.

The committee considers the performance targets for 2015 to be commercially sensitive. Details of performance measures, weightings and targets will be disclosed in the annual remuneration report for 2015 if and to the extent that the committee deems them to be no longer commercially sensitive.

#### Long-term incentives

The committee will continue to operate the long-term incentive plan for the executive directors and other members of the Pearson executive in line with the arrangements outlined in the 2013 report on directors' remuneration.

- › The weighting of the performance metrics will be half on earnings per share growth, one-third on return on invested capital and one-sixth on relative total shareholder return.
- › Performance will be tested over three years and 75% of the vested shares will be released at that point. However, there is a mandatory restriction on participants' ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further two years. Furthermore, participants' rights to the release of the 25% of the vested shares are subject to continued employment over the same period.

- › For 2015 and onwards, the averaging period for the calculation of relative total shareholder return will be moved to the period running up to the year end and the length of the averaging period will be increased to three months.

In addition, we will reduce the proportion of the maximum award that vests for threshold performance on all measures from 30% to 25% in line with institutional investors' preferences.

At the time of writing, the committee has yet to approve the 2015 long-term incentive awards and the associated performance targets for the executive directors and other members of the Pearson executive.

We will set the level of individual awards consistent with those seen in recent years and within the policy maximum taking into account:

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

We will set targets for the 2015 awards that are consistent with the company's strategic objectives over the period to 2017.

Full details of individual awards for the executive directors and the performance targets for 2015 will be set out in the annual remuneration report for 2015.

## Report on directors' remuneration continued

## PART 3 – ANNUAL REMUNERATION REPORT

**Appointment of CFO**

As announced to the stock exchange on 27 February 2015, Coram Williams will join Pearson as CFO designate on 1 July, and succeed Robin Freestone as CFO on 1 August, when he will also replace Robin on the Pearson board as an executive director. Full details of the terms of Coram's remuneration package will be included in the annual remuneration report for 2015.

The package will be in accordance with, and within the limits of, our approved remuneration policy and will comprise inter alia a base salary of £515,000 per year, an annual incentive opportunity of 85% of salary at target (up to 170% of salary at maximum) with any pay-out for 2015 being calculated pro-rata for his service, miscellaneous and family relocation allowances and temporary accommodation assistance in accordance with policy, membership of the Final Pay Section of the Pearson Group Pension Plan with an accrual rate of 1/60th of pensionable salary, subject to the Plan earnings cap (£145,800 per year for the 2014/2015 tax year), in accordance with earlier commitments given to him about the arrangements that would apply should he rejoin Pearson in the UK having moved from Pearson to Penguin US and subsequently Penguin Random House, and eligibility for long-term incentive awards on the terms normally applicable to executive directors and other members of the Pearson executive. Full details of his award will be disclosed in the 2015 report on directors' remuneration. There will be no compensation for incentives foregone at his previous employer.

In accordance with policy, the period of notice he would be required to give to terminate his employment would be 6 months and that which he would be entitled to receive from the company would be 12 months. In circumstances of termination of employment without cause, he would be entitled to contractual pay-in-lieu of notice comprising 12 months' base salary and annual cost of providing pension and other benefits (but excluding annual incentive). Payment in lieu may be paid in instalments and subject to reduction taking into account alternative employment.

**Chairman and non-executive directors**

The salary for the chairman and fees for the non-executive directors remain unchanged for 2015. Full details will be set out in the annual remuneration report and included in the single figure of total remuneration for 2015.



IMAGE REMOVED

David Arculus Director  
9 March 2015

## Additional disclosures

### REPORT OF THE DIRECTORS

Pages 57 to 112 of this document comprise the directors' report for the year ended 31 December 2014

Other information that is required by the Companies Act 2006 (the Act) to be included in the directors' report, and which is incorporated by reference, can be located as follows

Summary disclosures index	See more
Dividend recommendation	p12
Financial instruments and financial risk management	Note 19
Important events since year end	p193
Future development of the business	p06-09
Research and development activities	p43
Employment of disabled persons	p50
Employee involvement	p48
Greenhouse gas emissions	p53

There is no information to be disclosed in accordance with Listing Rule 9.8.4

#### Going concern

Having reviewed the Group's liquid resources and borrowing facilities and the Group's 2015 and 2016 cash flow forecasts, the directors believe that the Group has adequate resources to continue as a going concern for at least the next 12 months. For this reason, the financial statements have, as usual, been prepared on that basis. Information regarding the Group's borrowing liabilities and financial risk management can be found in notes 18 and 19 on pages 164 to 172.

#### Share capital

Details of share issues are given in note 27 to the accounts on page 186. The company has a single class of shares which is divided into ordinary shares of 25p each. The ordinary shares are in registered form. As at 31 December 2014, 819,882,967 ordinary shares were in issue. At the AGM held on 25 April 2014, the company was authorised, subject to certain conditions, to acquire up to 81,903,781 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 24 April 2015.

Information provided to the company pursuant to the Financial Conduct Authority's Disclosure and Transparency Rules (DTR) is published on a Regulatory Information Service and on the company's website.

As at 4 March 2015, being the latest practicable date before the publication of this report, the company had been notified under DTR5 of the following significant voting rights in its shares:

	Number of voting rights	Percentage as at date of notification
BlackRock, Inc	41,458,030	5.05%

#### Annual General Meeting

The notice convening the AGM, to be held at 12 noon on Friday, 24 April 2015 at 8 Northumberland Avenue, London WC2N 5BY, is contained in a circular to shareholders to be dated 20 March 2015.

#### Registered auditors

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

#### Auditors' independence

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

These allowable services are in accordance with relevant UK and US legislation. The audit committee approves all audit and non-audit services provided by PwC. Certain categories of allowable non-audit services have been pre-approved by the audit committee subject to the authorities below.

- Pre-approved non-audit services can be authorised by the chief financial officer up to £100,000 per project, subject to a cumulative limit of £500,000 per annum.

## Additional disclosures continued

## REPORT OF THE DIRECTORS

- › Acquisition or disposal transactions and due diligence up to £100,000 per project may be performed by our external auditors, in light of the need for confidentiality. Any project/transaction generating fees in excess of £100,000 must be specifically approved by the audit committee.
- › Tax compliance and related activities up to the greater of £1,000,000 per annum or 50% of the external audit fee.
- › For forward-looking tax advisory services we use the most appropriate adviser, usually after a tender process. Where we decide to use our independent auditors, authority, up to £100,000 per project subject to a cumulative limit of £500,000 per annum, has been delegated by the audit committee to management.

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

The audit committee receives regular reports summarising the amount of fees paid to the auditors. During 2014, Pearson spent considerably less on non-audit fees with PwC compared to 2013, when there was significant expenditure related to specific assurance and tax advisory services associated with the creation of the venture between Penguin and Random House. For 2014, non-audit fees represented 37% of external audit fees (89% in 2013).

For all non-audit work in 2014, PwC were selected only after consideration that they were best able to provide the services we required at a reasonable fee and within the terms of our external auditors policy. To assist in ensuring that independence and objectivity is maintained, for forward-looking tax advisory and due diligence work PwC assign a different partner from the one leading the external audit.

Significant non-audit work performed by PwC during 2014 included

- › Tax compliance services related to a routine audit by the US Internal Revenue Service
- › Tax advisory work on a number of UK, US and international tax matters
- › Audit related work in relation to potential and actual corporate finance transactions
- › Assurance services on a corporate bond issued in May 2014

A full statement of the fees for audit and services is provided in note 4 to the accounts on page 140.

## Fair, balanced and understandable reporting

As required by the Code, we have established arrangements to ensure that all information we report to investors and regulators is fair, balanced and understandable. A process and timetable for the production and approval of this year's report was agreed by the board and audit committee at their meetings in December 2014. The full board then had opportunity to review and comment on the report as it progressed.

Representatives from financial reporting, corporate affairs, company secretarial and internal audit and compliance are involved in the preparation of the Annual report to ensure a cohesive and balanced approach and, as with all of our financial reporting, our disclosure committee conducts a thorough verification of narrative and financial statements.

The audit committee is also available to advise the board on certain aspects of the report, to enable the directors to fulfil their responsibility in this regard.

## Directors in office

The following directors were in office during the year and up until signing of the financial statements:

G R Moreno  
J J Fallon  
R A D Freestone  
T D G Arculus  
E P L Corley (appointed 1 May 2014)  
V Cox  
K J Hydon  
S J Lewis  
L K Lomner  
H Manwani  
T Score (appointed 1 January 2015)

### Statement of directors' responsibilities

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

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

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

- › Select suitable accounting policies and then apply them consistently
- › Make judgements and accounting estimates that are reasonable and prudent
- › State whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements
- › Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company and/or the Group will continue in business

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

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

Each of the directors listed above confirms that to the best of their knowledge:

- › The Group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group and company
- › The directors' report contained in the Annual Report includes a fair review of the development and performance of the business and the position of the company and Group, together with a description of the principal risks and uncertainties that they face

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

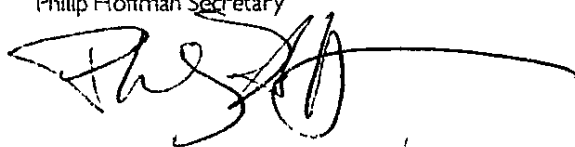
- › So far as the directors are aware, there is no relevant audit information of which the company's auditors are unaware
- › They have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information

In addition, the directors as at the date of this report consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

Approved by the board on 9 March 2015 and signed on its behalf by

IMAGE REMOVED

Philip Hoffman Secretary



## Additional disclosures continued

**ADDITIONAL SHAREHOLDER INFORMATION****Additional information for shareholders**

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

**Amendment to articles of association**

Any amendments to the articles of association of the company (the Articles) may be made in accordance with the provisions of the Act by way of a special resolution

**Rights attaching to shares**

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

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

Shareholders can declare a final dividend by passing an ordinary resolution but the amount of the dividend cannot exceed the amount recommended by the board. The board can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. In all cases the distributable profits of the company must be sufficient to justify the payment of the relevant dividend.

The board may, if authorised by an ordinary resolution of the shareholders, offer any shareholder the right to elect to receive new ordinary shares, which will be credited as fully paid, instead of their cash dividend.

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

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

**Voting at general meetings**

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

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



Pearson operates two employee benefit trusts to hold shares pending employees becoming entitled to them under the company's employee share plans. There were 7,192,412 shares held as at 31 December 2014. Each trust has an independent trustee which has full discretion in relation to the voting of such shares. A dividend waiver operates on the shares held in these trusts.

Pearson also operates a nominee shareholding arrangement known as Sharestore which holds shares on behalf of employees. There were 4,709,325 shares so held as at 31 December 2014. The beneficial owners of shares held through Sharestore are invited to submit voting instructions online at [www.shareview.co.uk](http://www.shareview.co.uk). If no instructions are given by the beneficial owner, the trustees holding these shares will not exercise the voting rights.

#### Transfer of shares

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

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

#### Variation of rights

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

- (i) with the written consent of the holders of at least 75% in nominal value of the issued shares of the relevant class or
- (ii) with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of the relevant class.

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

#### Appointment and replacement of directors

The Articles contain the following provisions in relation to directors:

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

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

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

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

## Additional disclosures continued

**ADDITIONAL SHAREHOLDER INFORMATION****Powers of the directors**

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

**Significant agreements**

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

Under the \$1,750,000,000 revolving credit facility agreement dated August 2014 which matures in August 2019 between, amongst others, the company, Barclays Bank plc (as facility agent) and the banks and financial institutions named therein as lenders (the Facility), any such bank may, upon a change of control of the company, require its outstanding advances, together with accrued interest and any other amounts payable in respect of such Facility, and its commitments to be cancelled, each within 60 days of notification to the banks by the facility agent. For these purposes, a 'change of control' occurs if the company becomes a subsidiary of any other company or one or more persons acting either individually or in concert, obtains control (as defined in section 1124 of the Corporation Tax Act 2010) of the company

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

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## Independent auditors' report to the members of Pearson plc

### Report on the financial statements

#### Our opinion

##### In our opinion

- › Pearson plc's consolidated financial statements and company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the company's affairs as at 31 December 2014 and of the Group's profit and the Group's and the company's cash flows for the year then ended
- › The consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union
- › The company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006
- › The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements Article 4 of the IAS Regulation

#### Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the financial statements, the Group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB)

#### Our audit approach

##### Overview

IMAGE REMOVED

- › Overall Group materiality £26m which represents 4% of adjusted profit before tax as disclosed in note 8. Refer to page 119 for further details
- › We conducted work in five key territories: US, UK, Brazil, China and South Africa. In addition we obtained an audit opinion on the financial information reported by the associate Penguin Random House (PRH)
- › The territories where we conducted audit procedures, together with work performed at corporate functions, shared service centres and consolidated Group level, accounted for approximately 68% of the Group's revenue, 74% of the Group's statutory profit before tax, and 65% of the Group's adjusted profit before tax
- › We focused on
  - Revenue recognition for multiple element and long-term revenue contracts
  - Goodwill and intangible assets impairment reviews
  - Provision for uncertain tax liabilities
  - Returns provisions
  - Recoverability of pre-publication assets and inventories
  - Acquisitions and disposals

In our opinion, the consolidated financial statements comply with IFRSs as issued by the IASB

#### What we have audited

Pearson plc's financial statements comprise

- › The consolidated and company balance sheets as at 31 December 2014
- › The consolidated income statement and consolidated statement of comprehensive income for the year then ended
- › The consolidated and company statements of changes in equity and cash flow statements for the year then ended
- › The notes to the financial statements, which include a summary of significant accounting policies and other explanatory information

Certain required disclosures have been presented elsewhere in the Annual report and accounts (the 'Annual report') rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the company financial statements, as applied in accordance with the provisions of the Companies Act 2006

### The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland))

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated and company financial statements. In particular, we looked at where management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as areas of focus in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the consolidated and company financial statements as a whole. Any comments we make on the results of our procedures should be read in this context. For each area of focus below, to the extent relevant, we evaluated the design and tested the operating effectiveness of key internal controls over financial reporting set in place by management, including testing the operation of IT systems from which financial information is generated. Each of the areas of focus below are also referred to in the audit committee report on pages 74 to 75 and in the accounting policies on pages 128 to 135. This is not a complete list of all risks identified by our audit.

#### Area of focus

#### How our audit addressed the area of focus

### Revenue recognition for multiple element and long-term revenue contracts

Refer to note 1 to the consolidated financial statements. There are two types of complex contracts that require significant judgements and estimates, which could be subject to either accidental errors or deliberate fraud:

- Multiple element arrangements, such as the sale of physical textbooks accompanied by digital content or supplementary workbooks, where revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its fair value
- Certain long-term contracts that span year end, where revenue is recognised using estimated percentage of completion based on costs. These include contracts to design, develop and deliver testing and accreditation and contracts to secure students and support the online delivery of their teaching.

These complex contracts generate material deferred revenue and accrued income balances and are areas where misstatements in the underlying assumptions or estimation calculations could have a material effect on the financial statements.

Where books are sold together with workbooks delivered later or companion digital materials available online we assessed the basis for allocation of the purchase price between each element and then tested the detailed calculations supporting these revenue deferrals. We used our knowledge of the Group and its industry to assess the completeness of identification of such arrangements. We found the revenue deferrals to be based on reasonable estimates of the relative fair value of each element and the methods used to calculate the deferrals properly calculated and consistently applied.

For a selection of the larger, more judgemental and more recent long-term contracts, covering both testing activities and online delivery of teaching, we read the contracts and assessed the accounting policy and methodologies being applied to calculate the proportion of revenue being recognised. We also tested costs incurred to date and management's estimates of forecast costs and revenues by reference to historical experience and current contract status, including examining correspondence where contracts are experiencing disputes.

Our testing showed that revenue recognition practices are in accordance with Group policies with appropriate methods for calculating the revenue recognised.

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## Independent auditors' report to the members of Pearson plc continued

Area of focus	How our audit addressed the area of focus
<p><b>Goodwill and intangible assets impairment reviews</b></p> <p>Refer to note 11 to the consolidated financial statements At year end the Group has £5 030m of goodwill and £1,280m of other intangible assets including software, acquired customer lists, contracts and relationships, acquired trademarks and brands and acquired publishing rights</p> <p>The carrying values of goodwill and intangible assets are contingent on future cash flows and there is risk that, if these cash flows do not meet the Group's expectations, the assets might be impaired The impairment reviews performed by management contain a number of significant judgements and estimates including cash generating unit (CGU) identification, revenue growth, profit margins and discount rate</p> <p>As part of the Group restructuring during the year management identified a new set of aggregated CGUs and reallocated goodwill accordingly These changes included a new North America aggregated CGU and the disaggregation of the Growth segment into its main constituent countries (refer to note 11 for details)</p> <p>For the larger aggregated CGUs management's model identified significant headroom In respect of the India CGU management recorded an impairment charge of £77m</p>	<p>We evaluated and challenged management's identification and aggregation of CGUs in light of the new Group structure and tested the allocation of goodwill to these aggregated CGUs In our view management's decision to disaggregate the Growth segment into its main constituent countries appropriately reflects the relative independence of these operations For the aggregated CGUs in North America and Core markets, management demonstrated reasonable bases for the aggregations, reflecting their relatively high levels of integration and synergies</p> <p>We tested the mathematical integrity of the forecasts and carrying values in management's impairment model We obtained board approved cash flow forecasts to agree them to management's impairment analysis and challenged key judgements and estimates within them We assessed the discount rates applied to each aggregated CGU by comparison to third-party data and to the Group's cost of capital and relevant risk factors We compared short and long-term growth rates including cash conversion, to historical trends and expectations We also considered the accuracy of prior period forecasts</p> <p>We performed sensitivity analyses around these key assumptions to ascertain the extent of change either individually or collectively that would indicate impairment We considered the likelihood of such a movement and the adequacy of the disclosures made regarding the assumptions and sensitivities</p> <p>For CGUs where headroom was limited we assessed management's sensitivity disclosures to check these were appropriate</p> <p>We checked for additional impairment triggers by reading board minutes, holding regular discussions with Group and local management, and examining the performance of recently acquired businesses to identify underperforming operations We did not identify any further impairments</p>

Area of focus	How our audit addressed the area of focus
<p><b>Provision for uncertain tax liabilities</b></p> <p>Refer to notes 7 and 13 to the consolidated financial statements. The Group is subject to several tax regimes due to the geographical diversity of its businesses.</p> <p>The directors are required to exercise significant judgement in determining the appropriate amount to provide in respect of potential tax exposures and uncertain tax provisions. The most significant of these relate to US tax.</p> <p>Changes in assumptions about the views that might be taken by tax authorities can materially impact the level of provisions recorded in the financial statements and there are significant judgements in estimating the amount of any provision required.</p>	<p>We obtained an understanding of the Group's tax strategy to identify tax risks relating to business and legislative developments. To assess the adequacy of the Group's tax provisions we first recalculated the valuation of tax provisions and determined whether the treatments adopted were in line with the Group's tax policies and had been applied consistently.</p> <p>We then evaluated key underlying assumptions about tax authority views on the Group's tax arrangements, particularly in the US and in territories with new cross-border tax structures. In doing this we considered the status of recent and current tax authority audits and enquiries, the outcome of previous claims, judgemental positions taken in tax returns and current year estimates, and developments in the tax environment.</p> <p>We were satisfied that management's provision estimates for uncertain tax positions were consistent with our own assessment of the related risks and correspondence with the relevant tax authorities.</p>
<p><b>Returns provisions</b></p> <p>There are material, judgemental provisions for anticipated book returns on the balance sheet as at 31 December 2014, particularly in US Higher Education.</p> <p>As the Group transitions from print to digital the returns profile might change to either decrease (as less books are shipped) or increase (if bookstores underestimate the speed of digital change and over-order traditional textbooks).</p>	<p>We performed testing over returns provisions in a number of locations, including US Higher Education.</p> <p>We tested the calculation of the provisions, assessing judgements for reasonableness against historical experience and the impact on returns of the ongoing business transition from print to digital.</p> <p>We also performed detailed testing of shipment and returns provisioning. This included checking cut-off at year end and evaluating whether any changes in shipping volumes around year end might increase the risk of returns. No misstatements were identified.</p> <p>We evaluated changes in estimates to check they were not indicators of management bias. We found the estimates used by management in the determination of the returns provisions to appropriately reflect both past experience and changes in the business.</p>

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## Independent auditors' report to the members of Pearson plc continued

Area of focus	How our audit addressed the area of focus
<b>Recoverability of pre-publication assets and inventories</b>	
<p>Refer to notes 20 and 21 to the consolidated financial statements. The Group has £820m of pre-publication assets and £224m of inventories at 31 December 2014. Pre-publication assets represent direct costs incurred in the development of education programmes and titles prior to their publication and inventories are unsold stock, usually physical textbooks.</p> <p>Judgement is required to assess the recoverability of these assets, this is further complicated by the transition to digital as the Group invests in new, less proven, digital content and platforms.</p>	<p>We first selected a sample of costs deferred to the balance sheet as pre-publication assets or inventories to test their appropriateness and magnitude.</p> <p>We then assessed the amortisation profiles of pre-publication assets against cash flows to test that the existing amortisation profiles remained appropriate in light of the transition towards digital products.</p> <p>We challenged the carrying value of certain pre-publication assets and inventories where sales have been lower than originally anticipated. We assessed forecast cash flows against historical experience and obtained supporting evidence for management's explanations.</p> <p>We found the Group's policies to be appropriate and consistently applied. While the carrying value of some assets depends on management's expectation of growth in future sales from them, overall we considered the carrying values of pre-publication assets and inventories to be reasonable.</p>
<b>Acquisitions and disposals</b>	
<p>Refer to notes 30 and 31 to the consolidated financial statements. In February 2014 the Group acquired Grupo Multi for £437m, recognising £240m of goodwill and £254m of intangible assets. This is a significant transaction requiring judgement to identify and value the intangible assets and assess their subsequent recoverability.</p> <p>As part of the Penguin Random House transaction the Group recorded an estimated £59m provision in 2013 for the cost of transferring the pension liability guarantee for Penguin employees to Bertelsmann. It was concluded during 2014 that Pearson would retain responsibility for this pension liability. The provision has been released within discontinued operations in the current year.</p> <p>In February 2014 the Group sold Mergermarket for £375m, resulting in a gain on disposal of £245m pre-tax and judgemental classification as discontinued operations.</p>	<p>The Group engagement team visited Brazil and met with local management of Grupo Multi to gain an understanding of the business.</p> <p>We performed detailed testing over the acquisition accounting, including fair value adjustments such as identification and valuation of intangible assets. Post-acquisition performance and forecasts were assessed to identify potential impairment triggers.</p> <p>We obtained the communication between Pearson and Bertelsmann confirming that Pearson will retain responsibility for the pension liability of the legacy Penguin employees. We tested the appropriate reversal of the provision within discontinued operations.</p> <p>We tested the gain on disposal for Mergermarket by agreeing the consideration to sales documents and cash received and agreed the net assets disposed to underlying records. We also evaluated its presentation in the Annual report.</p> <p>No material misstatements were identified by our testing and we found that relevant disclosures were included in the Annual report.</p>



### How we tailored our audit scope

We tailored our audit scope to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates

The Group is organised into three reportable segments, being North America, Core and Growth, plus the investment in associate Penguin Random House. Each segment comprises a number of reporting units. The consolidated financial statements comprise these reporting units plus the Group's centralised functions.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole.

During the year the Group engagement team visited each of the US, Brazilian, Chinese and South African component audit teams, held a planning meeting attended by partners from the Group engagement team and our UK and US component teams, and had regular dialogue with component teams throughout the year.

We identified two reporting units in the US and UK that required an audit of their complete financial information due to size alone, plus a further 13 reporting units in the US, UK, Brazil, China and South Africa that required either an audit or specified procedures on certain transactions and balances. We also obtained an audit opinion on the financial information of the associate Penguin Random House. The Group consolidation, financial statement disclosures and corporate functions were audited by the Group engagement team. This included our work over derivative financial instruments, hedge accounting, goodwill and intangible assets impairment reviews, litigation, pensions and share-based payments.

The reporting units where we performed audit work, together with work performed at corporate functions, shared service centres and consolidated Group level, accounted for approximately 74% of the Group's statutory profit before tax and 65% of adjusted profit before tax. This provided the evidence we needed for our opinion on the consolidated financial statements taken as a whole.

**Materiality** The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall group materiality	£26m (2013: £32m)
How we determined it	4% of adjusted profit before tax of £658m
Rationale for benchmark applied	Note 8 explains that the Group's principal measure of performance is adjusted operating profit (£722m), which excludes one-off gains and losses and acquired intangible asset amortisation, in order to present results from operating activities on a consistent basis. From adjusted operating profit we deducted net finance costs of £64m (see note 8) because these reflect recurring finance charges. To the resulting adjusted profit before tax we then applied 4% (rather than the usual 5%) as our materiality calculation was based on this adjusted measure.

We agreed with the audit committee that we would report to them misstatements identified during our audit above £2m (2013: £2m) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

## Independent auditors' report to the members of Pearson plc continued

**Going concern** Under the Listing Rules we are required to review the directors' statement, set out on page 107, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and company have adequate resources to remain in

operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and company's ability to continue as a going concern.

**Other required reporting****Consistency of other information**

**Companies Act 2006 opinion** In our opinion, the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**ISAs (UK & Ireland) reporting**

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

› Information in the Annual report is

- materially inconsistent with the information in the audited financial statements
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group and company acquired in the course of performing our audit
- otherwise misleading

We have no exceptions to report arising from this responsibility.

› The statement given by the directors on page 108 in accordance with provision C 1.1 of the UK Corporate Governance Code (the 'Code'), that they consider the Annual report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and company's performance, business model and strategy is materially inconsistent with our knowledge of the Group and company acquired in the course of performing our audit.

We have no exceptions to report arising from this responsibility.

› The section of the Annual report on pages 74 and 75, as required by provision C 3.8 of the Code, describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

We have no exceptions to report arising from this responsibility.

**Adequacy of accounting records and information and explanations received**

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

› We have not received all the information and explanations we require for our audit.

› Adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us.

› The company financial statements and the part of the directors' remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

### Directors' remuneration

**Directors' remuneration report – Companies Act 2006 opinion** In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006

**Other Companies Act 2006 reporting** Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility

### Corporate governance statement

Under the Listing Rules we are required to review the part of the corporate governance statement relating to the company's compliance with ten provisions of the Code. We have nothing to report having performed our review

### Responsibilities for the financial statements and the audit

#### Our responsibilities and those of the directors

As explained more fully in the statement of directors' responsibilities set out on page 109, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

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

### What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of

- › Whether the accounting policies are appropriate to the group's and the company's circumstances and have been consistently applied and adequately disclosed
- › The reasonableness of significant accounting estimates made by the directors
- › The overall presentation of the financial statements

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary, to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both

In addition, we read all the financial and non financial information in the Annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

*Stuart Newman*

Stuart Newman (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London, United Kingdom

9 March 2015

(a) The maintenance and integrity of the Pearson plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

# Consolidated income statement

Year ended 31 December 2014

All figures in £ millions	Notes	2014	2013
Sales	2	4,874	5,069
Cost of goods sold	4	(2,202)	(2,312)
Gross profit		2,672	2,757
Operating expenses	4	(2,325)	(2,353)
Share of results of joint ventures and associates	12	51	54
Operating profit	2	398	458
Finance costs	6	(141)	(111)
Finance income	6	48	35
Profit before tax		305	382
Income tax	7	(63)	(87)
Profit for the year from continuing operations		242	295
Profit for the year from discontinued operations	3	228	244
Profit for the year		470	539
Attributable to			
Equity holders of the company		471	538
Non-controlling interest		(1)	1
Earnings per share for profit from continuing and discontinued operations attributable to equity holders of the company during the year (expressed in pence per share)			
– basic	8	58.1p	66.6p
– diluted	8	58.0p	66.5p
Earnings per share for profit from continuing operations attributable to equity holders of the company during the year (expressed in pence per share)			
– basic	8	30.0p	36.4p
– diluted	8	29.9p	36.3p

# Consolidated statement of comprehensive income

Year ended 31 December 2014

All figures in £ millions	Notes	2014	2013
Profit for the year		470	539
Items that may be reclassified to the income statement			
Net exchange differences on translation of foreign operations – Group		150	(206)
Net exchange differences on translation of foreign operations – associates		25	(11)
Currency translation adjustment disposed – Group		(2)	(18)
Attributable tax	7	(6)	6
Items that are not reclassified to the income statement			
Remeasurement of retirement benefit obligations – Group	25	23	79
Remeasurement of retirement benefit obligations – associates		(15)	–
Attributable tax	7	(1)	(23)
Other comprehensive income/(expense) for the year		174	(173)
Total comprehensive income for the year		644	366
Attributable to			
Equity holders of the company		645	369
Non-controlling interest		(1)	(3)

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# Consolidated balance sheet

As at 31 December 2014

All figures in £ millions	Notes	2014	2013
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	10	334	342
Intangible assets	11	6,310	5,801
Investments in joint ventures and associates	12	1,118	1,092
Deferred income tax assets	13	295	250
Financial assets – derivative financial instruments	16	90	111
Retirement benefit assets	25	190	86
Other financial assets	15	54	94
Trade and other receivables	22	82	70
		<b>8,473</b>	<b>7,846</b>
<b>Current assets</b>			
Intangible assets – pre-publication	20	820	717
Inventories	21	224	224
Trade and other receivables	22	1,310	1,173
Financial assets – derivative financial instruments	16	24	13
Financial assets – marketable securities	14	16	6
Cash and cash equivalents (excluding overdrafts)	17	530	729
		<b>2,924</b>	<b>2,862</b>
Assets classified as held for sale	32	–	223
<b>Total assets</b>		<b>11,397</b>	<b>10,931</b>
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Financial liabilities – borrowings	18	(1,883)	(1,693)
Financial liabilities – derivative financial instruments	16	(73)	(48)
Deferred income tax liabilities	13	(714)	(612)
Retirement benefit obligations	25	(163)	(142)
Provisions for other liabilities and charges	23	(82)	(77)
Other liabilities	24	(310)	(257)
		<b>(3,225)</b>	<b>(2,829)</b>
<b>Current liabilities</b>			
Trade and other liabilities	24	(1,601)	(1,505)
Financial liabilities – borrowings	18	(342)	(533)
Financial liabilities – derivative financial instruments	16	(1)	–
Current income tax liabilities		(190)	(164)
Provisions for other liabilities and charges	23	(53)	(112)
		<b>(2,187)</b>	<b>(2,314)</b>
Liabilities directly associated with assets classified as held for sale	32	–	(82)
<b>Total liabilities</b>		<b>(5,412)</b>	<b>(5,225)</b>
<b>Net assets</b>		<b>5,985</b>	<b>5,706</b>

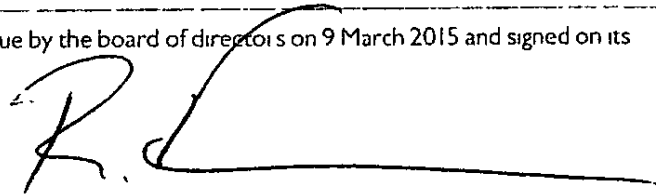
# Consolidated balance sheet continued

As at 31 December 2014

All figures in £ millions	Notes	2014	2013
<b>Equity</b>			
Share capital	27	205	205
Share premium	27	2,579	2,568
Treasury shares	28	(75)	(98)
Translation reserve		70	(103)
Retained earnings		3,200	3,128
<b>Total equity attributable to equity holders of the company</b>		<b>5,979</b>	<b>5,700</b>
Non-controlling interest		6	6
<b>Total equity</b>		<b>5,985</b>	<b>5,706</b>

These financial statements have been approved for issue by the board of directors on 9 March 2015 and signed on its behalf by

Robin Freestone Chief financial officer




OUR BUSINESS

OUR PERFORMANCE

OUR SOCIAL IMPACT

GOVERNANCE

FINANCIAL STATEMENTS

# Consolidated statement of changes in equity

Year ended 31 December 2014

All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2014	205	2,568	(98)	(103)	3,128	5,700	6	5,706
Profit for the year	-	-	-	-	471	471	(1)	470
Other comprehensive income	-	-	-	173	1	174	-	174
Total comprehensive income	-	-	-	173	472	645	(1)	644
Equity-settled transactions	-	-	-	-	32	32	-	32
Tax on equity-settled transactions	-	-	-	-	(3)	(3)	-	(3)
Issue of ordinary shares under share option schemes	-	11	-	-	-	11	-	11
Purchase of treasury shares	-	-	(9)	-	-	(9)	-	(9)
Release of treasury shares	-	-	32	-	(32)	-	-	-
Changes in non-controlling interest	-	-	-	-	-	-	2	2
Dividends	-	-	-	-	(397)	(397)	(1)	(398)
At 31 December 2014	205	2,579	(75)	70	3,200	5,979	6	5,985

All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2013	204	2,555	(103)	128	2,902	5,686	24	5,710
Profit for the year	-	-	-	-	538	538	1	539
Other comprehensive expense	-	-	-	(231)	62	(169)	(4)	(173)
Total comprehensive income	-	-	-	(231)	600	369	(3)	366
Equity-settled transactions	-	-	-	-	37	37	-	37
Tax on equity-settled transactions	-	-	-	-	-	-	-	-
Issue of ordinary shares under share option schemes	1	13	-	-	-	14	-	14
Purchase of treasury shares	-	-	(47)	-	-	(47)	-	(47)
Release of treasury shares	-	-	52	-	(52)	-	-	-
Changes in non-controlling interest	-	-	-	-	13	13	(15)	(2)
Dividends	-	-	-	-	(372)	(372)	-	(372)
At 31 December 2013	205	2,568	(98)	(103)	3,128	5,700	6	5,706

The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments. Changes in non-controlling interest in 2014 relate to the disposal of a non-controlling interest in a Chinese business. In 2013, the group purchased non-controlling interests in the South African and Indian businesses.



# Consolidated cash flow statement

Year ended 31 December 2014

All figures in £ millions	Notes	2014	2013	
<b>Cash flows from operating activities</b>				<b>OUR BUSINESS</b>
Net cash generated from operations	34	704	684	
Interest paid		(86)	(82)	
Tax paid		(163)	(246)	
<b>Net cash generated from operating activities</b>		<b>455</b>	<b>356</b>	
<b>Cash flows from investing activities</b>				
Acquisition of subsidiaries, net of cash acquired	30	(448)	(48)	
Acquisition of joint ventures and associates		(12)	(10)	<b>OUR PERFORMANCE</b>
Purchase of investments		(3)	(64)	
Purchase of property, plant and equipment		(75)	(118)	
Purchase of intangible assets		(107)	(64)	
Disposal of subsidiaries, net of cash disposed	31	327	(132)	
Proceeds from sale of associates		39	2	
Proceeds from sale of investments		9	2	
Proceeds from sale of property, plant and equipment	34	9	28	
Proceeds from sale of intangible assets		2	2	<b>OUR SOCIAL IMPACT</b>
Proceeds from sale of liquid resources		12	13	
Loans to related parties		(10)	(44)	
Loans advanced		(2)	(5)	
Investment in liquid resources		(22)	(14)	
Interest received		13	9	
Dividends received from joint ventures and associates		120	64	
<b>Net cash used in investing activities</b>		<b>(148)</b>	<b>(379)</b>	
<b>Cash flows from financing activities</b>				<b>GOVERNANCE</b>
Proceeds from issue of ordinary shares	27	11	14	
Purchase of treasury shares	28	(9)	(47)	
Proceeds from borrowings		404	319	
Repayment of borrowings		(538)	(225)	
Finance lease principal payments		(4)	(8)	
Dividends paid to company's shareholders	9	(397)	(372)	
Dividends paid to non-controlling interest		(1)	–	
Purchase of non-controlling interest	33	–	(76)	
<b>Net cash used in financing activities</b>		<b>(534)</b>	<b>(395)</b>	
Effects of exchange rate changes on cash and cash equivalents		(2)	21	
<b>Net decrease in cash and cash equivalents</b>		<b>(229)</b>	<b>(397)</b>	
Cash and cash equivalents at beginning of year		740	1,137	
Cash and cash equivalents at end of year	17	511	740	<b>FINANCIAL STATEMENTS</b>

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

# Notes to the consolidated financial statements

## General information

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 9 March 2015

## 1 Accounting policies

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

### a. Basis of preparation

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

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

1 Interpretations and amendments to published standards effective 2014. The following amendments and interpretations were adopted in 2014

- › Amendments to IFRS 10, IFRS 12 and IAS 27, 'Investment Entities', effective for annual reporting periods beginning on or after 1 January 2014. These amendments provide an exemption from consolidation of subsidiaries for entities which meet the definition of an investment entity

- › Amendments to IAS 39, 'Novation of Derivatives and Continuation of Hedge Accounting', effective for annual reporting periods beginning on or after 1 January 2014. The amendments mean there would be no need to discontinue hedge accounting if a hedge derivative was novated and certain criteria met

- › Amendments to IAS 32, 'Financial Instruments Presentation', effective for annual reporting periods beginning on or after 1 January 2014. The amendments clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet

- › IFRIC 21 'Levies', effective for annual reporting periods beginning on or after 1 January 2014. This details the accounting for an obligation to pay a levy that is not income tax

The adoption of these new pronouncements from 1 January 2014 does not have a material impact on the consolidated financial statements

2 Standards, interpretations and amendments to published standards that are not yet effective. The Group has not early adopted the following new pronouncements that are not yet effective

- › IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities. The Group is yet to assess the full impact of IFRS 9

- › IFRS 15 'Revenue from Contracts with Customers', effective for annual reporting periods beginning on or after 1 January 2017. The new standard specifies how and when an entity will recognise revenue, and requires more detailed disclosure. Adoption of the new standard is likely to have an impact on the Group and management is currently assessing the impact

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

## I Accounting policies continued

### a Basis of preparation continued

Consolidation Business combinations – determination of fair values

Consolidation Business combinations – classification of investments

Intangible assets Goodwill

Intangible assets Pre-publication assets

Taxation

Employee benefits Pensions

Revenue recognition

### b Consolidation

1 Business combinations The acquisition method of accounting is used to account for business combinations

The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred in the operating expenses line of the income statement.

Identifiable assets and contingent assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The determination of fair values often requires significant judgements and the use of estimates, and for material acquisitions, the fair value of the acquired intangible assets is determined by an independent valuer. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill.

See note 1e(1) for the accounting policy on goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the income statement.

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

Management exercises judgement in determining the classification of its investments in its businesses in line with the following:

2 Subsidiaries Subsidiaries are entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

3 Transactions with non-controlling interests Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions, that is as transactions with the owners in their capacity as owners. Any surplus or deficit arising from disposals to a non-controlling interest is recorded in equity. For purchases from a non-controlling interest, the difference between consideration paid and the relevant share acquired of the carrying value of the subsidiary is recorded in equity.

4 Joint ventures and associates Joint ventures are entities in which the Group holds an interest on a long-term basis and has rights to the net assets through contractually agreed sharing of control. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at the fair value of consideration transferred.

The Group's share of its joint ventures' and associates' post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves.

## Notes to the consolidated financial statements continued

**1 Accounting policies continued****b Consolidation continued**

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

5 Contribution of a subsidiary to an associate or joint venture. The gain or loss resulting from the contribution or sale of a subsidiary to an associate or a joint venture is recognised in full. Where such transactions do not involve cash consideration, significant judgements and estimates are used in determining the fair values of the consideration received.

**c Foreign currency translation**

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

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

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

- i) Assets and liabilities are translated at the closing rate at the date of the balance sheet.
- ii) Income and expenses are translated at average exchange rates.
- iii) All resulting exchange differences are recognised as a separate component of equity.

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

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.65 (2013: \$1.57) and the year end rate was \$1.56 (2013: \$1.66).

**d Property, plant and equipment**

Property, plant and equipment are stated at historical cost less depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for intended use. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives as follows:

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

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

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

**e Intangible assets**

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

**1 Accounting policies continued****e Intangible assets continued**

acquired Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures

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

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

IFRS 3 'Business Combinations' has not been applied retrospectively to business combinations before the date of transition to IFRS.

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

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

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

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

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 34).

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

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

**f Other financial assets**

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

## Notes to the consolidated financial statements continued

**l Accounting policies continued****g Inventories**

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

**h Royalty advances**

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

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors.

The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non-current assets.

**i Cash and cash equivalents**

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

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

**j Share capital**

Ordinary shares are classified as equity.

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

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

**k Borrowings**

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

**l Derivative financial instruments**

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

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

## l Accounting policies continued

### l Derivative financial instruments continued

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

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

### m Taxation

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

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

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

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

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

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide

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

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

### n Employee benefits

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

When the calculation results in a potential asset, the recognition of that asset is limited to the asset ceiling – that is the present value of any economic benefits available in the form of refunds from the plan or a reduction in future contributions. Management use judgement to determine the level of refunds available from the plan in recognising an asset.

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

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

## Notes to the consolidated financial statements continued

**1 Accounting policies continued****n Employee benefits continued**

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. Net interest is calculated by applying the discount rate to the net defined benefit obligation and is presented as finance costs or finance income.

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

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

**3 Share-based payments** The fair value of options or shares granted under the Group's share and option plans is recognised as an employee expense after taking into account the Group's best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised.

**o Provisions**

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

The Group recognises a provision for deferred consideration at fair value. Where this is contingent on future performance or a future event, judgement is exercised in establishing the fair value.

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

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

**p Revenue recognition**

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

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

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

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

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



## l Accounting policies continued

### p Revenue recognition continued

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

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

### q Leases

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

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

### r Dividends

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

### s Assets and liabilities held for sale

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

### t Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1p).

## 2 Segment information

From 1 January 2014 the Group has reorganised and is reporting new segmental analyses to reflect the new structure and operating model. The primary segments for management and reporting are geographies as outlined below. In addition, the group separately discloses the results from the Penguin Random House (PRH) associate.

### Continuing operations

North America School, Higher Education and Professional businesses in US and Canada

Growth School, Higher Education and Professional businesses in emerging markets which are investment priorities, including Brazil, China, India and South Africa

Core School, Higher Education and Professional businesses in more mature markets including UK, Australia and Italy

In addition the Group separately discloses the results of the Penguin Random House (PRH) associate.

The results of the Mergermarket business to 4 February 2014 are shown as discontinued in the relevant years. The results of the Penguin business to 30 June 2013 are also shown as discontinued in 2013.

Figures for 2013 have been restated to reflect the new segments.

## Notes to the consolidated financial statements continued

## 2 Segment information continued

For more detail on the services and products included in each business segment refer to the strategic report

								2014
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
<b>Continuing operations</b>								
Sales		2,974	1,154	746	-	-	-	4,874
Adjusted operating profit		464	152	35	69	-	-	720
Intangible charges		(110)	(22)	(132)	(54)	-	-	(318)
Acquisition costs		(2)	(1)	(3)	-	-	-	(6)
Other net gains and losses		2	-	-	-	-	-	2
Operating profit/(loss)		354	129	(100)	15	-	-	398
Finance costs	6							(141)
Finance income	6							48
Profit before tax								305
Income tax	7							(63)
Profit for the year from continuing operations								242
Segment assets		6,646	1,566	1,407	-	660	-	10,279
Joint ventures	12	1	9	3	-	-	-	13
Associates	12	1	9	-	1,095	-	-	1,105
Total assets		6,648	1,584	1,410	1,095	660	-	11,397
<b>Other segment items</b>								
Share of results of joint ventures and associates	12	-	19	(3)	35	-	-	51
Capital expenditure	10, 11	97	48	49	-	-	-	194
Pre-publication investment	20	209	77	72	-	-	-	358
Depreciation	10	41	17	16	-	-	-	74
Amortisation	11, 20	309	112	121	-	-	-	542
Impairment	11	-	-	77	-	-	-	77

## 2 Segment information continued

								2013
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
<b>Continuing operations</b>								
Sales		3,073	1,258	738	–	–	–	5,069
Adjusted operating profit		474	120	38	50	–	–	682
Intangible charges		(106)	(27)	(33)	(30)	–	–	(196)
Acquisition costs		(2)	(3)	(7)	–	–	–	(12)
Other net gains and losses		–	(16)	–	–	–	–	(16)
Operating profit/(loss)		366	74	(2)	20	–	–	458
Finance costs	6							(111)
Finance income	6							35
Profit before tax								382
Income tax	7							(87)
Profit for the year from continuing operations								295
<b>Other segment items</b>								
Segment assets		6,326	1,450	981	–	859	223	9,839
Joint ventures	12	1		2	–	–	–	3
Associates	12	1	18		1,070		–	1,089
Total assets		6,328	1,468	983	1,070	859	223	10,931
<b>Other segment items</b>								
Share of results of joint ventures and associates	12	1	26	(4)	31	–	–	54
Capital expenditure	10, 11	95	46	33	–	–	1	175
Pre-publication investment	20	202	90	72	–	–	–	364
Depreciation	10	46	19	16	–	–	1	82
Amortisation	11, 20	287	143	103	–	–	2	535
Impairment		–	–	–	–	–	–	–

For further information on adjusted measures above, see note 8

Included in other net gains and losses in continuing operations in 2014 are gains on the sale of joint venture interests in Safari Books Online and CourseSmart (£40m) and a loss on disposal of an investment in Nook Media (£38m)

Included in other net gains and losses in 2013 is a loss on the disposal of the Japanese school and local publishing assets

Both operating profit and adjusted operating profit in 2014 are stated after the following restructuring charges: North America £37m, with estimated in year benefits of £21m; Core £22m, with estimated in year benefits of £10m; Growth £6m, with estimated in year benefits of £2m; Penguin Random House £19m, with estimated in year benefits of £7m

Both operating profit and adjusted operating profit in 2013 are stated after the following restructuring charges: North America £77m, with estimated in year benefits of £24m; Core £63m, with estimated in year benefits of £13m; Growth £36m, with estimated in year benefits of £4m

## Notes to the consolidated financial statements continued

## 2 Segment information continued

In 2014, sales from the provision of goods were £2,711m (2013 £2,867m) and sales from the provision of services were £2,163m (2013 £2,202m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing and other service businesses are classified as being from the provision of services. There were no material inter-segment sales.

Corporate costs are allocated to business segments including discontinued operations on an appropriate basis depending on the nature of the cost, therefore the segment result is equal to the Group operating profit. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combination were £263m (2013 £202m) (see note 30). In 2013, capital expenditure, depreciation and amortisation included amounts relating to discontinued operations.

The Group operates in the following main geographic areas:

All figures in £ millions	Sales		Non-current assets	
	2014	2013	2014	2013
<b>Continuing operations</b>				
UK	610	649	1,056	1,068
Other European countries	347	366	180	200
US	2,826	2,913	5,243	5,026
Canada	110	128	288	301
Asia Pacific	598	624	416	495
Other countries	383	389	661	215
<b>Total continuing</b>	<b>4,874</b>	<b>5,069</b>	<b>7,844</b>	<b>7,305</b>
<b>Discontinued operations</b>				
UK	4	97	–	–
Other European countries	–	49	–	–
US	4	369	–	–
Canada	–	24	–	–
Asia Pacific	1	74	–	–
Other countries	–	8	–	–
<b>Total discontinued</b>	<b>9</b>	<b>621</b>	<b>–</b>	<b>–</b>
<b>Total</b>	<b>4,883</b>	<b>5,690</b>	<b>7,844</b>	<b>7,305</b>

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. The geographical split of non-current assets is based on the subsidiary's country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

### 3 Discontinued operations

Discontinued operations relate to Penguin and Mergermarket

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

All figures in £ millions	2014			2013		
	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total
Sales	–	9	9	513	108	621
Operating profit	–	2	2	28	24	52
Finance income	–	–	–	1	–	1
Profit before tax	–	2	2	29	24	53
Income tax	–	(1)	(1)	(9)	(9)	(18)
Profit after tax	–	1	1	20	15	35
Profit on disposal of Penguin	29	–	29	202	–	202
Attributable tax benefit	–	–	–	15	–	15
Profit on disposal of Mergermarket	–	244	244	–	–	–
Attributable tax expense	–	(46)	(46)	–	–	–
Mergermarket transaction costs	–	–	–	–	(8)	(8)
Profit for the year from discontinued operations	29	199	228	237	7	244
Operating cash flows	–	2	2	36	22	58
Investing cash flows	–	–	–	(6)	(2)	(8)
Financing cash flows	–	–	–	(8)	(29)	(37)
Total cash flows	–	2	2	22	(9)	13

Included within the cost of disposal of Penguin in 2013 are amounts in respect of the settlement of litigation related to the agency arrangement for eBooks. Also included in cost of disposal for Penguin for 2013 was a provision for amounts payable to Bertelsmann upon settlement of the transfer of Penguin's UK past service pension liabilities to the new PRH venture. During 2014, it was decided that this transfer would not go ahead as planned and the costs have been credited back in the £29m gain reported against the disposal in 2014.

### 4 Operating expenses

All figures in £ millions	2014	2013
By function		
Cost of goods sold	2,202	2,312
Operating expenses		
Distribution costs	87	90
Selling, marketing and product development costs	963	1,027
Administrative and other expenses	1,315	1,162
Restructuring costs	84	176
Other net gains and losses	(2)	16
Other income	(122)	(118)
Total net operating expenses	2,325	2,353
Total	4,527	4,665

Included in other income is service fee income from Penguin Random House of £41m (2013: £28m). Included in administrative and other expenses are research and efficacy costs of £22m (2013: £5m).

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## 4 Operating expenses continued

All figures in £ millions	Notes	2014	2013
<b>By nature</b>			
Royalties expensed		242	256
Other product costs		686	735
Employee benefit expense	5	1,978	2,100
Contract labour		185	194
Employee related expense		146	177
Promotional costs		169	167
Depreciation of property, plant and equipment	10	74	81
Amortisation of intangible assets – pre-publication	20	292	308
Amortisation of intangible assets - software	11	63	59
Amortisation of intangible assets – other	11	187	166
Impairment of intangible assets	11	77	–
Property and facilities		218	229
Technology and communications		139	104
Professional and outsourced services		264	259
Other general and administrative costs		128	119
Capitalised costs		(203)	(199)
Acquisition costs		6	12
Other net gains and losses		(2)	16
Other income		(122)	(118)
<b>Total</b>		<b>4,527</b>	<b>4,665</b>

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

All figures in £ millions	2014	2013
The audit of parent company and consolidated financial statements	5	4
The audit of the company's subsidiaries	2	2
<b>Total audit fees</b>	<b>7</b>	<b>6</b>
Other assurance services	1	1
<b>Total other assurance services</b>	<b>1</b>	<b>1</b>
Tax compliance services	1	2
Tax advisory services		2
<b>Total tax services</b>	<b>1</b>	<b>4</b>
<b>Total non-audit services</b>	<b>2</b>	<b>5</b>
<b>Total</b>	<b>9</b>	<b>11</b>

#### 4 Operating expenses continued

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

All figures in £ millions	2014	2013
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	7	6
Non-audit fees	2	5
<b>Total</b>	<b>9</b>	<b>11</b>

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts. Non-audit fees for 2013 includes £3m for assurance and tax services related to the Penguin Random House transaction.

#### 5 Employee information

All figures in £ millions	2014	2013
<b>Employee benefit expense</b>		
Wages and salaries (including termination benefits and restructuring costs)	1,728	1,836
Social security costs	134	136
Share-based payment costs	32	35
Retirement benefits – defined contribution plans	69	66
Retirement benefits – defined benefit plans	26	27
Other post retirement benefits	(11)	–
<b>Total</b>	<b>1,978</b>	<b>2,100</b>

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

Average number employed	2014	2013
<b>Employee numbers</b>		
North America	21,204	22,146
Core	7,887	8,807
Growth	11,603	10,975
Other	182	187
<b>Continuing operations</b>	<b>40,876</b>	<b>42,115</b>

The employee benefit expense relating to discontinued operations was £5m (2013: £168m) and the average number employed was 73 (2013: 3,592).

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## Notes to the consolidated financial statements continued

**6 Net finance costs**

All figures in £ millions	Notes	2014	2013
Interest payable		(82)	(82)
Net finance costs in respect of retirement benefits	25	–	(3)
Finance cost of put options deferred consideration associated with acquisitions and other interest charges related to transactions		–	(9)
Net foreign exchange losses		(53)	–
Other losses on financial instruments not in a hedging relationship			
– derivatives		(6)	(17)
<b>Finance costs</b>		<b>(141)</b>	<b>(111)</b>
Interest receivable		18	10
Net finance income in respect of retirement benefits	25	1	–
Net foreign exchange gains		17	20
Other gains on financial instruments in a hedging relationship			
– fair value hedges		–	1
Other gains on financial instruments not in a hedging relationship			
– derivatives		12	4
<b>Finance income</b>		<b>48</b>	<b>35</b>
<b>Net finance costs</b>		<b>(93)</b>	<b>(76)</b>
<b>Analysed as</b>			
Net interest payable reflected in adjusted earnings		(64)	(72)
Other net finance costs		(29)	(4)
<b>Total net finance costs</b>		<b>(93)</b>	<b>(76)</b>

Included in interest receivable is £1m (2013 £nil) of interest receivable from related parties. The net movement of £nil on fair value hedges in 2014 (2013 net gain of £1m) comprises a loss of £27m (2013 gain of £95m) on the underlying bonds, offset by a gain of £27m (2013 loss of £94m) on the related derivative financial instruments.

For further information on adjusted measures above, see note 8.



## 7 Income tax

All figures in £ millions	Notes	2014	2013
<b>Current tax</b>			
Charge in respect of current year		(103)	(129)
Adjustments in respect of prior years		30	(7)
<b>Total current tax charge</b>		<b>(73)</b>	<b>(136)</b>
<b>Deferred tax</b>			
In respect of temporary differences		8	14
Other adjustments in respect of prior years		2	35
<b>Total deferred tax credit</b>	13	<b>10</b>	<b>49</b>
<b>Total tax charge</b>		<b>(63)</b>	<b>(87)</b>

The adjustments in respect of prior years in both 2014 and 2013 mainly relate to changes in estimates arising from uncertain tax positions following settlements with tax authorities in the year

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the UK tax rate as follows

All figures in £ millions	2014	2013
Profit before tax	305	382
Tax calculated at UK rate (2014 21.5%, 2013 23.25%)	(66)	(89)
Effect of overseas tax rates	(12)	(13)
Joint venture and associate income reported net of tax	11	13
Net expense not subject to tax	(9)	(14)
Loss on sale of businesses not subject to tax	–	(6)
Utilisation of previously unrecognised tax losses and credits	–	1
Unutilised tax losses	(19)	(7)
Adjustments in respect of prior years	32	28
<b>Total tax charge</b>	<b>(63)</b>	<b>(87)</b>
<b>UK</b>	<b>(6)</b>	<b>(13)</b>
<b>Overseas</b>	<b>(57)</b>	<b>(74)</b>
<b>Total tax charge</b>	<b>(63)</b>	<b>(87)</b>
Tax rate reflected in earnings	20.7%	22.8%

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## Notes to the consolidated financial statements continued

## 7 Income tax continued

The tax rate reflected in adjusted earnings is calculated as follows

All figures in £ millions	2014	2013
Profit before tax	305	382
Adjustments		
Other net gains and losses	(2)	16
Acquisition costs	6	12
Amortisation of acquired intangibles	318	196
Other net finance costs	29	4
Adjusted profit before tax – continuing operations	656	610
Adjusted profit before tax – discontinued operations	2	54
Total adjusted profit before tax	658	664
Total tax charge	(63)	(87)
Adjustments		
Tax charge on other net gains and losses	1	32
Tax benefit on acquisition costs	(1)	(2)
Tax benefit on intangible charges	(73)	(51)
Tax benefit on other net finance costs	(5)	(1)
Tax amortisation benefit on goodwill and intangibles	24	30
Adjusted income tax charge – continuing operations	(117)	(79)
Adjusted income tax charge – discontinued operations	(1)	(18)
Total adjusted income tax charge	(118)	(97)
Tax rate reflected in adjusted earnings	17.9%	14.6%

For further information on adjusted measures above, see note 8

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

All figures in £ millions	2014	2013
Remeasurement of retirement benefit obligations	(1)	(23)
Net exchange differences on translation of foreign operations	(6)	6
	(7)	(17)

A tax charge of £3m (2013: tax charge £nil) relating to share-based payments has been recognised directly in equity

## 8 Earnings per share

### Basic

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares

### Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares

All figures in £ millions	Notes	2014	2013
Profit for the year from continuing operations		242	295
Non-controlling interest		1	(1)
Earnings from continuing operations		243	294
Profit for the year from discontinued operations	3	228	244
Earnings		471	538
Weighted average number of shares (millions)		810.9	807.8
Effect of dilutive share options (millions)		1.0	1.1
Weighted average number of shares (millions) for diluted earnings		811.9	808.9
Earnings per share from continuing and discontinued operations			
Basic		58.1p	66.6p
Diluted		58.0p	66.5p
Earnings per share from continuing operations			
Basic		30.0p	36.4p
Diluted		29.9p	36.3p
Earnings per share from discontinued operations			
Basic		28.1p	30.2p
Diluted		28.1p	30.2p

### Adjusted

In order to show results from operating activities on a consistent basis, an adjusted earnings per share is presented. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

Adjusted earnings includes the results from continuing and discontinued operations. The following items are excluded from adjusted earnings:

Other net gains and losses represent profits and losses on the acquisition and disposal of subsidiaries, joint ventures, associates and other financial assets that are included within continuing or discontinued operations but which distort the performance of the Group.

Amortisation of acquired intangibles, acquisition costs and movements in contingent acquisition consideration are also excluded from adjusted earnings as these items are not considered to be fully effective of the underlying performance of the Group.

## Notes to the consolidated financial statements continued

## 8 Earnings per share continued

Other net finance income/costs include finance costs in respect of retirement benefits, finance costs of put options and deferred consideration and foreign exchange and other gains and losses. Finance costs relating to retirement benefits are excluded as the consolidated income statement presentation under IAS 19 (revised) does not reflect the economic substance of the underlying assets and liabilities. Finance costs of put options and deferred consideration are excluded as they relate to future earn outs and similar payments on acquisitions and do not reflect cash expended. Foreign exchange and other gains and losses are excluded as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity. Other net finance costs of Group companies are included in finance costs or finance income as appropriate. Other net finance costs of joint ventures and associates are included within the share of results of joint ventures and associates within operating profit.

Tax on the above items is excluded from adjusted earnings. Where relevant the Group also excludes the benefit from recognising previously unrecognised pre-acquisition and capital losses. The Group includes the benefit of tax amortisation of goodwill and intangibles as this benefit more accurately aligns the adjusted tax charge with the expected rate of cash tax payments.

Non-controlling interest for the above items is excluded from adjusted earnings. The following tables reconcile statutory earnings to adjusted earnings.

All figures in £ millions	2011							
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	398	2	(2)	6	318	--	--	722
Net finance costs	(93)	--	--	--	--	29	--	(64)
Profit before tax	305	2	(2)	6	318	29	--	658
Income tax	(63)	(1)	1	(1)	(73)	(5)	24	(118)
Profit for the year from continuing operations	242	1	(1)	5	245	24	24	540
Profit for the year from discontinued operations	228	(1)	(227)	--	--	--	--	--
Profit for the year	470	--	(228)	5	245	24	24	540
Non-controlling interest	1	--	--	--	--	--	--	1
Earnings	471	--	(228)	5	245	24	24	541
Weighted average number of shares (millions)	810.9							810.9
Weighted average number of shares (millions) for diluted earnings	811.9							811.9
Earnings per share (basic)	58.1p							66.7p
Earnings per share (diluted)	58.0p							66.6p

## 8 Earnings per share continued

All figures in £ millions	2013						
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net financial income/losses	Tax amortisation benefit
Operating profit	458	54	16	12	196	—	—
Net finance costs	(76)	—	—	—	—	4	—
Profit before tax	382	54	16	12	196	4	—
Income tax	(87)	(18)	32	(2)	(51)	(1)	30
Profit for the year from continuing operations	295	36	48	10	145	3	30
Profit for the year from discontinued operations	244	(36)	(209)	—	2	(1)	—
Profit for the year	539	—	(161)	10	147	2	30
Non controlling interest	(1)	—	—	—	—	—	—
Earnings	538	—	(161)	10	147	2	30
Weighted average number of shares (millions)	807.8						
Weighted average number of shares (millions) for diluted earnings	808.9						
Earnings per share (basic)	66.6p						
Earnings per share (diluted)	66.5p						

## 9 Dividends

All figures in £ millions	2014	2013
Final paid in respect of prior year 32.0p (2013 30.0p)	259	242
Interim paid in respect of current year 17.0p (2013 16.0p)	138	130
	397	372

The directors are proposing a final dividend in respect of the financial year ended 31 December 2014 of 34.0p per share which will absorb an estimated £276m of shareholders' funds. It will be paid on 1 May 2015 to shareholders who are on the register of members on 7 April 2015. These financial statements do not reflect this dividend.

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## 10 Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
<b>Cost</b>				
At 1 January 2013	352	597	18	967
Exchange differences	(5)	(14)	–	(19)
Additions	33	58	22	113
Disposals	(13)	(78)	–	(91)
Acquisition through business combination	–	3	–	3
Disposal through business disposal	(1)	(2)	–	(3)
Reclassifications	9	(1)	(8)	–
Transfer from software	–	3	–	3
Transfer from assets held for sale	–	9	–	9
Transfer to assets held for sale	–	(7)	–	(7)
<b>At 31 December 2013</b>	<b>375</b>	<b>568</b>	<b>32</b>	<b>975</b>
Exchange differences	11	17	–	28
Additions	10	58	19	87
Disposals	(9)	(46)	(2)	(57)
Acquisition through business combination	–	2	–	2
Disposal through business disposal	–	(1)	–	(1)
Reclassifications	1	3	(4)	–
Transfer to software	–	–	(16)	(16)
<b>At 31 December 2014</b>	<b>388</b>	<b>601</b>	<b>29</b>	<b>1,018</b>

## 10 Property, plant and equipment continued

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
<b>Depreciation</b>				
At 1 January 2013	(195)	(445)	--	(640)
Exchange differences	3	13	--	16
Charge for the year	(25)	(57)	--	(82)
Disposals	7	64	--	71
Acquisition through business combination	--	(2)	--	(2)
Transfer from assets held for sale	--	(1)	--	(1)
Transfer to assets held for sale	--	5	--	5
<b>At 31 December 2013</b>	<b>(210)</b>	<b>(423)</b>	<b>--</b>	<b>(633)</b>
Exchange differences	(7)	(15)	--	(22)
Charge for the year	(23)	(51)	--	(74)
Disposals	9	36	--	45
<b>At 31 December 2014</b>	<b>(231)</b>	<b>(453)</b>	<b>--</b>	<b>(684)</b>
<b>Carrying amounts</b>				
At 1 January 2013	157	152	18	327
At 31 December 2013	165	145	32	342
At 31 December 2014	157	148	29	334

Depreciation expense of £16m (2013 £24m) has been included in the income statement in cost of goods sold and £58m (2013 £57m) in operating expenses. In 2014 £nil (2013 £1m) relates to discontinued operations.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £13m (2013 £11m).

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## 11 Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
<b>Cost</b>							
At 1 January 2013	5,077	466	729	258	207	394	7,131
Exchange differences	(122)	(6)	(25)	(8)	(12)	(11)	(184)
Additions – internal development	–	38	–	–	–	–	38
Additions – purchased	–	24	–	–	–	–	24
Disposals	–	(50)	–	–	–	–	(50)
Acquisition through business combination	(133)	–	190	–	3	7	67
Disposal through business disposal	(6)	–	–	–	–	(1)	(7)
Reclassifications	–	–	(10)	(1)	–	11	–
Transfer to PPE	–	(3)	–	–	–	–	(3)
Transfer to assets held for sale	(150)	–	(29)	(12)	–	(2)	(193)
At 31 December 2013	4,666	469	855	237	198	398	6,823
Exchange differences	198	17	34	5	–	14	268
Impairment	(67)	–	–	–	–	–	(67)
Additions – internal development	–	54	–	–	–	–	54
Additions – purchased	–	53	–	–	–	–	53
Disposals	–	(7)	–	–	–	–	(7)
Acquisition through business combination	238	–	5	69	–	186	498
Disposal through business disposal	(5)	(5)	–	(3)	(1)	–	(14)
Transfer from PPE	–	16	–	–	–	–	16
At 31 December 2014	5,030	597	894	308	197	598	7,624



## 11 Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
<b>Amortisation</b>							
At 1 January 2013	-	(312)	(204)	(86)	(139)	(172)	(913)
Exchange differences	-	6	10	4	6	7	33
Charge for the year	-	(59)	(78)	(21)	(15)	(54)	(227)
Disposals	-	49	-	-	-	-	49
Disposal through business disposal	-	-	-	-	-	1	1
Transfer to assets held for sale	-	-	23	10	-	2	35
At 31 December 2013	-	(316)	(249)	(93)	(148)	(216)	(1,022)
Exchange differences	-	(13)	(11)	(3)	-	(12)	(39)
Impairment	-	-	(6)	(2)	-	(2)	(10)
Charge for the year	-	(63)	(83)	(25)	(12)	(67)	(250)
Disposals	-	5	-	-	-	-	5
Disposal through business disposal	-	1	-	1	-	-	2
At 31 December 2014	-	(386)	(349)	(122)	(160)	(297)	(1,314)
<b>Carrying amounts</b>							
At 1 January 2013	5,077	154	525	172	68	222	6,218
At 31 December 2013	4,666	153	606	144	50	182	5,801
At 31 December 2014	5,030	211	545	186	37	301	6,310

**Goodwill**

The goodwill carrying value of £5,030m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

**Other intangible assets**

Other intangibles acquired include content, technology and software rights.

Intangible assets are valued separately for each acquisition and the primary method of valuation used is the discounted cash flow method. The majority of acquired intangibles are amortised using an amortisation profile based on the projected cashflows underlying the acquisition date valuation of the intangible asset, which generally results in a larger proportion of amortisation being recognised in the early years of the assets' life. The Group keeps the expected pattern of consumption under review.

Amortisation of £12m (2013: £15m) is included in the income statement in cost of goods sold and £238m (2013: £210m) in operating expenses. In 2014 £nil (2013: £2m) of amortisation relates to discontinued operations.

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## Notes to the consolidated financial statements continued

## 11 Intangible assets continued

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

Class of intangible asset	2014
	Useful economic life
Acquired customer lists, contracts and relationships	3–20 years
Acquired trademarks and brands	2–20 years
Acquired publishing rights	5–20 years
Other intangibles acquired	2–20 years

The expected amortisation profile of acquired intangible assets is shown below

Class of intangible asset	2014			
	One to five years	Six to ten years	More than ten years	Total
Acquired customer lists, contracts and relationships	340	148	57	545
Acquired trademarks and brands	97	54	35	186
Acquired publishing rights	34	3	—	37
Other intangibles acquired	219	72	10	301

## Impairment tests for cash-generating units (CGUs) containing goodwill

Impairment tests have been carried out where appropriate as described below

Following a reorganisation of the business effective 1 January 2014 goodwill was allocated to CGUs or aggregation of CGUs where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs summarised below

All figures in £ millions	2014	2013
North America	3,422	3,239
Core	618	624
Growth (includes China, Brazil, India and South Africa)	612	447
Pearson VUE	327	306
Financial Times Group	51	50
Total	5,030	4,666

The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

## 11 Intangible assets continued

### Impairment tests for cash-generating units containing goodwill continued

Following deterioration in the market conditions for the Group's online tutoring business based in India, it was determined in the course of the impairment review that the value in use of the India CGU no longer supported the carrying value of the goodwill in that CGU. An impairment of £67m was booked, thereby bringing the carrying value of goodwill in the India CGU down to £nil. An impairment of £10m was also booked in respect of other acquired intangibles in that CGU, bringing their carrying value to £nil. The India CGU incorporates all the Group's trading operations in India. A pre-tax discount rate of 13.6% was used to determine the value in use of the India CGU. No previous assessment had been made of the value in use of that CGU as the Group's India operations, prior to the 1 January 2014 reorganisation, were previously part of a larger Emerging Markets aggregated CGU.

### Key assumptions

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five-year period. The key assumptions used by management in the value in use calculations were:

**Discount rates** The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates range from 9.0% to 16.4%. Discount rates are lower for those businesses which operate in more mature markets with low inflation and higher for those operating in emerging markets with higher inflation.

**Perpetuity growth rates** A perpetuity growth rate of 2.0% (2013: 2.0%) was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 5.0% and 5.8% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historic growth rates in these markets.

The key assumptions used by management in setting the financial budgets for the initial five-year period were as follows:

**Forecast sales growth rates** Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key factors include the proportion of revenue expected to arise in emerging markets, the proportion of revenue expected to come from digital and services businesses relative to traditional print-based businesses and the changing product mix as a result of product investment. The five-year sales forecasts use average nominal growth rates between 1.1% and 3.3% for mature markets and between 8.3% and 15.7% for emerging markets with high inflation.

**Operating profits** Operating profits are forecast based on historic experience of operating margins, adjusted for the impact of changes to product costs and cost saving initiatives, including the impact of the global restructuring programme undertaken in 2013 and 2014.

**Cash conversion** Cash conversion is the ratio of operating cashflow to operating profit. Management forecasts cash conversion rates based on historic experience, adjusted for the impact of product investment priorities and the shift to digital and service based business.

### Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates. Based on the Group's sensitivity analysis, a reasonably possible increase of 0.8% pts in the discount rate or a decrease of 1.0% pt in the perpetuity growth rate could cause an impairment in respect of Brazil.

## Notes to the consolidated financial statements continued

## 12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows

All figures in £ millions	2014	2013
Associates	1,105	1,089
Joint ventures	13	3
<b>Total</b>	<b>1,118</b>	<b>1,092</b>

The amounts recognised in the income statement are as follows

All figures in £ millions	2014	2013
Associates	54	56
Joint ventures	(3)	(2)
<b>Total</b>	<b>51</b>	<b>54</b>

## Investment in associates

The Group has the following material associates

	Principal place of business	Ownership interest	Nature of relationship	Measurement method
Penguin Random House Ltd	UK/Global	47%	Note 1	Equity <sup>*</sup>
Penguin Random House LLC	US	47%	Note 1	Equity <sup>*</sup>
The Economist Newspaper Ltd	UK	50%	Note 2	Equity <sup>†</sup>

\*None of the associates has a quoted market price

Note 1 – On 1 July 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. The shareholder agreement includes protection rights for Pearson as the minority shareholder including rights to dividends. Management considers ownership percentage, board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over Penguin Random House and Bertelsmann has the power to direct the relevant activities and therefore control.

Note 2 – The Group has a 50% interest in The Economist Newspaper Ltd, publisher of one of the world's leading weekly business and current affairs magazines. The Economist has a unique structure of "A", "B" and Trustee shares, which was established to ensure its independence from proprietorial control. Pearson, as holder of the "B" shares, has never controlled the Economist by virtue of its shareholding or influence, and management assesses that it has significant influence over the company.

## 12 Investments in joint ventures and associates continued

## Investment in associates continued

The summarised financial information of the material associates is detailed below

All figures in £ millions	2014		2013 restated	
	Penguin Random House	Economist	Penguin Random House	Economist
<b>Assets</b>				
Current assets	1,355	110	1,210	103
Non-current assets	1,429	166	1,382	163
<b>Liabilities</b>				
Current liabilities	(1,113)	(190)	(905)	(190)
Non-current liabilities	(424)	(86)	(455)	(60)
<b>Net assets</b>	<b>1,247</b>	<b>—</b>	<b>1,232</b>	<b>16</b>
<b>Sales</b>	<b>2,416</b>	<b>320</b>	<b>1,315</b>	<b>340</b>
<b>Profit from continuing operations</b>	<b>74</b>	<b>42</b>	<b>66</b>	<b>52</b>
<b>Other comprehensive (expense)/income</b>	<b>(11)</b>	<b>(20)</b>	<b>(34)</b>	<b>9</b>
<b>Total comprehensive income</b>	<b>63</b>	<b>22</b>	<b>32</b>	<b>61</b>
<b>Dividends received from associate</b>	<b>95</b>	<b>21</b>	<b>43</b>	<b>21</b>

The information above reflects the amounts presented in the financial statements of the associates, adjusted for fair value and similar adjustments. The tax on Penguin Random House LLC is settled by the partners. For the purposes of clear and consistent presentation, the tax has been shown in the associate line items in the consolidated income statement and consolidated balance sheet, recording the Group's share of profit after tax consistently for the Penguin Random House associates.

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## Notes to the consolidated financial statements continued

## 12. Investments in joint ventures and associates continued

## Investment in associates continued

A reconciliation of the summarised financial information to the carrying value of the material associates is shown below

All figures in £ millions	2014		2013 restated	
	Penguin Random House	Economist	Penguin Random House	Economist
Opening net assets	1,232	16	--	--
Exchange differences	52	--	(68)	--
Profit for the period	74	42	66	52
Other comprehensive (expense)/income	(11)	(20)	(34)	9
Dividends, net of tax paid	(100)	(42)	(91)	(41)
Additions	--	--	1,359	--
Distribution from associate in excess of carrying value	--	4	--	--
Reversal of distribution from associate in excess of carrying value	--	--	--	(4)
Closing net assets	1,247	--	1,232	16
Share of net assets	586	--	579	8
Goodwill	509	--	491	--
Carrying value of associate	1,095	--	1,070	8

In 2013 the Group determined the fair value of the Penguin Random House venture for the purposes of accounting for the transaction. A valuation of the Penguin Random House ventures was determined during the negotiation of the transaction between Bertelsmann and Pearson. This valuation of the business was calculated using the income approach, discounting future cash flows to the present value. Cash flow projections were prepared for both businesses by country taking into account the front and backlist trends and extrapolated using long term growth rate assumptions. The cash flows were discounted using discount rates with risk premiums specific to each geographic region. A discount to the Group's share of the total value to reflect the Group's non-controlling minority ownership was applied.

The Group finalised its acquisition accounting for Penguin Random House in 2014 and an adjustment to the opening position with respect to deferred tax and goodwill was made. The overall carrying value of the associate in 2013 was unchanged however the additions and goodwill balances in the table above have been restated to reflect the final accounting.

Information on other individually immaterial associates is detailed below

All figures in £ millions	2014	2013
Loss from continuing operations	(2)	(1)
Other comprehensive income	--	--
Total comprehensive expense	(2)	(1)

## 12 Investments in joint ventures and associates continued

### Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2014 was £54m (2013 £44m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2014 was repaid in its entirety in January 2015.

The Group also has a current asset receivable of £41m (2013 £27m) from Penguin Random House arising from the provision of services. Included in other income (note 4) is £41m (2013 £28m) of service fees.

### Investment in joint ventures

Information on joint ventures, all of which are individually immaterial, is detailed below.

All figures in £ millions	2014	2013
Loss from continuing operations	(3)	(2)
Other comprehensive income	-	-
Total comprehensive expense	(3)	(2)

## 13 Deferred income tax

All figures in £ millions	2014	2013
Deferred income tax assets	295	250
Deferred income tax liabilities	(714)	(612)
Net deferred income tax	(419)	(362)

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

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. At 31 December 2014 the Group has unrecognised deferred income tax assets of £4m (2013 £4m) in respect of UK losses, £14m (2013 £11m) in respect of US losses and approximately £44m (2013 £36m) in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

All figures in £ millions	Notes	2014	2013
At beginning of year		(362)	(372)
Exchange differences		(22)	9
Income statement benefit	7	10	47
Acquisition through business combination	10	-	(37)
Disposal through business disposal	31	(1)	-
Tax charge to other comprehensive income or equity		(18)	(35)
Transfer to/from current tax		(26)	25
Transfer to assets held for sale		-	1
At end of year		(419)	(362)

Included in the income statement above for 2014 is a £nil charge (2013 £2m charge) relating to discontinued operations.

## Notes to the consolidated financial statements continued

## 13. Deferred income tax continued

The movement in deferred income tax assets and liabilities during the year is as follows

All figures in £ millions	Trading losses	Returns provisions	Retirement benefit obligations	Other	Total
<b>Deferred income tax assets</b>					
At 1 January 2013	18	45	47	119	229
Exchange differences	–	(1)	(1)	(4)	(6)
Acquisition through business combination	21	–	–	–	21
Income statement (charge)/benefit	(24)	(5)	25	22	18
Tax charge to other comprehensive income or equity	–	–	(36)	–	(36)
Transfer to current tax	–	–	–	25	25
Transfer from assets held for sale	–	–	7	(7)	–
Transfer to assets held for sale	–	–	–	(1)	(1)
At 31 December 2013	15	39	42	154	250
Exchange differences	1	2	4	5	12
Acquisition through business combination	2	–	–	–	2
Income statement benefit	10	3	7	35	55
Tax benefit/(charge) to other comprehensive income or equity	–	–	10	(7)	3
Transfer to current tax	–	–	–	(26)	(26)
Disposal through business disposal	–	–	(1)	–	(1)
At 31 December 2014	28	44	62	161	295

Other deferred income tax assets include temporary differences on share-based payments, inventory and other provisions

All figures in £ millions	Goodwill and intangibles	Other	Total
<b>Deferred income tax liabilities</b>			
At 1 January 2013	(475)	(126)	(601)
Exchange differences	13	2	15
Acquisition through business combination	(61)	3	(58)
Income statement (charge)/benefit	(61)	90	29
Tax benefit to other comprehensive income or equity	–	1	1
Transfer to assets held for sale	–	2	2
At 31 December 2013	(584)	(28)	(612)
Exchange differences	(30)	(4)	(34)
Acquisition through business combination	(2)	–	(2)
Income statement benefit/(charge)	18	(63)	(45)
Tax charge to other comprehensive income or equity	–	(21)	(21)
At 31 December 2014	(598)	(116)	(714)

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances



#### 14 Classification of financial instruments

The accounting classification of each class of the Group's financial assets and financial liabilities, together with their carrying values and market values, is as follows

								2014	
All figures in £ millions	Notes	Fair value			Amortised cost			Total carrying value	Total market value
		Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Other liabilities	Loans and receivables	Other liabilities		
Investments in listed securities	15	9	—	—	—	—	—	9	9
Investments in unlisted securities	15	45	—	—	—	—	—	45	45
Cash and cash equivalents	17	—	—	—	—	530	—	530	530
Marketable securities		16	—	—	—	—	—	16	16
Derivative financial instruments	16	—	6	108	—	—	—	114	114
Trade receivables	22	—	—	—	—	989	—	989	989
<b>Total financial assets</b>		<b>70</b>	<b>6</b>	<b>108</b>	<b>—</b>	<b>1,519</b>	<b>—</b>	<b>1,703</b>	<b>1,703</b>
Derivative financial instruments	16	—	(33)	(41)	—	—	—	(74)	(74)
Trade payables	24	—	—	—	—	—	(329)	(329)	(329)
Bank loans and overdrafts	18	—	—	—	—	—	(42)	(42)	(42)
Borrowings due within one year	18	—	—	—	—	—	(305)	(305)	(319)
Borrowings due after more than one year	18	—	—	—	—	—	(1,878)	(1,878)	(1,888)
<b>Total financial liabilities</b>		<b>—</b>	<b>(33)</b>	<b>(41)</b>	<b>—</b>	<b>—</b>	<b>(2,554)</b>	<b>(2,628)</b>	<b>(2,652)</b>

## Notes to the consolidated financial statements continued

## 14. Classification of financial instruments continued

All figures in £ millions	Notes	2011						Total carrying value	Total market value
		Available for sale	Derivatives designated held for trading	Derivatives not designated for trading	Other liabilities	Loans and receivables	Other liabilities		
Investments in unlisted securities – continuing operations	15	94	–	–	–	–	–	94	94
Cash and cash equivalents – continuing operations	17	–	–	–	–	729	–	729	729
Cash and cash equivalents classified within assets held for sale	12	–	–	–	–	36	–	36	36
Marketable securities		6	–	–	–	–	–	6	6
Derivative financial instruments	16	–	4	120	–	–	–	124	124
Trade receivables – continuing operations	22	–	–	–	–	882	–	882	882
Trade receivables classified within assets held for sale		–	–	–	–	25	–	25	25
<b>Total financial assets</b>		<b>100</b>	<b>4</b>	<b>120</b>	<b>–</b>	<b>1,672</b>	<b>–</b>	<b>1,896</b>	<b>1,896</b>
Derivative financial instruments	16	–	(16)	(32)	–	–	–	(48)	(48)
Trade payables – continuing operations	24	–	–	–	–	–	(316)	(316)	(316)
Trade payables classified within liabilities held for sale		–	–	–	–	–	(1)	(1)	(1)
Bank loans and overdrafts – continuing operations	18	–	–	–	–	–	(47)	(47)	(47)
Borrowings due within one year	18	–	–	–	–	–	(508)	(508)	(514)
Borrowings due after more than one year	18	–	–	–	–	–	(1,671)	(1,671)	(1,683)
<b>Total financial liabilities</b>		<b>–</b>	<b>(16)</b>	<b>(32)</b>	<b>–</b>	<b>–</b>	<b>(2,543)</b>	<b>(2,591)</b>	<b>(2,609)</b>

Certain of the Group's derivative financial instruments are classified as held for trading either as they do not meet the hedge accounting criteria specified in IAS 39 'Financial Instruments: Recognition and Measurement' or as the Group has chosen not to seek hedge accounting for these instruments. None of these derivatives are held for speculative trading purposes. Transactions in derivative financial instruments are only undertaken to manage risks arising from underlying business activity, in accordance with the Group's treasury policy as described in note 19.

The Group designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The Group also designates certain of its borrowings and derivative financial instruments as hedges of its investments in foreign operations (net investment hedges). Movements in the fair value of these financial instruments (to the extent they are effective) are recognised in other comprehensive income.

None of the Group's financial assets or liabilities are designated at fair value through the income statement upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies. The Group's approach to managing risks in relation to financial instruments is described in note 19.

## 15 Other financial assets

All figures in £ millions	2014	2013
At beginning of year	94	31
Exchange differences	6	—
Acquisition of investments	12	63
Disposal of investments	(58)	—
At end of year	54	94

Other financial assets comprise listed securities of £9m (2013 £nil) and unlisted securities of £45m (2013 £94m)

## 16 Derivative financial instruments

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows

All figures in £ millions	2014			2013		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,607	84	(5)	1,439	81	(32)
Interest rate derivatives – not in a hedge relationship	673	—	(7)	634	4	(16)
Cross currency rate derivatives – in a hedge relationship	889	24	(36)	220	39	—
Cross-currency rate derivatives – not in a hedge relationship	451	6	(26)	—	—	—
<b>Total</b>	<b>3,620</b>	<b>114</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>
<b>Analysed as expiring</b>						
In less than one year	200	24	(1)	312	13	—
Later than one year and not later than five years	1,386	67	(8)	1,377	111	—
Later than five years	2,034	23	(65)	604	—	(48)
<b>Total</b>	<b>3,620</b>	<b>114</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>

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## Notes to the consolidated financial statements continued

## 16 Derivative financial instruments continued

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

At the end of 2014, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross-currency rate derivatives, was US dollar £(607)m, sterling £214m, euro £430m, Brazilian real £4m and South African rand £nil (2013 US dollar £(151)m, sterling £243m, euro £nil, Brazilian real £nil and South African rand £(16)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2014 range from 1.10% to 14.48% (2013 1.10% to 9.28%) and the floating rates are based on LIBOR in US dollar, euro and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

Derivative financial assets and liabilities subject to offsetting arrangements are as follows:

	2014			2013		
	Gross derivative assets	Gross derivative liabilities	Net derivative assets/liabilities	Gross derivative assets	Gross derivative liabilities	Net derivative assets/liabilities
<i>All figures in £ millions</i>						
Counterparties in an asset position	94	(28)	66	122	(12)	110
Counterparties in a liability position	20	(46)	(26)	2	(36)	(34)
Total as presented in the balance sheet	114	(74)	40	124	(48)	76

All of the Group's derivative financial instruments are subject to enforceable netting arrangements with individual counterparties, allowing net settlement in the event of default of either party. Offset arrangements in respect of cash balances are shown in note 17.

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

**17 Cash and cash equivalents (excluding overdrafts)**

All figures in £ millions	2014	2013
Cash at bank and in hand	483	521
Short-term bank deposits	47	208
Continuing operations	530	729
Cash at bank and in hand classified within assets held for sale	-	36
	530	765

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

At the end of 2014 the currency split of cash and cash equivalents was US dollar 18% (2013 28%), sterling 13% (2013 18%), euro 3% (2013 5%), renminbi 28% (2013 27%) and other 38% (2013 22%)

Cash and cash equivalents have fair values that approximate to their carrying value due to their short-term nature  
Cash and cash equivalents include the following for the purpose of the cash flow statement

All figures in £ millions	2014	2013
Cash and cash equivalents - continuing operations	530	729
Cash at bank and in hand classified within assets held for sale	-	36
Bank overdrafts - continuing operations	(19)	(25)
	511	740

The Group has the following cash pooling arrangements in US dollars, sterling and euro, where both the company and the bank have a legal right of offset

All figures in £ millions	2014			2013		
	Offset asset	Offset liability	Net offset asset/liability	Offset asset	Offset liability	Net offset asset/liability
US dollars	267	(266)	1	298	(299)	(1)
Sterling	430	(427)	3	1,018	(1,027)	(9)
Euro	9	(8)	1	6	(5)	1
Total for continuing operations as presented in the balance sheet			5			(9)

At the end of 2013, the Group had offset US dollar, sterling and euro asset balances of £1m £16m and £nil respectively in respect of discontinued operations

Offset arrangements in respect of derivatives are shown in note 16

## Notes to the consolidated financial statements continued

## 18 Financial liabilities – borrowings

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

All figures in £ millions	2014	2013
<b>Non-current</b>		
6.0% Sterling bonds 2015 (nominal amount £300m)	–	299
4.0% US dollar notes 2016 (nominal amount \$350m)	231	221
6.25% Global dollar bonds 2018 (nominal amount \$550m)	390	375
4.625% US dollar notes 2018 (nominal amount \$300m)	210	202
1.875% Euro notes 2021 (nominal amount €500m)	408	–
3.75% US dollar notes 2022 (nominal amount \$500m)	319	283
3.25% US dollar notes 2023 (nominal amount \$500m)	315	286
Bank loans and overdrafts	5	22
Finance lease liabilities	5	5
	<b>1,883</b>	<b>1,693</b>
<b>Current</b>		
Due within one year or on-demand		
5.7% US dollar bonds 2014 (nominal amount \$400m)	–	248
7.0% Sterling bonds 2014 (nominal amount £250m)	–	254
6.0% Sterling bonds 2015 (nominal amount £300m)	300	–
Bank loans and overdrafts	37	25
Finance lease liabilities	5	6
	<b>342</b>	<b>533</b>
<b>Total borrowings</b>	<b>2,225</b>	<b>2,226</b>

Included in the non-current borrowings above is £13m of accrued interest (2013: £9m). Included in the current borrowings above is £1m of accrued interest (2013: £4m).

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

All figures in £ millions	2014	2013
Between one and two years	239	303
Between two and five years	602	821
Over five years	1,042	569
	<b>1,883</b>	<b>1,693</b>

## 18 Financial liabilities – borrowings continued

The carrying amounts and market values of borrowings are as follows

All figures in £ millions	Effective interest rate	Carrying value	2014	Carrying value	2013
			Market value		Market value
Bank loans and overdrafts	n/a	42	42	47	47
5.7% US dollar bonds 2014	5.88%	–	–	248	246
7.0% Sterling bonds 2014	7.20%	–	–	254	262
6.0% Sterling bonds 2015	6.27%	300	314	299	325
4.0% US dollar notes 2016	4.26%	231	233	221	223
6.25% Global dollar bonds 2018	6.46%	390	397	375	376
4.625% US dollar notes 2018	4.69%	210	205	202	195
1.875% Euro notes 2021	2.04%	408	407	–	–
3.75% US dollar notes 2022	3.94%	319	327	283	286
3.25% US dollar notes 2023	3.36%	315	314	286	273
Finance lease liabilities	n/a	10	10	11	11
		2,225	2,249	2,226	2,244

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings are denominated in the following currencies

All figures in £ millions	2014	2013
US dollar	1,491	1,645
Sterling	303	559
Euro	408	–
Other	23	22
	2,225	2,226

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## Notes to the consolidated financial statements continued

## 18 Financial liabilities – borrowings continued

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

All figures in £ millions	2014	2013
<b>Floating rate</b>		
– expiring within one year	–	–
– expiring beyond one year	1,122	1,057
	<b>1,122</b>	<b>1,057</b>

In addition to the above facilities, there are a number of short-term facilities that are utilised in the normal course of business

All of the Group's borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

The maturity of the Group's finance lease obligations is as follows

All figures in £ millions	2014	2013
<b>Finance lease liabilities – minimum lease payments</b>		
Not later than one year	5	6
Later than one year and not later than two years	3	4
Later than two years and not later than three years	1	1
Later than three years and not later than four years	1	–
Later than four years and not later than five years	–	–
Later than five years	–	–
Future finance charges on finance leases	–	–
<b>Present value of finance lease liabilities</b>	<b>10</b>	<b>11</b>

The present value of finance lease liabilities is as follows

All figures in £ millions	2014	2013
Not later than one year	5	6
Later than one year and not later than five years	5	5
Later than five years	–	–
	<b>10</b>	<b>11</b>

The carrying amounts of the Group's lease obligations approximate their fair value



## 19 Financial risk management

The Group's approach to the management of financial risks together with sensitivity analyses of its financial instruments is set out below

### Treasury policy

The Group holds financial instruments for two principal purposes – to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets and longer-term loans from banks and capital markets. The Group borrows principally in US dollars, euros and sterling, at both floating and fixed rates of interest, using derivative financial instruments ('derivatives'), where appropriate, to generate the desired currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised in this Note. All the treasury policies remained unchanged throughout the year, except for revisions to the Group's bank counterparty risk limits and a clarification of the Group's intention to maintain its credit ratings as outlined below.

The audit committee receives regular reports on the Group's treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.

### Liquidity and refinancing risk management

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective is to maintain the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) to be between three and ten years. At the end of 2014 the average maturity of gross borrowings was 4.7 years (2013: 4.2 years) of which bonds represented 97% (2013: 97%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. All of the Group's credit ratings remained unchanged during the year, although in January 2014, Moody's changed the outlook on their short-term and long-term ratings from 'Stable' to 'Negative'. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group also uses a range of ratios to monitor and manage its finances internally. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2014 the committed facilities amounted to \$1,750m (£1,122m) and their weighted average maturity was 4.6 years.

### Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates.

The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2014 the fixed to floating hedging ratio, on the above basis, was approximately 38%–62%. Steps will be taken in early 2015 to bring the Group back into compliance with this policy objective. A simultaneous 1% change on 1 January 2015 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have an £11m effect on profit before tax.

## Notes to the consolidated financial statements continued

**19. Financial risk management continued****Interest rate risk management continued**

The policy described above creates a further group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group's accounting objective in relation to its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

**Financial counterparty risk management**

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover the Group's total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

**Foreign currency risk management**

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross-currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. The Group policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross-currency swaps) were US dollar £2,005m and sterling £36m.

**Use of currency debt and currency derivatives**

The Group uses both currency denominated debt and derivative instruments to implement the above policy.

Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

## 19 Financial risk management continued

## Analysis of Group debt, including the impact of derivatives

The following tables analyse the Group's sources of funding and the impact of derivatives on the Group's debt instruments

The Group's net debt position is set out below

All figures in £ millions	2014	2013
Cash and cash equivalents	530	729
Marketable securities	16	6
Derivative financial instruments	40	76
Bank loans, overdrafts and loan notes	(42)	(47)
Bonds	(2,173)	(2,168)
Finance lease liabilities	(10)	(11)
Continuing operations	(1,639)	(1,415)
Cash and cash equivalents classified within assets held for sale	-	36
<b>Net debt</b>	<b>(1,639)</b>	<b>(1,379)</b>

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

All figures in £ millions	2014	2013
Fixed rate	597	612
Floating rate	1,042	767
<b>Total</b>	<b>1,639</b>	<b>1,379</b>

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

All figures in £ millions	2014	2013
US dollar	2,099	1,849
Sterling	104	339
Other	22	38
<b>Total</b>	<b>2,225</b>	<b>2,226</b>

As at 31 December 2014 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	342	842	1,041	2,225
Effect of rate derivatives	1,254	(225)	(1,029)	-
<b>Total</b>	<b>1,596</b>	<b>617</b>	<b>12</b>	<b>2,225</b>

## Notes to the consolidated financial statements continued

## 19 Financial risk management continued

The maturity of contracted cash flows associated with the Group's financial liabilities are as follows

All figures in £ millions				2014
	USD	GBP	Other	Total
Not later than one year	398	160	99	657
Later than one year and not later than five years	877	–	–	877
Later than five years	1,126	–	–	1,126
<b>Total</b>	<b>2,401</b>	<b>160</b>	<b>99</b>	<b>2,660</b>
<b>Analysed as</b>				
Bonds	1,711	318	439	2,468
Rate derivatives – inflows	(379)	(656)	(537)	(1,572)
Rate derivatives – outflows	893	444	98	1,435
Trade payables	176	54	99	329
<b>Total</b>	<b>2,401</b>	<b>160</b>	<b>99</b>	<b>2,660</b>

All figures in £ millions				2013
	USD	GBP	Other	Total
Not later than one year	434	316	113	863
Later than one year and not later than five years	1,000	106	–	1,106
Later than five years	648	–	–	648
<b>Total</b>	<b>2,082</b>	<b>422</b>	<b>113</b>	<b>2,617</b>
<b>Analysed as</b>				
Bonds	1,918	604	–	2,522
Rate derivatives – inflows	(350)	(248)	–	(598)
Rate derivatives – outflows	359	1	16	376
Trade payables	155	65	97	317
<b>Total</b>	<b>2,082</b>	<b>422</b>	<b>113</b>	<b>2,617</b>

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the Group net settles these amounts wherever possible.

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

## 19 Financial risk management continued

## Financial instruments – fair value measurement

The following table provides an analysis of those financial instruments that are measured subsequently to initial recognition at fair value grouped into levels 1 to 3, based on the degree to which the fair value is observable

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices), and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs)

All figures in £ millions	2014				2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Financial assets at fair value</b>								
Derivative financial assets	–	114	–	114	–	124	–	124
Marketable securities	–	16	–	16	–	6	–	6
<b>Available for sale financial assets</b>								
Investments in listed securities	–	9	–	9	–	–	–	–
Investments in unlisted securities	–	–	45	45	–	–	94	94
<b>Financial liabilities at fair value</b>								
Derivative financial liabilities	–	(74)	–	(74)	–	(48)	–	(48)
<b>Total</b>	<b>–</b>	<b>65</b>	<b>45</b>	<b>110</b>	<b>–</b>	<b>82</b>	<b>94</b>	<b>176</b>

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

All figures in £ millions	2014		2013	
	Investments in unlisted securities	Other financial liabilities	Investments in unlisted securities	Other financial liabilities
At beginning of year	94	–	31	(68)
Exchange differences	6	–	–	9
Additions	3	–	63	–
Fair value movements	–	–	–	(8)
Disposals	(58)	–	–	67
At end of year	45	–	94	–

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets

## Notes to the consolidated financial statements continued

## 19 Financial risk management continued

## Financial instruments – sensitivity analysis

As at 31 December 2014 the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in listed securities	9	–	–	(1)	1
Investments in unlisted securities	45	–	–	(4)	5
Cash and cash equivalents	530	–	–	(67)	82
Marketable securities	16	–	–	–	–
Derivative financial instruments	40	(66)	85	16	(19)
Bonds	(2,173)	71	(84)	(170)	208
Other borrowings	(52)	–	–	6	(7)
Other net financial assets	660	–	–	(53)	64
<b>Total financial instruments</b>	<b>(925)</b>	<b>5</b>	<b>1</b>	<b>(273)</b>	<b>334</b>

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. The class 'Other net financial assets' comprises trade assets less trade liabilities.

The sensitivities of derivative instruments are calculated using established estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%. A large proportion of the movements shown above would impact equity rather than the income statement, due to the location and functional currency of the entities in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

**20 Intangible assets – Pre-publication**

All figures in £ millions	2014	2013
<b>Cost</b>		
At beginning of year	1,933	1,876
Exchange differences	80	(46)
Additions	358	364
Disposal through business disposal	–	(29)
Disposals	(234)	(234)
Acquisition through business combination	1	2
<b>At end of year</b>	<b>2,138</b>	<b>1,933</b>
<b>Amortisation</b>		
At beginning of year	(1,216)	(1,210)
Exchange differences	(60)	46
Charge for the year	(292)	(308)
Disposal through business disposal	–	23
Disposals	234	234
Acquisition through business combination	–	(1)
Transfer to receivables	16	–
<b>At end of year</b>	<b>(1,318)</b>	<b>(1,216)</b>
<b>Carrying amounts</b>		
<b>At end of year</b>	<b>820</b>	<b>717</b>

Included in the above are pre-publication assets amounting to £546m (2013 £480m) which will be realised in more than one year

Amortisation is included in the income statement in cost of goods sold. There was no amortisation within discontinued operations in either year.

**21 Inventories**

All figures in £ millions	2014	2013
Raw materials	9	15
Work in progress	10	13
Finished goods	205	196
	<b>224</b>	<b>224</b>

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £387m (2013 £472m). In 2014 £38m (2013 £53m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

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**22 Trade and other receivables**

All figures in £ millions	2014	2013
<b>Current</b>		
Trade receivables	963	863
Royalty advances	18	23
Prepayments and accrued income	107	101
Other receivables	222	186
	<b>1,310</b>	<b>1,173</b>
<b>Non-current</b>		
Trade receivables	26	19
Royalty advances	8	8
Prepayments and accrued income	30	33
Other receivables	18	10
	<b>82</b>	<b>70</b>

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns. The movements on the provision for bad and doubtful debts are as follows:

All figures in £ millions	2014	2013
At beginning of year	(58)	(55)
Exchange differences	–	5
Income statement movements	(21)	(27)
Utilised	17	18
Acquisition through business combination	(11)	–
Transfer to assets classified as held for sale	–	1
<b>At end of year</b>	<b>(73)</b>	<b>(58)</b>

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



## 22 Trade and other receivables continued

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

All figures in £ millions	2014	2013
Within due date	869	783
Up to three months past due date	203	194
Three to six months past due date	40	36
Six to nine months past due date	15	22
Nine to 12 months past due date	15	9
More than 12 months past due date	11	1
<b>Total trade receivables</b>	<b>1,153</b>	<b>1,045</b>
Less provision for sales returns	(164)	(163)
<b>Net trade receivables</b>	<b>989</b>	<b>882</b>

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historic payment profiles. Management believe all the remaining receivable balances are fully recoverable.

## 23 Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2014	58	11	67	53	189
Exchange differences	4	—	—	1	5
Charged to income statement	—	1	—	10	11
Released to income statement	—	(1)	(43)	(4)	(48)
Acquisition through business combination	—	—	—	14	14
Utilised	(5)	(4)	(4)	(23)	(36)
<b>At 31 December 2014</b>	<b>57</b>	<b>7</b>	<b>20</b>	<b>51</b>	<b>135</b>

### Analysis of provisions

All figures in £ millions	2014				
	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	7	4	20	22	53
Non-current	50	3	—	29	82
	57	7	20	51	135
	2013				
	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	5	10	67	30	112
Non-current	53	1	—	23	77
	58	11	67	53	189

Deferred consideration primarily relates to the formation of a venture in a North America business in 2011.

Disposals and closures include liabilities related to the disposal of Penguin. In 2013 a provision was established for amounts payable to Bertelsmann upon settlement of the transfer of Penguin's UK past service pension liabilities to the new Penguin Random House venture. During 2014 it was decided that this transfer would not go ahead as planned and therefore the provision has been released.

Legal and other includes legal claims, contract disputes and potential contract losses.

## Notes to the consolidated financial statements continued

**24. Trade and other liabilities**

All figures in £ millions	2014	2013
Trade payables	329	316
Social security and other taxes	21	23
Accruals	501	478
Deferred income	801	698
Interest payable	28	22
Other liabilities	231	225
	1,911	1,762
<b>Less non-current portion</b>		
Accruals	22	25
Deferred income	201	155
Interest payable	19	21
Other liabilities	68	56
	310	257
<b>Current portion</b>	1,601	1,505

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

The deferred income balance comprises principally multi year obligations to deliver workbooks to adoption customers in school businesses, advance payments in assessment, testing and training businesses, subscription income in school, college and newspaper businesses, and obligations to deliver digital content in future years

**25 Retirement benefit and other post-retirement obligations****Background**

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world

The largest plan is the Pearson Group Pension Plan (UK Group plan) in the UK, which is sectionalised to provide both defined benefit and defined contribution pension benefits. The defined benefit section was closed to new members from 1 November 2006. The defined contribution section, opened in 2003, is open to new and existing employees. Finally, there is a separate section within the UK Group plan set up for auto-enrolment. The defined benefit section of the UK Group plan is a final salary pension plan which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends on the length of service and final pensionable pay. The UK Group plan is funded with benefit payments from trustee administered funds. The UK Group plan is administered in accordance with the Trust Deed and Rules in the interests of its beneficiaries by Pearson Group Pension Trustee Limited.

At 31 December 2014 the UK Group plan has approximately 26,500 members, analysed in the following table

%	Active	Deferred	Pensioners	Total
Defined benefit	2	25	32	59
Defined contribution	18	23	—	41
<b>Total</b>	<b>20</b>	<b>48</b>	<b>32</b>	<b>100</b>

## 25 Retirement benefit and other post-retirement obligations continued

### Background continued

The other major defined benefit plans are based in the US. These are also final salary pension plans which provide benefits to members in the form of a guaranteed pension payable for life, with the level of benefits dependent on length of service and final pensionable pay. The majority of the US plans are funded.

The Group also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

The defined benefit schemes expose the Group to actuarial risks, such as life expectancy, inflation risks, and investment risk including asset volatility and changes in bond yields. The Group is not exposed to any unusual, entity specific or plan specific risks.

### Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

%	2014			2013		
	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.0	2.5	2.5	3.4	2.5	2.5
Rate used to discount plan liabilities	3.6	3.7	3.7	4.4	4.4	4.4
Expected rate of increase in salaries	3.5	3.9	4.0	3.9	3.9	4.0
Expected rate of increase for pensions in payment and deferred pensions	1.9 to 5.05	–	–	2.3 to 5.1	–	–
Initial rate of increase in healthcare rate	–	–	7.0	–	–	7.5
Ultimate rate of increase in healthcare rate	–	–	5.0	–	–	5.0

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.0% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.0% has been used.

The expected rate of increase in salaries has been set at 3.5% for 2014 with a short-term assumption of 2.0% for three years.

For the UK plan, the mortality base table assumptions have been derived from the SAPS 'all pensioners' tables for males and the SAPS 'normal health pensioners' tables for females, adjusted to reflect the observed experience of the plan, with CMI model improvement factors. A 1.5% long-term rate improvement on the CMI model is applied for males, and 1.25% for females.

For the US plans, the mortality table (RP - 2014) and 2014 Improvement scale (MP - 2014) with no adjustments have been adopted for 2014, reflecting the mortality assumption most prevalent in the US. In 2013 the RP2000 table projected to 2020 was used.

## Notes to the consolidated financial statements continued

## 25 Retirement benefit and other post-retirement obligations continued

## Assumptions continued

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows

	UK		US	
	2014	2013	2014	2013
Male	24.4	24.3	21.6	19.2
Female	24.5	24.4	23.8	21.1

The remaining average life expectancy in years of a pensioner retiring at age 65, 15 years after the balance sheet date, for the UK and US Group plans is as follows

	UK		US	
	2014	2013	2014	2013
Male	26.6	25.9	23.3	19.2
Female	26.4	25.9	25.5	21.1

Although the Group anticipates that plan surpluses will be utilised during the life of the plan to address member benefits, the Group recognises its pension surplus in full in respect of the UK Group plan on the basis that it is management's judgement that there are no substantive restrictions on the return of residual plan assets in the event of a winding up of the plan after all member obligations have been met

## Financial statement information

The amounts recognised in the income statement are as follows

All figures in £ millions	2014					
	UK Group plan	Defined benefit other	Sub total	Defined contribution	PRMB	Total
Current service cost	20	2	22	69	2	93
Curtailments	(5)	–	(5)	–	(13)	(18)
Administration expenses	4	–	4	–	–	4
Total operating expense	19	2	21	69	(11)	79
Interest on plan assets	(103)	(7)	(110)	–	–	(110)
Interest on plan liabilities	98	8	106	–	3	109
Net finance (income)/expense	(5)	1	(4)	–	3	(1)
Net income statement charge/(income)	14	3	17	69	(8)	78

## 25. Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

All figures in £m, except	2014					2013
	UK Group plan	Defined benefit other	Sub total	Defined contribution	PRMB	Total
Current service cost	22	3	25	72	4	101
Curtailments	–	–	–	–	(4)	(4)
Administration expenses	4	–	4	–	–	4
Total operating expense	26	3	29	72	–	101
Interest on plan assets	(95)	(6)	(101)	–	–	(101)
Interest on plan liabilities	94	7	101	–	3	104
Net finance (income)/expense	(1)	1	–	–	3	3
Net income statement charge	25	4	29	72	3	104

Included within the 2014 results are discontinued operations consisting of a £5m credit (2013: £2m charge) relating to defined benefit schemes and a £nil m charge (2013: £6m charge) relating to defined contribution schemes

The amounts recognised in the balance sheet are as follows

All figures in £ millions	2014				2013			
	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
Fair value of plan assets	2,714	164	–	2,878	2,353	156	–	2,509
Present value of defined benefit obligation	(2,524)	(196)	(23)	(2,743)	(2,267)	(171)	(20)	(2,458)
Net pension asset/(liability)	190	(32)	(23)	135	86	(15)	(20)	51
Other post retirement medical benefit obligation				(81)				(77)
Other pension accruals				(27)				(30)
Net retirement benefit asset/(obligation)				27				(56)
Analysed as								
Retirement benefit assets				190				86
Retirement benefit obligations				(163)				(142)

## Notes to the consolidated financial statements continued

## 25. Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

The following gains/(losses) have been recognised in other comprehensive income

All figures in £ millions	2014	2013
Amounts recognised for defined benefit plans	36	70
Amounts recognised for post-retirement medical benefit plans	(13)	9
<b>Total recognised in year</b>	<b>23</b>	<b>79</b>

The fair value of plan assets comprises the following

	2014			2013		
	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
%						
Equities	26	2	28	28	2	30
Bonds	42	3	45	40	3	43
Property	9	--	9	9	--	9
Other	17	1	18	17	1	18

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

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

	2014		2013	
	Quoted market price	No quoted market price	Quoted market price	No quoted market price
%				
UK equities	5	1	6	1
Non-UK equities	20	2	20	3
Fixed-interest securities	19	--	19	--
Index-linked securities	26	--	24	--
Property	--	9	--	9
Other	--	18	--	18
<b>Total</b>	<b>70</b>	<b>30</b>	<b>69</b>	<b>31</b>

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

	2014	2013
%		
Liquid -- call < 1 month	72	72
Less liquid -- call 1-3 months	2	2
Liquid -- call > 3 months	26	26

## 25 Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

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

All figures in £ millions	2014			2013		
	UK Group plan	Other plans	Total	UK Group plan	Other plans	Total
<b>Fair value of plan assets</b>						
Opening fair value of plan assets	2,353	156	2,509	2,162	165	2,327
Exchange differences	-	4	4	-	(2)	(2)
Interest on plan assets	103	7	110	95	6	101
Return on plan assets excluding interest	286	9	295	103	6	109
Contributions by employer	62	4	66	77	5	82
Contributions by employee	2	-	2	2	-	2
Benefits paid	(92)	(16)	(108)	(86)	(24)	(110)
<b>Closing fair value of plan assets</b>	<b>2,714</b>	<b>164</b>	<b>2,878</b>	<b>2,353</b>	<b>156</b>	<b>2,509</b>
<b>Present value of defined benefit obligation</b>						
Opening defined benefit obligation	(2,267)	(191)	(2,458)	(2,181)	(220)	(2,401)
Exchange differences	-	(5)	(5)	-	4	4
Current service cost	(20)	(2)	(22)	(22)	(3)	(25)
Administration expenses	(4)	-	(4)	(4)	-	(4)
Cur tailments	5	-	5	-	-	-
Interest cost	(98)	(8)	(106)	(94)	(7)	(101)
Actuarial gains/(losses) – experience	11	(1)	10	5	1	6
Actuarial gains/(losses) – demographic	-	(8)	(8)	-	1	1
Actuarial gains/(losses) – financial	(241)	(20)	(261)	(55)	9	(46)
Contributions by employee	(2)	-	(2)	(2)	-	(2)
Benefits paid	92	16	108	86	24	110
<b>Closing defined benefit obligation</b>	<b>(2,524)</b>	<b>(219)</b>	<b>(2,743)</b>	<b>(2,267)</b>	<b>(191)</b>	<b>(2,458)</b>

The weighted average duration of the defined benefit obligation is 16.5 years for the UK and 9.7 years for the US

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## Notes to the consolidated financial statements continued

## 25 Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

Changes in the value of the US PRMB are as follows

All figures in £ millions	2014	2013
Opening defined benefit obligation	(77)	(89)
Exchange differences	(4)	1
Current service cost	(2)	(4)
Curtailments	13	4
Interest cost	(3)	(3)
Actuarial gains/(losses) – demographic	(7)	–
Actuarial gains/(losses) – financial	(6)	9
Benefits paid	5	5
Closing defined benefit obligation	(81)	(77)

## Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group in trust. The trustee of the plan is required to act in the best interest of the plan's beneficiaries. Assets of the plan are divided into two elements: matching assets, which are assets that produce cash flows that can be expected to match the cash flows for a proportion of the membership and include UK and overseas bonds, inflation linked property and infrastructure, return seeking assets, which are assets invested with a longer term horizon to generate the returns needed to provide the remaining expected cash flows for the beneficiaries, and include equities, property and alternative asset classes. The benchmark allocation is 60% matching and 40% return seeking assets.

The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2012 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by June 2017. In 2014 the Group contributed £43m (2013: £56m) towards the funding shortfall. Following the completion of the triennial funding valuation the Group has agreed to contribute £41m per annum until 2017 in excess of regular contributions. In addition, a mechanism has been agreed for the Group to make supplementary payments up to a maximum of £15m per annum if certain conditions are met. If such payments are made they are expected to accelerate the end date for extinguishing the deficit. Regular contributions to the plan in respect of the defined benefit sections are estimated to be £17m for 2015.

The Group expects to contribute \$10m in 2015 and \$11m in 2016 to its US defined benefit pension plans.



## 25 Retirement benefit and other post-retirement obligations continued

### Sensitivities

The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows

All figures in £ millions	2014	
	1% increase	1% decrease
<b>Effect</b>		
(Decrease)/increase in defined benefit obligation – UK Group plan	(371)	467
(Decrease)/increase in defined benefit obligation – US plan	(19)	22

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

All figures in £ millions	2014	
	1 year increase	1 year decrease
<b>Effect</b>		
Increase/(decrease) in defined benefit obligation – UK Group plan	88	(85)
Increase/(decrease) in defined benefit obligation – US plan	7	(6)

The effect of a half percentage point increase and decrease in the inflation rate is as follows

All figures in £ millions	2014	
	0.5% increase	0.5% decrease
<b>Effect</b>		
Increase/(decrease) in defined benefit obligation – UK Group plan	111	(104)
Increase/(decrease) in defined benefit obligation – US plan	–	–

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant, although in practice this is unlikely to occur and changes in some assumptions may be correlated. When calculating these sensitivities the same method has been applied to calculate the defined benefit obligation as has been applied when calculating the liability recognised in the balance sheet. This methodology is the same as prior periods.

## Notes to the consolidated financial statements continued

## 26 Share-based payments

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans

All figures in £ millions	2014	2013
Pearson plans	32	35

Share-based payment charges included in discontinued operations amounted to £nil (2013 £2m). The Group operates the following equity-settled employee option and share plans

**Worldwide Save for Shares Plan** Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three or five years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

**Employee Stock Purchase Plan** In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six-month periods. At the end of the period, the employee has the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

**Long-Term Incentive Plan** This plan was first introduced in 2001, renewed in 2006 and again in 2011. The plan consists of restricted shares. The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in May 2014 and May 2013, vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. Restricted shares awarded to senior management in November 2014 vest dependent on earnings per share growth. Other restricted shares awarded in 2014 and 2013 vest depending on continuing service over a three-year period.

**Annual Bonus Share Matching Plan** This plan permits executive directors and senior executives around the Group to invest up to 50% of any after-tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis of up to one matching share for every invested share, i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares. Awards under this plan ceased in 2013.

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

	2014		2013	
	Number of share options '000s	Weighted average exercise price £	Number of share options '000s	Weighted average exercise price £
Outstanding at beginning of year	2,792	8.73	3,373	8.24
Granted during the year	1,985	8.11	763	9.14
Exercised during the year	(727)	8.24	(820)	7.12
Forfeited during the year	(538)	8.76	(516)	8.75
Expired during the year	(5)	7.43	(8)	5.75
Outstanding at end of year	3,507	8.48	2,792	8.73
Options exercisable at end of year	43	8.24	35	6.95

## 26. Share-based payments continued

Options were exercised regularly throughout the year. The weighted average share price during the year was £11.41 (2013: £12.42). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

The options outstanding at the end of the year have weighted average remaining contractual lives and exercise prices as follows:

Range of exercise prices £	2014		2013	
	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	–	–	–	–
5 – 10	3,507	2.68	2,792	2.31
>10	–	–	–	–
	3,507	2.68	2,792	2.31

In 2014 and 2013 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

	2014 Weighted average	2013 Weighted average
Fair value	£2.41	£2.27
Weighted average share price	£11.09	£11.71
Weighted average exercise price	£8.11	£9.14
Expected volatility	21.27%	22.05%
Expected life	3.9 years	3.8 years
Risk free rate	1.3%	0.53%
Expected dividend yield	4.33%	3.84%
Forfeiture rate	3.4%	3.3%

The expected volatility is based on the historic volatility of the company's share price over the previous three to seven years depending on the vesting term of the options.

The following shares were granted under restricted share arrangements:

	2014		2013	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	5,875	11.44	3,482	11.52
Annual Bonus Share Matching Plan	–	–	99	12.06

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Participants under both plans are entitled to dividends during the vesting period and therefore the share price is not discounted.

## Notes to the consolidated financial statements continued

## 26 Share-based payments continued

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions are taken into consideration by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

## 27 Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2013	817,043	204	2,555
Issue of ordinary shares – share option schemes	1,537	1	13
At 31 December 2013	818,580	205	2,568
Issue of ordinary shares – share option schemes	1,303	–	11
At 31 December 2014	819,883	205	2,579

The ordinary shares have a par value of 25p per share (2013: 25p per share). All issued shares are fully paid. All shares have the same rights.

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings.

The Group reviews its capital structure on a regular basis and will balance its overall capital structure through payments of dividends, new share issues as well as the issue of new debt or the redemption of existing debt in line with the financial risk policies outlined in note 19.

## 28 Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2013	10,102	103
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
At 31 December 2013	9,282	98
Purchase of treasury shares	907	9
Release of treasury shares	(2,997)	(32)
At 31 December 2014	7,192	75

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 0.9% (2013: 1.1%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £1.8m (2013: £2.3m).

At 31 December 2014 the market value of Pearson plc treasury shares was £85.6m (2013: £124.4m).

## 29 Other comprehensive income

	2014				
	Attributable to equity holders of the company			Non controlling interest	Total
All figures in £ millions	Translation reserve	Retained earnings	Total		
Items that may be reclassified to the income statement					
Net exchange differences on translation of foreign operations – Group	150	–	150	–	150
Net exchange differences on translation of foreign operations – associate	25	–	25	–	25
Currency translation adjustment disposed – subsidiaries	(2)	–	(2)	–	(2)
Attributable tax	–	(6)	(6)	–	(6)
Items that are not reclassified to the income statement					
Remeasurement of retirement benefit obligations – Group	–	23	23	–	23
Remeasurement of retirement benefit obligations – associate	–	(15)	(15)	–	(15)
Attributable tax	–	(1)	(1)	–	(1)
Other comprehensive expense for the year	173	1	174	–	174

	2013				
	Attributable to equity holders of the company			Non controlling interest	Total
All figures in £ millions	Translation reserve	Retained earnings	Total		
<b>Items that may be reclassified to the income statement</b>					
Net exchange differences on translation of foreign operations – Group	(202)	-	(202)	(4)	(206)
Net exchange differences on translation of foreign operations – associate	(11)	-	(11)	-	(11)
Currency translation adjustment disposed – subsidiaries	(18)	-	(18)	-	(18)
Attributable tax	-	6	6	-	6
<b>Items that are not reclassified to the income statement</b>					
Remeasurement of retirement benefit obligations – Group	-	79	79	-	79
Remeasurement of retirement benefit obligations – associate	-	-	-	-	-
Attributable tax	-	(23)	(23)	-	(23)
<b>Other comprehensive expense for the year</b>	<b>(231)</b>	<b>62</b>	<b>(169)</b>	<b>(4)</b>	<b>(173)</b>

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## 30. Business combinations

On 11 February 2014, the Group acquired 100% of Grupo Multi, the leading adult English language training company in Brazil. Fair values for the assets and liabilities arising from the Grupo Multi acquisition and other smaller acquisitions completed in the year are set out below. There were no material adjustments to prior year acquisitions. There were no significant acquisitions in 2013. Adjustments were made in respect of prior year acquisitions in 2013 and included the recognition of intangibles of £185m on the EmbanetCompass acquisition.

Fair values for the assets and liabilities arising from acquisitions completed in the year are as follows

All figures in £ millions	Notes			2014	2013
		Grupo Multi fair value	Other fair value	Total fair value	Total fair value
Property, plant and equipment	10	1	1	2	1
Intangible assets	11	254	6	260	200
Intangible assets – pre-publication	20	1	–	1	1
Inventories		4	–	4	1
Trade and other receivables		35	1	36	9
Cash and cash equivalents (excluding overdrafts)		3	–	3	2
Financial liabilities – borrowings		(49)	–	(49)	–
Net deferred income tax assets/(liabilities)	14	2	(2)	–	(37)
Provisions for other liabilities and charges	24	(13)	(1)	(14)	–
Trade and other liabilities		(21)	(3)	(24)	(7)
Current income tax liabilities		(20)	–	(20)	–
<b>Net assets acquired at fair value</b>		<b>197</b>	<b>2</b>	<b>199</b>	<b>170</b>
Goodwill	11	240	(2)	238	(133)
Fair value of previously held interest arising on stepped acquisition		–	–	–	(7)
<b>Total</b>		<b>437</b>	<b>–</b>	<b>437</b>	<b>30</b>
<b>Satisfied by</b>					
Cash		(437)	–	(437)	(31)
Deferred consideration		–	–	–	(2)
Net prior year adjustments		–	–	–	3
<b>Total consideration</b>		<b>(437)</b>	<b>–</b>	<b>(437)</b>	<b>(30)</b>

The goodwill arising on these acquisitions results from cost and revenue synergies and from assets and benefits that cannot be separately recognised.

Goodwill of £240m arising on 2014 acquisitions is expected to be deductible for tax purposes (2013: £6m).

Intangible assets acquired in 2014 have the following useful economic lives: customer lists, contracts and relationships four years, trademarks and brands 20 years, and other acquired intangibles 12 years. Intangible assets recognised in 2013 have the following useful economic lives: customer lists, contracts and relationships 3–17 years, and trademarks and brands two years.

## 30 Business combinations continued

All figures in £ millions	2014	2013
Cash flow on acquisitions		
Cash – current year acquisitions	(437)	(25)
Deferred payments for prior year acquisitions and other items	(5)	(6)
Cash and cash equivalents acquired	3	2
Acquisition costs and other acquisition liabilities paid	(9)	(19)
Net cash outflow	(448)	(48)

In total, acquisitions completed in the year contributed an additional £70m of sales and £29m of adjusted operating profit. If the acquisitions had completed on 1 January 2014 then the Group estimates that sales for the year would have been £4,880m and total adjusted operating profit would have been £725m

## 31 Disposals including business closures

All figures in £ millions	2014				2013		
	Merger market	Penguin	Other	Total	Penguin	Other	Total
Disposal of subsidiaries							
Property, plant and equipment	(2)	-	(1)	(3)	(39)	(3)	(42)
Intangible assets	(12)	-	-	(12)	(43)	-	(43)
Investments in joint ventures and associates	-	-	-	-	(22)	-	(22)
Other financial assets	-	-	-	-	(1)	-	(1)
Intangible assets – pre-publication	-	-	-	-	(20)	(6)	(26)
Inventories	-	-	-	-	(91)	(3)	(94)
Trade and other receivables	(23)	-	(2)	(25)	(447)	(6)	(453)
Cash and cash equivalents (excluding overdrafts)	(19)	-	(11)	(30)	(34)	(3)	(37)
Net deferred income tax liabilities/(assets)	1	-	-	1	(22)	-	(22)
Retirement benefit obligations	-	-	-	-	-	4	4
Provisions for other liabilities and charges	4	-	-	4	7	-	7
Trade and other liabilities	69	-	12	81	224	10	234
Current income tax liabilities	6	-	-	6	-	-	-
Non-controlling interest	-	-	(2)	(2)	3	-	3
Attributable goodwill	(156)	-	(1)	(157)	(370)	(6)	(376)
Cumulative translation adjustment	2	-	-	2	18	-	18
Net assets disposed	(130)	-	(5)	(135)	(837)	(13)	(850)
Cash received	375	-	-	375	-	3	3
Deferred proceeds	-	-	6	6	-	-	-
Fair value of associate acquired	-	-	-	-	1,160	-	1,160
Costs	(1)	29	(2)	26	(121)	(14)	(135)
Gain/(loss) on disposal	244	29	(1)	272	202	(24)	178

The gain on disposal of Penguin in 2013 arises from the measurement at fair value of the associate investment acquired in Penguin Random House. Determination of fair value is described in note 12

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## Notes to the consolidated financial statements continued

**31 Disposals including business closures continued**

All figures in £ millions	2014	2013
<b>Cash flow from disposals</b>		
Cash – current year disposals	375	3
Cash and cash equivalents disposed	(30)	(37)
Costs and other disposal liabilities paid	(18)	(98)
<b>Net cash inflow/(outflow)</b>	<b>327</b>	<b>(132)</b>

**32 Held for sale**

Assets classified as held for sale in 2013 relate to Mergermarket

All figures in £ millions	Notes	2014	2013
Property, plant and equipment	10	–	2
Intangible assets	11	–	158
Deferred income tax assets	13	–	1
Trade and other receivables		–	26
Cash and cash equivalents (excluding overdrafts)	17	–	36
<b>Assets classified as held for sale</b>		<b>–</b>	<b>223</b>
Deferred income tax liabilities	13	–	(2)
Provisions for other liabilities and charges		–	(4)
Trade and other liabilities		–	(71)
Current income tax liabilities		–	(5)
<b>Liabilities directly associated with assets classified as held for sale</b>		<b>–</b>	<b>(82)</b>
<b>Net assets classified as held for sale</b>		<b>–</b>	<b>141</b>

**33 Purchase of non-controlling interest**

There were no purchases of non-controlling interests in 2014. In 2013 the Group purchased non-controlling interests in the South African business for £65m, and in the Indian business for £11m.



**34 Cash generated from operations**

All figures in £ millions	Notes	2014	2013
Profit		470	539
Adjustments for			
Income tax		110	90
Depreciation	10	74	82
Amortisation and impairment of acquired intangibles and goodwill	11	264	168
Amortisation of software	11	63	59
Net finance costs		93	75
Share of results of joint ventures and associates	12	(51)	(54)
Profit on disposals		(272)	(187)
Acquisition costs		6	12
Net foreign exchange adjustment from transactions		27	(40)
Share-based payment costs	26	32	37
Pre-publication		(52)	(77)
Inventories		6	18
Trade and other receivables		(69)	(50)
Trade and other liabilities		72	72
Retirement benefit obligations		(58)	(57)
Provisions for other liabilities and charges		(11)	(3)
<b>Net cash generated from operations</b>		<b>704</b>	<b>684</b>
Dividends from joint ventures and associates		120	64
Purchase of property, plant and equipment		(75)	(118)
Purchase of intangible assets		(107)	(64)
Proceeds from sale of property, plant and equipment		9	28
Proceeds from sale of intangible assets		2	2
Finance lease principal payments		(4)	(8)
<b>Operating cash flow</b>		<b>619</b>	<b>588</b>
Operating tax paid		(163)	(191)
Net operating finance costs paid		(73)	(73)
<b>Operating free cash flow</b>		<b>413</b>	<b>324</b>
Non operating tax paid		—	(55)
<b>Free cash flow</b>		<b>413</b>	<b>269</b>
Dividends paid (including to non-controlling interests)		(398)	(372)
<b>Net movement of funds from operations</b>		<b>15</b>	<b>(103)</b>
Acquisitions and disposals (net of tax)		(137)	(326)
Loans advanced (including to related parties)		(12)	(49)
Purchase of treasury shares	28	(9)	(47)
New equity		11	14
Other movements on financial instruments		15	(9)
<b>Net movement of funds</b>		<b>(117)</b>	<b>(520)</b>
Exchange movements on net debt		(143)	59
<b>Total movement in net debt</b>		<b>(260)</b>	<b>(461)</b>

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## Notes to the consolidated financial statements continued

**34. Cash generated from operations continued**

Net cash generated from operations is translated at an exchange rate approximating to the rate at the date of cash flow. The difference between this rate and the average rate used to translate profit gives rise to a currency adjustment in the reconciliation between net profit and net cash generated from operations. This adjustment reflects the timing difference between recognition of profit and the related cash receipts or payments.

Operating cash flow, operating free cash flow and total free cash flow are non-GAAP measures and have been disclosed as they are part of Pearson's corporate and operating measures.

In the cash flow statement, proceeds from sale of property, plant and equipment comprise

All figures in £ millions	2014	2013
Net book amount	12	19
(Loss)/profit on sale of property, plant and equipment	(3)	9
Proceeds from sale of property, plant and equipment	9	28

**35. Contingencies**

There are contingent Group liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries, joint ventures and associates. In addition there are contingent liabilities of the Group in respect of legal claims, contract disputes, royalties, copyright fees, permissions and other rights. None of these claims are expected to result in a material gain or loss to the Group.

**36. Commitments**

At the balance sheet date there were no commitments for capital expenditure contracted for but not yet incurred.

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £157m (2013: £183m).

The future aggregate minimum lease payments in respect of operating leases are as follows:

All figures in £ millions	2014	2013
Not later than one year	161	161
Later than one year and not later than two years	150	149
Later than two years and not later than three years	126	133
Later than three years and not later than four years	122	118
Later than four years and not later than five years	115	105
Later than five years	701	737
	1,375	1,403

### 37 Related party transactions

#### Joint ventures and associates

Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. Apart from transactions with the Group's joint ventures and associates, there were no other material related party transactions.

#### Key management personnel

From 1 January 2014 the key management personnel are deemed to be the members of the Pearson Executive (see page 9). It is this committee which had responsibility for planning, directing and controlling the activities of the Group in 2014. Key management personnel compensation is disclosed below.

All figures in £ millions	2014
Short-term employee benefits	10
Retirement benefits	1
Share-based payment costs	2
<b>Total</b>	<b>13</b>

There were no other material related party transactions. No guarantees have been provided to related parties.

### 38 Events after the balance sheet date

There were no material events after the balance sheet date.

## Notes to the consolidated financial statements continued

## 39. Accounts and audit exemptions

The Pearson plc subsidiary companies listed below are exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479A

	Company number		Company number
Aldwych Finance Limited	04720439	Pearson Education Limited	00872828
ASET Limited	04231636	Pearson Funding Four plc	07970304
ASET Group Limited	03964551	Pearson Funding One plc	02911143
ASET Management Limited	03139404	Pearson Funding Two plc	07210654
ASET Solutions Limited	03849880	Pearson Heinemann Limited	03099304
Blue Wharf Limited	04344573	Pearson in Practice ATA Limited	07679091
Burmedia Investments Limited	03060487	Pearson in Practice Holdings Limited	06337129
Edexcel Limited	04496750	Pearson in Practice Skills Based Learning Limited	03755464
Education Development International plc	03914767	Pearson in Practice Technology Limited	03786989
Embankment Finance Limited	04460625	Pearson International Finance Limited	02496206
eNVQ Limited	03985948	Pearson Loan Finance No 2 Unlimited	05632021
EQL Assessment Limited	05224778	Pearson Loan Finance No 3 Limited	05052661
Financial Times (ASC) Limited	00519261	Pearson Loan Finance No 4 Limited	02635107
Financial Times Group Limited	00879531	Pearson Loan Finance Unlimited	05144467
Fronter UK Limited	05737591	Pearson Management Services Limited	00096263
FT Business Information Limited	00758738	Pearson Overseas Holdings Limited	00145205
FT Labs Limited	04701650	Pearson PRH Holdings Limited	08561316
FT Personal Finance Limited	03855520	Pearson Professional Holdings Limited	00149375
Goal Limited	03566588	Pearson Services Limited	01341060
Green Wharf Limited	07009228	Pearson Shared Services Limited	04623186
Icodeon Limited	05068195	Peter Honey Publications Limited	03754757
Joint Examining Board Limited	03278422	Sector Training Limited	05342448
Longman Group (Overseas Holdings) Limited	00690236	St Clements Press (1988) Limited	02174119
Midlands Educational Technology Limited	01448842	Testchange Limited	02496240
Pearson Affordable Learning Fund Limited	08038068	The Coaching Space Limited	05333023
Pearson Amsterdam Finance Limited	03041245	The Financial Times (Benelux) Limited	01613899
Pearson Australia Finance Unlimited	05578463	The Financial Times (France) Limited	00867316
Pearson Books Limited	02512075	The Financial Times (Japan) Limited	01613900
Pearson Brazil Finance Ltd	08848874	The Financial Times (M-M UK) Limited	01398449
Pearson Canada Finance Unlimited	05578491	The Financial Times (Spain) Limited	01214411
Pearson Dollar Finance plc	05111013	TQ Catalis Limited	07307943
Pearson Dollar Finance Two plc	06507766	TQ Clapham Limited	07307925
Pearson Education Holdings Limited	00210859	TQ Global Limited	07802458
Pearson Education Investments Limited	08444933		

**39 Accounts and audit exemptions continued**

The Pearson plc subsidiary companies listed below are exempt from the requirements of the Companies Act 2006 to prepare individual accounts by virtue of section 394A

Company number		Company number	
Exec-Appointments Limited	04010964	Medley Global Advisors Limited	00931507
FDI Intelligence Limited	N1040129	The Financial News Limited	00607228
Financial Times Business Limited	00202281	The Financial Times (Switzerland) Limited	01613901
Financial Times Electronic Publishing Limited	02749250	The Financial Times (Zhongwen) Limited	01900030
Financial Times Investor Limited	04005565	Throgmorton Publications Limited	00905696
Mandatewire Limited	03855296		

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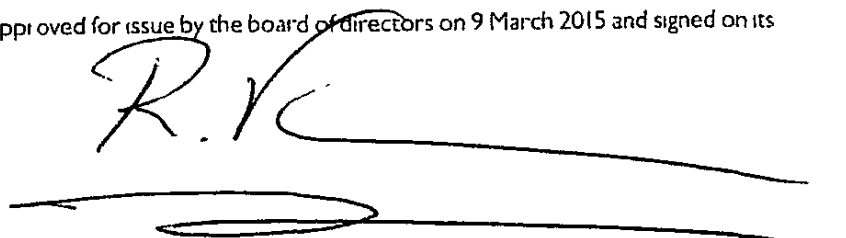
# Company balance sheet

As at 31 December 2014

All figures in £ millions	Notes	2014	2013
<b>Assets</b>			
<b>Non-current assets</b>			
Investments in subsidiaries	2	8,740	8,537
Amounts due from subsidiaries		27	2,009
Financial assets – derivative financial instruments	6	84	111
		8,851	10,657
<b>Current assets</b>			
Amounts due from subsidiaries		5,220	380
Amounts due from related parties		54	44
Current income tax assets		28	24
Financial assets – derivative financial instruments	6	24	13
Cash and cash equivalents (excluding overdrafts)	4	13	394
Other assets		2	–
		5,341	855
<b>Total assets</b>		14,192	11,512
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Amounts due to subsidiaries		(2,346)	(3,553)
Financial liabilities – borrowings	5	(210)	(202)
Financial liabilities – derivative financial instruments	6	(73)	(48)
		(2,629)	(3,803)
<b>Current liabilities</b>			
Amounts due to subsidiaries		(4,414)	(1,256)
Financial liabilities – borrowings	5	(629)	(766)
Financial liabilities – derivative financial instruments	6	(1)	–
Other liabilities		(2)	–
Provisions for other liabilities and charges	7	–	(42)
		(5,046)	(2,064)
<b>Total liabilities</b>		(7,675)	(5,867)
<b>Net assets</b>		6,517	5,645
<b>Equity</b>			
Share capital	8	205	205
Share premium	8	2,579	2,568
Treasury shares	9	1	(22)
Special reserve		447	447
Retained earnings		3,285	2,447
<b>Total equity attributable to equity holders of the company</b>		6,517	5,645

These financial statements have been approved for issue by the board of directors on 9 March 2015 and signed on its behalf by

Robin Freestone Chief financial officer



# Company statement of changes in equity

Year ended 31 December 2014

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2014	205	2,568	(22)	447	2,447	5,645
Profit for the year	-	-	-	-	1,267	1,267
Issue of ordinary shares under share option schemes <sup>†</sup>	-	11	-	-	-	11
Purchase of treasury shares	-	-	(9)	-	-	(9)
Release of treasury shares	-	-	32	-	(32)	-
Dividends	-	-	-	-	(397)	(397)
At 31 December 2014	205	2,579	1	447	3,285	6,517

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2013	204	2,555	(27)	447	2,069	5,248
Profit for the year	-	-	-	-	802	802
Issue of ordinary shares under share option schemes <sup>†</sup>	1	13	-	-	-	14
Purchase of treasury shares	-	-	(47)	-	-	(47)
Release of treasury shares	-	-	52	-	(52)	-
Dividends	-	-	-	-	(372)	(372)
At 31 December 2013	205	2,568	(22)	447	2,447	5,645

The special reserve represents the cumulative effect of cancellation of the company's share premium account

Included within retained earnings is an amount of £131m (2013: £131m) relating to profit on intra-Group disposals that is not distributable

<sup>†</sup> Full details of the share-based payment plans are disclosed in note 26 to the consolidated financial statements

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# Company cash flow statement

Year ended 31 December 2014

All figures in £ millions	Notes	2014	2013
<b>Cash flows from operating activities</b>			
Net profit		1,267	802
Adjustments for			
Income tax		(9)	(51)
Net finance costs		24	167
Amounts due to subsidiaries		(1,058)	(1,053)
<b>Net cash generated/(used in) from operations</b>		<b>224</b>	<b>(135)</b>
Interest paid		(73)	(82)
Tax received		6	14
<b>Net cash generated/(used in) from operating activities</b>		<b>157</b>	<b>(203)</b>
<b>Cash flows from investing activities</b>			
Disposal of subsidiaries, net of cash disposed		–	482
Loans to related parties		(10)	(44)
Interest received		15	10
<b>Net cash received from investing activities</b>		<b>5</b>	<b>448</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of ordinary shares	8	11	14
Net purchase of treasury shares		(9)	(48)
Repayment of borrowings		(250)	–
Dividends paid to company's shareholders		(397)	(372)
<b>Net cash used in financing activities</b>		<b>(645)</b>	<b>(406)</b>
Effects of exchange rate changes on cash and cash equivalents		(15)	18
<b>Net decrease in cash and cash equivalents</b>		<b>(498)</b>	<b>(143)</b>
Cash and cash equivalents at beginning of year		(118)	25
<b>Cash and cash equivalents at end of year</b>	4	<b>(616)</b>	<b>(118)</b>



# Notes to the company financial statements

## 1 Accounting policies

The financial statements on pages 196 to 204 comprise the separate financial statements of Pearson plc

As permitted by section 408 of the Companies Act 2006, only the consolidated income statement and statement of comprehensive income have been presented

The company has no employees

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the consolidated financial statements with the addition of the following

### Investments

Investments in subsidiaries are stated at cost less provision for impairment, with the exception of certain hedged investments that are held in a foreign currency and revalued at each balance sheet date

## 2 Investments in subsidiaries

All figures in £ millions	2014	2013
At beginning of year	8,537	9,108
Subscription for share capital in subsidiaries	138	424
Disposals/liquidations	-	(985)
Currency revaluations	65	(10)
At end of year	8,740	8,537

## 3 Financial risk management

The company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments and current and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. The company's approach to the management of financial risks is consistent with the Group's treasury policy, as discussed in note 19 to the consolidated financial statements. The company believes the value of its financial assets to be fully recoverable.

The company designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in a £66m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £85m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £169m, while a 10% weakening in the value of sterling would increase the carrying value by £89m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

## Notes to the company financial statements continued

## 3 Financial risk management continued

The maturity of contracted cash flows on the company's borrowings and all of its derivative financial instruments are as follows

All figures in £ millions	2014			
	USD	GBP	Other	Total
Not later than one year	172	(212)	(16)	(56)
Later than one year and not later than five years	224	–	(97)	127
Later than five years	418	–	(403)	15
<b>Total</b>	<b>814</b>	<b>(212)</b>	<b>(516)</b>	<b>86</b>
<b>Analysed as</b>				
Bonds	224	–	–	224
Rate derivatives – inflows	(303)	(656)	(537)	(1,496)
Rate derivatives – outflows	893	444	21	1,358
<b>Total</b>	<b>814</b>	<b>(212)</b>	<b>(516)</b>	<b>86</b>

All figures in £ millions	2013			
	USD	GBP	Other	Total
Not later than one year	(20)	233	16	229
Later than one year and not later than five years	287	(212)	–	75
Later than five years	(39)	–	–	(39)
<b>Total</b>	<b>228</b>	<b>21</b>	<b>16</b>	<b>265</b>
<b>Analysed as</b>				
Bonds	219	268	–	487
Rate derivatives – inflows	(350)	(248)	–	(598)
Rate derivatives – outflows	359	1	16	376
<b>Total</b>	<b>228</b>	<b>21</b>	<b>16</b>	<b>265</b>

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the company net settles these amounts wherever possible.

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

**4 Cash and cash equivalents (excluding overdrafts)**

All figures in £ millions	2014	2013
Cash at bank and in hand	2	269
Short term bank deposits	11	125
	13	394

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

At the end of 2014 the currency split of cash and cash equivalents was US dollar 33% (2013 76%), sterling 54% (2013 24%) and other 13% (2013 nil)

Cash and cash equivalents have fair values that approximate to their carrying amounts due to their short-term nature

Cash and cash equivalents include the following for the purpose of the cash flow statement

All figures in £ millions	2014	2013
Cash and cash equivalents	13	394
Bank overdrafts	(629)	(512)
	(616)	(118)

**5 Financial liabilities – borrowings**

All figures in £ millions	2014	2013
<b>Non-current</b>		
4.625% US dollar notes 2018 (nominal amount \$300m)	210	202
	210	202
<b>Current</b>		
<b>Due within one year or on-demand</b>		
7.0% Sterling bonds 2014 (nominal amount £250m)	–	254
Bank loans and overdrafts	629	512
	629	766
<b>Total borrowings</b>	<b>839</b>	<b>968</b>

Included in non-current borrowings above is £nil of accrued interest (2013 £nil). Included in current borrowings above is £nil of accrued interest (2013 £3m).

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## Notes to the company financial statements continued

## 5 Financial liabilities – borrowings continued

The maturity of the company's non-current borrowings is as follows

All figures in £ millions	2014	2013
Between one and two years	–	–
Between two and five years	210	202
Over five years	–	–
	210	202

As at 31 December 2014 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	629	210	–	839
Amounts due to subsidiaries	4,414	960	1,386	6,760
Effect of rate derivatives	1,254	(225)	(1,029)	–
	6,297	945	357	7,599

The carrying amounts and market values of borrowings are as follows:

All figures in £ millions	Effective interest rate	Carrying amount	2014 Market value	2013 Carrying amount	2013 Market value
Bank loans and overdrafts	n/a	629	629	512	512
7.0% Sterling bonds 2014	7.20%	–	–	254	262
4.625% US dollar notes 2018	4.69%	210	205	202	195
		839	834	968	969

The market values are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the company's borrowings are denominated in the following currencies

All figures in £ millions	2014	2013
US dollar	477	202
Sterling	354	762
Euro	8	4
	839	968

## 6 Derivative financial instruments

The company's outstanding derivative financial instruments are as follows

All figures in £ millions	2014			2013		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives - in a fair value hedge relationship	192	18	—	231	22	—
Interest rate derivatives - not in a hedge relationship	2,404	67	(31)	1,842	63	(48)
Cross-currency derivatives	952	23	(43)	220	39	—
<b>Total</b>	<b>3,548</b>	<b>108</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>
<b>Analysed as expiring</b>						
In less than one year	200	24	(1)	312	13	—
Later than one year and not later than five years	1,314	61	(8)	1,377	111	—
Later than five years	2,034	23	(65)	604	—	(48)
<b>Total</b>	<b>3,548</b>	<b>108</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

## 7 Provisions for other liabilities and charges

Provisions in the prior year were comprised of liabilities assumed on the closure of the business of a Group subsidiary. As anticipated, the provisions were utilised during the year.

## 8 Share capital and share premium

	Number of shares 000-	Ordinary shares £m	Share premium £m
At 1 January 2013	817,403	204	2,555
Issue of ordinary shares – share option schemes	1,537	1	13
At 31 December 2013	818,580	205	2,568
Issue of ordinary shares – share option schemes	1,303	—	11
At 31 December 2014	819,883	205	2,579

The ordinary shares have a par value of 25p per share (2013: 25p per share). All issued shares are fully paid. All shares have the same rights.

## Notes to the company financial statements continued

## 9. Treasury shares

	Number of shares 000s	£m
At 1 January 2013	10,102	27
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
At 31 December 2013	9,282	22
Purchase of treasury shares	907	9
Release of treasury shares	(2,997)	(32)
At 31 December 2014	7,192	(1)

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £1.8m (2013: £2.3m). At 31 December 2014 the market value of the company's treasury shares was £85.6m (2013: £124.4m). The gross book value of the shares at 31 December 2014 amounts to £75m. This value has been netted off with contributions received from operating companies of £76m, resulting in a net credit value of £1m.

## 10. Contingencies

There are contingent liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries. In addition there are contingent liabilities in respect of legal claims. None of these claims are expected to result in a material gain or loss to the company.

## 11. Audit fees

Statutory audit fees relating to the company were £35,000 (2013: £35,000).

## 12. Related party transactions

## Subsidiaries

The company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the company balance sheet.

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £143m (2013: £144m) and interest receivable from subsidiaries for the year of £73m (2013: £59m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £19m (2013: £55m). Dividends received from subsidiaries were £1,300m (2013: £1,363m).

## Associates

Amounts due from related parties, disclosed on the face of the company balance sheet, relate to loans to Penguin Random House, an associate of the Group. These loans are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2014 was £54m (2013: £44m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2014 was repaid in its entirety in January 2015.

## Key management personnel

From 1 January 2014, key management personnel are deemed to be the members of the Pearson Executive.

It is this committee which had responsibility for planning, directing and controlling the activities of the company in 2014. Key management personnel compensation is disclosed in note 37 to the consolidated financial statements.

There were no other material related party transactions. No guarantees have been provided to related parties.

## Principal subsidiaries

The principal operating subsidiaries at 31 December 2014 are listed below. They operate mainly in the countries of incorporation or registration. The investments are in equity share capital and they are all 100% owned.

	Country of incorporation or registration
Pearson Education Inc	US
Pearson Education Ltd	England
NCS Pearson Inc	US
The Financial Times Ltd	England

The company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements. A complete list of subsidiary and associated undertakings will be included in the next Pearson plc annual return filed with the Registrar of Companies.

## Five-year summary

All figures in £ millions	2010	2011	2012	2013 restated	2014
<b>Sales By geography<sup>a</sup></b>					
North America				3,073	2,974
Core				1,258	1,154
Growth				738	746
Continuing	4,532	4,728	4,959	5,069	4,874
Discontinued	1,427	1,134	1,153	621	9
<b>Total sales</b>	<b>5,959</b>	<b>5,862</b>	<b>6,112</b>	<b>5,690</b>	<b>4,883</b>

<b>Sales By line of business<sup>a</sup></b>					
School				2,303	2,027
Higher Education				1,664	1,695
Professional				1,102	1,152
Continuing	4,532	4,728	4,959	5,069	4,874
Discontinued	1,427	1,134	1,153	621	9
<b>Total sales</b>	<b>5,959</b>	<b>5,862</b>	<b>6,112</b>	<b>5,690</b>	<b>4,883</b>

<b>Adjusted operating profit By geography<sup>a</sup></b>					
North America				474	464
Core				120	152
Growth				38	35
Penguin Random House	--	--	--	50	69
Continuing	732	806	809	682	720
Discontinued	206	132	123	54	2
<b>Total adjusted operating profit</b>	<b>938</b>	<b>938</b>	<b>932</b>	<b>736</b>	<b>722</b>

<b>Adjusted operating profit By line of business<sup>a</sup></b>					
School				268	236
Higher Education				295	309
Professional				69	106
Penguin Random House	--	--	--	50	69
Continuing	732	806	809	682	720
Discontinued	206	132	123	54	2
<b>Total adjusted operating profit</b>	<b>938</b>	<b>938</b>	<b>932</b>	<b>736</b>	<b>722</b>

<sup>a</sup>Periods prior to 2013 have not been restated to reflect the new organisation structure, as there is no appropriate basis for restatement of those periods. 2011 onwards reflect the adoption of IAS 19 revised and have been restated, as appropriate. Prior periods have not been restated.



All figures in £ millions	2010	2011	2012	2013 re-stated	2014
Operating margin – continuing	16.2%	17.0%	16.3%	13.5%	14.8%
Adjusted earnings					
Total adjusted operating profit	938	938	932	736	722
Net finance costs	(85)	(55)	(65)	(72)	(64)
Income tax	(215)	(196)	(200)	(97)	(118)
Non controlling interest	(17)	1	(3)	(1)	1
Adjusted earnings	621	688	664	566	541
Weighted average number of shares (millions)	801.2	800.2	804.3	807.8	810.9
Adjusted earnings per share	77.5p	86.0p	82.6p	70.1p	66.7p
Cash flow					
Operating cash flow	1,057	983	788	588	649
Operating cash conversion	113%	105%	85%	80%	90%
Operating free cash flow	904	772	657	324	413
Operating free cash flow per share	112.8p	96.5p	81.7p	40.1p	50.9p
Total free cash flow	904	772	657	269	413
Total free cash flow per share	112.8p	96.5p	81.7p	33.3p	50.9p
Net assets	5,605	5,962	5,710	5,706	5,985
Net debt	430	499	918	1,379	1,639
Return on invested capital (gross basis)					
Total adjusted operating profit	938	938	932	736	722
Cash tax paid	(85)	(151)	(65)	(191)	(163)
Return	853	787	867	545	559
Average invested capital	8,315	8,731	9,578	10,130	9,900
Return on invested capital	10.3%	9.0%	9.1%	5.4%	5.6%
Dividend per share	38.7p	42.0p	45.0p	48.0p	51.0p

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## Corporate and operating measures

Pearson's corporate and operating measures include the results of Mergermarket throughout 2013 as the business was wholly-owned during that period

### Sales – underlying and constant exchange rate movement

Sales movements exclude Penguin, the impact of acquisitions, disposals and movements in exchange rates

All figures in £ millions	2014
Underlying decrease	(2)
Portfolio changes	79
Exchange differences	(272)
<b>Total sales decrease</b>	<b>(195)</b>
Underlying decrease	0%
Constant exchange rate increase	2%

### Adjusted income statement

Reconciliation of the consolidated income statement to the adjusted numbers presented as non-GAAP measures in the financial statements

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	398	2	(2)	6	318	–	–	722
Net finance costs	(93)	–	–	–	–	29	–	(64)
<b>Profit before tax</b>	<b>305</b>	<b>2</b>	<b>(2)</b>	<b>6</b>	<b>318</b>	<b>29</b>	<b>–</b>	<b>658</b>
Income tax	(63)	(1)	1	(1)	(73)	(5)	24	(118)
<b>Profit for the year from continuing operations</b>	<b>242</b>	<b>1</b>	<b>(1)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>540</b>
Profit for the year from discontinued operations	228	(1)	(227)	–	–	–	–	–
<b>Profit for the year</b>	<b>470</b>	<b>–</b>	<b>(228)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>540</b>
Non-controlling interest	1	–	–	–	–	–	–	1
<b>Earnings</b>	<b>471</b>	<b>–</b>	<b>(228)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>541</b>

## Adjusted income statement continued

All figures in £ millions	2013							Adjusted income statement
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	
Operating profit	458	54	16	12	196	–	–	736
Net finance costs	(76)	–	–	–	–	4	–	(72)
Profit before tax	382	54	16	12	196	4	–	664
Income tax	(87)	(18)	32	(2)	(51)	(1)	30	(97)
Profit for the year from continuing operations	295	36	48	10	145	3	30	567
Profit for the year from discontinued operations	244	(36)	(209)	–	2	(1)	–	–
Profit for the year	539	–	(161)	10	147	2	30	567
Non-controlling interest	(1)	–	–	–	–	–	–	(1)
Earnings	538	–	(161)	10	147	2	30	566

## Adjusted operating profit – underlying and constant exchange rate movement

## Operating profit movement excluding the impact of acquisitions, disposals and movements in exchange rates

All figures in £ millions	2014	
	Underlying increase	Constant exchange rate increase
Underlying increase	35	–
Portfolio changes	–	–
Exchange differences	(49)	(49)
Total adjusted operating profit decrease	(14)	(14)
Underlying increase	5%	5%
Constant exchange rate increase	5%	5%

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## Corporate and operating measures continued

## Free cash flow per share

Operating cash flow for continuing and discontinued operations before tax and finance charges divided by the weighted average number of shares in issue

All figures in £ millions	2014	2013
Adjusted operating profit	722	736
Cash conversion	90%	80%
Operating cash flow	649	588
Operating tax paid	(163)	(191)
Net operating finance costs paid	(73)	(73)
Total operating free cash flow	413	324
Non operating tax paid	–	(55)
Total free cash flow	413	269
Weighted average number of shares in issue (millions)	810.9	807.8
Operating free cash flow per share	50.9p	40.1p
Total free cash flow per share	50.9p	33.3p

## Return on invested capital

All figures in £ millions	Invested capital	
	2014	2013
Total adjusted operating profit	722	736
Operating tax paid	(163)	(191)
Return	559	545
Average goodwill and other intangibles	8,557	8,903
Average net operating assets	1,343	1,227
Average invested capital	9,900	10,130
Return on invested capital	5.6%	5.4%

Return on invested capital is calculated as total adjusted operating profit less operating cash tax paid expressed as a percentage of average invested capital. Invested capital includes the original unamortised goodwill and intangibles.

## Shareholder information

Pearson ordinary shares are listed on the London Stock Exchange and on the New York Stock Exchange in the form of American Depositary Receipts

### Corporate website

The investors' section of our corporate website [www.pearson.com/investors](http://www.pearson.com/investors) provides a wealth of information for shareholders. It is also possible to sign up to receive email alerts for reports and press releases relating to Pearson at [www.pearson.com/news/newsletter\\_subscribe.html](http://www.pearson.com/news/newsletter_subscribe.html)

### Shareholder information online

Shareholder information can be found on our website [www.pearson.com/investors/shareholder-information](http://www.pearson.com/investors/shareholder-information)

Our registrar, Equiniti, also provides a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at [www.shareview.co.uk](http://www.shareview.co.uk). For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2233\* or, for those shareholders with hearing difficulties, textphone number 0871 384 2255\*

### Information about the Pearson share price

The company's share price can be found on our website at [www.pearson.com](http://www.pearson.com). It also appears in the financial columns of the national press.

### 2014 dividends

	Payment date	Amount per share
Interim	12 September 2014	17 pence
Final	1 May 2015	34 pence

### Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0871 384 2043\*\*

### Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0871 384 2268\*

### Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to [www.shareview.co.uk/dealing](http://www.shareview.co.uk/dealing) or call customer services on 0845 300 0430\*

### Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact their telephone dealing helpline on 08456 037 037\* (weekdays only) or, for online dealing, log on to [www.shareview.co.uk/dealing](http://www.shareview.co.uk/dealing). You will need your shareholder reference number as shown on your share certificate.

A postal dealing service is also available through Equiniti. Please telephone 0871 384 2248\* for details or log on to [www.shareview.co.uk](http://www.shareview.co.uk) to download a form.

### ShareGift

Shareholders with small holdings of shares, whose value makes them uneconomic to sell, may wish to donate them to ShareGift, the share donation charity (registered charity number 1052686). Further information about ShareGift and the charities it has supported may be obtained from their website, [www.ShareGift.org](http://www.ShareGift.org) or by contacting them at ShareGift, PO Box 72253, London, SW1P 9LQ.

### American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact Bank of New York Mellon, Shareholder Correspondence (ADR), PO Box 30170, College Station, TX 77842-3170, telephone 1 (866) 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively you may email [shrrelations@cpushareownerservices.com](mailto:shrrelations@cpushareownerservices.com). Voting rights for registered ADR holders can be exercised through Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

\*Calls to these numbers are charged at 8p per minute plus network extras. Lines open 8.30am to 5.30pm Monday to Friday.

## Shareholder information continued

### Share register fraud protecting your investment

Pearson does not contact its shareholders directly to provide recommendation advice and neither does it appoint third parties to do so. As required by law our shareholder register is available for public inspection but we cannot control the use of information obtained by persons inspecting the register. Please treat any approaches purporting to originate from Pearson with caution.

For more information, please log on to our website at [www.pearson.com/investors/shareholder-information.html](http://www.pearson.com/investors/shareholder-information.html)

### Tips on protecting your shares

- › Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation
- › Inform our registrar, Equiniti, promptly when you change address
- › Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or better still, make arrangements to have the dividend paid directly into your bank account
- › Consider holding your shares electronically in a CREST account via a nominee

### 2015 financial calendar

Ex-dividend date	2 April
Record date	7 April
Last date for dividend reinvestment election	10 April
Payment date for dividend and share purchase date for dividend reinvestment	1 May
Annual General Meeting	24 April
Interim results	24 July
Payment date for interim dividend	11 September

#### Reliance on this document

Our strategic report on pages 2 to 56 has been prepared in accordance with section 414 ('Duty to prepare a strategic report') of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. It also incorporates much of the guidance set out in the Accounting Standards Board's Reporting Statement on the Operating and Financial Review.

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

#### Forward-looking statements

Except for the historical information contained herein, the matters discussed in this document include forward-looking statements. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing, anticipated costs savings and synergies and the execution of Pearson's strategy, are forward-looking statements. By their nature, forward-looking statements involve risks and uncertainties

because they relate to events and depend on circumstances that will occur in the future. They are based on numerous assumptions regarding Pearson's present and future business strategies and the environment in which it will operate in the future. There are a number of factors which could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including a number of factors outside Pearson's control. These include international, national and local conditions, as well as competition. They also include other risks detailed from time to time in Pearson's publicly-filed documents and you are advised to read, in particular, the risk factors set out in this document or otherwise in Pearson's latest annual report and accounts, which can be found on its website ([www.pearson.com/investors](http://www.pearson.com/investors)). Any forward-looking statements speak only as of the date they are made and Pearson gives no undertaking to update forward-looking statements to reflect any changes in its expectations with regard thereto or any changes to events, conditions or circumstances on which any such statement is based. No reliance should be placed on forward-looking statements.

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Pearson has supported the planting of 167 square metres of new native woodland with the Woodland Trust, helping to remove 6.7 tonnes of carbon dioxide emissions generated by the production of this report and associated documents.

This report has been printed on Edition Challenger Offset which is FSC® certified and made from 100% Elemental Chlorine Free (ECF) pulp. The mill and the printer are both certified to ISO 14001 environmental management system and registered to EMAS the eco management Audit Scheme. The report was printed using vegetable based inks by a CarbonNeutral® printer.

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