OUR STRATEGY
To find out more about our business strategy go to page 08

OUR PERFORMANCE
For an in-depth analysis of how we performed in 2011 go to page 13

OUR IMPACT ON SOCIETY
For an explanation of our approach to corporate responsibility go to page 36

ANNUAL REPORT AND ACCOUNTS 2011

ALWAYS LEARNING

PEARSON

Always learning

Pearson is the world's leading learning company. We have 41,000 people in more than 70 countries, helping people of all ages to make progress in their lives through all kinds of learning.

WE HAVE THREE WORLD-LEADING BUSINESSES:

PEARSON

FT

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

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

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

Learn more at our online reporting centre

www.pearson.com/ar2011

Directors' report

Business review

1 Overview

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

Also includes chief executive Marjorie Scardino's description of our business strategy and the key areas of investment and focus.

2 Our performance

An in-depth analysis of how we performed in 2011. Also looks at the outlook for 2012 and the principal risks and uncertainties affecting our businesses.

3 Our impact on society

Explains Pearson's approach to corporate responsibility, giving a summary of our work in 2011 and our plans for 2012.

4 Governance

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

5 Financial statements

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

Financial highlights

In financial terms, Pearson's goal is to achieve sustainable growth on three key financial goals – earnings, cash and return on invested capital, and reliable cash returns to our investors through healthy and growing dividends. Over the past five years we have produced, on average, 15% growth in earnings and 11% in cash flow. And we have sustained our growth even in the face of very tough economic and market conditions in recent years.

	2011 £m	2010 £m	Headline growth	CER growth	Underlying growth
Business performance					
Sales	5,862	5,663	4%	6%	1%
Adjusted operating profit	942	857	10%	12%	7%
Adjusted profit before tax	890	853	4%		
Adjusted earnings per share	86.5p	77.5p	12%		
Operating cash flow	983	1,057	(7)%		
Total free cash flow	772	904	(15)%		
Total free cash flow per share	96.5p	112.8p	(14)%		
Return on invested capital	9.1%	10.3%	(1.2)% pts		
Net debt	(499)	(430)	(16)%		
Statutory results					
Operating profit	1,226	743	65%		
Profit before tax	1,155	670	72%		
Basic earnings per share	119.6p	161.9p	(26)%		
Cash generated from operations	1,093	1,169	(7)%		
Dividend per share	42.0p	38.7p	9%		

Notes

Throughout this document:

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

b) Interactive Data was treated as a discontinued business in 2010 and sales and operating profit are stated on a continuing business basis, excluding Interactive Data from 2010. Until its sale on 29 July 2010, Interactive Data contributed 2010 revenues of £296m and 2010 adjusted operating profit of £81m.

c) The 'business performance' measures are non-GAAP measures and reconciliations to the equivalent statutory heading under IFRS are included in notes 2, 8 and 33 to the annual report.

2011 Sales

£5.9bn

+6%

2011 Adjusted operating profit

£942m

+12%

Our five-year record

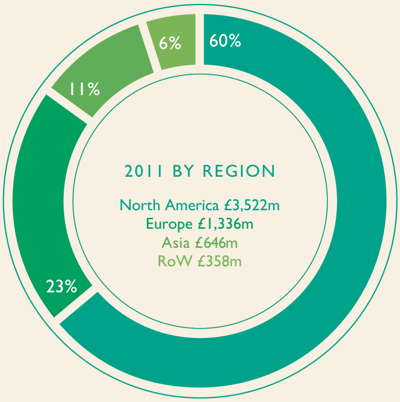
Average annual growth in headline terms, 2006–2011

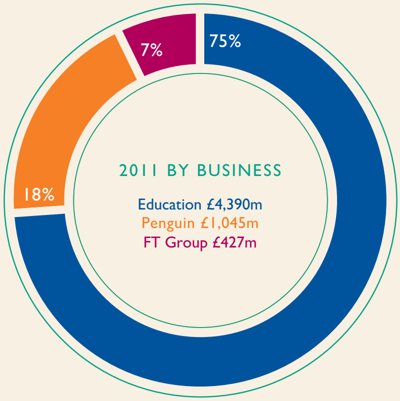
ADJUSTED EARNINGS PER SHARE

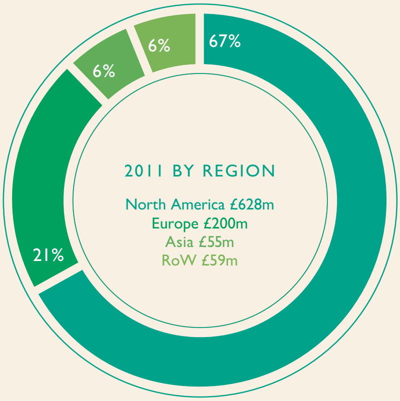
+15%

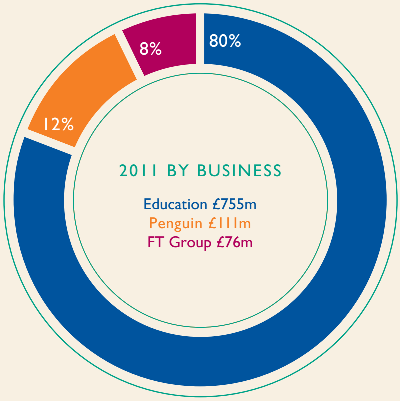
OPERATING CASH FLOW

+11%

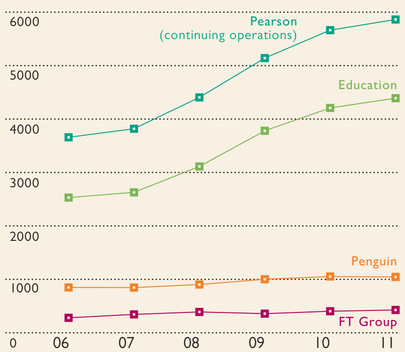




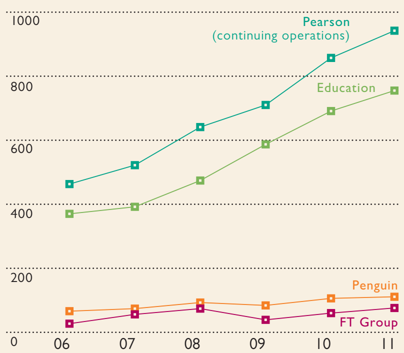




SALES £m



ADJUSTED OPERATING PROFIT £m



OVERVIEW
OUR PERFORMANCE
OUR IMPACT ON SOCIETY
GOVERNANCE
FINANCIAL STATEMENTS

Chairman's introduction

Pearson is pleased to report another year of solid progress on our financial and strategic goals, and on our returns to investors.

Watch the interview with Glen Moreno, Chairman
www.pearson.com/ar2011/glen-moreno

Dear shareholders,
Over the course of 2011, the value of our shares increased by 20%. They ended the year at a little over £12, their highest level for a decade. That growth was ahead of both the overall market (the FTSE100 was down 5.6%) and our sector (the DJ Stoxx 600 Media index was down 10.6%).

Add in the dividend and Pearson's total return to shareholders was 24.4% in 2011. This was ahead of the FTSE 100 (down 2.2%) and the DJ Stoxx 600 Media index (down 6.7%).

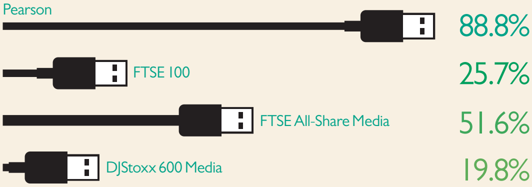
On a longer term view, our shares are up by almost 90% over the three years to the end of 2011 and by more than 50% over five years. Our total shareholder return is 113% over three years and 93% over five years.

This is a record we take some pride in. The board concentrates its time and energy on doing all we can to sustain it, even in the challenging economic conditions that face us. We do that by focusing on the following inter-related themes that we examine in more detail through this report.

SHARE PRICE PERFORMANCE

ONE YEAR % CHANGE
(01.01.11 – 31.12.11)

THREE YEAR % CHANGE
(01.01.09 – 31.12.11)



Source: Datastream as at 31 December 2011

Strategy

For more than a decade now, Pearson's strategy has revolved around our commitment to become the leading global learning company. The company saw tremendous social and economic need for education and skills, giving rise to significant business opportunities. We have therefore initiated – and continue to pursue – a radical shift in our business portfolio towards education.

That focus on lifelong learning has been accompanied by three related and ongoing changes in:

- what we deliver (from products to services);
- how we deliver it (from print to digital); and
- where we operate (from developed world to faster-growing developing economies).

As always, Marjorie provides a vivid description of how we are applying our strategy, and adapting to accelerating structural change in our industries, in her review.

See page 08 for the chief executive's strategic overview

Performance

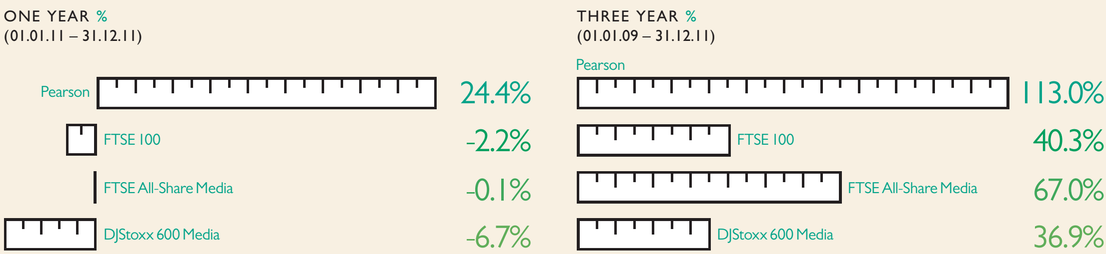
The board and management closely monitor the performance of Pearson's businesses against strategic and operating plans.

As our strategy unfolds, we are seeing some fundamental changes in the dynamics of our business. We are therefore developing additional measures of business and financial performance more appropriate to our changing business models.

We discuss these changes in detail within our performance section.

See page 13 for our performance review

TOTAL SHAREHOLDER RETURN



Source: Datastream as at 31 December 2011

Chairman's introduction continued

Governance

The board believes that good governance is closely linked to effective long-term strategy and value creation. The board agenda reflects our key priorities: Governance, Strategy, Business Performance and People.

We focus on board composition, board effectiveness, succession planning and engagement with shareholders.

We set out our framework and policies in the Governance section.

See page 46 for the Governance report

Risk

The board, the audit committee and management devote a good deal of time to evaluating, monitoring and mitigating traditional business risks from the impact of economic recession to business continuity to the loss of key assets or people.

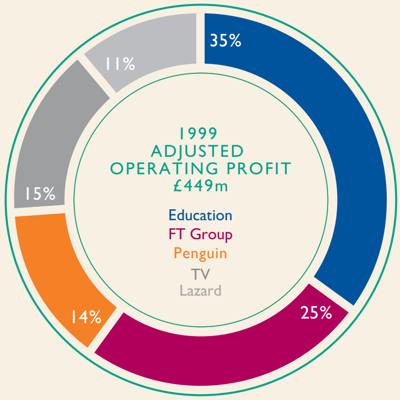
We also focus on newer risks that arise both from our evolving strategy and the changing economic, political and competitive environment. These newer risks include the emergence of disruptive technologies and technology-based competitors; operational and management challenges related to doing business in emerging markets; managing change in our traditional print-based publishing businesses; and protecting the reputation of Pearson and our world-famous brands.

We discuss these changes in detail within our strategy and performance sections.

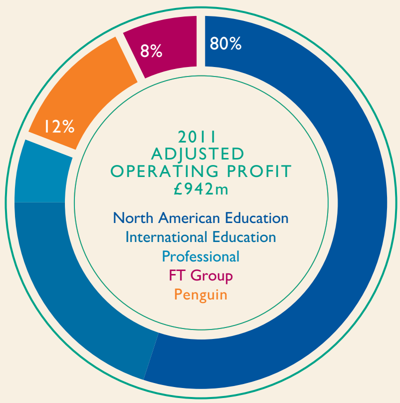
See page 13 for our performance section and the Audit Committee report

CHANGE AT PEARSON

OPERATING PROFIT



UK GAAP



IFRS

Remuneration

The board's commitment to long-term value creation through a clearly-defined strategy sets the agenda for our approach to remuneration. We set high performance hurdles for Pearson's senior managers. Where they have done well, our shareholders have done well too.

Even so, the board is deeply aware of the public debate and mood over executive compensation. This has influenced our remuneration plans for 2012.

We set out our policies and plans in full in our Remuneration report.

See page 65 for the Remuneration report

Responsibility

The board is keenly aware that Pearson's long-term value and franchise rests on fulfilling a social purpose. We exist to help improve people's lives through learning. Our value is a by-product of helping teachers teach and students learn; of helping business people understand the world and make good decisions; of informing and entertaining readers through one of life's greatest pleasures – a good book.

This is our core purpose and business, and we discuss it in detail both in Marjorie's Strategy review and in our Corporate Responsibility report.

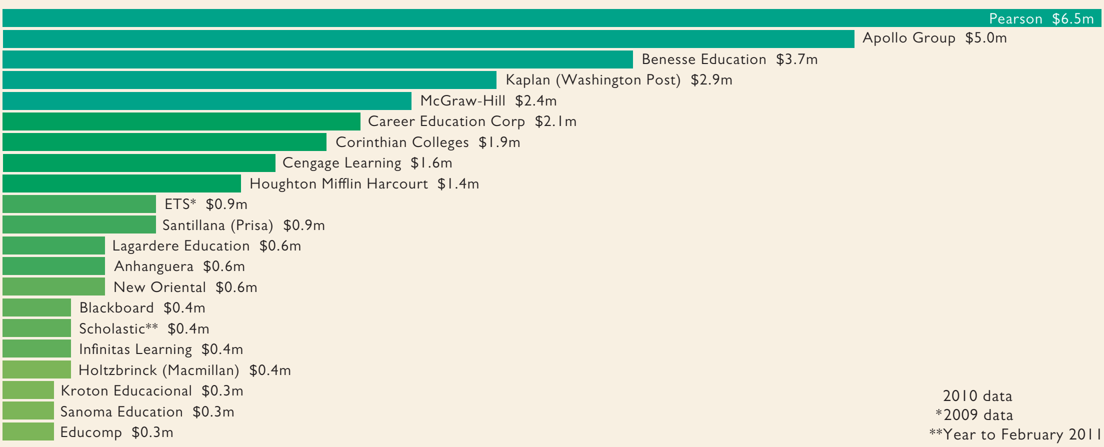
See page 08 for the chief executive's strategic overview
See page 36 for the Our impact on society report

We hope that shareholders find that this report adds both to their understanding of the company and to the way we approach our opportunities and responsibilities. We welcome your feedback on its content, and as always we very much hope to see you in person at our annual shareholders meeting at the end of April.

Glen Moreno Chairman

THE WORLD'S LEADING EDUCATION COMPANIES

EDUCATION REVENUES $m



Pearson's strategy: Marjorie Scardino, Chief executive

The outside environment has inspired us to move more quickly, to be more radical in our approach, to be more courageous.

Watch an interview with Marjorie Scardino, Chief executive:
www.pearson.com/ar2011/marjorie-scardino

Dear shareholders,
By the time you start to read this letter (and please forgive the presumption that you *do*), its subject – 2011 – will be ancient history. Pearson will be more than one quarter of the way through the *next* year, and making plans for the next five.

Like us, you may be more concerned about the future than the past. But we all know that what *has* happened is the best guide to what *might* happen, so I'd like to give last year a little time in this report before I talk about our plans.

What happened in 2011?

After several tough years in the world economy, we began the year hoping for a change for the better. But it turned out to be more of the same: slow economic growth in the developed world; austerity measures taking their toll on spending by governments and consumers; a crisis of unemployment – especially among young people – that played its part in social unrest.

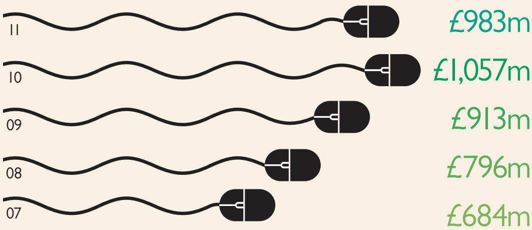
If that reads like a downbeat assessment of our world this past year, that's how it felt. The wind was not in our sails. Even so, I'm anything but downbeat about the resilience and creativity Pearson's people showed through those troubled and troubling waters.

Despite the gloom, they ground out another set of financial results to be proud of, and they achieved some goals that we believe will set us up for the future – and maybe even make the world a little better in the process.

KEY FINANCIAL MEASURES: FIVE YEAR RECORD

ADJUSTED EARNINGS PER SHARE PENCE

OPERATING CASH FLOW £m



You can see all the countable details in the charts on these pages, but to pick out a few of the high notes:

- Sales up 6%, and just shy of £5.9bn;
- Operating profits up 12%, to £942m;
- Earnings per share also up 12%, to 86.5p;
- A proposed dividend increase of 9%, taking our full-year payment to 42p; and
- An encouraging verdict from the stock market, which at year-end had pushed our shares 20% higher than last year (and almost 90% higher over the past three years).

That share price ended the year just over £12, a ten-year high. And on most of those financial measures, we set all-time highs for Pearson.

So, we can take one last look back at 2011 with some pride in a job well done. But we can't spend any time congratulating ourselves. Another quick glance at the past tells us why.

Back in 2007, as the financial crisis was taking hold, the best consumer book company on the planet (that would be Penguin) published the memoirs of Alan Greenspan, the former chairman of the US Federal Reserve. In the financial crisis that followed, his legacy came under fire, but looking back, the title of his book was remarkably prescient. He called it *The Age of Turbulence*.

That's a perfect description of what Pearson's future holds, and what we have to plan for now. And there's more than one kind of turbulence that's going to require our vigilance and imagination:

Economic turbulence

The prospects for the world economy look dim for the short term. Any recovery from the 2008 financial crisis was faint and short-lived. Europe is now ploughing through one urgent economic crisis after another; austerity measures around the over-indebted world are having a deep impact, and growth appears to be slowing even in some emerging markets now.

Still, the big shifts in economic growth and power are accelerating. Developing economies are growing on average 3% points a year faster than the US. And if that gap continues, those so-called 'emerging' markets will account for two-thirds of the world's output in less than 20 years. China may overtake America as the world's largest economy within the next ten. That's an exciting – and sobering – prospect for a company like ours that today makes around two-thirds of its profits in America and just 2% in China.

Social turbulence

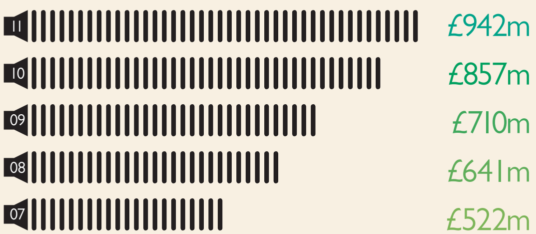
Economic turbulence generally builds to social upheaval. So those economic shifts are playing a part in protests across the Middle East, demonstrations in Western Europe and on Wall Street and riots in the UK.

Our flattening world is becoming more unequal. This past October, we reached a world population of seven billion people. More than half of them are living on $2 a day or less.

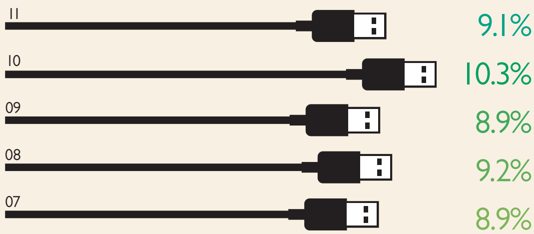
The world of work is one of the sources of profound disruption and anger (described by the *Financial Times* as 'the din of inequity').

KEY FINANCIAL MEASURES: FIVE YEAR RECORD

ADJUSTED OPERATING PROFIT £m



RETURN ON INVESTED CAPITAL %



Pearson's strategy: Marjorie Scardino, Chief executive continued

Around the globe more than 200 million people are unemployed. The young have been hit especially hard. In America, the youth unemployment rate has increased almost 70% to 18% since 2007; in the UK the rate is even higher, at more than 20%. In rich OECD countries, one in five young people is out of work; in much of the Middle East it's one in three; in parts of Southern Africa one in two.

And those who are 'no-longer-young' but still need to work can't find it either because they don't have the right skills. Creating new jobs – and helping people learn the skills that they'll need to secure them and succeed – will be one of the most pressing priorities for governments around the world.

(I recognise the inherent dangers of raising such matters as someone in a very fortunate position whose remuneration is there for all to see somewhere in the pages of this report. But I'm convinced that large companies and the people who run them are going to have to understand and respond to these kinds of issues.)

Political turbulence

If we needed someone to tell us, former US President Bill Clinton did in the FT Magazine back in October: "Successful countries are ones where economic forces and government work together to raise job growth, lower unemployment, and narrow inequalities in income, health care and education." But that kind of collaboration seems elusive right now.

In addition, our environment, both physical and social, is ever more political and ever more sensitive to political intervention. Managing those forces has come to be a requirement of every organisation. In our case that runs from consideration of media regulation and reform of education to copyright and intellectual property protection.

The public's scepticism of financial institutions is also provoking more scepticism of companies in general, and especially of those that make a profit out of providing a public service, such as journalism or education. A climate of suspicion will be a critical challenge for a company that is large, global, successful and heavily dependent on the public's trust and the public purse, as we are.

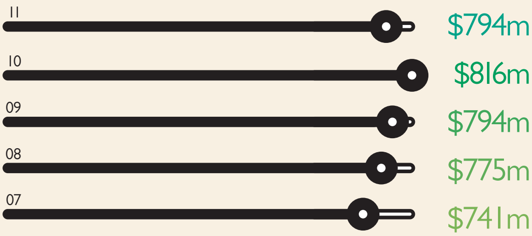
OUR STRATEGY

1

Long-term organic investment in content

Over the past five years, we have invested more than £4bn in our business: new education programmes; new and established authors for Penguin; the FT Group's journalism. We believe that this constant investment is critical to the quality and effectiveness of our products and that it has helped us gain share in many of our markets.

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

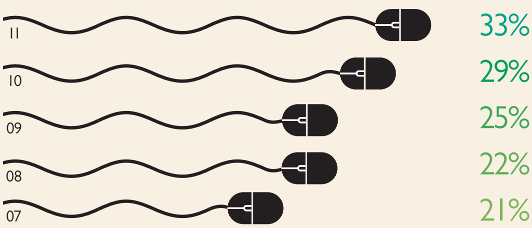


2

Digital products and services businesses

Our strategy is to add services to our content, usually enabled by technology, to make the content more useful, more personal and more valuable. These digital products and services businesses give us access to new, bigger and faster-growing markets. In 2011, our digital revenues were £2bn or 33% of Pearson's total sales.

PEARSON'S DIGITAL REVENUES
% OF SALES



Technological turbulence

The death of Steve Jobs, the leader of Apple, was a moment to reflect on the remarkable technological changes in our times. At the start of his life, the silicon chip hadn't been invented. By the end of it, only 56 years later, two billion people were using the internet and five billion were using mobile phones.

Not all of them by a long shot were using Apple devices, but that company did play a special role in the creation and growth of new consumer forms and technologies. It helped open fresh possibilities for many, including our company, and has made fundamental changes in what we do and how we do it. Those changes will only speed up.

What does that mean for our future?

So these are turbulent times for any company, but especially for one like ours. And this turbulence is not a freak storm at sea that will soon give way to calmer waters. This kind of disruption is our new reality. It's the environment we have made our plans around for the next five years at least.

This environment doesn't provoke us to change course, or to throw our strategy overboard. We think it remains a sound fundamental strategy, one that has proven it can enable the company to prosper through good times and bad. (In 2006, before the financial crisis and the subsequent recession, our sales were £4.4bn. In 2011, still in a downturn, they were more than 30% higher – around £6bn. In that time, our profit rose from less than £600m to close to £950m and earnings per share from a little over 40p to about 86p).

But the outside environment has inspired us to move more quickly, to be more radical in our approach, to be more courageous. The areas we'll be changing centre on themes that are familiar, but on which we're either moving faster or taking a different approach.

Here's a summary of them:

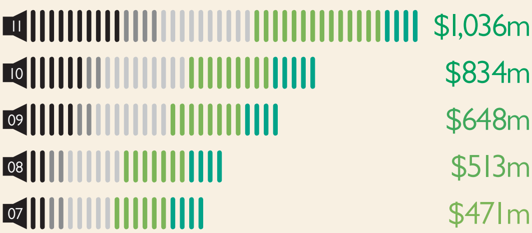
1. Investment: We're an aggressive, long-term investor in our businesses. This past year, we made some £0.5bn of organic investment: new learning programmes and technologies, new authors, taking our assets into new markets.

3

International expansion

We are already present in more than 70 countries and we are investing to become a much larger global company, with particular emphasis on fast-growing markets in China, India, Africa and Latin America. In 2011, Pearson generated $1bn of revenue in developing markets for the first time. They now account for 11% of our total sales and 22% of our people.

RAPID GROWTH IN EMERGING MARKETS
PEARSON REVENUES $m



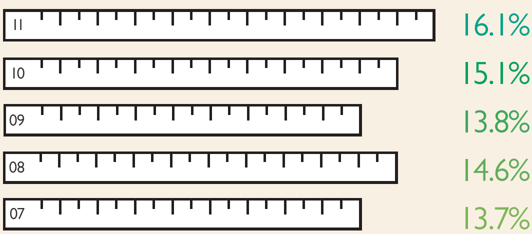
China/Hong Kong India Africa
Central/Latin America Middle East

4

Efficiency

Our investments in content, services and new geographic markets are fuelled by steady efficiency gains. Since 2007, our operating profit margins have increased from 13.7% to 16.1% and our ratio of average working capital to sales has improved from 20.1% to 16.9%.

PEARSON MARGINS %



Pearson's strategy: Marjorie Scardino, Chief executive continued

In addition, we have over the past five years invested £2.5bn in acquisitions, all of which have been additions or fill-ins to build our existing business. Our very strong balance sheet – just £500m of net debt at the end of 2011 – allows us to contemplate more of the same, should we see good opportunities.

2. Technology: Today's Pearson is a technology company as much as we are a newspaper or book publishing company (though those don't go away in the digital age – they are more flexible). Digital businesses last year contributed about one-third of our sales, or almost £2bn in total. Five years ago, they were 20%, about £720m. This represents a fundamental shift in our business, our culture and our growth opportunities.

3. Fast-growing markets: For many years, Pearson was primarily an Anglo-American company. Though we're still very much at home and working in those two countries, Pearson is now a truly international company with market-leading businesses from China to India to Brazil to southern Africa. 'Emerging markets' last year added up to 11% of our sales – and 22% of our people (because we're generating rapid growth there and getting ready for more).

4. Efficiency and scale: While we've been growing, a feature of Pearson has long been steady efficiency gains also. Our margins reached an all-time high of 16.1% this past year, and our cash generation was more than 100% of profits, as it has been for the last five years. Still, we see more to go for and more ways to go, especially as we accelerate our transition from traditional print-based activities to digital and services models.

What I've talked about in this report are the themes that have brought us to where we are, and made us a more durable company. We think they, too, are durable. But that doesn't mean that our plans and programmes aren't both innovative and brave.

Finally, as we encounter the future we've been preparing for, we will stand by some principles that have long been part of Pearson's DNA:

1. We want to follow our 'always learning' motto inside as well as outside our company – with our own people as well as with our customers. We want to educate our workforce for the needs of today, and, more importantly, for the needs they'll have throughout their working lives – needs to change skills, to teach themselves, and to excel rather than merely get by.

2. We want our work to be effective in tackling some big problems. That means helping people learn who have not had access to education; helping change the face of business through new ways of learning and making decisions; measuring ourselves by whether what we do is effective, not whether it's used.

3. We want to be a company that has a strong sense of social purpose (helping people make progress in their lives through learning) and high standards of ethical behaviour (which we summarise in Pearson's values: brave, imaginative and decent).

As we strive to achieve these goals, we want our shareholders to know and understand our direction. I hope you are enthused enough about it to support us into this future that we've planned and practiced for and now are taking head-on.

Thank you for the support you've given us up to now.

Marjorie Scardino Chief executive

Our performance: 2011 financial overview

In 2011, Pearson increased sales by 4% in headline terms to £5.9bn and adjusted operating profit from continuing operations by 10% to £942m.

The headline growth rates were reduced by currency movements and helped by acquisitions. Currency movements reduced sales by £122m and operating profits by £16m. This was the result of the weakening of the US dollar and other currencies against sterling: we generated approximately 60% of our sales and profits in US dollars and the average exchange rate moved from £1:$1.54 in 2010 to £1:$1.60 in 2011. At constant exchange rates (i.e. stripping out the impact of those currency movements), our sales and adjusted operating profit grew 6% and 12% respectively.

Acquisitions, primarily in our education company, contributed £262m to sales and £39m to operating profits. This includes integration costs and investments related to our newly-acquired companies, which we expense.

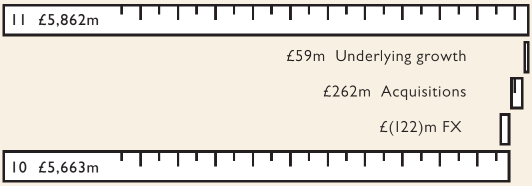
Our reshaping of Pearson continues to have a significant impact on our financial results. We sold Interactive Data in July 2010: it contributed seven months of sales, profits and cash in that year and none in 2011. We sold our 50% stake in FTSE International to the London Stock Exchange for net proceeds of £428m in December 2011: it contributed 2.2p to Pearson's earnings per share in 2011.

Our underlying revenue and operating profit (i.e. stripping out the benefit of both portfolio changes and currency movements) grew 1% and 7% respectively.

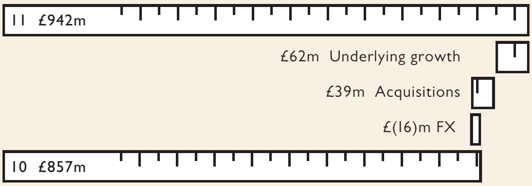
Our tax rate in 2011 was 22.4%, compared to 25.2% in 2010, reflecting a non-recurring benefit from settlement of various prior year tax affairs.

We increased adjusted earnings per share by 12% in headline terms to 86.5p.

SALES GROWTH £m



OPERATING PROFIT GROWTH £m



Our performance: 2011 financial overview continued

Cash generation

Headline operating cash flow declined by £74m as cash conversion returned to a more normalised rate of 104% (compared to 113% in 2010). The contribution to cash from working capital reduction was £39m (£149m in 2010, which was unusually high because in a strong adoption year pre-publication amortisation exceeded investment). Free cash flow declined by £132m to £772m, additionally reflecting higher tax payments following utilisation of the remaining available tax losses in 2010. Our average working capital to sales ratio improved by a further 3.2 percentage points to 16.9% reflecting the benefits of our shift to more digital and service-orientated businesses.

Return on invested capital

Our return on average invested capital was 9.1%, well ahead of our cost of capital. It was lower than the 2010 figure of 10.3%, due to several factors: the sale of Interactive Data, one of our least capital-intensive businesses; integration charges related to acquisitions; and an increased cash tax rate.

Statutory results

Our statutory results show an increase of £483m in operating profit to £1,226m (£743m in 2010). Basic earnings per share were 119.6p in 2011, down from 161.9p in 2010, with the profits on the sale of FTSE International in 2011 not matching those for Interactive Data in 2010.

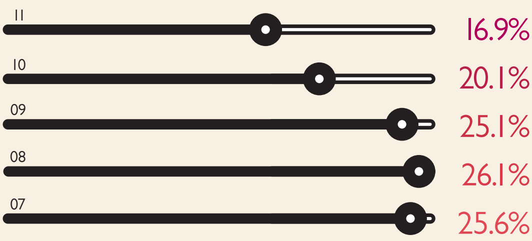
Balance sheet

Our net debt increased modestly to £499m (£430m in 2010). We benefited from the proceeds from the sale of FTSE International and strong cash generation, offset by acquisition investment of £896m and sustained investment in our businesses. Since 2000, Pearson's net debt/EBITDA ratio has fallen from 3.9x to 0.5x and our interest cover has increased from 3.1x to 18.1x.

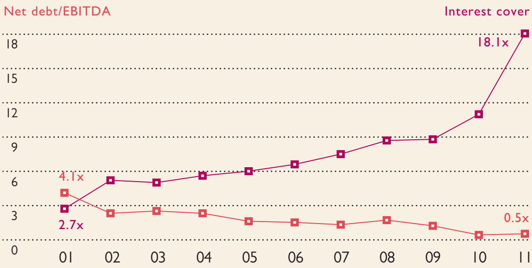
Dividend

The board is proposing a dividend increase of 9% to 42.0p, subject to shareholder approval. 2011 will be Pearson's 20th straight year of increasing our dividend above the rate of inflation. Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning more than £2.5bn to shareholders. We have a progressive dividend policy: we intend to sustain our dividend cover at around 2.0x over the long term, increasing our dividend more in line with earnings growth.

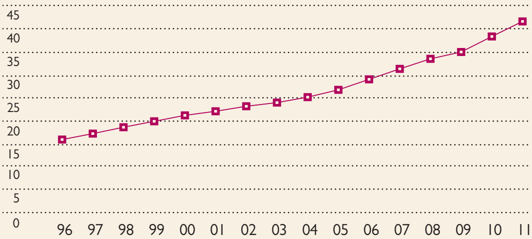
AVERAGE WORKING CAPITAL/SALES %



BALANCE SHEET STRENGTH



DIVIDEND PER SHARE PAID IN FISCAL YEAR
PENCE



Outlook: 2012

The external environment is likely to remain challenging in 2012 in the face of turbulent macroeconomic conditions and rapid structural change in our industries. However, we will once again make progress on our strategic goals of making Pearson more digital, more exposed to fast-growing markets and more directly engaged in helping students succeed.

Our 2012 financial results will reflect the sale of our 50% stake in FTSE International (which contributed no sales, £20m of operating profit and 2.2p of adjusted EPS in 2011) and higher tax rates (after one-off benefits in 2011). At this early stage in the year we expect Pearson to achieve growth in sales and operating profits in 2012. Margins will reflect integration costs on acquisitions made in 2011 (which are expensed) and the FTSE sale. This guidance is struck at current exchange rates (£1:$1.59).

Education

In Education, we expect to achieve continued growth in 2012. In North America, we anticipate modest growth in higher education as rapid take-up of our technology and services is partially offset by lower college enrolments and challenging conditions in the market for printed textbooks. We expect our Assessment and Information business to remain resilient as it prepares for the transition to next-generation Common Core assessments. We expect good growth in digital school programmes and services, but another tough year for the School textbook publishing industry, which will continue to be affected by pressure on state budgets and delays in purchasing decisions during the transition to the new Common Core standards.

International

We expect our International education business to show good growth. Austerity measures will continue to affect education spending in much of the developed world, but we see significant opportunity in emerging markets in China, south-east Asia, Latin America, the Middle East and Sub-Saharan Africa – which together accounted for more than 40% of our International education revenues in 2011. Across our education company, we will be integrating acquisitions made in 2011 (and expensing the costs) and making a series of organic investments in fast-growing segments including digital learning, English language teaching and institutional services.

Professional

We expect our Professional education business to grow again, benefiting from the continued strength of our worldwide professional testing business. In the UK, government funding pressures and policy change relating to apprenticeships are creating a tough trading environment in professional training.

FT Group

The FT Group's profits will be lower in 2012 than in 2011, reflecting the sale of our 50% stake in FTSE International and further actions weighted towards the first half of the year to accelerate the shift from print to digital. The Financial Times and The Economist Group (in which Pearson owns a 50% stake) are predicting weak advertising markets but strong growth in digital subscription revenues. Mergermarket will benefit from its high subscription renewal rates, although the outlook for M&A activity remains uncertain.

Penguin

Penguin has performed strongly in recent years in the context of rapid structural change in the consumer publishing industry. We expect it to perform in line with the overall industry this year, facing tough conditions in the physical bookstore channel but helped by its strong position in digital. eBook revenues accounted for 12% of Penguin revenues worldwide in 2011, up from 6% in 2010, and we expect this percentage to increase significantly again in 2012.

Interest and tax

In 2012, our net interest charge will be broadly level with 2011. We anticipate our P&L tax charge against adjusted earnings to be in the 24–26% range with our cash tax rates around the same level.

Exchange rates

Pearson generates approximately 60% of its sales in the US. A five cent move in the average £:$ exchange rate for the full year (which in 2011 was £1:$1.60) has an impact of approximately 1.3p on adjusted earnings per share.

OVERVIEW
OUR PERFORMANCE
OUR IMPACT ON SOCIETY
GOVERNANCE
FINANCIAL STATEMENTS

North American Education

North American Education is Pearson's largest business, with 2011 sales of £2.6bn and operating profit of £493m.

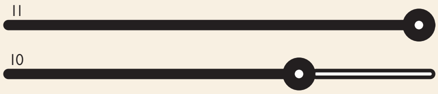
Watch an interview with
Will Ethridge, Chief executive,
North American Education
www.pearson.com/ar2011/will-ethridge

KEY PERFORMANCE INDICATORS

£ millions	2011	2010	Headline growth	CER growth	Underlying growth
Sales	2,584	2,640	(2)%	1%	(1)%
Adjusted operating profit	493	469	5%	9%	8%

SCHOOL PUBLISHING ADOPTION CYCLE WIN RATES

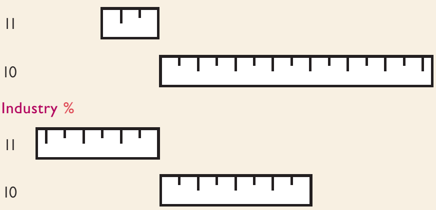
Win rate %



11: 37%
10: 28%

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

US EDUCATION PUBLISHING SCHOOL AND COLLEGE SALES GROWTH VS INDUSTRY



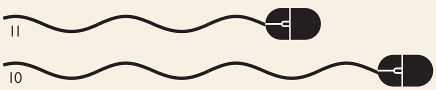
Pearson %
11: (0.7)%
10: 7.7%

Industry %
11: (3.5)%
10: 4.4%

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

ASSESSMENT AND INFORMATION TESTING CONTRACT WIN RATES

Win rate %

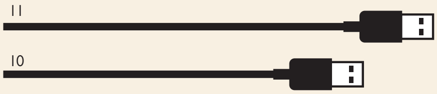


11: 61%
10: 79%

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

ONLINE LEARNING USERS

MyLab Registrations no.



11: 8.9m
10: 7.3m

The number of registrations by students to access one of our North American MyLabs online homework and assessment programmes.

North American Education is Pearson's largest business, with 2011 sales of £2.6bn and operating profit of £493m. Building on our roots as a leading publisher of educational materials and provider of assessment services, we have made significant investments and changes to transform Pearson into a world-leading provider of learning technologies for students and enterprise services for educational institutions. These technology services – including LearningStudio (formerly known as eCollege), OpenClass, PowerSchool, the MyLabs, Data Solutions (Edustructures), Schoolnet and Connections Education – are the backbone of our strategy to help educators raise student performance and institutions to become more effective. In 2011, our strength in digital and services businesses enabled us to perform ahead of our more traditional print publishing markets, which were adversely affected by state budget pressures and decline in college enrolments.

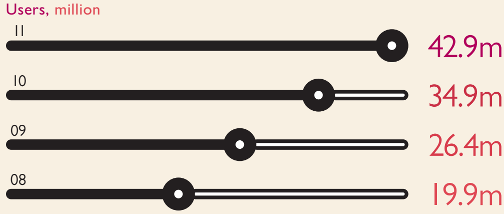
Higher Education highlights in 2011 include:

- The US higher education publishing market was broadly level with 2010, according to the Association of American Publishers, with solid revenue growth in public colleges offset by enrolment declines in for-profit colleges following changes in Federal regulations.
- Pearson gained share, benefiting from its lead in technology and customisation, and has now grown faster than the US higher education industry for 13 consecutive years.
- Pearson's pioneering 'MyLab' digital learning, homework and assessment programmes grew strongly with student registrations in North America up 22% to almost nine million. Usage continues to grow strongly with graded submissions up 39% to almost 250 million across the globe. Evaluation studies show that the use of MyLab programmes can significantly improve student test scores and institutional efficiency (http://bit.ly/ymMMAi).

Digital learning platforms

In 2011 student registrations on our digital learning platforms increased by 23% to 43 million.

DIGITAL LEARNING PLATFORMS



Watch our new digital highlights film: www.pearson.com/ar2011/digital

- We developed a new model of enterprise-wide support for online higher education with Arizona State University Online and Ocean Community College. Through these long-term partnerships, Pearson runs the full online learning programmes for these institutions and earns revenues based on the success of the institution and its students.
- Pearson LearningStudio increased fully-online student enrolments by 20% to ten million. Renewal rates remain high at more than 80% by value with fewer large accounts up for renewal in the year.
- We launched OpenClass, a dynamic, scalable and cloud-based Learning Management System which encourages social learning and is easy and free to use.

North American Education continued

Assessment and Information highlights in 2011 include:

- Revenues at our Assessment and Information division grew modestly in 2011. State funding pressures and the transition to Common Core assessments continued to make market conditions tough for our state assessment and teacher testing businesses; these were offset by good growth in diagnostic and clinical assessments.
- We signed several important contracts including state-wide student assessment contracts in New York, Kentucky and Arizona; Race to the Top Florida formative assessment; Indiana educator licensing and Ohio pre-service teacher assessment. We also renewed three important contracts, extending our relationships with Virginia and Maryland for state-wide student assessments and with ETS to service state-wide assessments for California.
- We signed an agreement with Stanford University to provide the capability to deliver the Teacher Performance Assessment (TPA) – a nationally available, web-based performance assessment for measuring the effectiveness of teacher candidates nationally.
- We delivered 13 million secure online tests in 2011 with strong growth in automated written and spoken assessment scoring volumes. We won the Online Assessment Readiness Tool contract from both the PARCC and SBAC Common Core consortia to help the 45 states prepare for the transition to online assessments.
- PowerSchool supported more than ten million students, up 6% on 2010, and developed its platform to enable 18 additional languages to be used on the PowerSchool parent portal.
- Our clinical assessment business grew well boosted by strong growth at AIMSweb, our progress monitoring service which enables early intervention and remediation for struggling students. Usage of AIMSweb increased dramatically with 47 million assessments delivered in 2011, up more than 40%.
- We acquired Schoolnet, a fast-growing and innovative education technology company that aligns assessment, curriculum and other services to help individualise instruction and improve teacher effectiveness. Schoolnet serves more than five million US pre K-12 students through partnerships with districts and states, supporting about one-third of America's largest cities.

Insight for learning

Schoolnet provides assessment, curriculum and other services to help personalise learning and improve teacher effectiveness. It supports more than five million students in primary and secondary education through partnerships with districts and states across the US.

Watch our new film about Schoolnet:
www.pearson.com/ar2011/schoolnet

School highlights in 2011 include:

- The US school textbook publishing market declined 9% in 2011, according to the Association of American Publishers. There were several pressures on the industry including weakness in state budgets, a lower new adoption opportunity (total opportunity of $650m in 2011 against $800m in 2010) and delays in purchasing decisions during the transition to the new Common Core standards.
- Pearson gained share with a strong adoption performance boosted by our blended print-and-digital programmes including Writing Coach, Prentice Hall Math and enVisionMATH. We took an estimated 37% of new adoptions competed for (or 31% of the total new adoption market).
- We acquired Connections Education which operates online K-12 schools in 21 states and a nationwide charter school programme. It served 33,200 students in 2011, up 43% from 2010. Connections Academy Schools have consistently high performance ratings, particularly in states focused on measuring growth in student learning.
- SuccessNet, our online learning platform for school teachers and students, generated more than six million registrations in 2011, up 5% on 2010. The number of assessments taken through SuccessNet increased by 32% to more than 11 million.
- We continue to develop digital programmes, platforms and apps to boost achievement, access and affordability. We launched two major new school programmes aimed at meeting rising literacy standards under the Common Core:

  i-lit (http://redefiningliteracy.com), a personalised digital reading programme. It combines our proven literacy model (with many students making two years of literacy growth in a single year), automated assessment capabilities and compelling literature from Penguin and Dorling Kindersley, all delivered through iPads.

  Pearson English Learning System, which benchmarks, monitors and tracks both student progress and teacher best practice to boost English language skills.
- Poptropica (www.poptropica.com) is one of the largest virtual worlds for young children in the US and was named by *Time* as one of 'The 50 Best Websites of 2011'. Poptropica has up to 9.7 million monthly unique visitors from more than 130 countries.

Bringing education home

Connections Education operates online or 'virtual' schools for more than 33,000 students in 21 states across the US. Virtual schools serve a diverse population of students including those who may be gifted, struggling, pursuing careers in sports or the arts, in need of scheduling flexibility, or who have chosen home schooling.

Watch our new film about Connections Education:
www.pearson.com/ar2011/connections-education

International Education

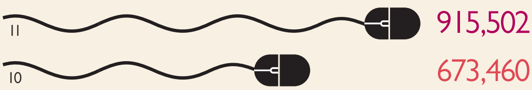
Our International Education company is active in more than 70 countries.

KEY PERFORMANCE INDICATORS

£ millions	2011	2010	Headline growth	CER growth	Underlying growth
Sales	1,424	1,234	15%	15%	4%
Adjusted operating profit	196	171	15%	13%	2%

ONLINE LEARNING USERS

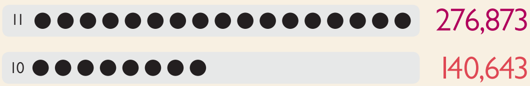
MyLab Registrations no.



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

ONLINE LEARNING LOGINS

Logins no.



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

Watch an interview with John Fallon, Chief executive, International Education
www.pearson.com/ar2011/john-fallon

Our International Education company is active in more than 70 countries. It is a major focus of our strategy, and sales and profits have broadly doubled since 2007. Our strategy is to combine educational content, assessment, technologies and related services to help educational institutions become more effective and their students more successful. We expect to benefit from a series of powerful long-term global trends: increasing public and private spending on education (despite current pressures on public spending in developed markets); growing participation rates; the demand for assessment to provide measures of achievement; the growing technology infrastructure in educational institutions; and the rise of English as a global language. In 2011, we continued to make significant organic investments in expanding the footprint of Wall Street English in China and the roll-out of our school services business in India as well as incurring significant charges from the integration of acquisitions, most notably the school systems business of SEB in Brazil.

Global highlights in 2011 include:

- Wall Street English, Pearson's worldwide chain of English language centres for professionals, increased student numbers by 9% to more than 190,000. We opened 19 new centres around the world, bringing the total number close to 450.
- More than 0.9 million students registered for our MyLab digital learning, homework and assessment programmes, an increase of 36%. They included more than 150,000 MyEnglishLab registrations, up 70%, and 28,000 registrations for our high school mathematics programme MathXL, a 54% increase.

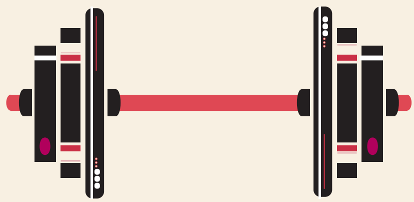
- We developed a new model of enterprise-wide support for online higher education with the University of New England (UNE) in Australia which will launch in 2012. The partnership enables UNE to expand its distance learning capacity and access to higher education and ties Pearson's revenue to the success of the institution and its students.
- Our Fronter learning management system grew strongly with new contracts won in Malta, Tasmania and Poland. Active users rose by 18% to 1.3 million and their logins by 11% to 154 million.
- Student test volumes for the Pearson Test of English Academic saw robust growth supported by recognition from almost 1,900 institutions including the Australian Department of Immigration & Citizenship and 95% of UK Universities.
- The Organisation for Economic Co-operation and Development chose Pearson to develop a competency and assessment framework for the 2015 cycle of The Programme of International Student Assessment (PISA) tests, one of the world's most prestigious programmes of international tests.

Developing markets highlights in 2011 include:

- In China, student enrolments at our Wall Street English centres increased 25% to 53,000, boosted by strong underlying demand and the launch of 11 new centres. Our students continue to rapidly acquire high-level English skills with average grade levels achieved by our students rising by 11% during 2011.
- We acquired Global Education and Technology Group, a leading provider of test preparation services for English Language and other professional qualifications, for $155m in cash. Global Education has approximately 450 (115 owned and 335 franchised) learning centres in 150 cities across China.
- In South Africa we gained share in school publishing, but market conditions were tougher than expected during a year of major curriculum reform. Student enrolments grew strongly at CTI, up 13% to 8,700, which continues to deliver significantly better completion rates than its peers and strong job placement rates of 70%. We delivered half a million secondary textbooks for Physics, Biology and History to all government secondary schools in Uganda, one million Junior African Writer readers to the Ministry of Education in Sierra Leone and almost two million textbooks in five subjects to secondary schools in Zimbabwe.
- In Brazil, we successfully completed the first stage of the SEB Pearson Sistemas integration with major investments and improvements across the business. Our Virtual Library grew strongly and now reaches two million students across 100 universities, and we entered the K-12 publishing market. In Colombia, we implemented a bilingual teacher training programme in several states and in Chile we won a contract to evaluate the national college admissions test.

In training for an international education

Global Education is a leading provider of test preparation services for students in China who are learning English. It has a network of 450 test preparation and training centres across 150 cities in China and also provides English language training for children, tutoring in a range of subjects and teaching for other foreign languages.



Watch our new film about Global Education:
www.pearson.com/ar2011/global-education

International Education continued

- In India, we incurred costs related to the acquisition of TutorVista and invested to grow the business. We have doubled the number of schools managed by TutorVista to 24 and the installations of its multimedia teaching tool Digiclass to approximately 10,000. Vocational and Professional enrolments at our IndiaCan joint-venture grew more than 50% to 86,000, with particular strength in spoken English, Chartered Accountancy, Engineering and MBA qualifications.
- In the Middle East, our performance was boosted by sales of Reading Street and Scott Foresman Math in Saudi Arabian schools; Giancoli Physics and Thomas Calculus along with strong MyLabs uptake in Turkish colleges; and Haeussler Mathematics and Hubert Engineering along with strong MyLab redemptions in Egypt.

United Kingdom highlights in 2011 include:

- Our UK business made solid progress during the year despite significant regulatory and policy changes in its markets, most notably in vocational and general qualifications, apprenticeships and in higher education.
- We marked more than 5.7 million GCSE, A/AS Level and other examinations with 90% using onscreen technology. We marked more than 3.8 million test scripts for over half a million pupils taking National Curriculum Tests at Key Stage Two in 2011 and have been selected to mark tests in 2012.
- Our Bug Club digital reading programme for primary schools combines engaging phonics-based books with games, assessments and teacher diagnostic tools to boost reading enjoyment and comprehension. In 2011, more than 145,000 online users in almost 900 schools subscribed to Bug Club online.
- We acquired EDI plc, a leading provider of education and training qualifications and assessment services, with a strong reputation for the use of information technology to administer learning programmes and deliver on-screen assessments. Registrations for our own BTEC Apprenticeships more than doubled to 80,000 students.

Rest of World highlights in 2011 include:

- We launched the Australian edition of our pioneering US digital maths curriculum, enVisionMATH. We have more local versions in development to bring high quality digital curriculum to new markets across the globe.
- In Italy, our new digital curriculum helped us gain significant share in lower secondary adoptions and to see good growth overall.
- In Germany, we acquired Stark Holding, a leading provider of education materials including test preparation resources for pupils and teachers.
- In Japan, we faced major disruption following the March 2011 tsunami but maintained operations and achieved notable successes, particularly with the Versant Test of Communicative English and the launch of BTEC.

Here's a conversation starter

Wall Street English provides spoken English training for adults in 450 learning centres in 25 territories across Asia, Europe, the Middle East and Latin America. In 2011 we opened 19 new centres around the world.

Professional Education

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

Over the past five years, we have increased operating profit from £27m in 2007 to £66m in 2011. We expect this business to benefit from rising demand for work-related skills and qualifications in both developed and developing markets, and from close connections with professional content and customers in other parts of Pearson.

Professional testing highlights in 2011 include:

- We continued to see good revenue and profit growth at Pearson VUE, which administered more than seven million tests during the year, benefiting from sales of additional services to customers and contractual fee increases. We won a number of new contracts including the Construction Industry Training Board in the UK, the National Council of Examiners for Engineering and Surveying in the US, and the HP certification examination worldwide.
- We formed a joint venture with the American Council on Education to develop an online General Educational Development (GED) test aligned with new Common Core standards. The GED test measures an adults' high school level knowledge and skills in math, reading, writing, science and social science.
- We launched a new touch-screen theory driving test for the Roads and Transport Authority for Dubai. The test is delivered in Arabic, English and Urdu. The new test follows the opening last year of a new Pearson VUE office in Dubai to meet the Middle East's demand for computer-based testing.

KEY PERFORMANCE INDICATORS

£ millions	2011	2010	Headline growth	CER growth	Underlying growth
Sales	382	333	15%	17%	2%
Adjusted operating profit	66	51	29%	31%	10%

Professional training

- Despite significant regulatory and policy changes in the apprenticeship market, Pearson in Practice successfully graduated its largest IT cohort and launched or enhanced several new apprenticeship programmes in logistics, construction, management and customer service, business and health.
- We acquired TQ Holdings Ltd which provides technical education and training services to governments, institutions and corporations around the world with particular expertise in skills related to the defence, engineering, oil and gas and construction sectors.

Professional publishing highlights in 2011 include:

- Our resilient performance in the US benefited from the breadth of our publishing and range of revenue streams, from online retail through digital subscriptions. As a result, digital products and services now account for more than 25% of our professional publishing revenues in the US. In some International markets such as Japan, professional publishers continued to face very challenging trading conditions.
- In the US, we launched MyGraphicsLab which integrates 50 hours of videos, 250 creative projects, 50 presentations and 1,000 quiz questions with real-world assignments to prepare students for the job market.

Financial Times Group

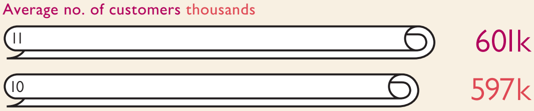
The FT Group is a leading provider of essential information in attractive niches of the global business information market.

KEY PERFORMANCE INDICATORS

£ millions	2011	2010	Headline growth	CER growth	Underlying growth
Sales	427	403	6%	8%	7%
Adjusted operating profit	76	60	27%	22%	17%

TOTAL PAID CONTENT

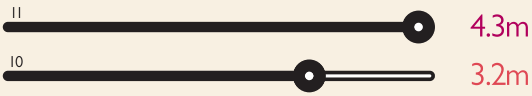
Average no. of customers thousands



The average number of daily and global FT paying customers across print and online.

FT.COM REGISTERED USERS

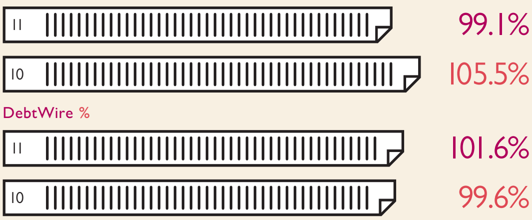
No. millions



The average number of monthly registered users.

MERGERMARKET RENEWAL RATES

Mergermarket %



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

Watch an interview with
Rona Fairhead, Chief executive,
Financial Times Group
www.pearson.com/ar2011/rona-fairhead

The FT Group is a leading provider of essential information in attractive niches of the global business information market. These include insight, news and analysis offered through a growing number of print, digital and mobile channels. In recent years, the FT Group has significantly shifted its business towards digital, subscription and content revenues, divested its data businesses and has continued to invest in talent and in services in faster-growing emerging markets. In 2011, FT Group produced strong revenue and profit growth with digital and services now accounting for 47% of FT Group revenues, up from 25% in 2007. Content revenues comprised 58% of total revenues, up from 41% in 2007, while advertising accounted for 42% of FT Group revenues, down from 59% in 2007.

Financial Times highlights in 2011 include:

- The FT produced strong and accelerating growth in its digital readership with online subscriptions up 29% to 267,000, 2,000 direct corporate licences and FT.com registered users up 33% to more than four million. Combined paid print and digital circulation reached 600,000 in 2011, the highest circulation in the history of the FT. At the end of 2011, digital subscribers exceeded print circulation in the US for the first time. The Average Daily Global Audience across print and online grew 3% to 2.2 million people worldwide, our largest audience ever.
- Readership continues to migrate online and to mobile, which now generates 19% of traffic to FT.com. We launched FT web apps optimised for iPad and Android devices including a custom app for India. The web apps provide FT subscribers access to our content online and through mobile devices with a single subscription and data analytics allow us to better serve our customers.

We also acquired Assanka, the FT's web app development partner, which we expect to yield benefits in FT Group and across Pearson.

› Advertising was generally weak and volatile with poor visibility. Growth in online advertising and the luxury category was offset by weakness in corporate advertising.

› FT Conferences had a very strong year, operating 75 events in 37 cities worldwide. Almost 9,000 senior executives from around the world attended these events.

› We launched the FT Non-Executive Certificate (in partnership with Pearson LearningStudio and Edexcel) in April 2011, enrolling more than 100 students. The certificate is designed to aid the professionalisation of the sector and increase diversity on UK boards. It is the first fully accredited formal education product for non-executive directors.

› We extended the breadth and depth of the FT's premium subscription services through the launch of Brazil Confidential, extending our successful China Confidential franchise into another growth market; Medley Global Advisors (MGA) grew modestly despite challenging conditions for its customers due to new contract wins; Money-Media grew strongly fuelled by an increase in subscriptions and advertising.

Mergermarket highlights in 2011 include:

› Mergermarket's strong editorial analysis continued to benefit from its global presence and product breadth. Usage increased, new sales grew and renewal rates were strong. Continued volatility in debt markets helped sustain the strong performance of Debtwire whilst volatile equity markets benefited dealReporter's event-driven strategy. Mergermarket saw strong growth in Asia-Pacific and the Americas while MergerID continued to benefit from a broadening network of users and strong growth in transaction matches.

› We launched a large number of new products, extending our reach into new geographies (US wealthmonitor, ABS Europe, dealReporter Middle East, dealReporter Russia Desk), new strategies (multi-strategy products), new coverage areas (municipal bonds, dividend arbitrage) and new platforms (mergermarket iPad app).

FT for everyone

The FT was the first major news publisher to launch an app that uses HTML5 technology and allows users to download the app directly from a browser. Since June 2011, the FT Web App has had over 1.3 million visitors and won an award for Best Mobile Innovation for Publishing at the Global Mobile Awards. In January 2012 the FT acquired Assanka, its partner in developing the app, which we expect to yield benefits within the FT Group and across Pearson.

Watch our new digital highlights film:
www.pearson.com/ar2011/digital

Joint ventures and associates highlights in 2011 include:

› **The Economist**, in which Pearson owns a 50% stake, increased global weekly circulation by 1% to 1.49 million (for the July – December 2011 ABC period) with an additional digital circulation in excess of 100,000; total annual online visits increased to 165 million, up 39% on 2010.

› **Business Day and Financial Mail (BDFM)**, our 50% owned joint-venture in South Africa with Avusa, improved profitability with revenue increasing by 10%. The business benefited from growth in advertising and circulation revenues.

› We sold our 50% stake in **FTSE International** to the London Stock Exchange for net proceeds of £428m in December 2011: it contributed £20m to Pearson's operating profit in 2011.

Penguin

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

KEY PERFORMANCE INDICATORS

£ millions	2011	2010	Headline growth	CER growth	Underlying growth
Sales	1,045	1,053	(1)%	1%	1%
Adjusted operating profit	111	106	5%	8%	8%

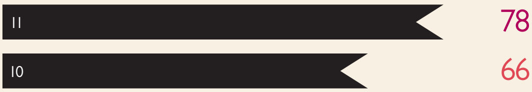
US BESTSELLERS

Bestsellers no.

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

UK BESTSELLERS

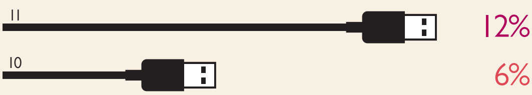
Bestsellers no.



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

E-BOOK SALES

Sales %



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

Watch an interview with
John Makinson, Chairman and chief executive, Penguin Group
www.pearson.com/ar2011/john-makinson

Penguin is one of the most famous brands in book publishing, known around the world for the quality of its publishing and its consistent record of innovation. Market conditions in 2011 were tough following the collapse of two major customers: Borders in the US and the REDGroup in Australia and New Zealand. Despite this, Penguin achieved robust sales and profits and gained market share in each of its major markets – the US, the UK and Australia.

Global highlights in 2011 include:

- A strong and consistent publishing performance across imprints and territories produced market share gains in the US, UK and Australia, our three largest markets in a very challenging retail environment with the closure of more than 750 stores.
- Growth in developing markets was boosted by the strength of the direct marketing channel and strong publishing in India, including its first 100,000 copy bestseller (Ravinder Singh's *Can Love Happen Twice?*). In China, Penguin launched a new English language publishing programme.
- Global publishing properties such as LEGO®, Wimpy Kid, Jamie Oliver and Kathryn Stockett's *The Help* sold in significant numbers in multiple markets.
- In January 2012, we acquired 45% of Companhia das Letras, a leading trade book publisher in Brazil, with whom we have an existing Classics publishing partnership.

Digital highlights in 2011 include:

- eBook revenues doubled on the previous year and accounted for 12% of Penguin revenues worldwide, and more than 20% in the US, in 2011. Since the beginning of 2008, digital downloads of apps and ebooks across the Group have totalled approximately 50 million.
- Penguin continued to invest in digital innovation, launching more than 100 apps and enhanced eBooks, including *Wreck this App*, *On the Road* and *Moshi Monsters*, and a new global digital-only publishing programme, *Penguin Shorts*.
- DK launched its first non-travel apps including the award-winning *DK Human Body*. In January 2012 DK became the first consumer publisher to publish four iBooks2 titles using Apple's new authoring tool.
- Penguin continued to invest in direct-to-consumer initiatives including new digital platforms for readers, specifically aNobii in the UK and Bookish in the US. In Australia Penguin acquired the REDGroup's online business. Penguin also signed its first author through its new self-publishing platform BookCountry. Its websites and social media channels around the world now have a global following of more than 11 million.
- Penguin continued to leverage Pearson-wide digital platforms to transform its internal publishing processes, enabling faster product development and greater re-use of content.

Publishing performance highlights in 2011 include:

- In the US Penguin published a record 254 *New York Times* bestsellers including some of its repeat bestselling authors such as Tom Clancy, Patricia Cornwell, Ken Follett, Nora Roberts and Clive Cussler, as well as new talent such as Deborah Harkness, Amor Towles and Eleanor Brown. Kathryn Stockett's *The Help* was the bestselling title across the US industry selling five million copies in print and digital in its third year since publication. The Young Readers' division had another strong year achieving a high of 41 *New York Times* bestsellers.
- Penguin UK published 78 top ten bestsellers, an increase of 15 on 2010, including two of the top five industry titles with Jamie Oliver's *30-Minute Meals* and Dawn French's *A Tiny Bit Marvellous*, and a robust performance by Penguin Children's who were named Children's Publisher of the Year in 2011. For a second consecutive year, Jamie Oliver secured the coveted Christmas number one slot with *Jamie's Great Britain*. Jeff Kinney's new *Wimpy Kid* title *Cabin Fever* sold 300,000 copies and was the fastest selling book of 2011.

Penguin takes off

Penguin saw eBook revenues in 2011 double on the previous year. In 2011 they accounted for 12% of Penguin revenues worldwide and more than 20% in the US. Since 2008, digital downloads of apps and ebooks across Penguin have totalled approximately 50 million.

PENGUIN: US EBOOK VOLUMES (MILLIONS)

Watch our new digital highlights film: www.pearson.com/ar2011/digital

Consumer Publishing: Penguin continued

› DK's bestseller success continued in 2011 with its LEGO® titles dominating the bestseller charts including *The LEGO® Ideas Book*, *LEGO® Star Wars Character Encyclopaedia* and *LEGO® Star Wars Visual Dictionary*. Titles from authors such as Annabel Karmel, Karl Pilkington and Mary Berry and the *MasterChef* titles also performed strongly.

› In Australia, Penguin had the two top-selling titles across the industry with Jamie's *30-Minute Meals* and Jeff Kinney's *Cabin Fever* and hit number one 24 times through the course of the year.

› Penguin has a strong publishing list for 2012 with major new books from authors including Tom Clancy, Ken Follett, Charlaine Harris, Nora Roberts, Deborah Harkness, Junot Diaz, Kofi Annan, John Grisham and Richelle Mead in the US, and Jamie Oliver, David Walliams, Pippa Middleton, Dawn French, Marian Keyes, Clare Balding, Zadie Smith, Neil MacGregor, Michelle Paver, Philip Pullman and Jacqueline Wilson in the UK. DK will launch more LEGO® titles including the *Ninjago Character Encyclopaedia, LEGO® Batman: The Visual Dictionary and LEGO® Friends Brickmaster*, as well as titles from bestselling authors such as Mary Berry and a new *MasterChef* title. New digital properties for 2012 include *Skylanders* and global gaming franchise, *Risen*.

Pick of the year

In 2011, Penguin enjoyed bestseller success around the world, including publishing 254 *New York Times* bestsellers and 78 top ten bestsellers in the UK. Here's a taste of the highlights:

Other financial information

Net finance costs

£ millions	2011	2010
Net interest payable	(55)	(73)
Finance income/(costs) in respect of retirement benefit plans	3	(12)
Net finance costs reflected in adjusted earnings	(52)	(85)
Other net finance (costs)/income	(19)	12
Total net finance costs	(71)	(73)

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

Net interest payable in 2011 was £55m, down from £73m in 2010. 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 0.3%. This reduction in floating market interest rates helped drive the Group's lower interest charge. These low rates, coupled with interest income on deposits in higher yielding currencies created a decrease in the Group's average net interest payable from 7.9% to 6.5%. The Group's average net debt fell by £82m, reflecting the timing of the reinvestment during 2011 of the proceeds from the Interactive Data disposal.

Net finance income relating to post-retirement plans was £3m in 2011 compared to a net charge of £12m in 2010. Also included in the statutory definition of net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. Finance costs for put options and deferred consideration are excluded from adjusted earnings as they relate to future earn outs and similar payments on acquisitions and do not reflect cash expended. Foreign exchange and other gains and losses are excluded from adjusted earnings as they represent short-term fluctuations in market value and are subject to significant volatility.

These other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity. In 2011, the total of these items excluded from adjusted earnings was a charge of £19m compared to a profit of £12m in 2010. The majority of the loss in 2011 relates to foreign exchange differences on a proportion of the unhedged US dollar proceeds from the Interactive Data sale. In 2010 the gain arose largely from foreign exchange on US dollar denominated debt.

Funding position and liquid resources

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

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

£ millions	2011	2010
Cash and cash equivalents	1,369	1,736
Marketable securities	9	12
Net derivative assets	174	134
Bonds	(1,955)	(2,226)
Bank loans and overdrafts	(78)	(73)
Finance leases	(18)	(13)
Net debt	(499)	(430)

Through acquisition activity in 2011, the Group largely reinvested the proceeds of the Interactive Data disposal received in 2010, but these cash outflows were largely offset by cash generated from operations and the proceeds from the disposal of FTSE International, leading to a relatively minor change 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 weakening of sterling against the US dollar during 2011 (from $1.57 to $1.55:£1) slightly increases the sterling equivalent value of our reported net debt.

Other financial information continued

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

In June 2011, the Group repaid a $500m bond on its scheduled maturity from available cash and cash equivalents.

The Group has a $1,750m committed revolving credit facility which matures in November 2015. At 31 December 2011 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 2011, 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 2011 was 22.4% as compared to an effective rate of 25.2% in 2010. 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 26.5% in 2011 and 28% in 2010). These higher tax rates were offset by amortisation-related tax deductions and, in 2011, by prior year adjustments arising from settlements with tax authorities.

The reported tax charge on a statutory basis was £199m (17.2%) compared to a charge of £146m (21.8%) in 2010. The reduction in the statutory rate is largely due to the low tax charge on the gain on disposal of FTSE together with the effect of the prior year adjustments referred to above.

In total these two items outweighed the favourable effect in 2010 from recognition of tax losses and credits utilised in connection with the Interactive Data sale. The tax charge relating to that sale in July 2010 is included in the profit on discontinued businesses.

Tax paid in 2011 was £151m compared to £335m in 2010. The 2010 payment included £250m relating to the Interactive Data sale. After taking account of the Interactive Data sale, there were higher tax payments in 2011 in the US, following the use of the remaining available losses in 2010, and in the UK.

Discontinued operations

There are no discontinued operations in 2011. Discontinued operations in 2010 relate to Interactive Data Corporation which was sold in July 2010.

Non-controlling interest

In 2011 there are non-controlling interests in the Group's businesses in South Africa, China and India although none of these are material to the Group numbers. The non-controlling interest in the Group's Brazilian business, Sistema Educacional Brasileiro (SEB), was bought out in the first half of 2011. The non-controlling interest in 2010 comprised mainly the publicly-held share of Interactive Data for the period until its disposal in July 2010.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The loss on translation of £44m in 2011 compares to a gain in 2010 of £173m. Although the Group is principally exposed to movements in the US dollar as a significant proportion of the Group's operations are based in the US, these movements have been less volatile over the course of the last two years and translation gains and losses have been relatively low. In 2010 the US dollar strengthened from an opening rate of £1:$1.61 to a closing rate at the end of that year of £1:$1.57. The dollar strengthened slightly again in 2011 closing at £1:$1.55.

Also included in other comprehensive income in 2011 is an actuarial loss of £64m in relation to post-retirement plans. This loss arose largely because the discount rate assumptions used in the actuarial valuation contributed to an increase in the value of liabilities, offsetting further improvement in asset returns for the UK Group pension plan. In 2010 there was a gain of £71m which arose largely from improved asset returns.

Dividends

The dividend accounted for in our 2011 financial statements totalling £318m represents the final dividend in respect of 2010 (25.7p) and the interim dividend for 2011 (14.0p). We are proposing a final dividend for 2011 of 28p, bringing the total paid and payable in respect of 2011 to 42.0p, a 9% increase on 2010. This final 2011 dividend was approved by the board in February 2012, is subject to approval at the forthcoming AGM and will be charged against 2012 profits. For 2011, the dividend is covered 2.1 times by adjusted earnings.

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

Pensions

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

The charge to profit in respect of worldwide pensions and post-retirement benefits for continuing operations amounted to £93m in 2011 (2010: £102m) of which a charge of £96m (2010: £90m) was reported in operating profit and a net benefit of £3m (2010: net charge £12m) was reported against net finance costs.

The overall deficit on the UK Group plan of £5m at the end of 2010 has become a surplus of £25m at 31 December 2011. This decrease is principally due to continued deficit funding in the year together with improved asset performance. In total, our worldwide deficit in respect of pensions and post-retirement benefits fell from a deficit of £148m in 2010 to a deficit of £141m at the end of 2011.

Acquisitions

In May 2011 the North American Education business acquired Schoolnet, a leading provider of data-driven education software for students and teachers. In June 2011, the International Education business completed the acquisition of EDI plc, a UK-listed education services company operating primarily in the work based learning sector. In November 2011 the North American Education business acquired Connections Education, a company that operates online or virtual public schools in the US and in December 2011 the International Education business acquired Global Education and Technology Group, a leading provider of test preparation services for students in China who are learning English.

Also in the year to 31 December 2011, the Group completed the acquisitions of CTI Education in South Africa, Tutorvista in India, Stark Holding in Germany, TQ in the UK and various other smaller acquisitions.

Net cash consideration for all acquisitions made in the year ended 31 December 2011 including the purchase of the remaining minority in SEB was £896m and provisional goodwill recognised was £620m. In total, acquisitions completed in the year contributed an additional £129m of sales and £9m of operating profit before acquisition costs and intangible amortisation.

Return on invested capital (ROIC)

Our ROIC is calculated as total adjusted operating profit less cash tax, expressed as a percentage of average gross invested capital. ROIC decreased by 1.2 percentage points from 10.3% in 2010 to 9.1% in 2011. This decrease reflects the impact of the Interactive Data disposal, reinvestment of proceeds which (after integration costs) yield lower returns in their first year and higher tax payments following utilisation of US tax losses and settlements.

Other financial information continued

Capital expenditure

Net capital expenditure in the year on property, plant equipment and software amounted to £156m. The analysis of capital expenditure and details of capital commitments are shown in notes 10, 11 and 35 of the financial statements.

Related party transactions

Transactions with related parties are shown in note 36 of the financial statements.

Post balance sheet events

There were no significant post balance sheet events.

Supplier payment policy

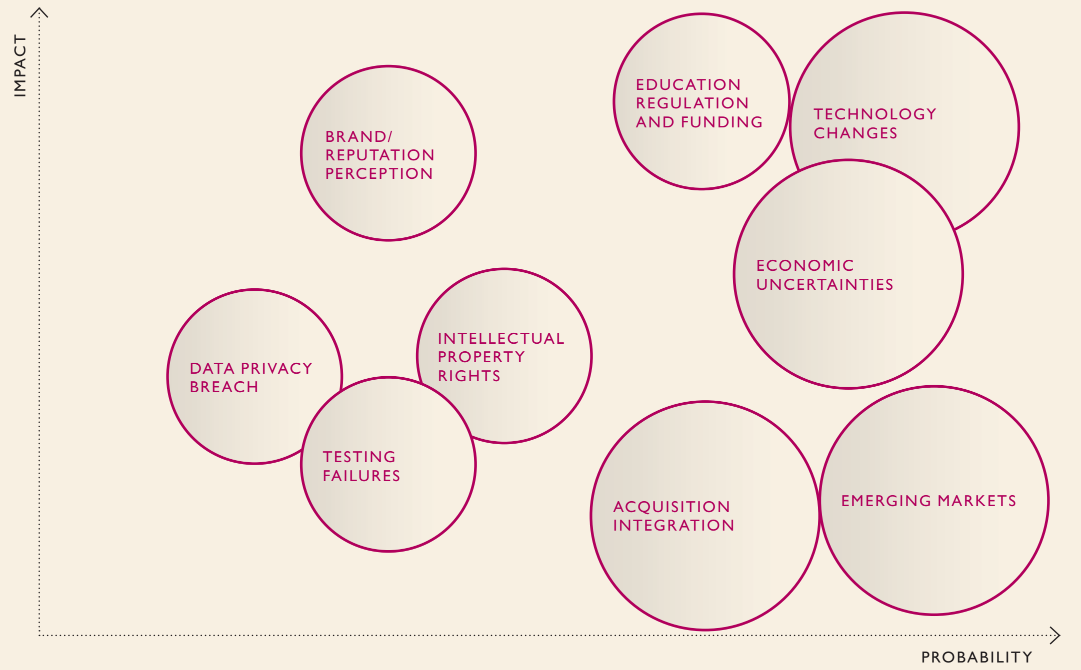
Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. These supplier payment terms vary by operating company reflecting the different industries and countries in which they operate. It is company policy that suppliers are aware of such terms of payment and that payments to them are made in accordance with these, provided that the supplier is also complying with all the relevant terms and conditions. Group trade creditors at 31 December 2011 were equivalent to approximately 32 days of purchases during the year ended on that date. The company does not have any significant trade creditors and therefore is unable to disclose average supplier payment terms.

Principal risks and uncertainties

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

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

PRINCIPAL RISKS – IMPACT AND PROBABILITY



Principal risks and uncertainties continued

Principal risks	Mitigating factors
Technology changes Our education, business information and book publishing businesses will be impacted by the rate of and state of technological change, including the digital evolution and other disruptive technologies. We operate in markets which are dependent on Information Technology (IT) systems and technological change.	We are transforming our products and services for the digital environment along with managing our print inventories. Our content is being adapted to new technologies across our businesses and is priced to drive demand. We develop new distribution channels by adapting our product offering and investing in new formats. We continue to monitor contraction in the consumer book market to minimise the downturn of bankruptcy. We mitigate these IT risks by establishing strong IT policies and operational controls, employing project management techniques to manage new software developments and/or systems implementations and have implemented an array of security measures to protect our IT assets from attacks or failures that could impact the confidentiality, availability or integrity of our systems.
Education regulation and funding Our US educational solutions and assessment businesses and our UK training businesses may be adversely affected by changes in government funding resulting from either general economic conditions, changes in government educational funding, programs, policy decisions, legislation and/or changes in the procurement processes.	In the US we actively monitor changes through participation in advisory boards and representation on standard setting committees. Our customer relationship teams have detailed knowledge of each state market. We are investing in new and innovative ways to expand and combine our product and services to provide a superior customer offering when compared to our competitors, thereby reducing our reliance on any particular funding stream in the US market. We work through our own government relations team and our industry trade associations including the Association of American Publishers. We are also monitoring municipal funding and the impact on our education receivables. In the UK we maintain relationships with those government departments and agencies that are responsible for policy and funding. We work proactively with them to ensure our training and apprenticeship programmes meet existing and new government objectives at the right quality.
Economic uncertainties Global economic conditions may adversely impact our financial performance. A significant deterioration in Group profitability and/or cash flow caused by prolonged economic instability could reduce our liquidity and/or impair our financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate our banking covenants. We generate a substantial proportion of our revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuation could adversely affect our earnings and the strength of our balance sheet.	The Group's approach to funding is described on page 29 and the Group's approach to the management of financial risks is set out in note 19 to the financial statements.

Principal risks	Mitigating factors
Intellectual property rights If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit our ability to grow.	We seek to mitigate this type of risk through general vigilance, co-operation with other publishers and trade associations, advances in technology, as well as recourse to law as necessary. Data rights management standards and monitoring programs have been developed. We have established a piracy task force to identify weaknesses and remediate breaches. We monitor activities and regulations in each market for developments in copyright/intellectual property law and enforcement and take legal action where necessary.
Emerging markets Our investment into inherently riskier emerging markets is growing and the returns may be lower than anticipated.	We draw on our experience of developing businesses outside our core markets and our existing international infrastructure to manage specific country risks. We have strengthened our financial control and managerial resources in these markets to manage expansion. The diversification of our international portfolio, and relative size of 'emerging markets' in relation to the Group, further minimises the effect any one territory could have on the overall Group results.
Data privacy breach Failure to comply with data privacy regulations and standards or weakness in internet security result in a major data privacy breach causing reputational damage to our brands and financial loss.	Through our global security we have established various data privacy and security programmes. We constantly test and re-evaluate our data security procedures and controls across all our businesses with the aim of ensuring personal data is secured and we comply with relevant legislation and contractual requirements. We pursue appropriate privacy accreditations, e.g., TRUSTe Privacy and Safe Harbor Seal. We regularly monitor regulation changes to assess impact on existing processes and programmes.
Testing failures A control breakdown or service failure in our school assessment businesses could result in financial loss and reputational damage. Our professional services and school assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed.	We seek to minimise the risk of a breakdown in our student marking with the use of robust quality assurance procedures and controls and oversight of contract performance, combined with our investment in technology, project management and skills development of our people. In addition to the internal business procedures and controls implemented to ensure we successfully deliver on our contractual commitments, we also seek to develop and maintain good relationships with our customers to minimise associated risks. We also look to diversity our portfolio to minimise reliance on any single contract.
Acquisition integration Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions could lead to goodwill and intangible asset impairments.	We perform pre-acquisition due diligence and closely monitor the post-integration performance to ensure we are meeting operational and financial targets. Any divergence from these plans will result in management action to improve performance and minimise the risk of any impairments. Executive management and the board receive regular reports on the status of acquisition performance.
Brand/reputation perception Our business depends on a strong brand, and any failure to maintain, protect and enhance our brand would hurt our ability to retain or expand our business.	We mitigate this risk through the development of comprehensive processes to enable our business units to effectively manage relationships with stakeholders, customers, communities and employees. We establish an ongoing process to understand and evaluate potential brand threats and monitor and evaluate information about our brand across media sources.

Our impact on society

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

Last year, we set out a new responsibility framework for Pearson:

1. We start with our company strategy and purpose. Pearson is a commercial organisation with a social purpose: to help people make progress in their lives through learning. We believe our commercial goals and our social purpose are mutually reinforcing and that our financial strength provides the means for us to invest and innovate.

2. We focus on three key issues of social and economic importance where we believe Pearson can make a unique contribution. They are literacy, learning outcomes and competitiveness.

3. Beyond those three issues, we have a wider agenda for responsible business practice that covers our interest in nurturing diversity, investment in community partnerships, supply chain management and environmental responsibility.

4. We recognise that our approach to responsible business is grounded in our company values, ethics and behaviour.

This framework is a good one for Pearson and in the pages that follow, we set out the commitments we have made and the actions we are taking around the company.

We are pleased that our commitment – and in particular the efforts of our people – continue to be recognised by authorities in the field. We led our sector and achieved gold status in the Dow Jones Sustainability Index, and were ranked Platinum level in Business in the Community's Corporate Responsibility Index.

Still, our company and our industries faced challenges in 2011. We contributed to the Leveson Inquiry into the culture, practices and ethics of the UK press; The Pearson Foundation was the subject of some public criticism (which it, and we, believe is misplaced); and the UK's examination boards, including our own Edexcel, faced intense media and political scrutiny.

We have learnt from all those issues, and many others besides. In fact our motto – always learning – does set out the way we try to think and operate as a company. We therefore welcome comments and feedback on this aspect of the company as we do any other. Please e-mail me at robin.freestone@pearson.com or contact our head of corporate responsibility, Peter Hughes, at peter.hughes@pearson.com with any questions or thoughts you may have.

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

Overview

We believe that there is no one single definition of responsible business practice that can be applied to every company. Instead, we have developed our own responsible business framework to reflect who we are as a company, what we do and the expectations that our investors, customers and the people that work at Pearson have of us. Our approach is dynamic, shaped and influenced by the priorities and views of our many stakeholders.

Our purpose

To help people of all ages to progress through their lives through learning

ALWAYS LEARNING

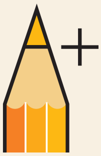
Our focus

Three priority issues where we can make the most difference

1 RAISING LITERACY LEVELS

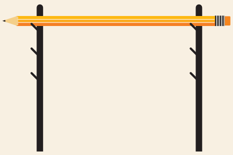
- At home
- In the classroom
- With our partners

2 IMPROVING LEARNING OUTCOMES



- Our programmes
- Closing achievement gaps
- Sharing what works

3 CONTRIBUTING TO COMPETITIVENESS



- Personal progress
- Informed business

Business strategy

LONG-TERM ORGANIC INVESTMENT IN CONTENT

DIGITAL PRODUCTS AND SERVICES BUSINESSES

INTERNATIONAL EXPANSION

EFFICIENCY

To learn more about our business strategy, visit the Our strategy section, page 08 in this report

Responsible business practice

ENVIRONMENT

SUPPLY CHAIN MANAGEMENT

PEOPLE

OUR CUSTOMERS

COMMUNITIES

Our values

BRAVE, IMAGINATIVE, DECENT

OVERVIEW
OUR PERFORMANCE
OUR IMPACT ON SOCIETY
GOVERNANCE
FINANCIAL STATEMENTS

Our impact on society continued

Our three priority issues:

1 RAISING LITERACY LEVELS

Through our products and partnerships, we play an important part in helping people to learn to read and to enjoy reading.

According to the most recent figures from 2009, nearly 800 million adults lack basic literacy skills – two-thirds of whom are women. Good reading skills are the basic cornerstone that help all of us progress throughout our lives.

Our businesses all depend on the premise that people can read, want to learn and enjoy doing it. We therefore have a keen interest in doing all we can to nurture enthusiastic readers.

Our approach

We play a part in three main ways:

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

Reading in the classroom

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

Case study: Bug Club

Bug Club is a ground-breaking whole-school reading programme that links 300+ books with an online reading world to teach today's children to read. It is phonics-based, which means students learn to read by recognising letters and words through sounds. Bug Club is carefully graded to allow individual students to develop and progress at their own pace. Bug Club is available in Australia, Hong Kong and Russia as well as the UK. Bug Club won the 'Best Use of Multimedia' award at the British Book Design and Production Awards 2011.

Case study: iLit (inspire literacy)

Pearson's iLit programme is like no other reading programme. Designed for struggling readers, it is the first reading programme built and delivered completely on the iPad. It supports, rewards, engages and instructs based around the learning needs of the individual student.

Reading in the home

Enthusiastic readers are inspired by great stories, well designed. Our Penguin books for children – Puffin, Frederick Warne and Ladybird books – all provide plenty of options. Reading today is changing. Children today read in many ways; at home and on the move. We believe in offering stories that are beautiful, engaging and fun, regardless of format.

Case study: DK My first ABC

One of the great opportunities presented by mobile devices is to reach learners at home and on the move. As part of the launch of Apple's education iBookstore, we published four interactive DK titles including My first ABC. Through widgets, video, animations and questions, the book breaks new ground for parents to help a child to learn their first words.

Partnering with others to encourage reading

A parent reading aloud with their children is one of the most powerful ways to boost vocabulary and language development, according to research we commissioned as part of our Booktime programme. Access to books providing opportunities for shared reading is vitally important.

This year, we have brought together a range of initiatives to give books to promote reading under the We Give Books banner. 2011 saw us achieve some important milestones. We gave our six millionth book under our Booktime programme, which sees every child in England starting school receive a book pack containing two free books from Penguin and Pearson Primary to take home, read and keep. And we are about to give our one millionth book to Book Aid, the charity that supports the development of libraries in schools and local communities in sub-Saharan Africa. One in five of the books donated to Book Aid came from Pearson, helping benefit more than 2,000 libraries last year.

Our three priority issues:

2 IMPROVING LEARNING OUTCOMES

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

In the past, there were limitations on the extent to which a textbook publisher selling products to education institutions could measure their impact on learning outcomes. As our transition towards being an education technology and solutions provider gathers pace, so do the opportunities to help understand what works best to help students succeed. We recognise this as we become more directly involved in the process of learning, and more accountable for outcomes.

We have:

- Appointed Sir Michael Barber as Chief education advisor. As part of his role, Michael will oversee our efforts on improving learning outcomes.
- Convened our first global research conference bringing together and sharing good practice among the research community within Pearson.
- Incorporated improving learning outcomes as one of the five core themes we debated at our annual strategy conference.
- Appointed a network of business champions to take forward our developing agenda.
- Piloted a new tool to help us assess learning outcomes.

We will:

- Set up an online portal to bring together all the research we commission from around the world into a single searchable site.
- Further extend our pilot into assessing learning outcomes.
- Start to map by product, service and geography our approach to assessing learning impacts.
- Establish a Pearson Executive Research Council to oversee the approach, process and consistency of commissioning and using research within Pearson.
- Run an internal awareness campaign on this aspect of the responsibility agenda within the company.

Our impact on society continued

We continue to devote significant resources to improving student success and institutional effectiveness by:

Ensuring that our own education programmes are developed and assessed for quality, efficacy and usability.

We work closely with teachers, students, researchers and others to ensure our programmes are assessed.

Helping close achievement gaps for individual learners and schools.

Pearson is investing in new models of education to set up or support schools and districts by helping to make fundamental changes and sustain improvements for the long term. We draw on Pearson's research and proven resources – including curriculum, assessment, technology, and teacher professional development products and services.

Case study: Bridge International Academies in Kenya

Bridge academies offers quality schooling for less than $4 per month. How to extend access to quality schooling as an affordable option for the world's poorest people is a vitally important question. Pearson is a significant minority investor in Bridge, and views the Bridge model as having the potential for providing low-cost schooling in other parts of the world as well. We have made a commitment for 2012 to look to further invest in new low-cost, sustainable solutions to schooling, inviting others to partner with us. Learning outcomes are key metrics in our investment model.

Case study: UK examination awarding bodies

Since becoming involved in the English examinations system in 2003 through acquiring the awarding body Edexcel, Pearson has drawn on cross-company technological and assessment expertise to make major strategic investments in on-screen marking and other sector-leading initiatives. Through this investment, Edexcel has built a reputation for innovation and reliability in the UK qualifications sector.

A series of media reports in December called into question the integrity and credibility of the exams system based on an investigation into events for teachers run by the major awarding organisations in the UK.

We have recognised that changes need to be made to the way awarding bodies hold and manage events and have introduced a series of changes to enable a much greater degree of transparency and public scrutiny. These changes include events being recorded and audited. Our statements can be viewed at: http://bit.ly/zdjLpr. We have also launched a major public consultation programme on the future direction of standards in the education system in the UK at:

http://www.leadingonstandards.com/

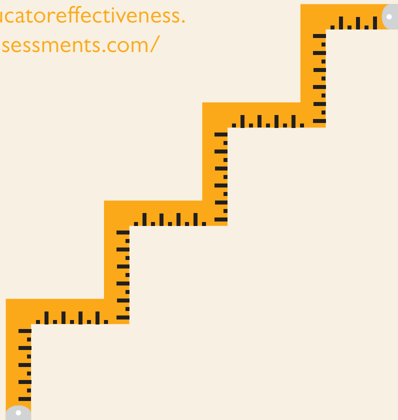
Supporting teacher education and development.

We work with teachers to improve teaching effectiveness providing content and services that help teachers develop from their earliest undergraduate experiences and throughout their teaching careers.

Case study: Educator effectiveness, Pearson North America

A priority for Pearson is to help teachers understand and improve their performance – what's working, what isn't, and what they need to do to continuously improve their impact on student learning. By giving teachers the insight they need, they can set their own improvement plans and in turn reach students in ever more meaningful ways. In 2011, we launched our educator effectiveness programme in the US to offer this service. By bringing together classroom observation, student performance data, peer reviews and performance surveys, it is possible to start to develop tailored support for educators throughout their career.

http://educatoreffectiveness.pearsonassessments.com/



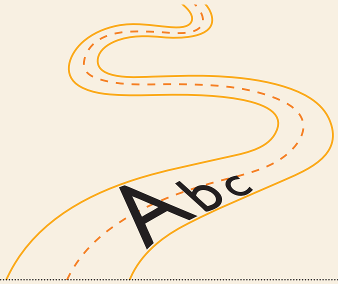
Case study: CTI Education Group, South Africa

CTI Education Group, a leading private higher education group in South Africa serving more than 9,000 students, has consistently produced a pass rate of more than 80% every year and has, over the last ten years, placed between 75% and 95% of its graduates into jobs within four months of completing their course.

Case study: Pearson Test of English

English language ability can often be the passport to work or academic opportunity for many, non-native speakers of English. The Pearson Test of English is designed to help demonstrate that ability. The test can be taken in a network of centres in nearly 50 countries from Australia to Venezuela taking in Brazil, China, Nepal and South Korea along the way.

http://pearsonpte.com/TestMe/Pages/TestMe.aspx



Our three priority issues:

3 CONTRIBUTING TO COMPETITIVENESS

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

Helping individuals get ready for work.

Getting a job depends on having relevant skills. At this time, when many countries are wrestling with the economic, social and personal cost of unemployment, particularly for the young, it is even more important that we help people develop the skills they need for work.

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

- BTEC, the vocational qualification recognised by schools, colleges, universities, employers and professional bodies across the United Kingdom and in over 100 countries worldwide.
- The Graduate Management Admission Test (GMAT), the leading test for entrance to business schools and management programmes worldwide.

Our impact on society continued

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

We also see that the world of work is changing. The pace of change is rapid and people starting work today can expect to be doing different types of work demanding different skills over a lifetime. Adult learning is one of our biggest global growth opportunities and we are developing ways to help people access and develop new skills.

Case study: MyFoundationsLab

College enrolments in the United States are at record levels, in part fuelled by people unable to access the job market. Many students are arriving on campus and finding they lack the mathematics and English skills needed to do college-level work. MyFoundationsLab is designed to offer students a way to quickly improve their mathematics, reading and writing skills and to avoid expensive remedial teaching programmes.

MyFoundationsLab®

Doing informed business

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

Case study: The *Financial Times*, active in education

In a partnership with the Pearson education businesses, the FT's world-class journalism has been made more easily accessible for graduates, students and professors. A new trademark licence agreement allows Pearson to use a new database of over 100,000 FT articles across its products and services for the education market around the world.

The FT also launched MBA Newslines in 2011, a new product aimed at business schools that enables students, faculty and practitioners from around the world to create and share annotations on FT articles. These practical case studies will help students to master business, understand financial markets or see the political economy or international law in action.

Case study: Media standards and the Leveson Inquiry

The Leveson Inquiry is currently investigating the culture, practices and ethics of the press in the UK. We have contributed a written statement to the inquiry and the editor of the FT presented evidence which is available at www.levesoninquiry.org.uk. The FT has its own ethical code which goes beyond what is required by the current Press Complaints Commission Code. The FT Code states that "It is fundamental to the integrity and success of the *Financial Times* that it upholds the highest possible professional and ethical standards of journalism, and is seen to do so".

http://aboutus.ft.com/corporate–responsibility/code–of–practice

Contributing to debate

We are committed to playing an active role in helping shape and inform the global debate around education and learning policy. With the 2015 deadline for achieving the Millennium Development Goals and Education for All Goals fast approaching, it is certainly time to take stock on the role that education has played and should play for the future. We have joined with a range of organisations as an active member of the Global Compact on Learning. Ways we are helping include contributing to developing and agreeing common metrics to measure the success of the Global Compact goals and innovating through new qualifications and support, such as 'Edupreneurs' – a way for people to be trained both as teachers and to help run schools in the developing world.

A key principle for us is that the private sector has an important contribution to make to developing education and learning policy. However, there is no global body in place to convene business on this issue. We are strong advocates of the view that there is value in engaging the wider business community in a coalition that focuses on the challenges facing developing countries in education and learning, mirroring the Global Business Coalition on Health. We were therefore delighted to support, encourage and help found the Global Business Coalition for Education under the guidance of former UK Prime Minister, Gordon Brown.

Responsible business practice

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

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

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

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

Highlights of our activities in 2011 include:

Environment: Climate change and avoiding deforestation

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

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

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

- Pearson was named the 33rd largest purchaser of renewable energy in the United States in the US Environmental Protection Agency Green Power Partnership list. We offset 100% of the electricity we use in North America through the purchase of wind power credits primarily in Iowa. Our UK buildings where we are responsible for purchasing utilities are powered by green electricity.
- Our first wind turbine became operational at our Owatonna office and printing centre in Minnesota.
- Pearson businesses in the UK and Australia are certified against ISO 14001, the environmental management standard. In the UK, we are also accredited against the Carbon Trust Standard.
- We expanded the Pearson/FT Rainforest in Costa Rica and helped the Woodland Trust launch Woodland Carbon to offset emissions we could not eliminate through other means.

Our impact on society continued

- The *Financial Times* has reduced the volume of newsprint and magazine papers it uses by 45% in four years. A key initiative has been to reduce the base weight of the papers used.
- Penguin Group in the UK was ranked seventh in the *Sunday Times* 2011 Best Green Companies list (up from eleventh in 2010).

Our customers, our people and our communities

Highlights of our activities in 2011 include:

- Pearson continued with its programme of Student Advisory Boards, providing an opportunity for students to input and influence our strategy in return for mentoring and company internships.
- During 2011, Pearson operations in the UK became accredited against ISO 18001, the international health and safety standard.
- Neo, Pearson's employee collaboration platform, won the Engage Employees category of the Jive Awards 2011. On average, 18,000 users log on each day.
- Pearson was again named joint winner of the FTSE Executive Women Award and included in *The Times* Top 50 Employers for Women, both run in partnership with Opportunity Now.
- Pearson in the US has been included in *Working Mother* magazine's 100 Best Companies list for its eleventh year and again by the Human Rights Campaign which campaigns for equal rights for lesbian, gay, bisexual and transgender people.
- The Pearson Diversity Summer Internship Programme won the Race for Opportunity (the UK's largest race equality organisation) Award for 'Widening the Talent Pool'.
- Providing an opportunity for our employees to share in the success of the company through owning a part of it is important to us. All our people have the opportunity to acquire and hold Pearson shares through participation in our employee share programmes.
- The fourth annual Penguin walk took place and almost 1,000 Penguin and DK employees from across the globe – from the US to South Africa, from China to New Zealand – joined forces to raise money for local charities.
- The *Financial Times* seasonal appeal was the most successful ever, raising $4.9 million on behalf of Sightsavers, the charity that fights blindness in the developing world.

Case study: The Pearson Foundation

The Pearson Foundation is an independent charity that aims to make a difference by promoting literacy, learning and great teaching. Pearson is its major (but not its only) funder. The Foundation runs a wide range of innovative philanthropic programmes in the US and around the world, designed to encourage people to read, to support great teachers and to share insight into best practice in education. In 2011 the Foundation was honoured to be awarded the NEA Foundation Award for Philanthropy in Public Education.

Still, it was a challenging year for the Pearson Foundation as several media reports criticised some of its programmes. Mark Nieker, the President/CEO of the Pearson Foundation, rejected the allegations and his response can be viewed at www.pearsonfoundation.org/mnstatement.html As the largest funder of the activities of the Pearson Foundation, Pearson has made clear our continued and ongoing commitment to support and fund the valuable work of the charity.

Values, principles and behaviour

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

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

Pearson has a zero tolerance policy towards bribery and corruption. During 2011, we reviewed our approach to combating bribery and corruption reflecting changes in legislation. An updated policy has been introduced setting out our standards; we carry out risk assessments and have a network of designated managers across the business responsible for compliance with our policy.

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

External benchmarks

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

	2011	2010	2009	2008
Dow Jones Sustainability Indexes	Global sector leader			
BITC Corporate Responsibility Index	Platinum	Platinum (retained)		Platinum (sector leader)
Inclusion in FTSE4Good	Yes			

Seven key commitments

We have established seven challenging aspirations and targets to help focus the business on achieving our responsible business vision while minimising our environmental impact. We believe this is a responsible and sustainable approach. We will be expanding and reviewing these commitments as we develop our approach.

ENVIRONMENT

Challenges	Climate change	Resource use	Avoiding global deforestation
Our commitment	1 To maintain our commitment to climate neutrality	2 To be ever more efficient in how we use paper as the most significant natural resource for us	3 To use FSC papers where we can and our own grading system
How we measure progress	Through carbon reduction; purchase of renewable energy; renewable energy generation at our sites and the purchase of carbon offsets	We track the metric tonnes of paper required to generate £1m of non-digital revenue (see chart below)	We track and report the FSC volume we purchase and the grading system we use to meet our requirement to purchase from known, responsible sources
	Electricity from renewable sources* 11 166,900 Mwh 10 170,700 Mwh 09 170,229 Mwh 08 3,255 Mwh Climate change data is published in April *>75% of electricity is from renewable sources	Paper usage 11 77 metric tonnes 10 84 metric tonnes 09 87 metric tonnes 08 105 metric tonnes	We publish a paper report in April

SOCIAL

Challenges	Investing in content	Access to learning, literacy and great teaching	Literacy	
Our commitment	4 To make sustained investment in new content	5 To maintain our total community investment at 1% or more of operating profit	6 Using 2010 as our base, to expand our book gifting activities	7 Growing take-up of digital-based reading
How we measure progress	Pre-publication expenditure and authors advances	One way we extend our reach is through partnerships with literacy and learning charities. We report on our community investment spend	Number of books donated to schools, libraries and literacy charities	Unlike traditional print programmes, we can track the number of users of our digital reading programmes
	Investing in content 11 $794m 10 $816m 09 $794m 08 $775m	Community investment spend 11 £11.5m (1.2%) 10 £13.1m* (1.6%) 09 £10.5m (1.4%) 08 £7.7m (1.1%)	Number of books donated 11 1.99m 10 1.66m 09 1.71m 08 1.74m	Reading programmes Bug Club: 145,000 SuccessMaker: 3.1m Waterford: 2.9m

Last year we set a series of plans for 2011. We report on our progress against those plans as part of our online Impact on Society report at http://cr2011.pearson.com

* Some 2011 projects were funded in 2010

Board of directors

Pearson's 12-member board brings a wide range of experience, skills and backgrounds.

Chairman

Glen Moreno Chairman
aged 68, appointed 1 October 2005

Chairman of the nomination committee and member of the remuneration committee

Glen has more than three decades of experience in business and finance, and is currently deputy chairman of The Financial Reporting Council Limited in the UK, deputy chairman and senior independent director at Lloyds Banking Group plc, and non-executive director of Fidelity International Limited. Previously, Glen was senior independent director of Man Group plc and acting chairman of UK Financial Investments Limited, the company set up by HM Treasury to manage the government's shareholdings in British banks.

Executive directors

Marjorie Scardino Chief executive
aged 65, appointed 1 January 1997

Member of the nomination committee

Marjorie brings a range of business, legal and publishing experience to Pearson. Before becoming Pearson CEO, she was chief executive of The Economist Group. Trained as a lawyer, she was a partner in a Savannah, Georgia, law firm and at the same time founded with her husband the Pulitzer Prize-winning *Georgia Gazette* newspaper. Marjorie is a director of Nokia Corporation and on the non-profit boards of Oxfam and the MacArthur Foundation. In 2003 she was made a Dame of the British Empire and in 2010 was named a fellow of the American Academy of Arts and Sciences.

Will Ethridge Chief executive, Pearson North American Education
aged 60, appointed 1 May 2008

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

Rona Fairhead Chairman and chief executive of The Financial Times Group
aged 50, appointed 1 June 2002

Rona has wide experience in business, finance, services and manufacturing. She was Pearson's chief financial officer before beginning her current role in 2006. In addition to the FT Group, Rona heads Pearson's professional and careers business that includes Pearson VUE (our electronic testing and certification business) and various skills and professional training businesses. She previously held senior management roles at specialty chemicals company ICI plc, and in aerospace with Bombardier/ Shorts. She has an MBA from Harvard Business School. Rona currently serves as non-executive director of The Cabinet Office of UK Government and of HSBC Holdings plc, where she chairs the risk committee. She is also a member of the Cambridge University Library Visiting Committee. She was made a Commander of the British Empire in 2012.

Robin Freestone Chief financial officer
aged 53, appointed 12 June 2006

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

John Makinson Chairman and chief executive of The Penguin Group
aged 57, appointed 15 March 1996

John's diverse background spans business, consultancy, financial journalism and publishing. He was finance director of Pearson before heading Penguin, and previously served as managing director of the *Financial Times* newspaper, where he had earlier served as editor of the popular Lex column. John co-founded Makinson Cowell, an international financial consultancy, and was vice chairman of the US holding company of advertising firm Saatchi & Saatchi. John is chairman of the National Theatre and a trustee of the Institute for Public Policy Research.

Board of directors continued

Non-executive directors

David Arculus Non-executive director
aged 65, appointed 28 February 2006

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

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

Patrick Cescau Senior independent director aged 63, appointed 1 April 2002

Member of the audit, remuneration and nomination committees

Patrick brings to Pearson more than 35 years global business experience in finance, consumer products, retailing and developing and emerging markets. He is the senior independent director of Tesco plc, Britain's largest retailer, a director of France-based INSEAD, the Business School for the World, and IAG, the International Consolidated Airlines Group, S.A., parent company of British Airways and Spain's Iberia. He was previously group chief executive of Unilever, the global consumer-goods company whose brands are known throughout the world. Patrick is a trustee of the Leverhulme Trust and chairman of the St. Jude Children Charity. In 2005 he was awarded the 'Légion d'Honneur', the highest decoration bestowed by France.

Vivienne Cox Non-executive director
aged 52, appointed 1 January 2012

Member of the audit, remuneration and nomination committees

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years, in Britain and continental Europe, in posts including executive vice president and chief executive of BP's Gas, Power & Renewables business and its Alternative Energy unit. She is also non-executive director of mining company Rio Tinto plc, energy company BG, the UK Department for International Development, and Vallourec, which supplies tubular systems for the energy industry. Vivienne also sits on the board of INSEAD.

Susan Fuhrman Non-executive director
aged 67, appointed 27 July 2004

Member of the audit and nomination committees

Susan's extensive experience in education includes her current role as president of Teachers College at Columbia University, America's oldest and largest graduate school of education. She is president of the National Academy of Education, and was previously dean of the Graduate School of Education at the University of Pennsylvania and on the board of trustees of the Carnegie Foundation for the Advancement of Teaching.

Ken Hydon Non-executive director
aged 67, appointed 28 February 2006

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

Ken's experience in finance and business includes roles in electronics, consumer products and healthcare. He is a non-executive director of Reckitt Benckiser Group plc, one of the world's leading manufacturers and marketers of branded products in household cleaning and health and personal care, retailer Tesco plc and the Royal Berkshire NHS Foundation Trust. Previously, Ken was finance director of Vodafone Group plc and of subsidiaries of Racal Electronics.

Josh Lewis Non-executive director
aged 49, appointed 1 March 2011

Member of the audit and nomination committees

Josh's experience spans finance, education and the development of digital enterprises. He is founder of Salmon River Capital LLC, a New York-based venture capital firm focused on technology-enabled businesses in education, financial services and other sectors. Over a 25 year private equity/venture capital career, 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 and the Bill & Melinda Gates Foundation.

Chairman's letter

Dear shareholders

This year, we are reporting against the revised UK Corporate Governance Code (the Code).

Role of the board

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

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 over significant business issues brings a valuable additional discipline to major decisions.

We organise our work around four major themes where we believe the board can add value: governance, strategy, business performance and people. Our board calendar and agenda provide ample time to focus on these themes.

Board composition

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

We recently added two new non-executive members to the board. Josh Lewis brings extensive knowledge of education, technology and the development of digital businesses; Vivienne Cox adds significant management experience, an understanding of natural resource markets, which are key to the development strategies of many emerging markets, and a deep personal interest in education and sustainable development.

We continue to search for a non-executive director who brings additional expertise in emerging markets, following C K Prahalad's untimely death in 2010. We are making good progress in this regard.

In the light of Lord Davies' report on 'Women on Boards' and the new Code provisions on gender diversity, we report that Pearson has four female board members (constituting one-third of the board). All were appointed for their outstanding records of achievement in their respective fields, and for the significant skills and insights that they bring to our company.

Patrick Cescau, our senior independent director, has now served on the board for more than nine years. The board has discussed in detail Patrick's record and contribution as a director and considers him to be vigorously independent. Given his experience as chief executive of a major global company, he currently plays an invaluable role in advising on our global expansion and organisational design. We have therefore asked Patrick to continue on the board. He has agreed, but advised us that he will wish to stand down by the end of 2013. In the meantime, he will stand down from the audit and remuneration committees, both of which will continue to have a majority of independent directors.

Succession planning

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

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

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

Glen Moreno Chairman

Board governance

Corporate governance

Introduction

The board believes that during 2011 the company was in full compliance with the UK Corporate Governance Code (the Code), except for a short period of time when it did not comply with the required ratio of independent non-executive directors to executive directors. Following the resignation of Terry Burns and the passing of C K Prahalad in 2010, there was an imbalance of executive and non-executive directors on the board during January and February 2011. However, with effect from 1 March 2011, Josh Lewis was appointed to the board as an independent non-executive director and, upon appointment, joined the nomination and audit committees.

In addition, with effect from 1 January 2012, Vivienne Cox was appointed to the board as an independent non-executive director and, on appointment, joined all of its committees.

The board embraces the Code's underlying principles with regard to board balance and diversity and the nomination committee, led by the chairman, is actively seeking an additional suitable candidate who possesses the right mix of knowledge, skills and experience, specifically in emerging markets, to enhance debate and decision-making. A detailed account of the provisions of the Code can be found on the FRC's website at www.frc.org.uk and on the company website at www.pearson.com/investors/shareholder-information/governance

Composition of the board

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

Chairman and chief executive

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

Senior independent director

Patrick Cescau is the company's senior independent director. The board believes that Patrick's extensive knowledge of Pearson together with his broad commercial experience, make him highly suitable for this role.

His role includes meeting regularly with the chairman and chief executive to discuss specific issues, e.g. strategy, as well as being available to shareholders if they should have concerns that have not been addressed through the normal channels. Patrick also makes a significant contribution to determining the structure and content of board meetings. During the year, Patrick held separate sessions with the other non-executive directors, the chief executive and an independent external evaluator, Boardroom Review, to appraise the performance of the chairman.

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

Independence of directors

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 particular, the board undertook a thorough review of Susan Fuhrman and Patrick Cescau, as they have served on the board for over seven and nine years respectively. In his letter introducing the governance report, the chairman has explained the board's consideration of Patrick's position.

After thoroughly reviewing Susan's positive contribution to board and committee work, and her position as a leader in educational reform and efficacy, the board has asked her to continue to serve as a director.

All of the other non-executive directors were considered by the board to be independent for the purposes of the Code during the year ended 31 December 2011.

Conflicts of interest

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

Board meetings

The board met six times in 2011, with most meetings taking place over two days. In recent years, we have developed our board meeting agenda to ensure that board discussion and debate is centred on the key strategic issues facing the company. Over the course of 2011 the major items covered by the board included:

BUSINESS PERFORMANCE: 24 AND 25 FEBRUARY 2011, LONDON

- 2010 report and accounts and dividend recommendation
- 2011 operating plan
- Risk assessment and review of mitigating actions
- Annual review of authorised conflicts
- Annual review of chief executive authorisation limits and procedures
- Appointment of Josh Lewis to the board
- The action to take with regard to the Libyan Investment Authority's investment in Pearson

GOVERNANCE: 28 APRIL 2011, LONDON

- Feedback on 2010 report and accounts
- Report on shareholders' views
- Review of corporate social responsibility
- External board effectiveness review
- Acquisition of Schoolnet

STRATEGY: 1 AND 2 JUNE 2011, BEIJING

- Strategy discussions – review of China businesses
- Acquisition of Education Development International plc

CASE STUDY

Looking to the future – planning for growth in China

In June 2011, the Pearson board held a two day meeting in Beijing, China. The purpose of this board meeting was to review our businesses in China. During their three day stay the board met with the key local management of all our businesses operating in mainland China and Hong Kong, visited a number of Wall Street English language schools and met key customers and other people who have important relationships with our China businesses. During 2012 the board plans to have similar meetings with local businesses in Brazil and India.

BUSINESS PERFORMANCE: 28 JULY 2011, LONDON

- Interim results
- Post-acquisition reviews
- Acquisition of Connections Education
- Acquisition of Stark Holding

STRATEGY: 6 AND 7 OCTOBER 2011, CALIFORNIA

- Review of technology strategy
- Strategic plan 2011 to 2013
- Review of audit, remuneration and nomination committee terms of reference
- Disposal of stake in FTSE
- Acquisition of Global Education
- Acquisition of TQ
- Investment in Companhia das Letras

STRATEGIC PLAN: 8 AND 9 DECEMBER 2011, NEW YORK

- Strategic review of Pearson legacy businesses
- Risk assessment and review of mitigating actions
- SEC and FINRA investigation in respect of the acquisition of Global Education
- Ofqual review of exam awarding bodies
- Appointment of Vivienne Cox to the board

Board governance continued

The following table sets out the attendance of the company's directors at board and committee meetings during 2011:

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

*appointed 1 March 2011.

The role and business of the board

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

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

The board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive board papers are circulated to the board and committee members at least one week in advance of each meeting and the board receives monthly reports from the chief executive. Directors can obtain independent professional advice, at the company's expense, in the performance of their duties as directors. All directors have access to the advice and services of the company secretary.

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

Board evaluation

The board conducts an annual review of its effectiveness. For the review of 2010, conducted in early 2011, the board commissioned a board effectiveness review from an independent third party provider, Boardroom Review (which has no other connection to the company). This review was designed to be forward looking; assessing the quality of the board's decision making and debate, its overall contribution to, and impact on, the long term health and success of the business and its preparation for future challenges.

The review covered a variety of aspects associated with board effectiveness, including the board's ability to achieve its objectives, to work together effectively and the management of its time. This was carried out through confidential interviews with all members of the board, through board observation and through a review of selected board papers.

Following the review a discussion document was produced to facilitate the board's discussion at their meeting in April, as well as to provide a reference point for the board's development and change.

The evaluation for 2010 indicated that the culture of the board is dominated by a sense of cohesiveness and collaboration; the dynamics encourage openness, transparency and cooperation between executive and non-executive directors. During the review itself, the board was seen to demonstrate several areas of strength, including:

- a focused strategic approach;
- a thoughtful approach to control and risk;
- strong executive leadership and corporate culture;
- a healthy alignment between performance and reward;
- a positive culture, dynamic debate, and leadership from the chairman; and
- the effective management of time and information.

The review also highlighted an opportunity for improvement, relating to the quality of discussion and debate over changes in the competitive environment, particularly with regard to technology and emerging markets. The board addressed this issue at subsequent board meetings during 2011, including holding a technology strategy session in October and arranging board visits to emerging markets; China in June 2011, Brazil and India in 2012.

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

For the review of 2011, to be conducted during the early part of 2012, the chairman will meet with each of the directors, executive and non-executive, on a one to one basis and discuss the board's effectiveness and progress made against objectives. He will also take the opportunity to discuss with each director their individual training and development needs.

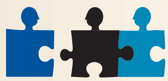
Directors' training and induction

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

The directors' training is supplemented with presentations about the company's operations, by holding board meetings at the locations of operating companies and by encouraging the directors to visit operating companies and local management as and when their schedule allows. Directors can also make use of external courses.

CASE STUDY

Induction – Josh Lewis appointed to Pearson Board



Josh Lewis was appointed to the board in March 2011 and a programme of induction was tailored to his particular requirements. Within the first few months of his appointment, Josh had met with the senior management teams from each of our businesses, as well as spending time with all of the members of our management committee. In addition, Josh visited our operations in China, India and a number of locations throughout the US. This induction programme resulted in Josh having a firm understanding of Pearson, its operations, culture and the key risks and issues the company is facing. A similar induction process is currently being prepared for Vivienne Cox, who was appointed to the board in January 2012.

Board governance continued

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 it is repaid not later than when the outcome becomes final if: (i) they are convicted in the proceedings; (ii) judgement is given against them; or (iii) the court refuses to grant the relief sought.

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

Shareholder engagement

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

In 2011, we continued with our shareholder outreach programme, seeing more than 500 institutional and private investors at more than 300 different institutions in Australia, Brazil, Canada, China, Continental Europe, Japan, the UK and the US.

There are five trading updates a year and the chief executive and chief financial officer present our preliminary and interim results updates. They also attend regular meetings throughout the year with investors both in the UK and around the world. In 2011, the chief financial officer and the director of investor relations met with representatives of the UK Shareholders' Association. The meeting included a presentation from Pearson describing the company's performance and a question and answer session to give shareholders the opportunity to question management directly.

The chairman and senior independent director also make themselves available to meet any significant shareholder as required. The non-executive directors meet informally with shareholders both before and after the AGM and respond to shareholder queries and requests as necessary.

The chairman ensures that the board is kept informed of principal investors' and advisers' views on strategy and corporate governance.

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

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

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

We encourage our private shareholders to become more informed investors and recently invited all shareholders, who had not already done so, to register their email addresses. This enables them to receive email alerts when trading updates and other important announcements are added to our website.

We are committed to ensuring that all our shareholders receive their dividends and with the final cash dividend mailing this year, we will be informing any shareholder who has outstanding unclaimed dividends, of the amounts owed to them and how they can claim these.

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

Our AGM – which will be held on 27 April this year – is an opportunity for all shareholders to meet the board and to hear presentations about Pearson's businesses and results.

Board committees

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

NOMINATION COMMITTEE

Chairman Glen Moreno

Members David Arculus, Patrick Cescau, Vivienne Cox, Susan Fuhrman, Ken Hydon, Josh Lewis, Glen Moreno and Marjorie Scardino

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

During 2011, the committee considered the recruitment of two non-executive directors, concluding with the appointment of Josh Lewis and Vivienne Cox to the board effective March 2011 and January 2012 respectively.

In addition, the committee met in February 2012 to review succession planning for non-executive and executive board positions and senior management, as well as board committee membership.

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

Pearson continues to show evidence of progress in relation to the retention of people with diverse backgrounds for both entry level and management positions and has made significant progress over the years in advancing women and culturally diverse people. As at December 2011, 27% of Pearson's top managers were women, a 35% increase from 2008.

The plan for 2012 is to continue to develop programmes and relationships that help attract talented diverse people into our business and retain them and to continue to track our progress.

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

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

REMUNERATION COMMITTEE

Chairman David Arculus

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

The remuneration committee reports to the full board and a letter from the chairman of the remuneration committee and its report on directors' remuneration, which has been considered and adopted by the board, is set out on pages 65 to 89.

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

Board governance continued

AUDIT COMMITTEE

Chairman Ken Hydon

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

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

Fundamental to this role is the committee's access to local management. Committee meetings are always attended by the chief financial officer and head of Group internal audit, and often by the chief executive and chairman. Individual managers join meetings for specific topics, e.g. treasury or business continuity planning. In total, 15 managers attended one or more meetings during the year. During the board's visit to Beijing, members of the committee met with local senior financial management to discuss risk management, financial control and the Pearson code of conduct. In December, the committee met with the company's chief information officer and director of digital strategy to discuss the approach of Pearson Technology to risk management. The committee will continue this method during 2012, and is planning to meet local management in at least two regular committee meetings and whenever the board is scheduled to meet in overseas locations.

Also fundamental to the role of the committee is its relationship with both the external auditors and Group internal audit. The committee has a healthy interaction with both and PWC attend all our regular committee meetings.

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

Ken Hydon

Members

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

The qualifications and relevant experience of the other committee members are detailed on page 48.

Role and responsibilities

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

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

The committee is responsible for assisting the board's oversight of the quality and integrity of the company's external financial reporting and statements and the company's accounting policies and practices. The Group's internal and external auditors have direct access to the committee to raise any matter of concern and to report on the results of work directed by the committee. The committee reports to the full board at every board meeting immediately following a committee meeting. It also reviews the independence of the external auditors, including the provision of non-audit services (further details of which can be found on page 60), and ensures that there is an appropriate audit relationship and that auditor objectivity and independence is upheld.

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 2011 and remains satisfied that the auditors provide effective independent challenge to management. The committee will continue to review the performance of the external auditors on an annual basis and will consider their independence and objectivity, taking account of all appropriate guidelines. There are no contractual obligations restricting the committee's choice of external auditors. In any event, the external auditors are required to rotate the audit partner responsible for the Group audit every five years. The current lead audit partner has been in place for four years and will rotate next year. In accordance with our external auditor policy, in 2010 Group internal audit performed a formal assessment of audit fees, services and independence. This formed the basis for a recommendation to the board to continue with PwC.

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

At the July 2011 audit committee meeting, the committee discussed and approved the auditors' Group audit plan, in which they identified the following key risks of misstatement of the Group's financial statements:

- Revenue recognition, specifically in relation to long-term contract accounting and increasingly to digital revenue streams where management assumptions and estimates are necessary;
- Accounting for acquisitions and disposals in light of material transactions in 2011, in particular, valuation of acquired intangibles which involves significant judgement;
- Key balance sheet judgements, since small changes in provisioning judgements or methodology can have notable impacts on the Group's balance sheet and income statement; and
- Assessment of goodwill and intangible assets for impairment in the context of current market conditions, recognising that management judgement is required.

The committee discussed these issues with the auditors at the time of their review of the half year interim financial statements in July 2011 and again at the conclusion of their audit of the financial statements for the year in February 2012. In December 2011, the committee discussed with the auditors the status of their work, focusing on their work in relation to internal controls. As the auditors concluded their audit, they explained to the committee:

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

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

Board governance continued

Training

The committee receives regular technical updates as well as specific or personal training as required. Committee members also meet with local management on an ongoing basis in order to gain a better understanding of how Group policies are embedded in operations. For example, during its visit to Beijing in June 2011, the committee met with local senior finance managers.

Meetings

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

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

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

- The 2010 annual report and accounts: preliminary announcement, financial statements and income statement;
- The Group accounting policies;
- Compliance with the UK Corporate Governance Code;
- Form 20-F and related disclosures including the annual Sarbanes-Oxley Act 404 attestation of financial reporting internal controls;
- Receipt of the external auditors' report on the Form 20-F and on the year end audit;
- Assessment of the effectiveness of the Group's internal control environment;
- Reappointment, remuneration and engagement letter of the external auditors;
- UK Bribery Act adequate procedures guidance;
- Risk management in Asia;
- Review of the interim financial statements and announcement;
- Annual re-approval of the internal audit mandate;
- Compliance with SEC & NYSE requirements including Sarbanes-Oxley;
- Reviews of the effectiveness of the audit committee, the external auditors and the Group internal audit function;
- Pearson's anti-corruption programme;
- Review of the committee's terms of reference;
- Annual internal audit plan;
- Review of company risk returns including Social, Ethical and Environmental (SEE) risks; and
- Annual review of treasury policy.

In February 2012, the committee also considered the 2011 annual report and accounts, including the preliminary announcement, financial statements, business review, directors' report, corporate governance compliance statement and the income statement.

Internal control and risk management

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

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

Control environment

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

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

The identification and mitigation of significant business risks is the responsibility of Group senior management and operating company management. Each operating company, including the corporate centre, maintains internal controls and procedures appropriate to its structure, business environment and risk assessment, whilst complying with Group policies, standards and guidelines.

Financial management and reporting

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

We have an ongoing process to monitor the risks and effectiveness of controls in relation to the financial reporting and consolidation process including the related information systems. This includes up-to-date Group financial policies, formal requirements for business unit finance functions, Group consolidation reviews and analysis of material variances, Group finance technical reviews, including the use of technical specialists, and review and sign-off by senior finance managers. These processes are monitored and assessed during the year by the Group internal audit and Group compliance functions.

These controls include those over external financial reporting which are documented and tested in accordance with the requirements of section 404 of the Sarbanes-Oxley Act, which is relevant to our US listing.

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

Risk management

A risk management framework is in place to identify, evaluate and manage risks, including key financial reporting risks. Operating companies undertake semi-annual risk reviews to identify new or potentially under-managed risks. Throughout the year, risk sessions facilitated by the head of Group internal audit and risk assurance are held with Group and operating company management to identify the key risks the company faces in achieving its objectives, to assess the probability and impact of those risks and to document the actions being taken to manage those risks. The Pearson management committee reviews the output of these sessions, focusing on the significant risks facing the business. Management has the responsibility to consider and execute appropriate action to mitigate these risks whenever possible. The results of these reviews are reported to the board in detail via the audit committee.

Group internal audit

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

The head of Group internal audit is jointly responsible with the Group legal counsel for monitoring compliance with our Code of Conduct, and investigating any reported incidents including ethical, corruption and fraud allegations. The Pearson anti-bribery and corruption programme has been enhanced to support the UK Bribery Act 2010.

Board governance continued

Treasury management

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

Insurance

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

Going concern

Having reviewed the Group's liquid resources and borrowing facilities and the Group's 2012 and 2013 cash flow forecasts, the directors believe that the Group has adequate resources to continue as a going concern. For this reason, the financial statements have, as usual, been prepared on that basis. Information regarding the Group's borrowing liabilities and financial risk management can be found in notes 18 and 19 on pages 130 to 138.

Share capital

Details of share issues are given in note 27 to the accounts on page 150. 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 2011, 815,626,237 ordinary shares were in issue. At the AGM held on 28 April 2011, the company was authorised, subject to certain conditions, to acquire up to 81,310,000 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 27 April 2012.

Information provided to the company pursuant to the Financial Services Authority's Disclosure and Transparency Rules is published on a Regulatory Information Service and on the company's website. As at 31 December 2011, the company had been notified under DTR5 of the following significant voting rights in its shares:

	Number of shares	Percentage
Legal & General Group plc	32,385,175	3.97%
Libyan Investment Authority	24,431,000	3.01%

No notifications under DTR5 had been received by the company during the period from 1 January 2012 to 5 March 2012, being the last practicable date before the publication of this report.

Annual General Meeting (AGM)

The notice convening the AGM, to be held at 12 noon on Friday, 27 April 2012 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 22 March 2012.

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

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

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

A full statement of the fees for audit and services is provided in note 4 to the accounts on page 110.

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 that the financial statements comply with IFRSs as adopted by the European Union or disclose and explain any material departures from those IFRSs; and
- Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company and/or the Group will continue in business.

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

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

Each of the directors, whose names and functions are listed on pages 46 to 48, confirm that to the best of their knowledge and belief:

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

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

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

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

Approved by the board on 7 March 2012 and signed on its behalf by

Philip Hoffman Secretary

Board governance continued

Additional information for shareholders

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

Amendment to Articles of Association

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

Rights attaching to shares

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

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

Shareholders can declare a final dividend by passing an ordinary resolution but the amount of the dividend cannot exceed the amount recommended by the board. The board can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. 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 on trustees upon such trusts for the benefit of the shareholders.

Voting at general meetings

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

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

Pearson operates two employee benefit trusts to hold shares, pending employees becoming entitled to them under the company's employee share plans. There were 14,665,223 shares so held as at 31 December 2011. 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 4,137,566 shares so held as at 31 December 2011. The trustees holding these shares seek voting instructions from the employee as beneficial owner, and voting rights are not exercised if no instructions are given.

Transfer of shares

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

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

Variation of rights

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

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

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

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

Appointment and replacement of directors

The Articles contain the following provisions in relation to directors:

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

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

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

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

Board governance continued

Powers of the directors

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

Significant agreements

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

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

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

Report on directors' remuneration

Dear Shareholder

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

We are committed to long-term value creation and this sets the agenda for our approach to remuneration.

The company has performed strongly and has delivered:

› record earnings

› a share price around its highest level for a decade

› total shareholder return ahead of that of the market and our sector

› return on invested capital above our cost of capital

› Pearson's 20th straight year of increasing our dividend above the rate of inflation. Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning more than £2.5bn to shareholders

Our remuneration policy centres on three major elements to support and sustain performance: competitive base salaries that reflect the market and individual roles and contribution; annual incentives that reward achievement of strategic goals; and long-term incentives that drive long-term earnings and share price growth and encourage people to acquire and hold Pearson shares in line with shareholders' interests.

Pearson's people have shared in the company's success through cash awards and worldwide participation in share ownership plans continuing practices first started in 1998.

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

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

For 2012, the committee endorsed the recommendation of the executive directors and other members of the Pearson Management Committee that they should receive no increase in base salaries.

In addition, the committee has decided that there will be a reduction in the number of shares awarded to the Pearson Management Committee as their long-term incentives.

Looking back to some specific aspects of policy:

› we undertook a normal review of base salaries for 2011 that took into account the guideline for the general level of increases elsewhere across the company

› annual incentives paid to executives for 2011 performance were generally lower than for 2010, reflecting more challenging targets and a tougher business environment

› shareholders approved the renewal of the long-term incentive plan at the Annual General Meeting (AGM) on 28 April 2011

› we introduced formal shareholding guidelines for executive directors to complement the operation of the company's long-term incentive arrangements

› we reviewed the company's powers to reclaim variable remuneration in exceptional circumstances of misstatement or misconduct

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

Finally, I have great pleasure in welcoming Vivienne Cox, who is widely experienced in remuneration matters, as a member of the committee with effect from her appointment as independent non-executive director of the board on 1 January 2012. I would also like to thank my fellow members of the committee and the people who have assisted us for their contribution over the past year.

David Arculus Chairman, Remuneration Committee

Report on directors' remuneration continued

Governance

The board presents its report on directors' remuneration to shareholders. This report complies with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and was approved by the board of directors on 7 March 2012.

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

We will put a resolution to shareholders at the AGM on 27 April 2012 inviting them to consider and approve this report.

The remuneration committee & its activities

David Arculus chaired the remuneration committee for the year 2011; the other members were Patrick Cescau, Ken Hydon and Glen Moreno. David Arculus, Patrick Cescau and Ken Hydon are independent non-executive directors. Glen Moreno, chairman of the board, is a member of the committee as permitted under the UK Corporate Governance Code. Terry Burns stepped down from his membership of the committee and his role as a non-executive director on 30 April 2010.

Marjorie Scardino, chief executive, Robin Freestone, chief financial officer, Robin Baliszewski, director for people, Robert Head, director for executive reward, and Stephen Jones, head of company secretarial and deputy secretary, provided material assistance to the committee during the year. They attended meetings of the committee, although none of these was involved in any decisions relating to his or her own remuneration.

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

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

The Committee's duties are also:

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

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

The committee met four times during 2011. The matters discussed and actions taken were as follows:

17 AND 25 FEBRUARY 2011

- Reviewed and approved 2010 annual incentive plan payouts
- Reviewed and approved 2008 long-term incentive plan payouts and release of shares
- Approved vesting of 2006 and 2008 annual bonus share matching awards and release of shares
- Reviewed and approved 2011 base salary increases for the Pearson Management Committee
- Reviewed and approved 2011 Pearson and operating company annual incentive plan targets
- Reviewed and approved 2011 individual annual incentive opportunities for the Pearson Management Committee
- Discussed renewal of long-term incentive plan
- Reviewed and approved 2011 long-term incentive awards and associated performance conditions for the Pearson Management Committee

- Reviewed and approved 2010 report on directors' remuneration
- Noted company's use of equity for employee share plans
- Reviewed and approved the remuneration package for the chief executive

29 JULY 2011

- Approved 2011 long-term incentive awards for executives and managers
- Reviewed committee's charter and terms of reference

7 DECEMBER 2011

- Discussed Towers Watson's overview of the current remuneration environment
- Considered Towers Watson's report on remuneration for the Pearson Management Committee for 2012
- Reviewed status of outstanding long-term incentive awards
- Considered the approach to 2012 long-term incentive plan awards for the Pearson Management Committee
- Reviewed 2012 annual incentive plan metrics
- Reviewed committee's performance

Remuneration policy & business strategy

This report sets out the company's policy on directors' remuneration that applies to executive directors for 2012 and, so far as practicable, for subsequent years. Future reports, which will continue to be subject to shareholder approval, will describe any changes in this policy.

The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the company's business environment and in remuneration practice.

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

Our goal as a company is to make an impact on people's lives and on society through education and information. Our strategy to achieve that goal is pursued by all Pearson's businesses in some shape or form and has four parts: long-term investment in our business; technology; working in fast-growing markets around the world; and efficiency and scale.

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

Performance conditions

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

As part of our ongoing review, we have concluded that no fundamental changes are required to the performance measures used in the company's annual and long-term incentive plans.

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

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

Misstatement or misconduct

In accordance with the UK Corporate Governance Code, in 2011 the committee reviewed the company's powers to reclaim variable remuneration in exceptional circumstances of misstatement or misconduct. The company will follow its legal rights and reclaim rewards gained in the event of proven wrong doing which led to misstatement of the company's accounts.

Report on directors' remuneration continued

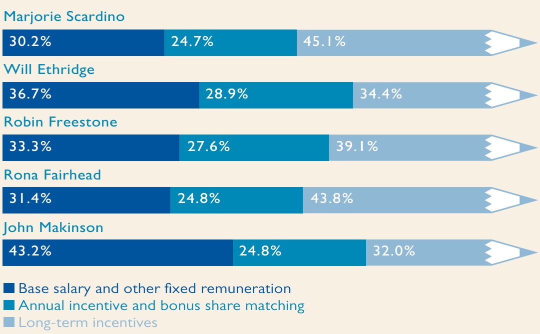
Main elements of remuneration

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

Element	Objective	Performance period	Performance conditions
Base salary (see page 69)	Reflects competitive market level, role and individual contribution	Not applicable	Normally reviewed annually taking into account general economic conditions and the wider pay scene, the level of increases applicable to employees across the company as a whole, the remuneration of directors and executives in comparable companies and individual performance
Annual incentives (see page 70)	Motivates achievement of annual strategic goals	One year	Subject to achievement of targets for sales, earnings per share or profit, working capital, cash flow and personal objectives
Bonus share matching (see page 71)	Encourages executive directors and other senior executives to acquire and hold Pearson shares. Aligns executives' and shareholders' interests	Three years	Subject to achievement of target for earnings per share growth
Long-term incentives (see page 73)	Drives long-term earnings and share price growth and value creation. Aligns executives' and shareholders' interests	Three years	Subject to achievement of targets for relative total shareholder return, return on invested capital and earnings per share growth

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

PROPORTION OF TOTAL COMPENSATION



Note The method for valuing the different elements of remuneration is summarised in the table on page 69.

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

Benchmarking

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

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

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

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

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

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

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

Note Expected value means our independent advisers' assessment of the awards' net present value taking into account the vesting schedule and the probability that any performance targets will be met.

Base salary

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

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

For 2012, the company has reviewed or is reviewing salaries for employees taking into account the location and economic conditions of each business as it did for 2011.

The committee has reviewed executive directors' base salaries for 2012 consistent with the policy and process set out above. In the light of the prevailing economic conditions and consistent with the action that continues to be taken across the company to control costs, the committee endorsed the recommendation of the executive directors and other members of the Pearson Management Committee that they should receive no increase in base salaries for 2012.

Full details of the executive directors' remuneration for 2012 will be set out in the report on directors' remuneration for 2012.

For 2011, there was a normal review of base salaries for the executive directors and other members of the Pearson Management Committee that took into account the guideline for the general level of increases elsewhere across the company. Some individual increases were above this level because of relativity to the market, relativity to peers and performance. Full details of the executive directors' 2011 remuneration are set out in table 1 on page 82.

Allowances and benefits

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

Report on directors' remuneration continued

Annual incentives

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

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

Annual incentive payments do not form part of pensionable earnings.

Performance measures

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

A proportion (which for 2012 may be up to 30%) of the total annual incentive opportunity for the executive directors and other members of the Pearson Management Committee is based on performance against personal objectives as agreed with the chief executive (or, in the case of the chief executive, the chairman). These comprise functional, operational, strategic and non-financial objectives relevant to the executives' specific areas of responsibility and *inter alia* may include objectives relating to environmental, social and governance issues.

For 2012, the principal financial performance measures are: sales; operating profit (for the operating companies) and growth in underlying earnings per share for continuing operations at constant exchange rates (for Pearson plc); average working capital as a ratio to sales; and operating cash flow. The selection and weighting of performance measures takes into account the strategic objectives and the business priorities relevant to each operating company and to Pearson overall each year.

Incentive opportunities

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

For 2012, there are no changes to the target and maximum annual incentive opportunities for the chief executive which remain at 100% and 180% respectively, of base salary (as in 2011).

For the other members of the Pearson Management Committee, individual incentive opportunities take into account their membership of that committee and the contribution of their respective businesses or role to Pearson's overall financial goals. In the case of the executive directors, the target individual incentive opportunity for 2012 is in a range from 80% to 87.5% of base salary (as in 2011). The maximum opportunity remains at twice target (as in 2011).

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

The committee may also award individual discretionary incentive payments although no such payments were awarded in respect of 2011.

For 2011, total annual incentive opportunities were based on Pearson plc and operating company financial performance and performance against personal objectives as follows:

Name	Pearson plc	Operating company/ companies	Personal objectives
Marjorie Scardino	90%	–	10%
Will Ethridge	30%	60% Pearson North America	10%
Rona Fairhead	30%	40% Professional Assessment & Training 10% FT Publishing	20%
Robin Freestone	80%	–	20%
John Makinson	30%	60% Penguin Group	10%

2011 performance

Performance in 2011 against the relevant incentive plans was as follows:

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

Details of actual payouts for 2011 which range from 52% to 76% of maximum (89% to 100% in 2010) are set out in table 1 on page 82.

Bonus share matching

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

Invested and matching shares

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

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

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

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

Report on directors' remuneration continued

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

Performance condition

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

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

Dividend shares

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

Outstanding awards

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

Date of award	Share price on date of award	Vesting	Status of award
20 April 2011	1,129.0p	20 April 2014	Outstanding subject to 2010 to 2013 performance
21 April 2010	1,024.1p	21 April 2013	Outstanding subject to 2009 to 2012 performance
16 April 2009	670.0p	16 April 2012	Performance condition for release of maximum matching award met. Real compound annual growth in earnings per share for 2008 to 2011 of 10.1% against target of 5%. Shares held pending release on 16 April 2012
4 June 2008	670.7p	4 June 2011	Target met as reported in report on directors' remuneration for 2010. Shares released on 4 June 2011
22 May 2007 (See note 1)	899.9p	100% on 22 May 2012	Performance condition for release of 100% of matching award met. Real compound annual growth in earnings per share for 2006 to 2011 of 11.2% against target of 3%. Shares held pending release on 22 May 2012
12 April 2006 (See note 1)	776.2p	100% on 12 April 2011	Target met as reported in report on directors' remuneration for 2010. Shares released on 12 April 2011

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

Marjorie Scardino, Will Ethridge, Rona Fairhead and Robin Freestone hold or held awards under this plan in 2011. Details are set out in table 4 on pages 85 to 87 and itemised as a or a*.

Long-term incentives

At the AGM in 2011, shareholders approved the renewal of the long-term incentive plan.

The plan enables the company to recruit and retain the most able managers worldwide and to ensure their long-term incentives encourage outstanding performance and are competitive in the markets in which we operate.

Under the plan, executive directors, senior executives and other managers can participate in this plan which can deliver restricted stock and/or stock options. Approximately 6% of the company's employees currently hold awards under this plan.

The aim is to give the committee a range of tools with which to link corporate performance to management's long-term reward in a flexible way. It is not the committee's intention to grant stock options in 2012 or for the foreseeable future.

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

Performance measures

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

The performance measures that will apply for the executive directors for awards in 2012 and subsequent years will continue to be focused on delivering and improving returns to shareholders. These measures, which have applied since 2004, are relative total shareholder return (TSR), return on invested capital (ROIC) and earnings per share (EPS) growth.

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

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

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

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

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

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

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

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

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

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

Report on directors' remuneration continued

The committee has discretion to make adjustments taking into account exceptional factors that distort underlying business performance. In exercising such discretion, the committee is guided by the principle of aligning shareholder and management interests. No such adjustments were made for performance periods ending in 2011.

Restricted stock may be granted without performance conditions to satisfy recruitment and retention objectives. Restricted stock awards that are not subject to performance conditions will not be granted to any of the current executive directors.

Performance targets

We will set targets for the 2012 awards that are consistent with the company's strategic objectives over the period to 2014 and that are no less stretching than in previous years. Full details of the performance targets for 2012 will be set out in the report on directors' remuneration for 2012.

Value of awards

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

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

For 2012, we reviewed award levels taking into account the value of individual awards and market practice and, as a consequence, reduced the number of shares awarded to executive directors and other members of the Pearson Management Committee compared to practice in recent years.

Future awards

For awards beyond 2012, the committee may use the same performance measures and targets, or apply different ones that are consistent with the company's objectives and which it considers to be similarly demanding. The committee also has the flexibility to vary individual award levels.

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

Dividends

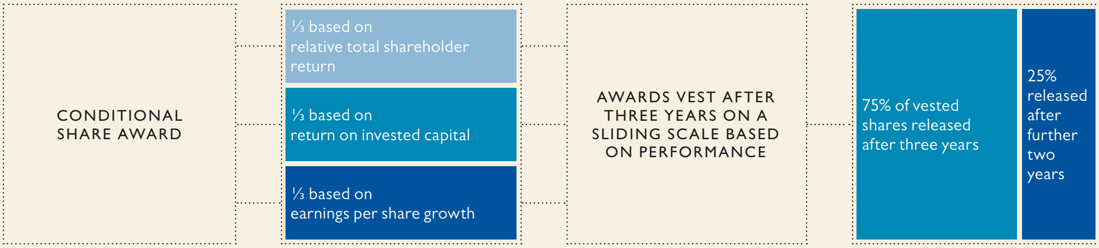
Where shares vest, in accordance with the plan, participants also receive additional shares representing the gross value of dividends that would have been paid on these shares during the performance period and reinvested.

Retention period

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

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

All of the executive directors hold awards under the long-term incentive plan. Details are set out in table 4 on pages 85 to 87 and itemised as b or b*.



Outstanding awards

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

Date of award	Share price on date of award	Vesting date	Performance measures (award split equally across three measures)	Performance period	Payout at threshold	Payout at maximum	Actual performance	% of award vested	Status of award
03/05/11	1,149.0p	03/05/14	Relative TSR	2011 to 2014	30% at median	100% at upper quartile	–	–	Outstanding
			ROIC	2013	25% for ROIC of 9.0%	100% for ROIC of 10.5%	–	–	Outstanding
			EPS growth	2013 compared to 2010	30% for EPS growth of 6.0%	100% For EPS growth of 12.0%	–	–	Outstanding
03/03/10	962.0p	03/03/13	Relative TSR	2010 to 2013	30% at median	100% at upper quartile	–	–	Outstanding
			ROIC	2012	25% for ROIC of 8.5%	100% for ROIC of 10.5%	–	–	Outstanding
			EPS growth	2012 compared to 2009	30% for EPS growth of 6.0%	100% For EPS growth of 12.0%	–	–	Outstanding
03/03/09	654.0p	03/03/12	Relative TSR	2009 to 2012	30% at median	100% at upper quartile	–	–	Outstanding
			ROIC	2011	25% for ROIC of 8.5%	100% for ROIC of 10.5%	9.1%	47.5%	Vested and remain held pending release
			EPS growth	2011 compared to 2008	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	14.4%	100%	Vested and remain held pending release

Report on directors' remuneration continued

Date of award	Share price on date of award	Vesting date	Performance measures (award split equally across three measures)	Performance period	Payout at threshold	Payout at maximum	Actual performance	% of award vested	Status of award
04/03/08	649.5p	04/03/11	Relative TSR	2008 to 2011	30% at median	100% at upper quartile	93.3rd percentile	100%	97.5% of shares vested. Three-quarters released on 05 April 2011. If after tax number of shares are retained for a further two years, the remaining quarter will be released on 4 March 2013.
			ROIC	2010	25% for ROIC of 8.5%	100% for ROIC of 10.5%	10.3%	92.5%	
			EPS growth	2010 compared to 2007	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	18.4%	100%	

All-employee share plans

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

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

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

Dilution and use of equity

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

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

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

At 31 December 2011, 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 2011 amounted to 1.8% 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	2011	2010	2009
All Pearson plans	8.3%	7.6%	6.4%
Executive or discretionary plans	5.0%	4.1%	3.0%
Shares held in trust	3.2%	3.3%	3.3%

Shareholding of executive directors

The committee expects executive directors to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership and operates formal shareholding guidelines for executive directors. The target holding is 2 times salary for the chief executive and 1.25 times salary for the other executive directors consistent with median practice in FTSE 100 companies that operate such arrangements.

Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children (as set out in table 3 on page 84) plus any shares vested but held pending release under a restricted share plan (as marked as * in table 4 on pages 85 to 87).

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

The current value of the executive directors' holdings based on the middle market value of Pearson shares of 1,251.0p on 24 February 2012 (which is the latest practicable date before the results announcement) against the base salaries in 2011 comfortably exceeded these guidelines:

Own shares	Number of shares	Value (x salary)	Guideline (x salary)	Guideline met
Marjorie Scardino	1,809,655	22.8	2.00	✓
Will Ethridge	560,407	10.8	1.25	✓
Rona Fairhead	554,241	13.1	1.25	✓
Robin Freestone	442,657	11.1	1.25	✓
John Makinson	562,885	12.8	1.25	✓

Service agreements

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

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

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

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

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

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

Report on directors' remuneration continued

We summarise the service agreements that applied during 2011 and that continue to apply for 2012 as follows:

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

Retirement benefits

We describe the retirement benefits for each of the executive directors. Details of directors' pension arrangements are set out in table 2 on page 83 of this report.

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

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

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

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

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

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

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

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at 6 April 2006, was abolished by the Finance Act 2004. However the Pearson Group Pension Plan has retained its own 'cap', which will increase annually in line with the UK Government's Index of Retail Prices (All Items). The cap was £129,600 as at 6 April 2011.

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

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

Marjorie Scardino

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

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

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

Will Ethridge

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

Rona Fairhead

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

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

Report on directors' remuneration continued

Robin Freestone

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

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

John Makinson

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

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

Executive directors' non-executive directorships

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

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

	Company	Fees/benefits
Marjorie Scardino	Nokia Corporation	€150,000
	MacArthur Foundation	$28,000
Rona Fairhead	HSBC Holdings plc	£200,000

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

Chairman's remuneration

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

The committee reviewed the chairman's remuneration in 2010. In the light of this review, the board approved the committee's recommendation that the chairman's remuneration be increased to £500,000 per year with effect from 1 April 2011. The next review will take place in 2014.

Non-executive directors

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

With effect from 1 July 2010, the structure and fees are as follows:

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

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

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

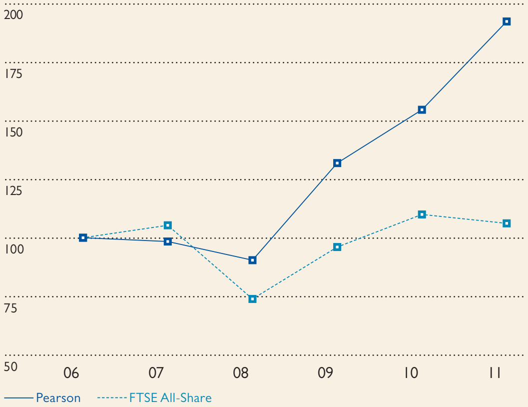
Total shareholder return performance

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

First, we set out Pearson's total shareholder return performance relative to the FTSE All-Share index on an annual basis over the five-year period 2006 to 2011.

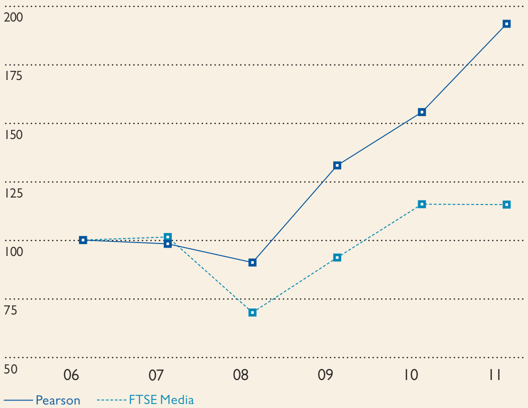
We have chosen this index, and used it consistently in each report on directors' remuneration since 2002, on the basis that it is a recognisable reference point and an appropriate comparator for the majority of our investors.

TOTAL SHAREHOLDER RETURN



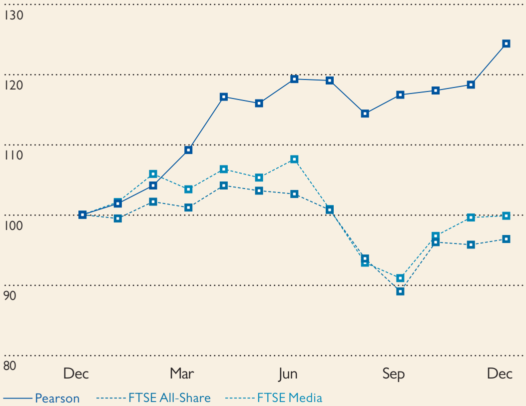
Secondly, to illustrate performance against our sector, we show Pearson's total shareholder return relative to the FTSE Media index over the same five-year period.

TOTAL SHAREHOLDER RETURN



And thirdly, we show Pearson's total shareholder return relative to the FTSE All-Share and Media indices on a monthly basis over 2011, the period to which this report relates.

TOTAL SHAREHOLDER RETURN



Report on directors' remuneration continued

Items subject to audit

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

Table 1: Remuneration of the directors

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

	2011					2010
All figures in £000s	Salaries/fees	Annual incentive	Allowances	Benefits	Total	Total
Chairman						
Glen Moreno	488	–	–	–	488	450
Executive directors						
Marjorie Scardino	993	1,353	73	36	2,455	2,662
Will Ethridge	652	738	–	–	1,390	1,671
Rona Fairhead	529	440	12	18	999	1,373
Robin Freestone	500	580	7	7	1,094	1,158
John Makinson	549	641	224	3	1,417	1,575
Non-executive directors						
David Arculus	95	–	–	–	95	90
Patrick Cescau	100	–	–	–	100	86
Susan Fuhrman	75	–	–	–	75	73
Ken Hydon	95	–	–	–	95	90
Joshua Lewis (appointed 1 March 2011)	63	–	–	–	63	–
Total	4,139	3,752	316	64	8,271	9,228
Total 2010 (including former directors)	3,989	4,928	321	48	–	9,286

Note 1 Allowances for Marjorie Scardino include £47,120 in respect of housing costs and a US payroll supplement of £12,551. John Makinson is entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US and received £210,464 for 2011.

Note 2 Benefits include company car, car allowance and UK healthcare premiums. US health and welfare benefits for Marjorie Scardino and Will Ethridge are self-insured and the company cost, after employee contributions, is tax free to employees. For Marjorie Scardino, benefits include £33,310 for pension planning and financial advice. Marjorie Scardino, Rona Fairhead and John Makinson have the use of a chauffeur.

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

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

Directors' pensions	Age at 31 Dec 11	Accrued pension at 31 Dec 11 £000[1]	Increase in accrued pension over the period £000[2]	Transfer value at 31 Dec 10 £000[3]	Transfer value at 31 Dec 11 £000[4]	Increase in transfer value over the period £000[5]	Increase/(decrease) in accrued pension over the period £000[6]	Transfer value of the increase/(decrease) in accrued pension at 31 Dec 11 £000[5/6]	Other pension costs to the company over the period £000[7]	Other allowances in lieu of pension £000[8]	Other pension related benefit costs £000[9]
Marjorie Scardino	64	4.7	0.1	47.3	49.5	2.2	(0.1)	(1.1)	7.2	644.5	56.7
Will Ethridge	59	194.4	34.4	1,418.4	2,039.3	620.9	26.4	276.9	45.6	–	1.7
Rona Fairhead	50	42.2	4.1	489.2	579.3	83.9	2.2	24.0	–	121.2	16.4
Robin Freestone	53	–	–	–	–	–	–	–	19.8	124.5	5.5
John Makinson	57	308.0	30.6	4,767.0	5,906.5	1,133.3	16.7	314.1	–	–	11.9

Note 1 The accrued pension at 31 December 2011 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2011. For Marjorie Scardino this relates to a fixed pension from the US plan. For Will Ethridge the pension quoted in this column relates to his pension from the US Plan and the US SERP. For Rona Fairhead it relates to the pension payable from the UK Plan. For John Makinson it relates to the pension from the UK Plan, the FURBS and the UURBS in aggregate. Robin Freestone does not accrue defined benefits.

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

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

Note 4 The UK transfer values at 31 December 2011 are calculated using the assumptions for cash equivalents payable from the UK Plan and are based on the accrued pension at that date. The only change in the transfer value methodology was to make an allowance for the fact that the future increases to deferred pensions will be based on the increase in the CPI as opposed to RPI. For the US SERP, transfer values are calculated using a discount rate equivalent to current US long term bond yields. The US Plan is a lump sum plan and the accrued balance is included where applicable.

Note 5 Less directors' contributions.

Note 6 Net of UK inflation (where inflation is the increase in CPI to the previous September, subject to a minimum of 0% pa and a maximum of 5% pa). The increase in the CPI in the year to September 2011 was 5.2%. As this exceeded 5%, the inflation figure used in these calculations was 5%.

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

Note 8 This column represents the cash allowances paid in lieu of the previous unfunded defined contribution plan for Marjorie Scardino and of the previous FURBS arrangements for Rona Fairhead and Robin Freestone. John Makinson's deferred FURBS entitlement is referred to in note 1 above.

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

Report on directors' remuneration continued

Table 3: Interests of directors

	Ordinary shares at 1 Jan 11	Ordinary shares at 31 Dec 11
Glen Moreno	150,000	150,000
Marjorie Scardino	1,107,118	1,346,618
David Arculus	14,053	14,798
Patrick Cescau	6,282	7,117
Will Ethridge	333,395	405,295
Rona Fairhead	342,669	425,023
Robin Freestone	193,954	308,731
Susan Fuhrman	11,363	12,927
Ken Hydon	10,715	14,028
John Makinson	551,039	438,667
Joshua Lewis (appointed 1 March 2011)	0	3,891

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

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

Note 3 The register of directors' interests (which is open to inspection during normal office hours) contains full details of directors' shareholdings and options to subscribe for shares. The market price on 31 December 2011 was 1,210.0p per share and the range during the year was 983.0p to 1,222.0p.

Note 4 At 31 December 2011, Patrick Cescau held 168,000 Pearson bonds.

Note 5 There were no movements in ordinary shares between 1 January 2012 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.

Table 4: Movements in directors' interests in restricted shares

Restricted shares designated as: a annual bonus share matching plan; b long-term incentive plan; * where shares at 31 December 2011 have vested and are held pending release; and ** where dividend-equivalent shares were added to the released shares.

Date of award	1 Jan 11	Awarded	Released	Lapsed	31 Dec 11	Market value at date of award	Earliest release date	Date of release	Market value at date of release
Marjorie Scardino									
a* 22/5/07	60,287				60,287	899.9p	22/5/10		
a* 4/6/08	99,977		99,977		0	670.7p	4/6/11	6/6/11	1,143.0p
a 21/4/10	63,497				63,497	1,024.1p	21/4/13		
a 20/4/11	0	71,446			71,446	1,129.0p	20/4/14		
a** 6/6/11	0	14,697	14,697		0	1,143.0p	6/6/11	6/6/11	1,143.0p
b* 13/10/06	93,750		93,750		0	767.5p	13/10/09	13/10/11	1,162.0p
b* 30/7/07	84,000				84,000	778.0p	2/3/10		
b* 4/3/08	390,000		292,500		97,500	649.5p	4/3/11	5/4/11	1,146.0p
b* 3/3/09	300,000			78,750	221,250	654.0p	3/3/12		
b 3/3/09	150,000				150,000	654.0p	3/3/12		
b 3/3/10	400,000				400,000	962.0p	3/3/13		
b 3/5/11	0	400,000			400,000	1,149.0p	3/5/14		
b** 5/4/11	0	45,630	45,630		0	1,146.0p	5/4/11	5/4/11	1,146.0p
b** 13/10/11	0	23,344	23,344		0	1,162.0p	13/10/11	13/10/11	1,162.0p
Total	1,641,511	555,117	569,898	78,750	1,547,980				
Will Ethridge									
a* 22/5/07	2,508				2,508	899.9p	22/5/12		
a 16/4/09	112,515				112,515	670.0p	16/4/12		
a 21/4/10	7,880				7,880	1,024.1p	21/4/13		
a 20/4/11	0	4,517			4,517	1,131.0p	20/4/14		
b* 13/10/06	41,667		41,667		0	767.5p	13/10/09	13/10/11	1,162.0p
b* 30/7/07	30,000				30,000	778.0p	2/3/10		
b* 4/3/08	146,250		109,688		36,562	649.5p	4/3/11	5/4/11	1,146.0p
b* 3/3/09	116,667			30,625	86,042	654.0p	3/3/12		
b 3/3/09	58,333				58,333	654.0p	3/3/12		
b 3/3/10	150,000				150,000	962.0p	3/3/13		
b 3/5/11	0	150,000			150,000	1,149.0p	3/5/14		
b** 5/4/11	0	17,112	17,112		0	1,146.0p	5/4/11	5/4/11	1,146.0p
b** 13/10/11	0	10,376	10,376		0	1,162.0p	13/10/11	13/10/11	1,162.0p
Total	665,820	182,005	178,843	30,625	638,357				

Report on directors' remuneration continued

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

Restricted shares designated as: a annual bonus share matching plan; b long-term incentive plan; * where shares at 31 December 2011 have vested and are held pending release; and ** where dividend-equivalent shares were added to the released shares.

Date of award	1 Jan 11	Awarded	Released	Lapsed	31 Dec 11	Market value at date of award	Earliest release date	Date of release	Market value at date of release
Rona Fairhead									
a* 12/4/06	16,101		16,101		0	776.2p	12/4/11	12/4/11	1,087.0p
a** 12/4/11	0	272	272		0	1,087.0p	12/4/11	12/4/11	1,087.0p
b* 13/10/06	29,167		29,167		0	767.5p	13/10/09	13/10/11	1,162.0p
b* 30/7/07	25,000				25,000	778.0p	2/3/10		
b* 4/3/08	121,875		91,407		30,468	649.5p	4/3/11	5/4/11	1,146.0p
b* 3/3/09	100,000			26,250	73,750	654.0p	3/3/12		
b 3/3/09	50,000				50,000	654.0p	3/3/12		
b 3/3/10	125,000				125,000	962.0p	3/3/13		
b 3/5/11	0	165,000			165,000	1,149.0p	3/5/14		
b** 5/4/11	0	14,260	14,260		0	1,146.0p	5/4/11	5/4/11	1,146.0p
b** 13/10/11	0	7,263	7,263		0	1,162.0p	13/10/11	13/10/11	1,162.0p
Total	467,143	186,795	158,470	26,250	469,218				
Robin Freestone									
a* 12/4/06	3,435		3,435		0	776.2p	12/4/11	12/4/11	1,087.0p
a* 22/5/07	4,708				4,708	899.9p	22/5/12		
a* 4/6/08	37,906		37,906		0	670.7p	4/6/11	6/6/11	1,143.0p
a 16/4/09	35,446				35,446	670.0p	16/4/12		
a 21/4/10	31,114				31,114	1,024.1p	21/4/13		
a 20/4/11	0	29,049			29,049	1,129.0p	20/4/14		
a** 12/4/11	0	58	58		0	1,087.0p	12/4/11	12/4/11	1,087.0p
a** 6/6/11	0	5,573	5,573		0	1,143.0p	6/6/11	6/6/11	1,143.0p
b* 13/10/06	26,042		26,042		0	767.5p	13/10/09	13/10/11	1,162.0p
b* 30/7/07	25,000				25,000	778.0p	2/3/10		
b* 4/3/08	121,875		91,407		30,468	649.5p	4/3/11	5/4/11	1,146.0p
b* 3/3/09	100,000			26,250	73,750	654.0p	3/3/12		
b 3/3/09	50,000				50,000	654.0p	3/3/12		
b 3/3/10	125,000				125,000	962.0p	3/3/13		
b 3/5/11	0	125,000			125,000	1,149.0p	3/5/14		
b** 5/4/11	0	14,260	14,260		0	1,146.0p	5/4/11	5/4/11	1,146.0p
b** 13/10/11	0	6,485	6,485		0	1,162.0p	13/10/11	13/10/11	1,162.0p
Total	560,526	180,425	185,166	26,250	529,535				

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

Restricted shares designated as: a annual bonus share matching plan; b long-term incentive plan; * where shares at 31 December 2011 have vested and are held pending release; and ** where dividend-equivalent shares were added to the released shares.

Date of award	1 Jan 11	Awarded	Released	Lapsed	31 Dec 11	Market value at date of award	Earliest release date	Date of release	Market value at date of release
John Makinson									
b* 13/10/06	29,167		29,167		0	767.5p	13/10/09	13/10/11	1,162.0p
b* 30/7/07	20,000				20,000	778.0p	2/3/10		
b* 4/3/08	121,875		91,407		30,468	649.5p	4/3/11	5/4/11	1,146.0p
b* 3/3/09	100,000			26,250	73,750	654.0p	3/3/12		
b 3/3/09	50,000				50,000	654.0p	3/3/12		
b 3/3/10	125,000				125,000	962.0p	3/3/13		
b 3/5/11	0	125,000			125,000	1,149.0p	3/5/14		
b** 5/4/11	0	14,260	14,260		0	1,146.0p	5/4/11	5/4/11	1,146.0p
b** 13/10/11	0	7,263	7,263		0	1,168.9p	13/10/11	13/10/11	1,162.0p
Total	446,042	146,523	142,097	26,250	424,218				
Total	3,781,042	1,250,865	1,234,474	188,125	3,609,308				

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

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

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

Note 4 In the case of the long-term incentive plan awards made on 3 March 2009, we detail separately the part of the award based on ROIC and EPS growth (two-thirds of total award) and that part based on relative TSR (one-third of total award), because vesting of that part of the awards based on TSR was not known at the date of the 2011 report.

Report on directors' remuneration continued

Table 5: Movements in directors' interests in share options

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

	Date of grant	1 Jan 11	Granted	Exercised	Lapsed	31 Dec 11	Option price	Earliest exercise date	Expiry date	Date of exercise	Price on exercise	Gain on exercise
Marjorie Scardino												
a	8/5/09	1,672				1,672	547.2p	1/8/12	1/2/13			
b*	9/5/01	41,550			41,550	0	1,421.0p	9/5/02	9/5/11			
b*	9/5/01	41,550			41,550	0	1,421.0p	9/5/03	9/5/11			
b*	9/5/01	41,550			41,550	0	1,421.0p	9/5/04	9/5/11			
b*	9/5/01	41,550			41,550	0	1,421.0p	9/5/05	9/5/11			
Total		167,872	0	0	166,200	1,672						£0
Will Ethridge												
b*	9/5/01	11,010			11,010	0	$21.00	9/5/02	9/5/11			
b*	9/5/01	11,010			11,010	0	$21.00	9/5/03	9/5/11			
b*	9/5/01	11,010			11,010	0	$21.00	9/5/04	9/5/11			
b*	9/5/01	11,010			11,010	0	$21.00	9/5/05	9/5/11			
Total		44,040	0	0	44,040	0						$0
Rona Fairhead												
a	4/5/07	2,371				2,371	690.4p	1/8/12	1/2/13			
b*	1/11/01	20,000		20,000		0	822.0p	1/11/02	1/11/11	19/9/11	1,136.0p	£62,800
b*	1/11/01	20,000		20,000		0	822.0p	1/11/03	1/11/11	19/9/11	1,136.0p	£62,800
b*	1/11/01	20,000		20.000		0	822.0p	1/11/04	1/11/11	19/9/11	1,136.0p	£62,800
Total		62,371	0	60,000	0	2,371						£188,400

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

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

Date of grant	1 Jan 10	Granted	Exercised	Lapsed	31 Dec 10	Option price	Earliest exercise date	Expiry date	Date of exercise	Price on exercise	Gain on exercise
Robin Freestone											
a 9/5/08	1,757		1,757	0	0	534.8p	1/8/11	1/2/12	1/8/11	1,180.0p	£11,336
Total	1,757	0	1,757	0	0						£11,336
John Makinson											
b* 9/5/01	19,785			19,785	0	1,421.0p	9/5/02	9/5/11			
b* 9/5/01	19,785			19,785	0	1,421.0p	9/5/03	9/5/11			
b* 9/5/01	19,785			19,785	0	1,421.0p	9/5/04	9/5/11			
b* 9/5/01	19,785			19,785	0	1,421.0p	9/5/05	9/5/11			
Total	79,140	0	0	79,140	0						£0
Total	355,180	0	61,757	289,380	4,043						£199,736

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

Note 2 Each plan is described below.

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

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

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

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

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

Note 4 The market price on 31 December 2011 was 1,210p per share and the range during the year was 983p to 1,222p.

Approved by the board and signed on its behalf by

David Arculus Director
7 March 2012

Consolidated income statement

Year ended 31 December 2011

All figures in £ millions	Notes	2011	2010
Sales	2	5,862	5,663
Cost of goods sold	4	(2,624)	(2,588)
Gross profit		3,238	3,075
Operating expenses	4	(2,457)	(2,373)
Profit on sale of associate	12	412	–
Share of results of joint ventures and associates	12	33	41
Operating profit	2	1,226	743
Finance costs	6	(97)	(109)
Finance income	6	26	36
Profit before tax		1,155	670
Income tax	7	(199)	(146)
Profit for the year from continuing operations		956	524
Profit for the year from discontinued operations	3	–	776
Profit for the year		956	1,300
Attributable to:			
Equity holders of the company		957	1,297
Non-controlling interest		(1)	3
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	119.6p	161.9p
– diluted	8	119.3p	161.5p
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	119.6p	66.0p
– diluted	8	119.3p	65.9p

Consolidated statement of comprehensive income

Year ended 31 December 2011

All figures in £ millions	Notes	2011	2010
Profit for the year		956	1,300
Net exchange differences on translation of foreign operations		(44)	173
Currency translation adjustment disposed – subsidiaries		–	13
Actuarial (losses)/gains on retirement benefit obligations – Group	25	(56)	70
Actuarial (losses)/gains on retirement benefit obligations – associate	12	(8)	1
Tax on items recognised in other comprehensive income	7	3	(41)
Other comprehensive (expense)/income for the year		(105)	216
Total comprehensive income for the year		851	1,516
Attributable to:			
Equity holders of the company		858	1,502
Non-controlling interest		(7)	14

Consolidated balance sheet
As at 31 December 2011

All figures in £ millions	Notes	2011	2010
Assets			
Non-current assets			
Property, plant and equipment	10	383	366
Intangible assets	11	6,342	5,467
Investments in joint ventures and associates	12	32	71
Deferred income tax assets	13	287	276
Financial assets – Derivative financial instruments	16	177	134
Retirement benefit assets	25	25	–
Other financial assets	15	26	58
Trade and other receivables	22	151	129
		7,423	6,501
Current assets			
Intangible assets – Pre-publication	20	650	647
Inventories	21	407	429
Trade and other receivables	22	1,386	1,337
Financial assets – Derivative financial instruments	16	–	6
Financial assets – Marketable securities	14	9	12
Cash and cash equivalents (excluding overdrafts)	17	1,369	1,736
		3,821	4,167
Total assets		11,244	10,668
Liabilities			
Non-current liabilities			
Financial liabilities – Borrowings	18	(1,964)	(1,908)
Financial liabilities – Derivative financial instruments	16	(2)	(6)
Deferred income tax liabilities	13	(620)	(471)
Retirement benefit obligations	25	(166)	(148)
Provisions for other liabilities and charges	23	(115)	(42)
Other liabilities	24	(325)	(246)
		(3,192)	(2,821)
Current liabilities			
Trade and other liabilities	24	(1,741)	(1,605)
Financial liabilities – Borrowings	18	(87)	(404)
Financial liabilities – Derivative financial instruments	16	(1)	–
Current income tax liabilities		(213)	(215)
Provisions for other liabilities and charges	23	(48)	(18)
		(2,090)	(2,242)
Total liabilities		(5,282)	(5,063)
Net assets		5,962	5,605

All figures in £ millions	Notes	2011	2010
Equity			
Share capital	27	204	203
Share premium	27	2,544	2,524
Treasury shares	28	(149)	(137)
Translation reserve		364	402
Retained earnings		2,980	2,546
Total equity attributable to equity holders of the company		5,943	5,538
Non-controlling interest		19	67
Total equity		5,962	5,605

These financial statements have been approved for issue by the board of directors on 7 March 2012 and signed on its behalf by

Robin Freestone Chief financial officer

Consolidated statement of changes in equity

Year ended 31 December 2011

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

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

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

Consolidated cash flow statement

Year ended 31 December 2011

All figures in £ millions	Notes	2011	2010
Cash flows from operating activities			
Net cash generated from operations	33	1,093	1,169
Interest paid		(70)	(78)
Tax paid		(151)	(85)
Net cash generated from operating activities		872	1,006
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	30	(779)	(535)
Acquisition of joint ventures and associates		(9)	(22)
Purchase of investments		(12)	(7)
Purchase of property, plant and equipment		(67)	(76)
Purchase of intangible assets		(77)	(56)
Disposal of subsidiaries, net of cash disposed	31	(6)	984
Proceeds from sale of associates	12	428	–
Proceeds from sale of investments		75	–
Proceeds from sale of property, plant & equipment	33	9	–
Proceeds from sale of intangible assets		3	–
Tax paid on disposal of subsidiaries		–	(250)
Interest received		10	10
Dividends received from joint ventures and associates		30	23
Net cash (used in)/received from investing activities		(395)	71
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	21	12
Purchase of treasury shares	28	(60)	(77)
Proceeds from borrowings		–	241
Liquid resources sold		2	53
Repayment of borrowings		(318)	(13)
Finance lease principal payments		(8)	(3)
Dividends paid to company's shareholders	9	(318)	(292)
Dividends paid to non-controlling interest		(1)	(6)
Transactions with non-controlling interest	32	(108)	(7)
Net cash used in financing activities		(790)	(92)
Effects of exchange rate changes on cash and cash equivalents		(60)	(1)
Net (decrease)/increase in cash and cash equivalents		(373)	984
Cash and cash equivalents at beginning of year		1,664	680
Cash and cash equivalents at end of year	17	1,291	1,664

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

Independent auditors' report to the members of Pearson plc

We have audited the consolidated and company financial statements (together the 'financial statements') of Pearson plc for the year ended 31 December 2011. The consolidated financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes to the consolidated financial statements. The company financial statements comprise the company balance sheet, the company statement of changes in equity, the company cash flow statement and the related notes to the company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

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

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report and accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- The financial statements give a true and fair view of the state of the Group's and of the company's affairs as at 31 December 2011 and of the Group's profit and Group's and company's cash flows for the year then ended;
- The consolidated financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- The company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

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

Ranjan Sriskandan (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
7 March 2012

Notes to the consolidated financial statements

General information

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 7 March 2012.

1. Accounting policies

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

a. Basis of preparation

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

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

1. Interpretations and amendments to published standards effective in 2011

The following amendments and interpretations were adopted in 2011 and have not had an impact on the Group financial statements:

- Amendments to IAS 24 'Related Parties'.
- Amendments to IAS 32 'Financial Instruments: Presentation' – Classification of Rights.
- IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments'.
- Amendments to IFRIC 14 'Prepayments of a Minimum Funding Requirement'.
- 'Improvements to IFRSs – 2010'.

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 and are evaluating the effect on the financial statements:

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

1. Accounting policies continued

a. Basis of preparation continued

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

- Amendments to IAS 19 'Employee Benefits (2011)', effective for annual reporting periods beginning on or after 1 January 2013. The amendments include the elimination of the corridor approach, changes to the calculation of the net interest component and changes to disclosure.

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

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

b. Consolidation

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

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

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

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

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

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

Notes to the consolidated financial statements continued

1. Accounting policies continued

b. Consolidation continued

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

c. Foreign currency translation

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

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

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

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

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

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

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

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.60 (2010: $1.54) and the year end rate was $1.55 (2010: $1.57).

d. Property, plant and equipment

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

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

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

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

1. Accounting policies continued

e. Intangible assets

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

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

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

IFRS 3 'Business Combinations' has not been applied retrospectively to business combinations before the date of transition to IFRS.

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

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

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

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

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 33).

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.

Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

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

f. Other financial assets

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

g. Inventories

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

h. Royalty advances

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

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

i. Newspaper development costs

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

j. Cash and cash equivalents

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

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

k. Share capital

Ordinary shares are classified as equity.

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

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

1. Accounting policies continued

l. Borrowings

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

m. Derivative financial instruments

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

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

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

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

n. Taxation

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

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

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

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

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

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

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

Notes to the consolidated financial statements continued

1. Accounting policies continued

o. Employee benefits

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

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

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

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

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

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

3. Share-based payments The fair value of options or shares granted under the Group's share and option plans is recognised as an employee expense after taking into account the Group's best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised.

p. Provisions

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

The Group recognises a provision for deferred consideration at fair value.

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

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

q. Revenue recognition

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

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

1. Accounting policies continued

q. Revenue recognition continued

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

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

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

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

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

r. Leases

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

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

s. Dividends

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

t. Non-current assets and liabilities held for sale

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

u. Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1q).

Notes to the consolidated financial statements continued

2. Segment information

The Group is organised into five business segments:

North American Education Educational publishing, assessment and testing for the school and higher education market within the USA and Canada;

International Education Educational publishing, assessment and testing for the school and higher education market outside of North America;

Professional Business and technology publishing, training, testing and certification for professional bodies;

FT Group Publisher of the *Financial Times*, business magazines and specialist information;

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

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

The results of the Interactive Data segment are shown as discontinued for the period until its disposal on 29 July 2010.

									2011
All figures in £ millions	Notes	North American Education	International Education	Professional	FT Group	Penguin	Corporate	Discontinued operations	Group
Continuing operations									
Sales (external)		2,584	1,424	382	427	1,045	–	–	5,862
Sales (inter-segment)		3	–	9	–	2	–	–	14
Adjusted operating profit		493	196	66	76	111	–	–	942
Amortisation of acquired intangibles		(57)	(60)	(11)	(8)	(3)	–	–	(139)
Acquisition costs		(2)	(9)	–	(1)	–	–	–	(12)
Other net gains and losses		29	(6)	–	412	–	–	–	435
Operating profit		463	121	55	479	108	–	–	1,226
Finance costs	6								(97)
Finance income	6								26
Profit before tax									1,155
Income tax	7								(199)
Profit for the year from continuing operations									956
Segment assets		5,198	2,388	626	424	1,021	1,555	–	11,212
Joint ventures	12	–	16	–	1	1	–	–	18
Associates	12	1	8	–	4	1	–	–	14
Total assets		5,199	2,412	626	429	1,023	1,555	–	11,244
Other segment items									
Share of results of joint ventures and associates	12	–	(2)	1	34	–	–	–	33
Capital expenditure	10, 11	75	33	17	19	12	–	–	156
Pre-publication investment	20	237	60	2	–	32	–	–	331
Depreciation	10	36	14	8	4	8	–	–	70
Amortisation	11, 20	309	128	16	20	45	–	–	518

2. Segment information continued

All figures in £ millions	Notes	North American Education	International Education	Professional	FT Group	Penguin	Corporate	Discontinued operations	Group
									2010
Continuing operations									
Sales (external)		2,640	1,234	333	403	1,053	–	–	5,663
Sales (inter-segment)		–	–	5	–	3	–	–	8
Adjusted operating profit		469	171	51	60	106	–	–	857
Amortisation of acquired intangibles		(53)	(35)	(7)	(9)	(1)	–	–	(105)
Acquisition costs		(1)	(7)	(2)	(1)	–	–	–	(11)
Other net gains and losses		–	(10)	–	12	–	–	–	2
Operating profit		415	119	42	62	105	–	–	743
Finance costs	6								(109)
Finance income	6								36
Profit before tax									670
Income tax	7								(146)
Profit for the year from continuing operations									524
Segment assets		4,401	2,122	601	447	1,138	1,888	–	10,597
Joint ventures	12	15	–	1	1	1	–	–	18
Associates	12	24	6	–	23	–	–	–	53
Total assets		4,440	2,128	602	471	1,139	1,888	–	10,668
Other segment items									
Share of results of joint ventures and associates	12	(3)	1	1	42	–	–	–	41
Capital expenditure	10, 11	45	27	16	17	18	–	21	144
Pre-publication investment	20	215	61	7	–	36	–	–	319
Depreciation	10	23	19	9	5	13	–	13	82
Amortisation	11, 20	307	111	18	23	43	–	12	514

In 2011, sales from the provision of goods were £4,054m (2010: £4,200m) and sales from the provision of services were £1,808m (2010: £1,463m). 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.

Notes to the consolidated financial statements continued

2. Segment information continued

Corporate costs are allocated to business segments on an appropriate basis depending on the nature of the cost and therefore the segment result is equal to the Group operating profit. Inter-segment pricing is determined on an arm's-length basis. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combination were £404m (2010: £311m) (see note 30). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations.

The Group operates in the following main geographic areas:

	Sales		Non-current assets	
All figures in £ millions	2011	2010	2011	2010
Continuing operations				
UK	865	790	1,237	1,031
Other European countries	471	415	225	237
USA	3,313	3,361	4,325	3,790
Canada	209	228	226	235
Asia Pacific	646	577	570	364
Other countries	358	292	325	376
Total continuing	5,862	5,663	6,908	6,033
Discontinued operations				
UK	–	31	–	–
Other European countries	–	48	–	–
USA	–	196	–	–
Canada	–	2	–	–
Asia Pacific	–	18	–	–
Other countries	–	1	–	–
Total discontinued	–	296	–	–
Total	5,862	5,959	6,908	6,033

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 in 2010 relate to the Group's interest in Interactive Data (sold on 29 July 2010).

There were no discontinued operations in 2011.

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

All figures in £ millions	2011 Interactive Data	2010 Interactive Data
Sales	–	296
Operating profit	–	73
Finance income	–	–
Profit before tax	–	73
Attributable tax expense	–	(28)
Profit after tax	–	45
Profit on disposal of discontinued operations before tax	–	1,037
Attributable tax expense	–	(306)
Profit for the year from discontinued operations	–	776
Operating cash flows	–	85
Investing cash flows	–	(35)
Financing cash flows	–	49
Total cash flows	–	99

4. Operating expenses

All figures in £ millions	2011	2010
By function:		
Cost of goods sold	2,624	2,588
Operating expenses		
Distribution costs	273	298
Administrative and other expenses	2,342	2,190
Other income	(158)	(115)
Total net operating expenses	2,457	2,373
Total	5,081	4,961

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

Notes to the consolidated financial statements continued

4. Operating expenses continued

All figures in £ millions	Notes	2011	2010
By nature:			
Utilisation of inventory	21	829	836
Depreciation of property, plant and equipment	10	70	69
Amortisation of intangible assets – Pre-publication	20	331	350
Amortisation of intangible assets – Other	11	187	152
Employee benefit expense	5	1,983	1,849
Operating lease rentals		185	166
Other property costs		50	50
Royalties expensed		500	524
Advertising, promotion and marketing		280	250
Information technology costs		77	78
Other costs		747	752
Other income		(158)	(115)
Total		5,081	4,961

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

All figures in £ millions	2011	2010
Fees payable to the company's auditors for the audit of parent company and consolidated financial statements	4	4
The audit of the company's subsidiaries pursuant to legislation	2	2
Tax services	2	2
Other services	1	2
Total	9	10

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

All figures in £ millions	2011	2010
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	6	6
Non-audit fees	3	4
Total	9	10

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Tax services include services related to tax planning and various other tax advisory matters. Other services mainly relate to due diligence on acquisitions.

5. Employee information

All figures in £ millions	Notes	2011	2010
Employee benefit expense			
Wages and salaries (including termination benefits and restructuring costs)		1,711	1,603
Social security costs		136	121
Share-based payment costs	26	40	35
Retirement benefits – defined contribution plans	25	69	66
Retirement benefits – defined benefit plans	25	24	22
Other post-retirement benefits	25	3	2
Total		1,983	1,849

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

Average number employed	2011	2010
Employee numbers		
North American Education	16,133	14,828
International Education	13,646	10,713
Professional	4,561	3,721
FT Group	2,765	2,557
Penguin	3,557	3,470
Other	859	1,028
Continuing operations	41,521	36,317

Notes to the consolidated financial statements continued

6. Net finance costs

All figures in £ millions	Notes	2011	2010
Interest payable		(66)	(82)
Net finance costs in respect of retirement benefits	25	–	(12)
Finance cost of put options and deferred consideration associated with acquisitions		(4)	–
Net foreign exchange losses		(22)	(9)
Other losses on financial instruments in a hedging relationship:			
– fair value hedges		–	–
Other losses on financial instruments not in a hedging relationship:			
– derivatives		(5)	(6)
Finance costs		(97)	(109)
Interest receivable		11	9
Net finance income in respect of retirement benefits	25	3	–
Net foreign exchange gains		11	18
Other gains on financial instruments in a hedging relationship:			
– fair value hedges		–	–
Other gains on financial instruments not in a hedging relationship:			
– amortisation of transitional adjustment on bonds		1	2
– derivatives		–	7
Finance income		26	36
Net finance costs		(71)	(73)
Analysed as:			
Net interest payable		(55)	(73)
Net finance income/(costs) in respect of retirement benefits	25	3	(12)
Net finance costs reflected in adjusted earnings – continuing operations		(52)	(85)
Other net finance (costs)/income		(19)	12
Total net finance costs		(71)	(73)

The net movement on fair value hedges of nil in both 2011 and 2010 comprises a £39m loss (2010: £40m loss) on the underlying bonds offset by a £39m gain (2010: £40m gain) on the related derivative financial instruments.

7. Income tax

All figures in £ millions	Notes	2011	2010
Current tax			
Charge in respect of current year		(205)	(82)
Adjustments in respect of prior years		43	13
Total current tax charge		(162)	(69)
Deferred tax			
In respect of temporary differences		(35)	(77)
Other adjustments in respect of prior years		(2)	–
Total deferred tax charge	13	(37)	(77)
Total tax charge		(199)	(146)

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the UK tax rate as follows:

All figures in £ millions	2011	2010
Profit before tax	1,155	670
Tax calculated at UK rate (2011: 26.5%, 2010: 28%)	(306)	(188)
Effect of overseas tax rates	(35)	(40)
Joint venture and associate income reported net of tax	9	11
Net income not subject to tax	6	8
Gain on sale of businesses not subject to tax	88	–
Utilisation of previously unrecognised tax losses and credits	1	56
Unutilised tax losses	(3)	(6)
Adjustments in respect of prior years	41	13
Total tax charge	(199)	(146)
UK	(15)	(28)
Overseas	(184)	(118)
Total tax charge	(199)	(146)
Tax rate reflected in earnings	17.2%	21.8%

A number of changes to the UK corporation tax system were announced in the June 2010 Budget Statement. The Finance (No.2) Act 2010 was enacted in July 2010 and reduced the main rate of corporation tax from 28% to 27% from 1 April 2011. The March 2011 Budget further reduced the rate of corporation tax from 1 April 2011 to 26% and this was substantially enacted at the end of March 2011. The Finance (No. 3) Act 2011 was enacted in July 2011 and reduces the main rate of corporation tax to 25% from 1 April 2012. The reduction in the rate of corporation tax to 25% did not result in a significant movement in the net deferred tax asset owing to the size of the net deferred tax asset in the UK.

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	2011	2010
Profit before tax	1,155	670
Adjustments:		
Other net gains	(435)	(2)
Acquisition costs	12	11
Amortisation of acquired intangibles	139	105
Other net finance costs/(income)	19	(12)
Adjusted profit before tax – continuing operations	890	772
Adjusted profit before tax – discontinued operations	–	81
Total adjusted profit before tax	890	853
Total tax charge	(199)	(146)
Adjustments:		
Tax charge/(benefit) on other net gains	19	(1)
Tax benefit on acquisition costs	(4)	(4)
Tax benefit on amortisation of acquired intangibles	(44)	(35)
Tax (benefit)/charge on other net finance income	(5)	3
Tax amortisation benefit on goodwill and intangibles	34	36
Recognition of pre-acquisition tax losses and capital losses	–	(37)
Adjusted income tax charge – continuing operations	(199)	(184)
Adjusted income tax charge – discontinued operations	–	(31)
Total adjusted income tax charge	(199)	(215)
Tax rate reflected in adjusted earnings	22.4%	25.2%

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

All figures in £ millions	2011	2010
Pension contributions and actuarial gains and losses	7	(42)
Net investment hedges and other foreign exchange gains and losses	(4)	1
	3	(41)

A tax benefit of £3m (2010: tax benefit £4m) 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	2011	2010
Profit for the year from continuing operations		956	524
Non-controlling interest		1	5
Earnings from continuing operations		957	529
Profit for the year from discontinued operations	3	–	776
Non-controlling interest		–	(8)
Earnings		957	1,297
Weighted average number of shares (millions)		800.2	801.2
Effect of dilutive share options (millions)		1.7	1.8
Weighted average number of shares (millions) for diluted earnings		801.9	803.0
Earnings per share from continuing and discontinued operations			
Basic		119.6p	161.9p
Diluted		119.3p	161.5p
Earnings per share from continuing operations			
Basic		119.6p	66.0p
Diluted		119.3p	65.9p
Earnings per share from discontinued operations			
Basic		–	95.9p

Adjusted

In order to show results from operating activities on a consistent basis, an adjusted earnings per share is presented. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

The following items are excluded from adjusted earnings:

Other net gains and losses represent profits and losses on the acquisition and disposal of subsidiaries, joint ventures, associates and other financial assets that are included within continuing or discontinued operations but which distort the performance of the Group.

Amortisation of acquired intangibles, acquisition costs and movements in contingent acquisition consideration are also excluded from adjusted earnings as these items are not considered to be fully reflective of the underlying performance of the Group.

Notes to the consolidated financial statements continued

8. Earnings per share continued

Other net finance income/costs include the finance costs of put options and deferred consideration that relate to future earn outs and similar payments on acquisition, foreign exchange and other gains and losses that represent short-term fluctuations in market value and foreign exchange movements on transactions and balances that are no longer in a hedge relationship. In the case of acquisition related items these are excluded as they do not reflect cash expended and foreign exchange and other gains and losses are subject to significant volatility and may not be realised in due course as it is normally the intention to hold these instruments to maturity. Other net finance costs of Group companies are included in finance costs or finance income as appropriate. Other net finance costs of joint ventures and associates are included within the share of results of joint ventures and associates within operating profit.

Tax on the above items is excluded from adjusted earnings. Where relevant the Group also excludes the benefit from recognising previously unrecognised pre-acquisition and capital losses. The Group adds the benefit of tax amortisation of goodwill and intangibles as this benefit more accurately aligns the adjusted tax charge with the expected medium-term rate of cash tax payments.

Non-controlling interest for the above items is excluded from adjusted earnings.

The following tables reconcile statutory earnings to adjusted earnings.

									2011
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Tax loss recognition	Adjusted income statement
Operating profit	1,226	–	(435)	12	139	–	–	–	942
Net finance costs	(71)	–	–	–	–	19	–	–	(52)
Profit before tax	1,155	–	(435)	12	139	19	–	–	890
Income tax	(199)	–	19	(4)	(44)	(5)	34	–	(199)
Profit for the year	956	–	(416)	8	95	14	34	–	691
Non-controlling interest	1	–	–	–	–	–	–	–	1
Earnings	957	–	(416)	8	95	14	34	–	692
Weighted average number of shares (millions)	800.2								800.2
Adjusted earnings per share	119.6p								86.5p

8. Earnings per share continued

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Tax loss recognition	Adjusted income statement
									2010
Operating profit	743	81	(2)	11	105	–	–	–	938
Net finance costs	(73)	–	–	–	–	(12)	–	–	(85)
Profit before tax	670	81	(2)	11	105	(12)	–	–	853
Income tax	(146)	(31)	(1)	(4)	(35)	3	36	(37)	(215)
Profit for the year from continuing operations	524	50	(3)	7	70	(9)	36	(37)	638
Profit for the year from discontinued operations	776	(50)	(731)	–	5	–	–	–	–
Profit for the year	1,300	–	(734)	7	75	(9)	36	(37)	638
Non-controlling interest	(3)	–	(12)	–	(2)	–	–	–	(17)
Earnings	1,297	–	(746)	7	73	(9)	36	(37)	621
Weighted average number of shares (millions)	801.2								801.2
Adjusted earnings per share	161.9p								77.5p

9. Dividends

All figures in £ millions	2011	2010
Final paid in respect of prior year 25.7p (2010: 23.3p)	206	187
Interim paid in respect of current year 14.0p (2010: 13.0p)	112	105
	318	292

The directors are proposing a final dividend in respect of the financial year ended 31 December 2011 of 28.0p per share which will absorb an estimated £225m of shareholders' funds. It will be paid on 4 May 2012 to shareholders who are on the register of members on 10 April 2012. These financial statements do not reflect this dividend.

Notes to the consolidated financial statements continued

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2010	348	815	7	1,170
Exchange differences	8	28	–	36
Additions	21	55	12	88
Disposals	(4)	(58)	–	(62)
Acquisition through business combination	8	25	–	33
Disposal through business disposal	(48)	(201)	–	(249)
Reclassifications	3	5	(8)	–
At 31 December 2010	336	669	11	1,016
Exchange differences	2	(2)	–	–
Additions	15	51	13	79
Disposals	(13)	(31)	–	(44)
Acquisition through business combination	11	21	–	32
Disposal through business disposal	–	(2)	–	(2)
Reclassifications	12	–	(12)	–
At 31 December 2011	363	706	12	1,081

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2010	(174)	(608)	–	(782)
Exchange differences	(4)	(19)	–	(23)
Charge for the year	(16)	(66)	–	(82)
Disposals	3	58	–	61
Acquisition through business combination	(3)	(13)	–	(16)
Disposal through business disposal	28	164	–	192
At 31 December 2010	(166)	(484)	–	(650)
Exchange differences	(1)	1	–	–
Charge for the year	(16)	(54)	–	(70)
Disposals	2	29	–	31
Acquisition through business combination	(1)	(10)	–	(11)
Disposal through business disposal	–	2	–	2
Reclassifications	(5)	5	–	–
At 31 December 2011	(187)	(511)	–	(698)
Carrying amounts				
At 1 January 2010	174	207	7	388
At 31 December 2010	170	185	11	366
At 31 December 2011	176	195	12	383

10. Property, plant and equipment continued

Depreciation expense of £15m (2010: £10m) has been included in the income statement in cost of goods sold, £10m (2010: £7m) in distribution expenses and £45m (2010: £52m) in administrative and other expenses. In 2011 £nil (2010: £13m) 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 £18m (2010: £12m).

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2010	4,346	339	347	143	215	261	5,651
Exchange differences	140	9	10	4	9	10	182
Additions – internal development	–	41	–	–	–	–	41
Additions – purchased	–	15	–	–	–	–	15
Disposals	(11)	(18)	–	–	–	–	(29)
Acquisition through business combination	288	9	159	40	6	76	578
Disposal through business disposal	(195)	(43)	(85)	(1)	–	(41)	(365)
At 31 December 2010	4,568	352	431	186	230	306	6,073
Exchange differences	15	(1)	1	(1)	(12)	(1)	1
Additions – internal development	–	49	–	–	–	–	49
Additions – purchased	–	28	–	–	–	–	28
Disposals	–	(9)	–	–	–	–	(9)
Acquisition through business combination	620	9	200	68	–	100	997
Disposal through business disposal	(4)	–	–	–	(5)	–	(9)
At 31 December 2011	5,199	428	632	253	213	405	7,130

Notes to the consolidated financial statements continued

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2010		(224)	(96)	(27)	(85)	(90)	(522)
Exchange differences	–	(5)	(3)	(2)	(2)	(1)	(13)
Charge for the year	–	(51)	(39)	(12)	(24)	(38)	(164)
Disposals	–	16	–	–	–	–	16
Acquisition through business combination	–	(5)	–	–	–	–	(5)
Disposal through business disposal	–	19	35	–	–	28	82
At 31 December 2010	–	(250)	(103)	(41)	(111)	(101)	(606)
Exchange differences	–	(2)	1	–	4	(3)	–
Charge for the year	–	(48)	(55)	(22)	(22)	(40)	(187)
Disposals	–	6	–	–	–	–	6
Acquisition through business combination	–	(2)	–	–	–	–	(2)
Disposal through business disposal	–	–	–	–	1	–	1
At 31 December 2011	–	(296)	(157)	(63)	(128)	(144)	(788)
Carrying amounts							
At 1 January 2010	4,346	115	251	116	130	171	5,129
At 31 December 2010	4,568	102	328	145	119	205	5,467
At 31 December 2011	5,199	132	475	190	85	261	6,342

Goodwill

The goodwill carrying value of £5,199m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. £3,138m of the carrying value relates to acquisitions completed between 1 January 1998 and 31 December 2002 and £2,061m relates to acquisitions completed after 1 January 2003 (the date of transition to IFRS).

For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

Other intangible assets

Other intangibles acquired include content, technology, contracts and software rights.

Amortisation of £10m (2010: £3m) is included in the income statement in cost of goods sold and £177m (2010: £149m) in administrative and other expenses. In 2011 £nil (2010: £12m) of amortisation relates to discontinued operations.

11. Intangible assets continued

Impairment tests for cash-generating units containing goodwill

Impairment tests have been carried out where appropriate as described below. The recoverable amount for each unit tested exceeds its carrying value.

Goodwill in respect of continuing operations is allocated to 13 cash-generating units (CGUs) within the business segments as follows:

All figures in £ millions	2011	2010
US Education Publishing	2,127	1,976
US School Assessment and Information	792	683
Canada	192	197
International – Emerging Markets	508	310
International – UK	460	398
International – Rest Of World	228	205
Professional Publishing	13	13
Professional Assessment and Training	377	287
Pearson Education total	4,697	4,069
Financial Times	49	48
Mergermarket	138	136
FT Group total	187	184
Penguin US	198	196
Penguin UK	102	103
Penguin Asia Pacific & International	15	16
Penguin total	315	315
Total goodwill	5,199	4,568

Following a reorganisation within the International Education business the CGUs have been re-analysed into Emerging Markets, UK and Rest Of World to align with the management and reporting structure. The goodwill has been reallocated accordingly.

The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

Key assumptions

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five-year period. The key assumptions used by management in the value in use calculations were:

Discount rate The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates used are in the range of 10.7% to 13.3% for the Pearson Education businesses (2010: 11.2% to 12.1%), 11.6% to 17.9% for the FT Group businesses (2010: 12.9% to 20.0%) and 10.7% to 12.5% for the Penguin businesses (2010: 10.5% to 13.0%).

Notes to the consolidated financial statements continued

11. Intangible assets continued

Impairment tests for cash-generating units containing goodwill continued

Perpetuity growth rates A perpetuity growth rate of 2.0% was used for cash flows subsequent to the approved budget period for all CGUs in 2011 (2010: 2.0%). This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates.

Cash flow growth rates The cash flow growth rates are derived from management's latest forecast of sales taking into consideration experience of operating margins achieved in the CGU. Historically, such forecasts have been reasonably accurate.

Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group's sensitivity analysis, a reasonably possible change in any of these assumptions is unlikely to cause an impairment in any of the CGUs.

12. Investments in joint ventures and associates

Joint ventures

All figures in £ millions	2011	2010
At beginning of year	18	18
Exchange differences	(3)	–
Share of loss after tax	(2)	(1)
Dividends	(2)	(3)
Additions and further investment	7	4
At end of year	18	18

Investments in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost. The total goodwill recorded on acquisition of joint ventures at 31 December 2011 was £11m (2010: £12m).

12. Investments in joint ventures and associates continued

The aggregate of the Group's share of its joint ventures' assets (including goodwill) and liabilities, none of which are individually significant, are as follows:

All figures in £ millions	2011	2010
Assets		
Non-current assets	15	15
Current assets	17	14
Liabilities		
Non-current liabilities	(1)	–
Current liabilities	(13)	(11)
Net assets	18	18
Income	22	17
Expenses	(24)	(18)
Loss after tax	(2)	(1)

Associates

All figures in £ millions	2011	2010
At beginning of year	53	12
Exchange differences	(3)	(1)
Share of profit after tax	35	42
Dividends	(30)	(20)
Additions	2	17
Disposals	(15)	–
Reversal of distribution from associate in excess of carrying value	–	(7)
Actuarial (losses)/gains on retirement benefit obligations	(8)	1
Transfer from other financial assets	–	9
Transfer to subsidiary	(20)	–
At end of year	14	53

In addition to the amounts disclosed above, FTSE International Ltd paid royalties of £13m (2010: £11m) to the FT Group during the year. This royalty payment ceased upon the disposal of FTSE International Ltd.

Included in the share of profit after tax in 2010 is a gain in fair value of £12m arising on a stepped acquisition by FTSE International Ltd.

Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The total goodwill recorded on acquisition of associates at 31 December 2011 was £nil (2010: £21m).

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

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

* FTSE International Ltd included to date of disposal

Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

All figures in £ millions	Country of incorporation	% interest held	Assets	Liabilities	Revenues	Profit
						2010
The Economist Newspaper Ltd	England	50	129	(129)	169	25
FTSE International Ltd	England	50	62	(44)	45	17
Other			41	(6)	9	–
Total			232	(179)	223	42

The interests held in associates are equivalent to voting rights.

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

Gain on sale of FTSE International Ltd

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

13. Deferred income tax

All figures in £ millions	2011	2010
Deferred income tax assets	287	276
Deferred income tax liabilities	(620)	(471)
Net deferred income tax	(333)	(195)

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

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The Group has unrecognised deferred income tax assets of £13m at 31 December 2011(2010: £14m) in respect of UK losses, and approximately £15m (2010: £16m) in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

All figures in £ millions	Notes	2011	2010
At beginning of year		(195)	(86)
Exchange differences		(5)	(4)
Income statement charge	7	(37)	(72)
Acquisition through business combination	30	(96)	(37)
Disposal through business disposal	31	1	47
Tax charge to other comprehensive income or equity		(1)	(43)
At end of year		(333)	(195)

Included in the income statement charge above for 2010 is a £5m credit relating to discontinued operations.

13. Deferred income tax continued

The movement in deferred income tax assets and liabilities during the year is as follows:

All figures in £ millions	Trading losses	Goodwill and intangibles	Returns provisions	Retirement benefit obligations	Other	Total
Deferred income tax assets						
At 1 January 2010	22	11	92	68	194	387
Exchange differences	1	–	3	–	5	9
Acquisition through business combination	–	–	–	–	4	4
Disposal through business disposal	–	–	–	–	(7)	(7)
Income statement (charge)/benefit	(18)	(7)	1	(9)	(35)	(68)
Tax (charge)/benefit to other comprehensive income or equity	–	–	–	(53)	4	(49)
At 31 December 2010	5	4	96	6	165	276
Exchange differences	–	–	1	–	2	3
Acquisition through business combination	8	–	–	–	1	9
Income statement benefit/ (charge)	1	(4)	(8)	19	(6)	2
Tax (charge)/benefit to other comprehensive income or equity	–	–	–	(6)	3	(3)
At 31 December 2011	14	–	89	19	165	287

Other deferred income tax assets include temporary differences on share-based payments, inventory and other provisions.

All figures in £ millions	Goodwill and intangibles	Other	Total
Deferred income tax liabilities			
At 1 January 2010	(319)	(154)	(473)
Exchange differences	(9)	(4)	(13)
Acquisition through business combination	(41)	–	(41)
Disposal through business disposal	25	29	54
Income statement benefit/(charge)	10	(14)	(4)
Tax benefit to other comprehensive income or equity	–	6	6
At 31 December 2010	(334)	(137)	(471)
Exchange differences	(6)	(2)	(8)
Acquisition through business combination	(102)	(3)	(105)
Disposal through business disposal	–	1	1
Income statement charge	(22)	(17)	(39)
Tax benefit to other comprehensive income or equity	–	2	2
At 31 December 2011	(464)	(156)	(620)

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

Notes to the consolidated financial statements continued

14. Classification of financial instruments

The accounting classification of each class of the Group's financial assets and financial liabilities, together with their fair values, is as follows:

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

14. Classification of financial instruments continued

All figures in £ millions	Notes	Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Fair value: Other liabilities	Amortised cost: Loans and receivables	Amortised cost: Other liabilities	Total carrying value	Total market value
									2010
Investments in unlisted securities	15	58	–	–	–	–	–	58	58
Cash and cash equivalents	17	–	–	–	–	1,736	–	1,736	1,736
Marketable securities		12	–	–	–	–	–	12	12
Derivative financial instruments	16	–	8	132	–	–	–	140	140
Trade receivables	22	–	–	–	–	1,031	–	1,031	1,031
Total financial assets		70	8	132	–	2,767	–	2,977	2,977
Derivative financial instruments	16	–	–	(6)	–	–	–	(6)	(6)
Trade payables	24	–	–	–	–	–	(470)	(470)	(470)
Other financial liabilities – put option over non-controlling interest	24	–	–	–	(25)	–	–	(25)	(25)
Bank loans and overdrafts	18	–	–	–	–	–	(73)	(73)	(73)
Borrowings due within one year	18	–	–	–	–	–	(331)	(331)	(333)
Borrowings due after more than one year	18	–	–	–	–	–	(1,908)	(1,908)	(1,939)
Total financial liabilities		–	–	(6)	(25)	–	(2,782)	(2,813)	(2,846)

Certain of the Group's derivative financial instruments are classified as held for trading either as they do not meet the hedge accounting criteria specified in IAS 39 'Financial Instruments: Recognition and Measurement' or the Group has chosen not to seek hedge accounting for these instruments. None of these derivatives are held for speculative trading purposes. Transactions in derivative financial instruments are only undertaken to manage risks arising from underlying business activity, in accordance with the Group's treasury policy as described in note 19.

The Group designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The Group also designates certain of its borrowings and derivative financial instruments as hedges of its investments in foreign operations (net investment hedges). Movements in the fair value of these financial instruments (to the extent they are effective) are recognised in other comprehensive income.

None of the Group's financial assets or liabilities are designated at fair value through the income statement upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies. The Group's approach to managing risks in relation to financial instruments is described in note 19.

Notes to the consolidated financial statements continued

15. Other financial assets

All figures in £ millions	2011	2010
At beginning of year	58	62
Exchange differences	–	1
Acquisition of investments	12	7
Transfers to associates	–	(9)
Disposal of investments	(44)	(3)
At end of year	26	58

Other financial assets comprise non-current unlisted securities.

16. Derivative financial instruments

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

	2011			2010		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,208	151	–	1,327	112	–
Interest rate derivatives – not in a hedge relationship	65	3	(1)	256	8	–
Cross currency rate derivatives – in a net investment hedge relationship	220	23	(2)	220	20	(6)
Total	1,493	177	(3)	1,803	140	(6)
Analysed as expiring:						
In less than one year	–	–	(1)	319	6	–
Later than one year and not later than five years	946	81	(2)	749	74	(6)
Later than five years	547	96	–	735	60	–
Total	1,493	177	(3)	1,803	140	(6)

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 2011, 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 £(66)m, sterling £263m and South African rand £(23)m (2010: US dollar £(97)m, sterling £259m and South African rand £(28)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2011 range from 3.65% to 9.28% (2010: 3.65% to 9.28%) and the floating rates are based on LIBOR in US dollar and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

16. Derivative financial instruments continued

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2011	2010
Cash at bank and in hand	864	763
Short-term bank deposits	505	973
	1,369	1,736

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

At the end of 2011 the currency split of cash and cash equivalents was US dollar 31% (2010: 73%), sterling 38% (2010: 9%), euro 8% (2010: 6%) and other 23% (2010: 12%).

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	2011	2010
Cash and cash equivalents	1,369	1,736
Bank overdrafts	(78)	(72)
	1,291	1,664

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	2011	2010
Non-current		
5.5% Global Dollar Bonds 2013 (nominal amount $350m)	233	236
5.7% US Dollar Bonds 2014 (nominal amount $400m)	286	288
7.0% Sterling Bonds 2014 (nominal amount £250m)	257	256
6.0% Sterling Bonds 2015 (nominal amount £300m)	298	297
4.0% US Dollar Notes 2016 (nominal amount $350m)	238	227
6.25% Global Dollar Bonds 2018 (nominal amount $550m)	419	389
4.625% US Dollar Notes 2018 (nominal amount $300m)	224	208
Finance lease liabilities	9	7
	1,964	1,908
Current		
Due within one year or on demand:		
Bank loans and overdrafts	78	73
7.0% Global Dollar Bonds 2011 (nominal amount $500m)	–	325
Finance lease liabilities	9	6
	87	404
Total borrowings	2,051	2,312

Included in the non-current borrowings above is £12m of accrued interest (2010: £12m). Included in the current borrowings above is £nil of accrued interest (2010: £1m).

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

All figures in £ millions	2011	2010
Between one and two years	241	4
Between two and five years	1,080	1,080
Over five years	643	824
	1,964	1,908

18. Financial liabilities – Borrowings continued

The carrying amounts and market values of borrowings are as follows:

All figures in £ millions	Effective interest rate 2011	Carrying value 2011	Market value 2011	Carrying value 2010	Market value 2010
Bank loans and overdrafts	n/a	78	78	73	73
7.0% Global Dollar Bonds 2011	n/a	–	–	325	327
5.5% Global Dollar Bonds 2013	5.76%	233	237	236	241
5.7% US Dollar Bonds 2014	5.88%	286	280	288	277
7.0% Sterling Bonds 2014	7.20%	257	282	256	282
6.0% Sterling Bonds 2015	6.27%	298	340	297	329
4.0% US Dollar Notes 2016	4.26%	238	237	227	226
6.25% Global Dollar Bonds 2018	6.46%	419	409	389	385
4.625% US Dollar Notes 2018	4.69%	224	206	208	192
Finance lease liabilities	n/a	18	18	13	13
		2,051	2,087	2,312	2,345

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	2011	2010
US dollar	1,488	1,759
Sterling	563	553
Euro	–	–
	2,051	2,312

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

All figures in £ millions	2011	2010
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,126	1,118
	1,126	1,118

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.

Notes to the consolidated financial statements continued

18. Financial liabilities – Borrowings continued

The maturity of the Group's finance lease obligations is as follows:

All figures in £ millions	2011	2010
Finance lease liabilities – minimum lease payments		
Not later than one year	9	6
Later than one year and not later than two years	8	4
Later than two years and not later than three years	1	3
Later than three years and not later than four years	–	–
Later than four years and not later than five years	–	–
Later than five years	–	–
Future finance charges on finance leases	–	–
Present value of finance lease liabilities	18	13

The present value of finance lease liabilities is as follows:

All figures in £ millions	2011	2010
Not later than one year	9	6
Later than one year and not later than five years	9	7
Later than five years	–	–
	18	13

The carrying amounts of the Group's lease obligations approximate their fair value.

19. Financial risk management

The Group's approach to the management of financial risks together with sensitivity analyses of its financial instruments is set out below.

Treasury policy

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. The Group borrows principally in US dollars and sterling, at both floating and fixed rates of interest, using derivative financial instruments ('derivatives'), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised below. All the treasury policies remained unchanged throughout, except for a revision to the Group's bank counterparty limits.

The audit committee receives reports on the Group's treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.

19. Financial risk management continued

Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39 'Financial Instruments: Recognition and Measurement') to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2011 the fixed to floating hedging ratio, on the above basis, was approximately 104%. This above-policy level reflects the receipt of the proceeds from the divestment of FTSE International Ltd in December 2011, combined with strong cash collections, resulting in lower than typical net debt and hence a higher hedging ratio. Our policy does not require us to cancel derivative contracts and we expect to return to compliance with this policy during 2012. A simultaneous 1% change on 1 January 2012 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £1m effect on profit before tax.

Use of interest rate derivatives

The policy described in the section above creates a group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a second group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates. The Group's accounting objective in its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces sharply the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

Liquidity and refinancing risk management

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2011 the average maturity of gross borrowings was 4.0 years (2010: 4.4 years) of which bonds represented 95% (2010: 96%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of the Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2011 the committed facilities amounted to £1,126m and their weighted average maturity was 3.9 years.

Notes to the consolidated financial statements continued

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	2011	2010
Cash and cash equivalents	1,369	1,736
Marketable securities	9	12
Derivative financial instruments	174	134
Bank loans, overdrafts and loan notes	(78)	(73)
Bonds	(1,955)	(2,226)
Finance lease liabilities	(18)	(13)
Net debt	(499)	(430)

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

All figures in £ millions	2011	2010
Fixed rate	510	577
Floating rate	(11)	(147)
Total	499	430

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

All figures in £ millions	2011	2010
US dollar	1,687	1,954
Sterling	343	333
Other	21	25
Total	2,051	2,312

As at 31 December 2011 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	87	1,321	643	2,051
Effect of rate derivatives	1,273	(726)	(547)	–
Total	1,360	595	96	2,051

19. Financial risk management continued

The maturity of contracted cash flows associated with the Group's financial liabilities are as follows:

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

				2010
All figures in £ millions	USD	GBP	Other	Total
Not later than one year	571	117	160	848
Later than one year and not later than five years	767	399	32	1,198
Later than five years	792	–	–	792
Total	2,130	516	192	2,838
Analysed as:				
Bonds	1,938	710	–	2,648
Rate derivatives – inflows	(364)	(297)	–	(661)
Rate derivatives – outflows	340	7	34	381
Trade creditors	216	96	158	470
Total	2,130	516	192	2,838

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the Group net settles these amounts wherever possible.

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover our total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

Notes to the consolidated financial statements continued

19. Financial risk management continued

Foreign currency risk management

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. Our policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross currency swaps) were: US dollar £1,266m, sterling £(185)m and South African rand £(1)m.

Use of currency debt and currency derivatives

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

Financial instruments – fair value measurement

The following table provides an analysis of those financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

19. Financial risk management continued

Financial instruments – fair value measurement continued

All figures in £ millions	2011 Level 1	2011 Level 2	2011 Level 3	2011 Total	2010 Level 1	2010 Level 2	2010 Level 3	2010 Total
Financial assets at fair value								
Derivative financial assets	–	177	–	177	–	140	–	140
Marketable securities	–	9	–	9	–	12	–	12
Available for sale financial assets								
Investments in unlisted securities	–	–	26	26	–	–	58	58
Financial liabilities at fair value								
Derivative financial liabilities	–	(3)	–	(3)	–	(6)	–	(6)
Other financial liabilities – put options over non-controlling interest	–	–	(86)	(86)	–	–	(25)	(25)
Total	–	183	(60)	123	–	146	33	179

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

All figures in £ millions	2011 Investments in unlisted securities	2011 Other financial liabilities	2010 Investments in unlisted securities	2010 Other financial liabilities
At beginning of year	58	(25)	62	(23)
Exchange differences	–	3	1	–
Additions	13	(63)	7	(2)
Fair value movements	–	(1)	–	–
Disposals	(45)	–	(12)	–
At end of year	26	(86)	58	(25)

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets. The fair value of other financial liabilities represents the present value of the estimated future liability.

Financial instruments – sensitivity analysis

As at 31 December 2011 the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in unlisted securities	26	–	–	1	(1)
Cash and cash equivalents	1,369	–	–	(78)	96
Marketable securities	9	–	–	–	–
Derivative financial instruments	174	(53)	56	8	(10)
Bonds	(1,955)	52	(53)	127	(156)
Other borrowings	(96)	–	–	8	(10)
Put options over non-controlling interest	(86)	–	–	8	(10)
Other net financial assets	578	–	–	(43)	53
Total financial instruments	19	(1)	3	31	(38)

Notes to the consolidated financial statements continued

19. Financial risk management continued

Financial instruments – sensitivity analysis continued

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. The class 'Other net financial assets' comprises trade assets less trade liabilities.

The sensitivities of derivative instruments are calculated using established estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%. A large proportion of the movements shown above would impact equity rather than the income statement, depending on the location and functional currency of the entity in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

20. Intangible assets – Pre-publication

All figures in £ millions	2011	2010
Cost		
At beginning of year	1,863	1,727
Exchange differences	6	52
Additions	331	319
Disposals	(249)	(248)
Acquisition through business combination	14	13
At end of year	1,965	1,863
Amortisation		
At beginning of year	(1,216)	(1,077)
Exchange differences	(11)	(33)
Charge for the year	(331)	(350)
Disposals	249	248
Acquisition through business combination	(6)	(4)
At end of year	(1,315)	(1,216)
Carrying amounts		
At end of year	650	647

Included in the above are pre-publication assets amounting to £413m (2010: £399m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold.

21. Inventories

All figures in £ millions	2011	2010
Raw materials	24	34
Work in progress	20	19
Finished goods	363	376
	407	429

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 £829m (2010: £836m). In 2011 £74m (2010: £87m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

22. Trade and other receivables

All figures in £ millions	2011	2010
Current		
Trade receivables	1,048	1,028
Royalty advances	107	111
Prepayments and accrued income	90	77
Other receivables	141	121
	1,386	1,337
Non-current		
Trade receivables	13	3
Royalty advances	88	89
Prepayments and accrued income	34	28
Other receivables	16	9
	151	129

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	2011	2010
At beginning of year	(83)	(76)
Exchange differences	1	(2)
Income statement movements	(31)	(33)
Utilised	17	26
Acquisition through business combination	(8)	(3)
Disposal through business disposal	2	5
At end of year	(102)	(83)

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

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

All figures in £ millions	2011	2010
Within due date	1,097	1,180
Up to three months past due date	297	234
Three to six months past due date	46	39
Six to nine months past due date	10	6
Nine to 12 months past due date	14	13
More than 12 months past due date	50	21
Total trade receivables	1,514	1,493
Less: provision for bad and doubtful debts	(102)	(83)
Less: provision for sales returns	(351)	(379)
Net trade receivables	1,061	1,031

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historic payment profiles. Management believe all the remaining receivable balances are fully recoverable.

Notes to the consolidated financial statements continued

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Legal and other	Total
At 1 January 2011	29	20	11	60
Exchange differences	–	–	1	1
Charged to income statement	1	2	32	35
Released to income statement	–	(3)	–	(3)
Acquisition through business combination – current year	69	–	9	78
Utilised	(2)	(2)	(4)	(8)
At 31 December 2011	97	17	49	163

All figures in £ millions	2011	2010
Analysis of provisions		
Non-current	115	42
Current	48	18
	163	60

Deferred consideration primarily relates to the acquisition of Fronter in 2009 and the formation of a venture in the US Professional business in 2011 for which deferred consideration of £66m is recognised.

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

24. Trade and other liabilities

All figures in £ millions	2011	2010
Trade payables	483	470
Social security and other taxes	25	22
Accruals	544	559
Deferred income	678	559
Interest payable	18	12
Put options over non-controlling interest	86	25
Other liabilities	232	204
	2,066	1,851
Less: non-current portion		
Accruals	25	26
Deferred income	147	120
Put options over non-controlling interest	62	25
Interest payable	6	–
Other liabilities	85	75
	325	246
Current portion	1,741	1,605

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

24. Trade and other liabilities continued

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

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

25. Retirement benefit and other post-retirement obligations

Background

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world. For the defined benefit plans, benefits are based on employees' length of service and final pensionable pay. Defined contribution benefits are based on the amount of contributions paid in respect of an individual member, the investment returns earned and the amount of pension this money will buy when a member retires.

The largest plan is the Pearson Group Pension Plan ('UK Group plan') with both defined benefit and defined contribution sections. From 1 November 2006, all sections of the UK Group plan were closed to new members with the exception of a defined contribution section that was opened in 2003. This section is available to all new employees of participating companies. The other major defined benefit plans are based in the US.

Other defined contribution plans are operated principally overseas with the largest plan being in the US. The specific features of these plans vary in accordance with the regulations of the country in which employees are located.

Pearson also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

			2011			2010
%	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.0	2.5	2.5	3.5	2.5	2.5
Rate used to discount plan liabilities	4.9	4.2	4.2	5.5	5.1	5.1
Expected return on assets	5.7	6.4	–	6.0	6.6	–
Expected rate of increase in salaries	4.0	4.0	–	4.7	4.0	–
Expected rate of increase for pensions in payment and deferred pensions	2.4 to 4.3	–	–	2.6 to 4.4	–	–
Initial rate of increase in healthcare rate	–	–	7.5	–	–	8.0
Ultimate rate of increase in healthcare rate	–	–	5.0	–	–	5.0

The UK discount rate is based on the annualised yield on the iBoxx over 15-year AA-rated corporate bond index, adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The 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 change from RPI to CPI for deferred revaluation and Post 88 GMP pension increases in payment for 2010 has been included in the prior year results, resulting in a gain of £23m, taken as an actuarial gain on the obligation.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

The expected rates of return on categories of plan assets are determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio, plus a diversification premium.

The expected rate of increase in salaries has been set at 4.0% for 2011 with a short-term assumption of 3.3% for three years.

For the UK plan the mortality base table assumptions have been derived from the SAPS 'all pensioners' tables for males and the SAPS 'normal health pensioners' tables for females, adjusted to reflect the observed experience of the plan, with medium cohort improvement factors. A 1.5% improvement floor on the medium cohort is applied for males, and 1.25% for females, with tapering.

For the US plans the RP2000 table is used, reflecting the mortality assumption most prevalent in the US. In 2010 a 10 year projection was added.

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows:

	UK		US	
	2011	2010	2011	2010
Male	22.6	22.8	19.2	18.4
Female	23.5	23.6	21.1	20.6

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

	UK		US	
	2011	2010	2011	2010
Male	25.2	25.4	19.2	18.4
Female	25.6	25.7	21.1	20.6

Financial statement information

The amounts recognised in the income statement are as follows:

						2011
All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	21	3	24	69	3	96
Total operating expense	21	3	24	69	3	96
Expected return on plan assets	(107)	(7)	(114)	–	–	(114)
Interest on plan liabilities	100	8	108	–	3	111
Net finance (income)/expense	(7)	1	(6)	–	3	(3)
Net income statement charge	14	4	18	69	6	93
Actual return on plan assets	161	5	166	–	–	166

25. Retirement benefit and other post-retirement obligations continued

All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
						2010
Current service cost	21	2	23	68	2	93
Curtailments	(5)	–	(5)	–	–	(5)
Total operating expense	16	2	18	68	2	88
Expected return on plan assets	(93)	(7)	(100)	–	–	(100)
Interest on plan liabilities	100	9	109	–	3	112
Net finance expense	7	2	9	–	3	12
Net income statement charge	23	4	27	68	5	100
Actual return on plan assets	177	13	190	–	–	190

There are no amounts in the 2011 results relating to discontinued operations.

Included within the 2010 results are discontinued operations of £5m relating to the curtailment credit, a £1m charge relating to defined benefit schemes and a £2m charge relating to defined contribution schemes.

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
				2011				2010
Fair value of plan assets	2,008	149	–	2,157	1,847	135	–	1,982
Present value of defined benefit obligation	(1,983)	(173)	(24)	(2,180)	(1,852)	(158)	(20)	(2,030)
Net pension asset/(liability)	25	(24)	(24)	(23)	(5)	(23)	(20)	(48)
Other post-retirement medical benefit obligation				(85)				(72)
Other pension accruals				(33)				(28)
Net retirement benefit obligations				(141)				(148)
Analysed as:								
Retirement benefit assets				25				–
Retirement benefit obligations				(166)				(148)

The following (losses)/gains have been recognised in other comprehensive income:

All figures in £ millions	2011	2010
Amounts recognised for defined benefit plans	(47)	75
Amounts recognised for post-retirement medical benefit plans	(9)	(5)
Total recognised in year	(56)	70
Cumulative amounts recognised	(232)	(176)

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

The fair value of plan assets comprises the following:

%	2011 UK Group plan	2011 Other funded plans	2011 Total	2010 UK Group plan	2010 Other funded plans	2010 Total
Equities	31.6	2.7	34.3	27.0	3.3	30.3
Bonds	44.7	3.4	48.1	49.3	2.7	52.0
Properties	11.1	0.1	11.2	11.2	0.1	11.3
Other	5.6	0.8	6.4	5.6	0.8	6.4

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

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

All figures in £ millions	2011 UK Group plan	2011 Other plans	2011 Total	2010 UK Group plan	2010 Other plans	2010 Total
Fair value of plan assets						
Opening fair value of plan assets	1,847	135	1,982	1,609	118	1,727
Exchange differences	–	1	1	–	4	4
Expected return on plan assets	107	7	114	93	7	100
Actuarial gains/(losses)	54	(2)	52	84	6	90
Contributions by employer	71	18	89	132	13	145
Contributions by employee	3	–	3	3	–	3
Benefits paid	(74)	(10)	(84)	(74)	(13)	(87)
Closing fair value of plan assets	2,008	149	2,157	1,847	135	1,982
Present value of defined benefit obligation						
Opening defined benefit obligation	(1,852)	(178)	(2,030)	(1,798)	(169)	(1,967)
Exchange differences	–	–	–	–	(5)	(5)
Current service cost	(21)	(3)	(24)	(21)	(2)	(23)
Curtailment	–	–	–	5	–	5
Interest cost	(100)	(8)	(108)	(100)	(9)	(109)
Actuarial losses	(81)	(18)	(99)	(9)	(6)	(15)
Contributions by employee	(3)	–	(3)	(3)	–	(3)
Benefits paid	74	10	84	74	13	87
Closing defined benefit obligation	(1,983)	(197)	(2,180)	(1,852)	(178)	(2,030)

25. Retirement benefit and other post-retirement obligations continued

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

All figures in £ millions	2011	2010
Opening defined benefit obligation	(72)	(65)
Exchange differences	(2)	(2)
Current service cost	(3)	(2)
Interest cost	(3)	(3)
Actuarial losses	(9)	(5)
Benefits paid	4	5
Closing defined benefit obligation	(85)	(72)

The history of the defined benefit plans is as follows:

All figures in £ millions	2011	2010	2009	2008	2007
Fair value of plan assets	2,157	1,982	1,727	1,578	1,853
Present value of defined benefit obligation	(2,180)	(2,030)	(1,967)	(1,594)	(1,811)
Net pension (liability)/asset	(23)	(48)	(240)	(16)	42
Experience adjustments on plan assets	52	90	56	(268)	29
Experience adjustments on plan liabilities	(99)	(15)	(351)	194	50

Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group. The trustees of the plan are required to act in the best interest of the plan's beneficiaries. The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2009 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by 31 December 2020. In 2011 the Group contributed £48m (2010: £41m) towards the funding shortfall and has agreed to contribute a similar amount per annum until 2020 in excess of regular contributions. Regular contributions to the plan are estimated to be £22m for 2012.

Under UK law (section 75 debt) a company that participates in a multi-employer defined benefit plan is liable, on withdrawal from that pension plan, for its share of the total deficit in the plan calculated on a 'solvency' or 'buy out' basis. The Interactive Data sale and the termination of Interactive Data Corporation (Europe) Ltd's participation in the UK Group plan triggered this 'section 75' liability. £68m was contributed to the plan in respect of this liability in 2010.

The Group expects to contribute $83m in 2012 and $86m in 2013 to its US pension plans.

Future benefit payments

The following table shows the expected benefit payments from the defined benefit plans over the next 10 years. These use actuarial assumptions as at 31 December 2011. These represent payments from the pension funds to pensioners and others entitled to benefits, and are not an indication of payments from the company. For company funding requirements refer to the prior section.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

All figures in £ millions	UK Group plan	Defined benefit other	Total
Expected future benefit payments:			
2012	74	24	98
2013	76	23	99
2014	79	24	103
2015	82	21	103
2016	86	18	104
2017 to 2021 combined	479	80	559

Sensitivities

The net retirement benefit obligations are calculated using a number of assumptions, the most significant being the discount rate used to calculate the defined benefit obligation. The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows:

	2011	
All figures in £ millions	1% increase	1% decrease
Effect on:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(282.0)	348.5
Decrease of aggregate of service cost and interest cost – UK Group plan	(0.7)	(1.2)
(Decrease)/increase in defined benefit obligation – US plan	(11.7)	14.0

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

	2011	
All figures in £ millions	1 year increase	1 year decrease
Effect on:		
Increase/(decrease) in defined benefit obligation – UK Group plan	53.6	(52.1)
Increase/(decrease) in defined benefit obligation – US plan	1.9	(2.0)

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

	2011	
All figures in £ millions	1% increase	1% decrease
Effect on:		
Increase/(decrease) in post-retirement medical benefit obligation	3.2	(2.8)
Increase/(decrease) of aggregate of service cost and interest cost	0.1	(0.1)

26. Share-based payments

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

All figures in £ millions	2011	2010
Pearson plans	40	35

Share-based payments included in discontinued operations amounted to £nil (2010: £4m).

The Group operates the following equity-settled employee option and share plans:

Worldwide Save for Shares Plan Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

Employee Stock Purchase Plan In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six month periods. At the end of the period, the employee has the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

Long-Term Incentive Plan This plan was first introduced in 2001, renewed in 2006 and again in 2011. The plan consists of two parts: share options and/or restricted shares.

Options were last granted under this plan in 2001 based on a pre-grant earnings per share growth test and were not subject to further performance conditions on exercise. The options became exercisable in tranches and lapsed if they remained unexercised at the tenth anniversary of the date of grant. Any outstanding options remaining lapsed during 2011.

The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in March 2010 and May 2011 vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2010 and 2011 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.

In addition to the above, share options under Executive Share Option, Reward and Special Share Option Plans, legacy plans which were replaced with the introduction of the Long-Term Incentive Plan in 2001, lapsed during 2011.

Notes to the consolidated financial statements continued

26. Share-based payments continued

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

	2011		2010	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	8,878	10.20	12,487	12.78
Granted during the year	1,157	8.92	628	8.06
Exercised during the year	(2,323)	7.27	(1,154)	7.12
Forfeited during the year	(457)	8.54	(457)	9.08
Expired during the year	(4,052)	14.12	(2,626)	23.47
Outstanding at end of year	3,203	7.15	8,878	10.20
Options exercisable at end of year	64	5.54	5,825	12.40

Options were exercised regularly throughout the year. The weighted average share price during the year was £11.14 (2010: £9.63). 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:

	2011		2010	
Range of exercise prices £	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	–	–	38	0.65
5 – 10	3,203	2.51	4,757	1.86
10 – 15	–	–	4,083	0.36
15 – 20	–	–	–	–
20 – 25	–	–	–	–
>25	–	–	–	–
	3,203	2.51	8,878	1.17

In 2011 and 2010 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.

26. Share-based payments continued

The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

	2011 Weighted average	2010 Weighted average
Fair value	£2.97	£2.14
Weighted average share price	£11.47	£9.48
Weighted average exercise price	£8.92	£8.06
Expected volatility	27.50%	28.28%
Expected life	4.0 years	4.0 years
Risk free rate	1.91%	2.24%
Expected dividend yield	3.37%	3.75%
Forfeiture rate	3.5%	3.5%

The expected volatility is based on the historic volatility of the company's share price over the previous three to seven years depending on the vesting term of the options.

The following shares were granted under restricted share arrangements:

	2011		2010	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	4,854	10.44	4,742	9.45
Annual Bonus Share Matching Plan	285	11.29	266	10.25

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Participants under both plans are entitled to dividends during the vesting period and therefore the share price is not discounted.

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions are taken into consideration by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

Notes to the consolidated financial statements continued

27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2010	810,799	203	2,512
Issue of ordinary shares – share option schemes	1,878	–	12
At 31 December 2010	812,677	203	2,524
Issue of ordinary shares – share option schemes	2,949	1	20
At 31 December 2011	815,626	204	2,544

The ordinary shares have a par value of 25p per share (2010: 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		Interactive Data		Total
	Number of shares 000s	£m	Number of shares 000s	£m	£m
At 1 January 2010	9,665	96	10,485	130	226
Purchase of treasury shares	8,000	77	–	–	77
Release/cancellation of treasury shares	(3,656)	(36)	(10,485)	(130)	(166)
At 31 December 2010	14,009	137	–	–	137
Purchase of treasury shares	5,387	60	–	–	60
Release of treasury shares	(4,731)	(48)	–	–	(48)
At 31 December 2011	14,665	149	–	–	149

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.8% (2010: 1.7%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £3.7m (2010: £3.5m).

At 31 December 2011 the market value of Pearson plc treasury shares was £177.4m (2010: £141.2m).

29. Other comprehensive income

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

All figures in £ millions	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
					2010
	Attributable to equity holders of the Company				
Net exchange differences on translation of foreign operations	162	–	162	11	173
Currency translation adjustment disposed – subsidiaries	13	–	13	–	13
Actuarial gains on retirement benefit obligations – Group	–	70	70	–	70
Actuarial gains on retirement benefit obligations – associate	–	1	1	–	1
Tax on items recognised in other comprehensive income	–	(41)	(41)	–	(41)
Total other comprehensive income for the year	175	30	205	11	216

30. Business combinations

On 31 May 2011 the North American Education business acquired Schoolnet, a leading provider of data-driven education software for students and teachers. On 10 June 2011, the International Education business completed the acquisition of EDI plc, a UK listed education services company operating primarily in the work based learning sector. On 1 November 2011 the North American Education business acquired Connections Education, a company that operates online or virtual public schools in the US and on 19 December 2011 the International Education business acquired Global Education and Technology Group, a leading provider of test preparation services for students in China who are learning English. The Group acquired a 100% interest in all the investments noted above.

Also in the year to 31 December 2011, the Group completed the acquisitions of CTI Education in South Africa, Tutorvista in India, Stark Holding in Germany, TQ in the UK and various other smaller acquisitions.

Notes to the consolidated financial statements continued

30. Business combinations continued

Provisional values for the assets and liabilities arising from these and other acquisitions completed in the year together with adjustments to prior year acquisitions are as follows:

All figures in £ millions	Notes	Schoolnet fair value	EDI fair value	Connections fair value	Global Education fair value	Other fair value	2011 Total fair value	2010 Total fair value
Property, plant and equipment	10	1	4	4	9	3	21	17
Intangible assets	11	56	57	141	1	120	375	285
Intangible assets – Pre-publication	20	–	–	9	–	(1)	8	9
Inventories		–	–	–	–	2	2	2
Trade and other receivables		4	14	22	4	14	58	41
Cash and cash equivalents		2	10	8	90	41	151	26
Financial liabilities – Borrowings		–	–	–	–	(9)	(9)	(13)
Net deferred income tax liabilities	13	(15)	(13)	(51)	–	(17)	(96)	(37)
Retirement benefit obligations		–	(1)	–	–	(3)	(4)	(1)
Provisions for other liabilities and charges	23	–	–	–	–	(78)	(78)	(10)
Trade and other liabilities		(8)	(16)	(13)	(21)	(57)	(115)	(37)
Current income tax liabilities		–	–	–	–	(2)	(2)	(3)
Non-controlling interest		–	–	–	–	(1)	(1)	(39)
Net assets acquired at fair value		40	55	120	83	12	310	240
Goodwill	11	102	60	130	103	225	620	288
Fair value of previously held interest arising on stepped acquisition		–	–	–	–	(15)	(15)	–
Total		142	115	250	186	222	915	528
Satisfied by:								
Cash		(142)	(115)	(250)	(186)	(220)	(913)	(530)
Deferred consideration		–	–	–	–	–	–	(8)
Net prior year adjustments		–	–	–	–	(2)	(2)	10
Total consideration		(142)	(115)	(250)	(186)	(222)	(915)	(528)

The goodwill arising on these acquisitions results from substantial cost and revenue synergies and from benefits that cannot be separately recognised, such as the assembled workforce.

The fair value of trade and other receivables is £58m and includes trade receivables with a fair value of £47m. The gross contractual amount for trade receivables due is £55m of which £8m is expected to be uncollectable.

A provisional value of £1m of goodwill arising on 2011 acquisitions is expected to be deductible for tax purposes (2010: £12m).

30. Business combinations continued

All figures in £ millions	2011	2010
Cash flow on acquisitions		
Cash – Current year acquisitions	(913)	(530)
Deferred payments for prior year acquisitions and other items	(5)	(20)
Cash and cash equivalents acquired	151	26
Acquisition costs paid	(12)	(11)
Net cash outflow	(779)	(535)

Acquisitions in 2011 contributed £129m to sales and £9m to operating profit before acquisition costs and amortisation of acquired intangibles from the date of acquisition to the balance sheet date. Of these amounts, Schoolnet contributed £15m of sales and a loss of £2m, EDI contributed £17m of sales and £5m of profit and Connections contributed £24m of sales and £6m of profit. As Global Education was acquired late in December 2011 it did not contribute a significant amount of sales or profit in 2011.

If the acquisitions had completed on 1 January 2011, the Group estimates that sales for the period would have been £6,042m and profit before tax would have been £1,163m.

Notes to the consolidated financial statements continued

31. Disposals

All figures in £ millions	Notes	2011 Total	2010 Total
Disposal of subsidiaries			
Property, plant and equipment	10	–	(57)
Intangible assets	11	(4)	(88)
Other financial assets		–	(3)
Inventories		(7)	–
Trade and other receivables		(5)	(103)
Cash and cash equivalents		(6)	(165)
Net deferred income tax liabilities	13	1	47
Retirement benefit obligations		1	8
Trade and other liabilities		2	132
Current income tax liabilities		1	12
Non-controlling interest		7	271
Attributable goodwill	11	(4)	(195)
Cumulative translation adjustment		–	(13)
Net assets disposed		(14)	(154)
Cash received		–	1,234
Costs		–	(43)
(Loss)/profit on sale		(14)	1,037

All figures in £ millions	2011	2010
Cash flow from disposals		
Cash – Current year disposals	–	1,234
Cash and cash equivalents disposed	(6)	(165)
Costs paid	–	(32)
Pension contribution paid on disposal	–	(53)
Net cash (outflow)/inflow	(6)	984

The disposal in 2011 relates to Longman Nigeria and in 2010 to Interactive Data. Further details of the Interactive Data disposal are shown in note 3.

32. Transactions with non-controlling interest

In 2011 the remaining non-controlling interest in Sistema Educacional Brasileiro was acquired for £108m. In 2010 the transactions with non-controlling interests (£7m) comprise the acquisition of the remaining non-controlling interest in our Italian Education business and the receipt of proceeds from shares issued to employees of Interactive Data.

33. Cash generated from operations

All figures in £ millions	Notes	2011	2010
Profit		956	1,300
Adjustments for:			
Income tax		199	480
Depreciation	10	70	82
Amortisation of acquired intangible assets	11	139	113
Amortisation of other intangible assets	11	48	51
Loss on sale of property, plant and equipment		–	3
Net finance costs	6	71	73
Share of results of joint ventures and associates	12	(33)	(41)
Profit on disposal of discontinued operations	3	–	(1,037)
(Profit)/loss on disposals		(435)	10
Acquisition costs		12	11
Net foreign exchange adjustment from transactions		24	(3)
Share-based payment costs	26	40	39
Pre-publication		2	29
Inventories		15	37
Trade and other receivables		(9)	(82)
Trade and other liabilities		31	165
Retirement benefit obligations		(65)	(64)
Provisions for other liabilities and charges		28	3
Net cash generated from operations		1,093	1,169
Dividends from joint ventures and associates		30	23
Purchase of property, plant and equipment		(67)	(76)
Purchase of intangible assets		(77)	(56)
Proceeds from sale of property, plant and equipment		9	–
Proceeds from sale of intangible assets		3	–
Finance lease principal payments		(8)	(3)
Operating cash flow		983	1,057
Operating tax paid		(151)	(85)
Net operating finance costs paid		(60)	(68)
Free cash flow		772	904
Dividends paid (including to non-controlling interests)		(319)	(298)
Net movement of funds from operations		453	606
Acquisitions and disposals (net of tax)		(420)	150
Purchase of treasury shares		(60)	(77)
New equity		21	12
Other movements on financial instruments		(8)	2
Net movement of funds		(14)	693
Exchange movements on net debt		(55)	(31)
Total movement in net debt		(69)	662

Notes to the consolidated financial statements continued

33. 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	2011	2010
Net book amount	9	3
Loss on sale of property, plant and equipment	–	(3)
Proceeds from sale of property, plant and equipment	9	–

The principal other non-cash transactions are movements in finance lease obligations of £10m (2010: £2m).

34. 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.

During the year various government bodies in the US and Europe have been in the process of investigating Penguin and other major publishers over the agency arrangements for selling e-books. These investigations are ongoing and Penguin is cooperating fully with these inquiries. At the same time beginning in August 2011, Penguin and various other book publishers and book retailers have been sued in a number of private consumer class action law suits in the US which allege violation of the anti-trust and unfair competition laws by the defendants in connection with the adoption of the agency selling model for e-books. The complaints in those suits generally seek treble damages, injunctive relief and attorneys' fees. Penguin is defending itself in those actions and believes that it was fully compliant with all applicable laws.

35. Commitments

There were no commitments for capital expenditure contracted for at the balance sheet date but not yet incurred.

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. The lease expenditure charged to the income statement during the year is disclosed in note 4.

The future aggregate minimum lease payments in respect of operating leases are as follows:

All figures in £ millions	2011	2010
Not later than one year	179	164
Later than one year and not later than two years	164	151
Later than two years and not later than three years	149	130
Later than three years and not later than four years	134	112
Later than four years and not later than five years	119	95
Later than five years	980	785
	1,725	1,437

36. Related party transactions

Joint ventures and associates

Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. There are no material amounts falling due from joint ventures and associates. In December 2011, the Group disposed of its 50% interest in FTSE International Ltd and details of this transaction are also shown in note 12.

Key management personnel

Key management personnel are deemed to be the members of the board of directors of Pearson plc. It is this board which has responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the directors' remuneration report.

There were no other material related party transactions.

No guarantees have been provided to related parties.

37. Events after the balance sheet date

There were no significant post balance sheet events.

Company balance sheet
As at 31 December 2011

All figures in £ millions	Notes	2011	2010
Assets			
Non-current assets			
Investments in subsidiaries	2	9,056	9,180
Amounts due from subsidiaries		318	323
Financial assets – Derivative financial instruments	6	177	134
		9,551	9,637
Current assets			
Amounts due from subsidiaries		2,944	1,602
Prepayments		4	8
Financial assets – Derivative financial instruments	6	–	6
Current income tax assets		–	9
Cash and cash equivalents (excluding overdrafts)	4	469	944
		3,417	2,569
Total assets		12,968	12,206
Liabilities			
Non-current liabilities			
Amounts due to subsidiaries		(1,370)	(2,752)
Financial liabilities – Borrowings	5	(481)	(464)
Financial liabilities – Derivative financial instruments	6	(2)	(6)
		(1,853)	(3,222)
Current liabilities			
Amounts due to subsidiaries		(5,850)	(4,306)
Current income tax liabilities		(10)	–
Financial liabilities – Borrowings	5	(703)	(859)
Financial liabilities – Derivative financial instruments	6	(1)	–
		(6,564)	(5,165)
Total liabilities		(8,417)	(8,387)
Net assets		4,551	3,819
Equity			
Share capital	7	204	203
Share premium	7	2,544	2,524
Treasury shares	8	(94)	(82)
Special reserve		447	447
Retained earnings		1,450	727
Total equity attributable to equity holders of the company		4,551	3,819

These financial statements have been approved for issue by the board of directors on 7 March 2012 and signed on its behalf by

Robin Freestone Chief financial officer
7 March 2012

Company statement of changes in equity
Year ended 31 December 2011

All figures in £ millions	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
	Equity attributable to equity holders of the company					
At 1 January 2011	203	2,524	(82)	447	727	3,819
Profit for the year	–	–	–	–	1,089	1,089
Issue of ordinary shares under share option schemes	1	20	–	–	–	21
Purchase of treasury shares	–	–	(60)	–	–	(60)
Release of treasury shares	–	–	48	–	(48)	–
Dividends	–	–	–	–	(318)	(318)
At 31 December 2011	204	2,544	(94)	447	1,450	4,551

All figures in £ millions	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
	Equity attributable to equity holders of the company					
At 1 January 2010	203	2,512	(47)	447	766	3,881
Profit for the year	–	–	–	–	289	289
Issue of ordinary shares under share option schemes	–	12	–	–	–	12
Net purchase of treasury shares	–	–	(71)	–	–	(71)
Release of treasury shares	–	–	36	–	(36)	–
Dividends	–	–	–	–	(292)	(292)
At 31 December 2010	203	2,524	(82)	447	727	3,819

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 (2010: £131m) relating to profit on intra-group disposals that is not distributable.

Company cash flow statement

Year ended 31 December 2011

All figures in £ millions	Notes	2011	2010
Cash flows from operating activities			
Net profit		1,089	289
Adjustments for:			
Income tax		(39)	(40)
Net finance costs		85	115
Amounts due (to)/from subsidiaries		(917)	873
Net cash generated from operations		218	1,237
Interest paid		(112)	(156)
Tax received		57	50
Net cash generated from operating activities		163	1,131
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired		(114)	(93)
Interest received		–	1
Net cash used in investing activities		(114)	(92)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	7	21	12
Net purchase of treasury shares		(60)	(71)
Repayment of borrowings		(307)	–
Dividends paid to company's shareholders		(318)	(292)
Net cash used in financing activities		(664)	(351)
Effects of exchange rate changes on cash and cash equivalents		(29)	17
Net (decrease)/increase in cash and cash equivalents		(644)	705
Cash and cash equivalents at beginning of year		410	(295)
Cash and cash equivalents at end of year	4	(234)	410

Notes to the company financial statements

1. Accounting policies

The financial statements on pages 158 to 166 comprise the separate financial statements of Pearson plc. As permitted by section 408 of the Companies Act 2006, only the consolidated income statement and statement of comprehensive income has been presented.

The company has no employees.

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the consolidated financial statements with the addition of the following:

Investments

Investments in subsidiaries are stated at cost less provision for impairment, with the exception of certain hedged investments that are held in a foreign currency and revalued at each balance sheet date.

2. Investments in subsidiaries

All figures in £ millions	2011	2010
At beginning of year	9,180	8,547
Subscription for share capital in subsidiaries	279	1,884
Disposals/liquidations	(413)	(1,291)
Currency revaluations	10	40
At end of year	9,056	9,180

3. Financial risk management

The company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments and current and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. The company's approach to the management of financial risks is consistent with the Group's treasury policy, as discussed in note 19 to the consolidated financial statements. The company believes the value of its financial assets to be fully recoverable.

The company designates certain of its qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in a £40m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £41m 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 £122m, while a 10% decrease in the value of sterling would increase the carrying value by £149m. 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:

				2011
All figures in £ millions	USD	GBP	Other	Total
Not later than one year	(24)	3	2	(19)
Later than one year and not later than five years	128	24	25	177
Later than five years	176	–	–	176
Total	280	27	27	334
Analysed as:				
Bonds	251	303	–	554
Rate derivatives – inflows	(292)	(281)	–	(573)
Rate derivatives – outflows	321	5	27	353
Total	280	27	27	334

				2010
All figures in £ millions	USD	GBP	Other	Total
Not later than one year	297	3	3	303
Later than one year and not later than five years	109	27	32	168
Later than five years	158	–	–	158
Total	564	30	35	629
Analysed as:				
Bonds	589	320	–	909
Rate derivatives – inflows	(364)	(297)	–	(661)
Rate derivatives – outflows	339	7	35	381
Total	564	30	35	629

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	2011	2010
Cash at bank and in hand	–	2
Short-term bank deposits	469	942
	469	944

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

At the end of 2011 the currency split of cash and cash equivalents was US dollar 2% (2010: 86%), sterling 98% (2010: 13%) and Hong Kong dollar 0% (2010: 1%).

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	2011	2010
Cash and cash equivalents	469	944
Bank overdrafts	(703)	(534)
	(234)	410

5. Financial liabilities – Borrowings

All figures in £ millions	2011	2010
Non-current		
7.0% Sterling Bonds 2014 (nominal amount £250m)	257	256
4.625% US Dollar notes 2018 (nominal amount $300m)	224	208
	481	464
Current		
Due within one year or on demand:		
Bank loans and overdrafts	703	534
7.0% Global Dollar Bonds 2011 (nominal amount $500m)	–	325
	703	859
Total borrowings	1,184	1,323

Included in the non-current borrowings above is £4m of accrued interest (2010: £4m).

Included in the current borrowings above is £nil of accrued interest (2010: £1m).

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	2011	2010
Between one and two years	–	–
Between two and five years	257	256
Over five years	224	208
	481	464

As at 31 December 2011 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows:

All figures in £ millions	One year	One to five years	More than five years	Total
Re-pricing profile of borrowings	703	257	224	1,184
Amounts due to subsidiaries	5,850	825	545	7,220
Effect of rate derivatives	1,273	(726)	(547)	–
	7,826	356	222	8,404

The carrying amounts and market values of borrowings are as follows:

		2011		2010	
All figures in £ millions	Effective interest rate	Carrying amount	Market value	Carrying amount	Market value
Bank loans and overdrafts	n/a	703	703	534	534
7.0% Global Dollar Bonds 2011	n/a	–	–	325	327
7.0% Sterling Bonds 2014	7.20%	257	282	256	282
4.625% US Dollar notes 2018	4.69%	224	206	208	192
		1,184	1,191	1,323	1,335

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	2011	2010
US dollar	373	579
Sterling	802	736
Euro	9	8
	1,184	1,323

6. Derivative financial instruments

The company's outstanding derivative financial instruments are as follows:

All figures in £ millions	2011 Gross notional amounts	2011 Assets	2011 Liabilities	2010 Gross notional amounts	2010 Assets	2010 Liabilities
Interest rate derivatives – in a fair value hedge relationship	243	35	–	369	24	–
Interest rate derivatives – not in a hedge relationship	1,030	119	–	1,214	96	–
Cross currency derivatives	220	23	(3)	220	20	(6)
Total	1,493	177	(3)	1,803	140	(6)
Analysed as expiring:						
In less than one year	–	–	(1)	319	6	–
Later than one year and not later than five years	946	81	(2)	749	74	(6)
Later than five years	547	96	–	735	60	–
Total	1,493	177	(3)	1,803	140	(6)

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

7. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2010	810,799	203	2,512
Issue of shares – share option schemes	1,878	–	12
At 31 December 2010	812,677	203	2,524
Issue of shares – share option schemes	2,949	1	20
At 31 December 2011	815,626	204	2,544

The ordinary shares have a par value of 25p per share (2010: 25p per share). All issued shares are fully paid. All shares have the same rights.

Notes to the company financial statements continued

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2010	9,665	47
Purchase of treasury shares	8,000	77
Contribution from subsidiaries	–	(6)
Release of treasury shares	(3,656)	(36)
At 31 December 2010	14,009	82
Purchase of treasury shares	5,387	60
Contribution from subsidiaries	–	–
Release of treasury shares	(4,731)	(48)
At 31 December 2011	14,665	94

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £3.7m (2010: £3.5m). At 31 December 2011 the market value of the company's treasury shares was £177.4m (2010: £141.2m).

9. Contingencies

There are contingent liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries. In addition there are contingent liabilities in respect of legal claims. None of these claims are expected to result in a material gain or loss to the company.

10. Audit fees

Statutory audit fees relating to the company were £35,000 (2010: £35,000).

11. Related party transactions

Subsidiaries

The company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the company balance sheet.

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £176m (2010: £209m) and interest receivable from subsidiaries for the year of £54m (2010: £56m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £17m (2010: £33m). Dividends received from subsidiaries were £1,471m (2010: £1,695m).

Key management personnel

Key management personnel are deemed to be the members of the board of directors of the company. It is this board which has responsibility for planning, directing and controlling the activities of the company. Key management personnel compensation is disclosed in the report on directors' remuneration in the consolidated financial statements.

There were no other material related party transactions.

Principal subsidiaries

The principal operating subsidiaries at 31 December 2011 are listed below. They operate mainly in the countries of incorporation or registration. The investments are in equity share capital and they are all 100% owned.

	Country of incorporation or registration
Pearson Education	
Pearson Education Inc.	US
Pearson Education Ltd	England
Edexcel Ltd*	England
NCS Pearson Inc.	US
FT Group	
The Financial Times Ltd	England
Mergermarket Ltd	England
The Penguin Group	
Penguin Group (USA) Inc.	US
The Penguin Publishing Co Ltd	England
Dorling Kindersley Holdings Ltd*	England

* Direct investment of Pearson plc.

The company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements. A complete list of subsidiary and associated undertakings will be included in the next Pearson plc annual return filed with the Registrar of Companies.

Five year summary

All figures in £ millions	2007	2008	2009	2010	2011
Sales					
North American Education	1,667	2,002	2,470	2,640	2,584
International Education	735	866	1,035	1,234	1,424
Professional	226	244	275	333	382
Education	2,628	3,112	3,780	4,207	4,390
FT Group	344	390	358	403	427
Penguin	846	903	1,002	1,053	1,045
Continuing	3,818	4,405	5,140	5,663	5,862
Discontinued	511	414	484	296	–
Total sales	4,329	4,819	5,624	5,959	5,862
Adjusted operating profit					
North American Education	273	303	403	469	493
International Education	92	135	141	171	196
Professional	27	36	43	51	66
Education	392	474	587	691	755
FT Group	56	74	39	60	76
Penguin	74	93	84	106	111
Continuing	522	641	710	857	942
Discontinued	112	121	148	81	–
Total adjusted operating profit	634	762	858	938	942
Operating margin – continuing	13.7%	14.6%	13.8%	15.1%	16.1%
Adjusted earnings					
Total adjusted operating profit	634	762	858	938	942
Net finance costs	(85)	(88)	(97)	(85)	(52)
Income tax	(145)	(178)	(194)	(215)	(199)
Non-controlling interest	(32)	(36)	(44)	(17)	1
Adjusted earnings	372	460	523	621	692
Weighted average number of shares (millions)	796.8	797.0	799.3	801.2	800.2
Adjusted earnings per share	46.7p	57.7p	65.4p	77.5p	86.5p

All figures in £ millions	2007	2008	2009	2010	2011
Cash flow					
Operating cash flow	684	796	913	1,057	983
Operating cash conversion	108%	104%	106%	113%	104%
Operating free cash flow	533	631	723	904	772
Operating free cash flow per share	66.9p	79.2p	90.5p	112.8p	96.5p
Total free cash flow	407	631	723	904	772
Total free cash flow per share	51.1p	79.2p	90.5p	112.8p	96.5p
Net assets	3,874	5,024	4,636	5,605	5,962
Net debt	973	1,460	1,092	430	499
Return on invested capital (gross basis)					
Total adjusted operating profit	634	762	858	938	942
Cash tax paid	(61)	(89)	(103)	(85)	(151)
Return	573	673	755	853	791
Average invested capital	6,423	7,337	8,504	8,315	8,731
Return on invested capital	8.9%	9.2%	8.9%	10.3%	9.1%
Dividend per share	31.6p	33.8p	35.5p	38.7p	42.0p

Corporate and operating measures

Sales – underlying and constant exchange rate movement

Sales movement for continuing operations excluding the impact of acquisitions and disposals and movements in exchange rates.

All figures in £ millions	2011
Underlying increase	59
Portfolio changes	262
Exchange differences	(122)
Total sales increase	199
Underlying increase	1%
Constant exchange rate increase	6%

Adjusted income statement

Reconciliation of the consolidated income statement to the adjusted numbers presented as non-GAAP measures in the financial statements.

					2011				
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Tax loss recognition	Adjusted income statement
Operating profit	1,226	–	(435)	12	139	–	–	–	942
Net finance costs	(71)	–	–	–	–	19	–	–	(52)
Profit before tax	1,155	–	(435)	12	139	19	–	–	890
Income tax	(199)	–	19	(4)	(44)	(5)	34	–	(199)
Profit for the year	956	–	(416)	8	95	14	34	–	691
Non-controlling interest	1	–	–	–	–	–	–	–	1
Earnings	957	–	(416)	8	95	14	34	–	692

Adjusted income statement continued

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Tax loss recognition	Adjusted income statement
									2010
Operating profit	743	81	(2)	11	105	–	–	–	938
Net finance costs	(73)	–	–	–	–	(12)	–	–	(85)
Profit before tax	670	81	(2)	11	105	(12)	–	–	853
Income tax	(146)	(31)	(1)	(4)	(35)	3	36	(37)	(215)
Profit for the year from continuing operations	524	50	(3)	7	70	(9)	36	(37)	638
Profit for the year from discontinued operations	776	(50)	(731)	–	5	–	–	–	–
Profit for the year	1,300	–	(734)	7	75	(9)	36	(37)	638
Non-controlling interest	(3)	–	(12)	–	(2)	–	–	–	(17)
Earnings	1,297	–	(746)	7	73	(9)	36	(37)	621

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	2011
Underlying increase	62
Portfolio changes	39
Exchange differences	(16)
Total adjusted operating profit increase	85
Underlying increase	7%
Constant exchange rate increase	12%

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	2011	2010
Adjusted operating profit	942	938
Cash conversion	104%	113%
Operating cash flow	983	1,057
Operating tax paid	(151)	(85)
Net operating finance costs paid	(60)	(68)
Total operating free cash flow	772	904
Non operating tax paid	–	–
Total free cash flow	772	904
Weighted average number of shares in issue (millions)	800.2	801.2
Operating free cash flow per share	96.5p	112.8p
Total free cash flow per share	96.5p	112.8p

Return on invested capital

	Net invested capital		Gross invested capital	
All figures in £ millions	2011	2010	2011	2010
Total adjusted operating profit	942	938	942	938
Amortisation of acquired intangibles	(139)	(113)	–	–
Operating tax paid	(151)	(85)	(151)	(85)
Return	652	740	791	853
Average goodwill and other intangibles	5,680	5,362	7,684	7,341
Average net operating assets	1,047	974	1,047	974
Average invested capital	6,727	6,336	8,731	8,315
Return on invested capital	9.7%	11.7%	9.1%	10.3%

Return on invested capital is calculated using two methods:

Gross basis – total adjusted operating profit less operating cash tax paid expressed as a percentage of average gross invested capital. Gross invested capital includes the original unamortised goodwill and intangibles.

Net basis – total adjusted operating profit less intangible amortisation and operating cash tax paid expressed as a percentage of average net invested capital. Net invested capital includes the carrying value (after amortisation) of goodwill and intangibles.

Index to financial statements

Shareholder information

Pearson ordinary shares are listed on the London Stock Exchange and on the New York Stock Exchange in the form of American Depositary Receipts.

Corporate website

The investors' section of our corporate website www.pearson.com/investors provides a wealth of information for shareholders. It is also possible to sign up to receive email alerts for reports and press releases relating to Pearson at www.pearson.com/investors/announcements/email-alerts

Shareholder information online

Equiniti provides a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at www.shareview.co.uk. For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2233* or, for those shareholders with hearing difficulties, textphone number 0871 384 2255*.

Information about the Pearson share price

The company's share price can be found on our website at www.pearson.com. It also appears in the financial columns of the national press.

Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0871 384 2043*.

Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0871 384 2268*.

Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to www.shareview.co.uk/dealing or call customer services on 0845 300 0430*.

Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact their telephone dealing helpline on 08456 037 037 (weekdays only) or, for online dealing, log on to www.shareview.co.uk/dealing. You will need your shareholder reference number as shown on your share certificate.

A weekly postal dealing service is also available through Equiniti. Please telephone 0871 384 2248* for details or log on to www.shareview.co.uk to download a form.

ShareGift

Shareholders with small holdings of shares, whose value makes them uneconomic to sell, may wish to donate them to ShareGift, the share donation charity (registered charity number 1052686). Further information about ShareGift and the charities it has supported may be obtained from their website, www.ShareGift.org or by contacting them at 17 Carlton House Terrace, London SW1Y 5AH.

American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact The Bank of New York Mellon, PO Box 358516, Pittsburgh, PA 15252-8516, telephone 1 866 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively, you may e-mail shrrelations@bnymellon.com, or log on to www.bnymellon.com/shareowner. Voting rights for registered ADR holders can be exercised through The Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

*Calls to these numbers are charged at 8p per minute from a BT landline. Other provider costs may vary. Lines open 8.30am to 5.30pm Monday to Friday.

Share register fraud: protecting your investment

Pearson does not contact its shareholders directly to provide recommendation advice and neither does it appoint third parties to do so. As required by law, our shareholder register is available for public inspection but we cannot control the use of information obtained by persons inspecting the register. Please treat any approaches purporting to originate from Pearson with caution.

For more information, please log on to our website at www.pearson.com/investors/shareholder-information/boiler-room-scams and www.pearson.com/shareholderfaqs

Tips on protecting your shares

- Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation
- Inform our registrar, Equiniti promptly when you change address
- Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or better still, make arrangements to have the dividend paid directly into your bank account
- Consider holding your shares electronically in a CREST account via a nominee

2012 Financial calendar

Ex-dividend date	4 April
Record date	10 April
Last date for dividend reinvestment election	13 April
Annual General Meeting	27 April
Payment date for dividend and share purchase date for dividend reinvestment	4 May
Interim results	27 July
Payment date for interim dividend	14 September

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Pearson has supported the planting of 625 square metres of new native woodland with the Woodland Trust, helping to remove 25 tonnes of carbon dioxide emissions generated by the production of this report.

This report has been printed on Edixion 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.

Notes

Reliance on this document

Our Business Review on pages 02 to 45 has been prepared in accordance with the Directors' Report Business Review Requirements of section 417 of the Companies Act 2006. It also incorporates much of the guidance set out in the Accounting Standards Board's Reporting Statement on the Operating and Financial Review.

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

Forward-looking statements

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

Learn more at www.pearson.com

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