

Financial statements: contents

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Independent auditors' report to the members of Pearson plc

Report on the financial statements

Our opinion

In our opinion:

- › The financial statements, defined below, give a true and fair view of the state of the Group's and company's affairs as at 31 December 2013 and of the Group's profit and of the Group's and company's cash flows for the year then ended;
- › The consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- › The company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; 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.

This opinion is to be read in the context of what we say in the remainder of this report.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the financial statements, the Group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the consolidated financial statements comply with IFRSs as issued by the IASB.

What we have audited

The consolidated financial statements and company financial statements (the 'financial statements'), which are prepared by Pearson plc, comprise:

- › the consolidated and company balance sheet as at 31 December 2013;
- › the consolidated income statement and statement of comprehensive income for the year then ended;
- › the consolidated and company statements of changes in equity and cash flow statements for the year then ended; and

- › the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and, as regards the company, as applied in accordance with the provisions of the Companies Act 2006.

Certain disclosures required by the financial reporting framework have been presented elsewhere in the annual report and accounts (the 'annual report'), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). 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 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 to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Overview of our audit approach

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Using our professional judgement, we determined materiality for the consolidated financial statements as a whole to be £32m. This is based on 5% of profit before tax, after adjusting for non-recurring items such as gain on disposal of subsidiaries, this being an appropriate measure of the group's underlying performance.

We agreed with the audit committee that we would report to them misstatements identified during our audit above £2m as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

The Group is organised into four business segments, being North American Education, International Education, Professional and FT Group, plus the investment in associate Penguin Random House. Each segment comprises a number of reporting units. The consolidated financial statements comprise these reporting units plus the Group's centralised functions.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole.

Across these segments, we identified two reporting units in the US and UK that required an audit of their complete financial information due to size alone, plus a further nine reporting units in the US, UK, Brazil, China and South Africa that required specified procedures on certain transactions and balances. We also obtained an audit opinion on the financial information of the associate Penguin Random House. Our audit work at these reporting units and at head office gave us coverage of approximately 80% of the Group's profit before tax. This, together with procedures at the consolidated Group level and at the Group's shared service centres, provided the evidence we needed for our opinion on the consolidated financial statements taken as a whole.

Areas of particular audit focus

In preparing the financial statements, the directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the audit committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on pages 68 and 69.

Independent auditors' report to the members of Pearson plc continued

Area of focus

How the scope of our audit addressed the area of focus

Risk of fraud in revenue recognition

Auditing standards require us to consider the risk of fraud in revenue recognition.

We focused on material products and services where revenue recognition practices are particularly complex and subject to estimates, being:

- › multiple element arrangements, such as the provision of supplementary (print or digital) materials or training with textbooks, where revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its fair value; and
- › certain long-term contracts in the Education segments, where revenue is recognised using estimated percentage of completion based on costs.

We evaluated the relevant systems and tested the internal controls over the accurate and complete recording of revenue.

We assessed the accounting treatment of new contracts at inception, including examination of evidence supporting key assumptions and estimates.

We assessed the profitability and percentage of completion estimates made for material long-term revenue contracts and assessed multiple-element arrangements and the related fair value allocations.

We performed substantive testing of revenue recorded during the year and evaluated any changes in estimates to determine if they were indicators of management bias.

We also tested manual journals posted to revenue to determine their appropriateness and compliance with Group revenue recognition policies.

Risk of management override of internal controls

Auditing standards require us to consider the risk of management override of internal controls.

We assessed the overall control environment of the Group, including the arrangements for staff to 'whistleblow' inappropriate actions, and interviewed senior management and the Group's internal audit function. We examined the significant accounting estimates and judgements relevant to the financial statements for evidence of bias by the directors that may represent a risk of material misstatement due to fraud. We also tested manual journal entries, including consolidation entries, and incorporated elements of unpredictability in the nature, timing and extent of our audit procedures.

Penguin Random House transaction

On 1 July 2013, management announced the completion of the Penguin Random House combination which resulted in a number of complex accounting and business model changes as follows:

- › disposal accounting, including the gain on the sale;
- › valuation of the new business and intangible assets; and
- › associate accounting, including alignment of accounting policies and presentation of results in the consolidated financial statements.

We focused on this area because it was a complex transaction which required the directors to exercise a significant level of judgement.

We evaluated the directors' assessment of this transaction as a disposal of a business segment and an acquisition.

We evaluated the valuation of the business and associated gain on disposal. We also assessed the resulting associate accounting including the fair value acquisition adjustments such as recognition of intangible assets and alignment of accounting policies and their application. For the valuation exercises we assessed the directors' cash flow forecasts, comparing them to board approved plans and challenged the underlying assumptions.

Area of focus

How the scope of our audit addressed the area of focus

Provision for uncertain tax liabilities

The Group is subject to several tax regimes due to the geographical diversity of its businesses.

The directors are required to exercise significant judgement in determining the appropriate amount to provide in respect of potential tax exposures and uncertain tax provisions. The most significant of these relate to US tax.

We focused on this area because of the inherent judgements required in estimating the amount of any provision required. Changes in assumptions can materially impact the level of provisions recorded in the financial statements.

We obtained an understanding of the Group's tax strategy to identify tax risks relating to business and legislative developments. We recalculated the directors' valuation of tax provisions and determined whether the calculations were in line with the Group's tax policies and had been applied consistently.

We evaluated key underlying assumptions, particularly in the US and in territories with new cross border tax structures, having due regard to ongoing correspondence between the Group and local tax authorities.

Returns provisions

We focused on this area because there are material judgemental provisions for anticipated book returns within the Education segments particularly as the Group transitions from print to digital.

We tested the calculation of the provisions, assessing judgements for reasonableness against historical experience and the impact on returns of the ongoing business transition from print to digital. We also tested controls in the shipment and returns provisioning processes.

Valuation of pre-publication assets and inventories

We focused on this area because there are material pre-publication assets and inventories within the Education segments. Judgement is required to evaluate the valuation of these assets which may be more complex during the transition from print to digital.

We evaluated the recoverability of the pre-publication assets and inventories held, by assessing actual experience against historical estimates and in light of business transition from print to digital.

We also tested controls in the pre-publication assets and inventories processes.

Goodwill impairment reviews

We focused on this area because the Group carries significant goodwill and acquired intangible asset balances. There is judgement in the identification and aggregation of cash generating units (CGUs) and in the assumptions used in the annual goodwill impairment review.

We tested management's impairment analysis by examining their identification and aggregation of CGUs and by evaluating the underlying assumptions through assessment of forecasts, market conditions and sensitivity analysis and through assessing the historical accuracy of forecasts and budgets.

We assessed management's calculation of discount rates and perpetuity growth rates and we tested the integrity of the valuation model.

Independent auditors' report to the members of Pearson plc continued

Going concern

Under the Listing Rules we are required to review the directors' statement, set out on page 72, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the consolidated and company financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and company have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and the company's ability to continue as a going concern.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion:

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

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

- › we have not received all the information and explanations we require for our audit; or
- › 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 directors' remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Corporate Governance Statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code (the Code). We have nothing to report having performed our review.

On page 74 of the annual report, as required by the Code Provision C.1.1, the directors state that they consider the annual report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy.

On pages 68 and 69, as required by C.3.8 of the Code, the audit committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- › the statement given by the directors is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or
- › the section of the annual report describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

We have no exceptions to report arising from this responsibility.

Other information in the annual report

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- › materially inconsistent with the information in the audited financial statements; or
- › apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and company acquired in the course of performing our audit; or
- › is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Independent auditors' report to the members of Pearson plc continued

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the statement of directors' responsibilities set out on page 74, the directors are responsible for the preparation of the consolidated and company 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 consolidated and company financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose.

We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Stuart Newman (Senior Statutory Auditor)

For and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

London, United Kingdom

10 March 2014

Notes:

- (a) The maintenance and integrity of the Pearson plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

Year ended 31 December 2013

All figures in £ millions	Notes	2013	2012 Restated
Sales	2	5,069	4,959
Cost of goods sold	4	(2,312)	(2,187)
Gross profit		2,757	2,772
Operating expenses	4	(2,353)	(2,181)
Loss on closure of subsidiary		–	(113)
Share of results of joint ventures and associates	12	54	9
Operating profit	2	458	487
Finance costs	6	(111)	(115)
Finance income	6	35	19
Profit before tax		382	391
Income tax	7	(87)	(138)
Profit for the year from continuing operations		295	253
Profit for the year from discontinued operations	3	244	61
Profit for the year		539	314
Attributable to:			
Equity holders of the company		538	311
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	66.6p	38.7p
– diluted	8	66.5p	38.6p
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	36.4p	31.1p
– diluted	8	36.3p	31.0p

Consolidated statement of comprehensive income

Year ended 31 December 2013

All figures in £ millions	Notes	2013	2012 Restated
Profit for the year		539	314
Items that may be reclassified to the income statement			
Net exchange differences on translation of foreign operations – Group		(206)	(238)
Net exchange differences on translation of foreign operations – associates		(11)	–
Currency translation adjustment disposed – Group		(18)	–
Attributable tax	7	6	1
Items that are not reclassified to the income statement			
Remeasurement of retirement benefit obligations – Group	25	79	(100)
Remeasurement of retirement benefit obligations – associates		–	(3)
Attributable tax	7	(23)	50
Other comprehensive expense for the year		(173)	(290)
Total comprehensive income for the year		366	24
Attributable to:			
Equity holders of the company		369	23
Non-controlling interest		(3)	1

Consolidated balance sheet

As at 31 December 2013

All figures in £ millions	Notes	2013	2012
Assets			
Non-current assets			
Property, plant and equipment	10	342	327
Intangible assets	11	5,801	6,218
Investments in joint ventures and associates	12	1,092	15
Deferred income tax assets	13	250	229
Financial assets – Derivative financial instruments	16	111	174
Retirement benefit assets	25	86	–
Other financial assets	15	94	31
Trade and other receivables	22	70	79
		7,846	7,073
Current assets			
Intangible assets – Pre-publication	20	717	666
Inventories	21	224	261
Trade and other receivables	22	1,173	1,104
Financial assets – Derivative financial instruments	16	13	4
Financial assets – Marketable securities	14	6	6
Cash and cash equivalents (excluding overdrafts)	17	729	1,062
		2,862	3,103
Assets classified as held for sale	32	223	1,172
Total assets		10,931	11,348
Liabilities			
Non-current liabilities			
Financial liabilities – Borrowings	18	(1,693)	(2,010)
Financial liabilities – Derivative financial instruments	16	(48)	–
Deferred income tax liabilities	13	(612)	(601)
Retirement benefit obligations	25	(142)	(172)
Provisions for other liabilities and charges	23	(77)	(110)
Other liabilities	24	(257)	(282)
		(2,829)	(3,175)
Current liabilities			
Trade and other liabilities	24	(1,505)	(1,556)
Financial liabilities – Borrowings	18	(533)	(262)
Current income tax liabilities		(164)	(291)
Provisions for other liabilities and charges	23	(112)	(38)
		(2,314)	(2,147)
Liabilities directly associated with assets classified as held for sale	32	(82)	(316)
Total liabilities		(5,225)	(5,638)
Net assets		5,706	5,710

Consolidated balance sheet continued

As at 31 December 2013

All figures in £ millions	Notes	2013	2012
Equity			
Share capital	27	205	204
Share premium	27	2,568	2,555
Treasury shares	28	(98)	(103)
Translation reserve		(103)	128
Retained earnings		3,128	2,902
Total equity attributable to equity holders of the company		5,700	5,686
Non-controlling interest		6	24
Total equity		5,706	5,710

These financial statements have been approved for issue by the board of directors on 10 March 2014 and signed on its behalf by

Robin Freestone Chief financial officer

Consolidated statement of changes in equity

Year ended 31 December 2013

All figures in £ millions	Equity attributable to equity holders of the company							Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total			
At 1 January 2013	204	2,555	(103)	128	2,902	5,686	24	5,710	
Profit for the year	–	–	–	–	538	538	1	539	
Other comprehensive expense	–	–	–	(231)	62	(169)	(4)	(173)	
Equity-settled transactions	–	–	–	–	37	37	–	37	
Tax on equity-settled transactions	–	–	–	–	–	–	–	–	
Issue of ordinary shares under share option schemes	1	13	–	–	–	14	–	14	
Purchase of treasury shares	–	–	(47)	–	–	(47)	–	(47)	
Release of treasury shares	–	–	52	–	(52)	–	–	–	
Put options over non-controlling interest	–	–	–	–	–	–	–	–	
Changes in non-controlling interest	–	–	–	–	13	13	(15)	(2)	
Dividends	–	–	–	–	(372)	(372)	–	(372)	
At 31 December 2013	205	2,568	(98)	(103)	3,128	5,700	6	5,706	

All figures in £ millions	Equity attributable to equity holders of the company							Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total			
At 1 January 2012	204	2,544	(149)	364	2,980	5,943	19	5,962	
Profit for the year	–	–	–	–	311	311	3	314	
Other comprehensive expense	–	–	–	(236)	(52)	(288)	(2)	(290)	
Equity-settled transactions	–	–	–	–	32	32	–	32	
Tax on equity-settled transactions	–	–	–	–	(6)	(6)	–	(6)	
Issue of ordinary shares under share option schemes	–	11	–	–	–	11	–	11	
Purchase of treasury shares	–	–	–	–	–	–	–	–	
Release of treasury shares	–	–	46	–	(46)	–	–	–	
Put options over non-controlling interest	–	–	–	–	39	39	–	39	
Changes in non-controlling interest	–	–	–	–	(10)	(10)	6	(4)	
Dividends	–	–	–	–	(346)	(346)	(2)	(348)	
At 31 December 2012	204	2,555	(103)	128	2,902	5,686	24	5,710	

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 2013

All figures in £ millions	Notes	2013	2012
Cash flows from operating activities			
Net cash generated from operations	34	684	916
Interest paid		(82)	(75)
Tax paid		(246)	(65)
Net cash generated from operating activities		356	776
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	30	(48)	(716)
Acquisition of joint ventures and associates		(10)	(39)
Purchase of investments		(64)	(10)
Purchase of property, plant and equipment		(118)	(78)
Purchase of intangible assets		(64)	(73)
Disposal of subsidiaries, net of cash disposed	31	(132)	(11)
Proceeds from sale of associates		2	–
Proceeds from sale of investments		2	–
Proceeds from sale of property, plant and equipment	34	28	1
Proceeds from sale of intangible assets		2	3
Proceeds from sale of liquid resources		13	23
Investment in liquid resources		(14)	(19)
Interest received		9	9
Dividends received from joint ventures and associates		64	27
Net cash used in investing activities		(330)	(883)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	14	11
Purchase of treasury shares	28	(47)	–
Proceeds from borrowings		319	327
Loans to related parties		(44)	–
Loans advanced		(5)	–
Liquid resources acquired		–	(1)
Repayment of borrowings		(225)	–
Finance lease principal payments		(8)	(8)
Dividends paid to company's shareholders	9	(372)	(346)
Dividends paid to non-controlling interest		–	(2)
Transactions with non-controlling interest	33	(76)	(4)
Net cash used in financing activities		(444)	(23)
Effects of exchange rate changes on cash and cash equivalents		21	(24)
Net decrease in cash and cash equivalents		(397)	(154)
Cash and cash equivalents at beginning of year		1,137	1,291
Cash and cash equivalents at end of year	17	740	1,137

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

Notes to the consolidated financial statements

General information

Pearson plc (the company) its subsidiaries and associates (together the Group) are international 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 10 March 2014.

1. Accounting policies

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

a. Basis of preparation

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

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

1. Interpretations and amendments to published standards effective 2013

- The following amendments and interpretations were adopted in 2013:
- Amendments to IAS 19 'Employee Benefits (2011)', effective for annual reporting periods beginning on or after 1 January 2013. The amendments include the elimination of the corridor approach, changes to the calculation of the net interest and service cost components and changes to disclosure. The 2012 results have been restated for IAS 19 (2011) with the results as follows:

Operating profit reduced by £4m.
Net finance costs increased by £15m.
Income tax charge reduced by £4m.

The remeasurement of retirement benefit obligations charge in the statement of other comprehensive income reduced by £15m.

If the results for 2013 had been prepared under IAS 19 (rev 2008) the service cost would have been £4m lower and the net interest income would have been £28m higher.

- 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 the income statement in subsequent periods, and those that will not. The statement of other comprehensive income has been updated to present this information.
- 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 not mandatory for the Group until 1 January 2014. However, the Group has early adopted these standards and amendments as of 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, provides guidance on its determination, and introduces disclosure requirements on fair value measurements.
- Amendments to IFRS 7, 'Financial Instruments – Disclosures' regarding asset and liability offsetting.

Amendments to IAS 36, 'Impairment of assets', on the recoverable amount disclosures for non-financial assets. This amendment removed certain disclosures of the recoverable amount of CGUs which had been included in IAS 36 by the issue of IFRS 13. The amendment is not mandatory for the Group until 1 January 2014. However, the Group has early adopted the amendments as of 1 January 2013.

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

With the exception of IAS 19 'Employee Benefits (2011)', the adoption of these new pronouncements from 1 January 2013, does not have a material impact on the consolidated financial statements. Disclosure requirements have been updated as required.

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

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

- › IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities. The Group is yet to assess the full impact of IFRS 9, and will do so once the remaining sections of the standard are completed.
- › IFRIC 21, 'Levies' details the accounting for an obligation to pay a levy that is not income tax. As the Group is not currently subjected to significant levies the impact on the Group is not material.

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

Taxation

Employee benefits: Pension obligations

Revenue recognition

b. Consolidation

1. Business combinations The acquisition method of accounting is used to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred in the operating expenses line of the income statement.

Identifiable assets and contingent assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. For material acquisitions, the fair value of the acquired intangible assets is determined by an independent valuer. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill.

See note 1e(1) for the accounting policy on goodwill. If this is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

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

2. Subsidiaries Subsidiaries are entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

3. Transactions with non-controlling interests Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions, that is as transactions with the owners in their capacity as owners. Any surplus or deficit arising from disposals to a non-controlling interest is recorded in equity. For purchases from a non-controlling interest, the difference between consideration paid and the relevant share acquired of the carrying value of the subsidiary is recorded in equity.

4. Joint ventures and associates Joint ventures are entities in which the Group holds an interest on a long-term basis and has rights to the net assets through contractually agreed sharing of control. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at the fair value of consideration transferred.

I. 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 \$1.57 (2012: \$1.59) and the year end rate was \$1.66 (2012: \$1.63).

d. Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for intended use. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives as follows:

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

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

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

e. Intangible assets

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

Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

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 aggregated cash-generating units for the purpose of impairment testing. The allocation is made to those aggregated cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

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

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

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

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

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

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

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 34).

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

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

f. Other financial assets

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

I. Accounting policies continued

g. Inventories

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

h. Royalty advances

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

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

i. Cash and cash equivalents

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

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

j. Share capital

Ordinary shares are classified as equity.

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

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

k. Borrowings

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

l. Derivative financial instruments

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

Notes to the consolidated financial statements continued

I. Accounting policies continued

I. Derivative financial instruments continued

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

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

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

m. Taxation

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

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

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

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

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

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

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

n. Employee benefits

I. 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 and longevity.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. Net interest is calculated by applying the discount rate to the net defined benefit obligation and is presented as finance costs or finance income.

1. Accounting policies continued

n. Employee benefits continued

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

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

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

o. Provisions

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

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

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

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

p. Revenue recognition

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

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

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

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials 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.

Notes to the consolidated financial statements continued

I. Accounting policies continued

p. Revenue recognition continued

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

q. Leases

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

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

r. Dividends

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

s. Assets and liabilities held for sale

Assets and liabilities are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is 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.

t. Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1p).

2. Segment information

The Group is organised into the following business segments:

Continuing operations:

North American Education Educational publishing, assessment and testing for the school and higher education market within the USA and Canada;

International Education Educational publishing, assessment and testing for the school and higher education market outside of North America;

Professional Business and technology publishing, training, testing and certification for professional bodies;

FT Group Publisher of the *Financial Times*, business magazines and specialist information.

In addition the Group separately discloses the results of the Penguin Random House (PRH) associate. The results of the Penguin segment to 30 June 2013 and the Mergermarket business (previously included as part of the FT Group) are shown as discontinued in both 2012 and 2013.

2. Segment information continued

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

		2013							
All figures in £ millions	Notes	North American Education	International Education	Professional	FT Group	PRH	Corporate	Discontinued operations	Group
Continuing operations									
Sales (external)		2,779	1,539	410	341	–	–	–	5,069
Sales (inter-segment)		3	1	15	–	–	–	–	19
Adjusted operating profit		406	140	57	29	50	–	–	682
Intangible charges		(92)	(60)	(12)	(2)	(30)	–	–	(196)
Acquisition costs		(2)	(9)	–	(1)	–	–	–	(12)
Other net gains and losses		–	(16)	–	–	–	–	–	(16)
Operating profit		312	55	45	26	20	–	–	458
Finance costs	6								(111)
Finance income	6								35
Profit before tax									382
Income tax	7								(87)
Profit for the year from continuing operations									295
Other segment items									
Segment assets		5,544	2,311	609	293	–	859	223	9,839
Joint ventures	12	–	3	–	–	–	–	–	3
Associates	12	1	9	–	8	1,070	1	–	1,089
Total assets		5,545	2,323	609	301	1,070	860	223	10,931
Other segment items									
Share of results of joint ventures and associates	12	(1)	(4)	2	26	31	–	–	54
Capital expenditure	10, 11	92	37	23	22	–	–	1	175
Pre-publication investment	20	288	69	7	–	–	–	–	364
Depreciation	10	43	21	8	9	–	–	1	82
Amortisation	11, 20	355	141	22	15	–	–	2	535

Notes to the consolidated financial statements continued

2. Segment information continued

All figures in £ millions	Notes							2012
		North American Education	International Education	Professional	FT Group	Corporate	Discontinued operations	Restated
Continuing operations								
Sales (external)		2,658	1,568	390	343	–	–	4,959
Sales (inter-segment)		5	1	12	–	–	–	18
Adjusted operating profit		536	214	37	22	–	–	809
Intangible charges		(66)	(73)	(37)	(3)	–	–	(179)
Acquisition costs		(7)	(8)	(1)	(4)	–	–	(20)
Other net gains and losses		–	–	(123)	–	–	–	(123)
Operating profit		463	133	(124)	15	–	–	487
Finance costs	6							(115)
Finance income	6							19
Profit before tax								391
Income tax	7							(138)
Profit for the year from continuing operations								253
Segment assets								
Segment assets		5,449	2,390	631	445	1,246	1,145	11,306
Joint ventures	12	–	7	–	1	–	–	8
Associates	12	1	4	–	2	–	27	34
Total assets		5,450	2,401	631	448	1,246	1,172	11,348
Other segment items								
Share of results of joint ventures and associates								
Share of results of joint ventures and associates	12	–	(3)	(11)	23	–	–	9
Capital expenditure	10, 11	66	33	16	26	–	11	152
Pre-publication investment	20	250	76	7	–	–	31	364
Depreciation	10	41	16	8	7	–	8	80
Amortisation	11, 20	311	142	45	13	–	42	553

In 2013, sales from the provision of goods were £2,867m (2012: £2,946m) and sales from the provision of services were £2,202m (2012: £2,013m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing and other service businesses are classified as being from the provision of services.

Included in other net gains and losses in continuing operations in 2013 is a loss on the disposal of the Japanese school and local publishing assets and in 2012 is a loss on closure of Pearson in Practice (£113m) and an impairment loss on a joint venture (£10m).

2. Segment information continued

Corporate costs are allocated to business segments including discontinued operations on an appropriate basis depending on the nature of the cost and therefore the segment result is equal to the Group operating profit. Inter-segment pricing is determined on an arm's-length basis. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combination were £202m (2012: £296m) (see note 30). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations.

The Group operates in the following main geographic areas:

All figures in £ millions	Sales		Non-current assets	
	2013	2012	2013	2012
Continuing operations				
UK	649	678	1,068	803
Other European countries	366	377	200	234
USA	2,913	2,756	5,026	4,496
Canada	128	144	301	307
Asia Pacific	624	633	495	524
Other countries	389	371	215	275
Total continuing	5,069	4,959	7,305	6,639
Discontinued operations				
UK	97	187	–	–
Other European countries	49	92	–	–
USA	369	647	–	–
Canada	24	57	–	–
Asia Pacific	74	153	–	–
Other countries	8	17	–	–
Total discontinued	621	1,153	–	–
Total	5,690	6,112	7,305	6,639

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.

Notes to the consolidated financial statements continued

3. Discontinued operations

Discontinued operations relate to Penguin and Mergermarket.

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

All figures in £ millions	2013			2012		
	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total
Sales	513	108	621	1,053	100	1,153
Operating profit	28	24	52	62	24	86
Finance income	1	–	1	–	–	–
Profit before tax	29	24	53	62	24	86
Attributable tax expense	(9)	(9)	(18)	(19)	(6)	(25)
Profit after tax	20	15	35	43	18	61
Profit on disposal of Penguin before tax	202	–	202	–	–	–
Attributable tax benefit	15	–	15	–	–	–
Mergermarket transaction costs	–	(8)	(8)	–	–	–
Profit for the year from discontinued operations	237	7	244	43	18	61
Operating cash flows	36	22	58	83	26	109
Investing cash flows	(6)	(2)	(8)	(81)	(24)	(105)
Financing cash flows	(8)	(29)	(37)	10	(6)	4
Total cash flows	22	(9)	13	12	(4)	8

4. Operating expenses

All figures in £ millions	2013	2012 Restated
By function:		
Cost of goods sold	2,312	2,187
Operating expenses		
Distribution costs	90	82
Selling, marketing and product development costs	1,027	925
Administrative and other expenses	1,162	1,242
Restructuring costs	176	–
Other net gains and losses	16	10
Other income	(118)	(78)
Total net operating expenses	2,353	2,181
Total	4,665	4,368

Included in other income in 2013 is service fee income from Penguin Random House of £28m.

4. Operating expenses continued

All figures in £ millions	Notes	2013	2012 Restated
By nature:			
Royalties expensed		256	245
Other product costs		793	865
Employee benefit expense	5	2,100	1,866
Contract labour		194	137
Employee related expense		177	168
Promotional costs		167	155
Depreciation of property, plant and equipment	10	81	72
Amortisation of software		59	49
Amortisation of intangible assets – Other		166	179
Amortisation of intangible assets – Pre-publication	20	308	283
Property and facilities		229	188
Technology and communications		104	80
Professional and outsourced services		259	253
Other general and administrative costs		61	38
Capitalised costs		(199)	(162)
Acquisition costs		12	20
Other net gains and losses		16	10
Other income		(118)	(78)
Total		4,665	4,368

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

All figures in £ millions	2013	2012
The audit of parent company and consolidated financial statements	4	4
The audit of the company's subsidiaries	2	2
Total audit fees	6	6
Other assurance services	1	1
Total assurance services	1	1
Tax compliance services	2	1
Tax advisory services	2	1
Total tax services	4	2
Total non-audit services	5	3
Total	11	9

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

All figures in £ millions	2013	2012
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	6	6
Non-audit fees	5	3
Total	11	9

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts. Non-audit fees for 2013 includes £3m for assurance and tax services related to the Penguin Random House transaction.

Notes to the consolidated financial statements continued

5. Employee information

All figures in £ millions	Notes	2013	2012 Restated
Employee benefit expense			
Wages and salaries (including termination benefits and restructuring costs)		1,836	1,610
Social security costs		136	129
Share-based payment costs	26	35	28
Retirement benefits – defined contribution plans	25	66	69
Retirement benefits – defined benefit plans	25	27	26
Other post-retirement benefits	25	–	4
Total		2,100	1,866

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

Average number employed	2013	2012
Employee numbers		
North American Education	19,670	18,552
International Education	16,113	16,751
Professional	3,357	3,706
FT Group	2,216	2,243
Other	759	883
Continuing operations	42,115	42,135

The employee benefit expense relating to discontinued operations was £168m (2012: £265m) and the average number employed was 3,592 (2012: 5,387).

6. Net finance costs

All figures in £ millions	Notes	2013	2012 Restated
Interest payable		(82)	(75)
Net finance costs in respect of retirement benefits	25	(3)	(2)
Finance cost of put options, deferred consideration associated with acquisitions and other interest charges related to transactions		(9)	(27)
Net foreign exchange losses		–	(8)
Other losses on financial instruments in a hedging relationship:			
– fair value hedges		–	(1)
Other losses on financial instruments not in a hedging relationship:			
– derivatives		(17)	(2)
Finance costs		(111)	(115)
Interest receivable		10	10
Net foreign exchange gains		20	9
Other gains on financial instruments in a hedging relationship:			
– fair value hedges		1	–
Other gains on financial instruments not in a hedging relationship:			
– derivatives		4	–
Finance income		35	19
Net finance costs		(76)	(96)
Analysed as:			
Net interest payable reflected in adjusted earnings		(72)	(65)
Other net finance costs		(4)	(31)
Total net finance costs		(76)	(96)

The net gain of £1m on fair value hedges in 2013 (2012: net loss of £1m) comprises a gain of £95m (2012: gain of £7m) on the underlying bonds, offset by a loss of £94m (2012: loss of £8m) on the related derivative financial instruments.

Notes to the consolidated financial statements continued

7. Income tax

All figures in £ millions	Notes	2013	2012 Restated
Current tax			
Charge in respect of current year		(129)	(147)
Adjustments in respect of prior years		(7)	18
Total current tax charge		(136)	(129)
Deferred tax			
In respect of temporary differences		14	(45)
Other adjustments in respect of prior years		35	36
Total deferred tax credit/(charge)	13	49	(9)
Total tax charge		(87)	(138)

The adjustments in respect of prior years in 2013 mainly relate to changes in estimates arising from uncertain tax positions following settlements with tax authorities in the year.

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the UK tax rate as follows:

All figures in £ millions	2013	2012 Restated
Profit before tax	382	391
Tax calculated at UK rate (2013: 23.25%, 2012: 24.5%)	(89)	(96)
Effect of overseas tax rates	(13)	(51)
Joint venture and associate income reported net of tax	13	2
Net expense not subject to tax	(14)	(15)
Loss on sale of businesses not subject to tax	(6)	(28)
Utilisation of previously unrecognised tax losses and credits	1	2
Unutilised tax losses	(7)	(6)
Adjustments in respect of prior years	28	54
Total tax charge	(87)	(138)
UK	(13)	(14)
Overseas	(74)	(124)
Total tax charge	(87)	(138)
Tax rate reflected in earnings	22.8%	35.3%

7. Income tax continued

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

All figures in £ millions	2013	2012 Restated
Profit before tax	382	391
Adjustments:		
Other net gains and losses	16	123
Acquisition costs	12	20
Amortisation of acquired intangibles	196	179
Other net finance costs	4	31
Adjusted profit before tax – continuing operations	610	744
Adjusted profit before tax – discontinued operations	54	123
Total adjusted profit before tax	664	867
Total tax charge	(87)	(138)
Adjustments:		
Tax charge on other net gains and losses	32	–
Tax benefit on acquisition costs	(2)	(5)
Tax benefit on amortisation of acquired intangibles	(51)	(54)
Tax benefit on other net finance costs	(1)	(1)
Tax amortisation benefit on goodwill and intangibles	30	36
Adjusted income tax charge – continuing operations	(79)	(162)
Adjusted income tax charge – discontinued operations	(18)	(38)
Total adjusted income tax charge	(97)	(200)
Tax rate reflected in adjusted earnings	14.6%	23.1%

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

All figures in £ millions	2013	2012 Restated
Remeasurement of retirement benefit obligations	(23)	50
Net exchange differences on translation of foreign operations	6	1
	(17)	51

A tax charge of £nil (2012: tax benefit £6m) relating to share-based payments has been recognised directly in equity.

Notes to the consolidated financial statements continued

8. Earnings per share

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares.

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares.

All figures in £ millions	Notes	2013	2012 Restated
Profit for the year from continuing operations		295	253
Non-controlling interest		(1)	(3)
Earnings from continuing operations		294	250
Profit for the year from discontinued operations	3	244	61
Non-controlling interest		–	–
Earnings		538	311
Weighted average number of shares (millions)		807.8	804.3
Effect of dilutive share options (millions)		1.1	1.3
Weighted average number of shares (millions) for diluted earnings		808.9	805.6
Earnings per share from continuing and discontinued operations			
Basic		66.6p	38.7p
Diluted		66.5p	38.6p
Earnings per share from continuing operations			
Basic		36.4p	31.1p
Diluted		36.3p	31.0p
Earnings per share from discontinued operations			
Basic		30.2p	7.6p
Diluted		30.2p	7.6p

Adjusted

In order to show results from operating activities on a consistent basis, an adjusted earnings per share is presented. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

Adjusted earnings includes the results from continuing and discontinued operations.

The following items are excluded from adjusted earnings:

Other net gains and losses represent profits and losses on the acquisition and disposal of subsidiaries, joint ventures, associates and other financial assets that are included within continuing or discontinued operations but which distort the performance of the Group.

Amortisation of acquired intangibles, acquisition costs and movements in contingent acquisition consideration are also excluded from adjusted earnings as these items are not considered to be fully reflective of the underlying performance of the Group.

8. Earnings per share continued

Other net finance income/costs include finance costs in respect of retirement benefits, finance costs of put options and deferred consideration and foreign exchange and other gains and losses. Finance costs relating to retirement benefits are excluded as the Group's interpretation is that the new presentation under IAS 19 (revised) does not reflect the economic substance of the underlying assets and liabilities. Finance costs of put options and deferred consideration are excluded as they relate to future earn outs and similar payments on acquisitions and do not reflect cash expended. Foreign exchange and other gains and losses are excluded as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity. Other net finance costs of Group companies are included in finance costs or finance income as appropriate. Other net finance costs of joint ventures and associates are included within the share of results of joint ventures and associates within operating profit.

Tax on the above items is excluded from adjusted earnings. Where relevant the Group also excludes the benefit from recognising previously unrecognised pre-acquisition and capital losses. The Group includes the benefit of tax amortisation of goodwill and intangibles as this benefit more accurately aligns the adjusted tax charge with the expected rate of cash tax payments.

Non-controlling interest for the above items is excluded from adjusted earnings.

The following tables reconcile statutory earnings to adjusted earnings.

	2013							
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	458	54	16	12	196	–	–	736
Net finance costs	(76)	–	–	–	–	4	–	(72)
Profit before tax	382	54	16	12	196	4	–	664
Income tax	(87)	(18)	32	(2)	(51)	(1)	30	(97)
Profit for the year from continuing operations	295	36	48	10	145	3	30	567
Profit for the year from discontinued operations	244	(36)	(209)	–	2	(1)	–	–
Profit for the year	539	–	(161)	10	147	2	30	567
Non-controlling interest	(1)	–	–	–	–	–	–	(1)
Earnings	538	–	(161)	10	147	2	30	566
Weighted average number of shares (millions)	807.8							807.8
Adjusted earnings per share	66.6p							70.1p

Notes to the consolidated financial statements continued

8. Earnings per share continued

All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/ costs	Tax amortisation benefit	2012
								Restated
								Adjusted income statement
Operating profit	487	123	123	20	179	–	–	932
Net finance costs	(96)	–	–	–	–	31	–	(65)
Profit before tax	391	123	123	20	179	31	–	867
Income tax	(138)	(38)	–	(5)	(54)	(1)	36	(200)
Profit for the year from continuing operations	253	85	123	15	125	30	36	667
Profit for the year from discontinued operations	61	(85)	20	1	3	–	–	–
Profit for the year	314	–	143	16	128	30	36	667
Non-controlling interest	(3)	–	–	–	–	–	–	(3)
Earnings	311	–	143	16	128	30	36	664
Weighted average number of shares (millions)	804.3							804.3
Adjusted earnings per share	38.7p							82.6p

9. Dividends

All figures in £ millions	2013	2012
Final paid in respect of prior year 30.0p (2012: 28.0p)	242	225
Interim paid in respect of current year 16.0p (2012: 15.0p)	130	121
	372	346

The directors are proposing a final dividend in respect of the financial year ended 31 December 2013 of 32.0p per share which will absorb an estimated £259m of shareholders' funds. It will be paid on 2 May 2014 to shareholders who are on the register of members on 4 April 2014. These financial statements do not reflect this dividend.

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2012	363	706	12	1,081
Exchange differences	(9)	(23)	–	(32)
Additions	12	51	15	78
Disposals	(2)	(20)	–	(22)
Acquisition through business combination	4	13	–	17
Disposal through business disposal	(1)	(4)	–	(5)
Reclassifications	8	–	(8)	–
Transfer from/(to) software	9	(27)	–	(18)
Transfer from pre-publication	–	3	–	3
Transfer to assets held for sale	(32)	(102)	(1)	(135)
At 31 December 2012	352	597	18	967
Exchange differences	(5)	(14)	–	(19)
Additions	33	58	22	113
Disposals	(13)	(78)	–	(91)
Acquisition through business combination	–	3	–	3
Disposal through business disposal	(1)	(2)	–	(3)
Reclassifications	9	(1)	(8)	–
Transfer from software	–	3	–	3
Transfer from assets held for sale	–	9	–	9
Transfer to assets held for sale	–	(7)	–	(7)
At 31 December 2013	375	568	32	975

Notes to the consolidated financial statements continued

10. Property, plant and equipment continued

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2012	(187)	(511)	–	(698)
Exchange differences	6	17	–	23
Charge for the year	(21)	(59)	–	(80)
Disposals	2	19	–	21
Acquisition through business combination	(1)	(6)	–	(7)
Disposal through business disposal	–	2	–	2
Reclassifications	(8)	8	–	–
Transfer (from)/to software	(3)	7	–	4
Transfer to assets held for sale	17	78	–	95
At 31 December 2012	(195)	(445)	–	(640)
Exchange differences	3	13	–	16
Charge for the year	(25)	(57)	–	(82)
Disposals	7	64	–	71
Acquisition through business combination	–	(2)	–	(2)
Transfer from assets held for sale	–	(1)	–	(1)
Transfer to assets held for sale	–	5	–	5
At 31 December 2013	(210)	(423)	–	(633)
Carrying amounts				
At 1 January 2012	176	195	12	383
At 31 December 2012	157	152	18	327
At 31 December 2013	165	145	32	342

Depreciation expense of £24m (2012: £23m) has been included in the income statement in cost of goods sold and £57m (2012: £49m) in operating expenses. In 2013 £1m (2012: £8m) relates to discontinued operations.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £11m (2012: £17m).

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2012	5,199	428	681	253	213	356	7,130
Exchange differences	(213)	(13)	(26)	(11)	(9)	(18)	(290)
Additions – internal development	–	38	–	–	–	–	38
Additions – purchased	–	36	–	–	–	–	36
Disposals	–	(11)	–	–	–	–	(11)
Acquisition through business combination	505	12	182	27	10	56	792
Disposal through business disposal	(50)	–	(89)	(2)	–	–	(141)
Transfer from PPE	–	18	–	–	–	–	18
Transfer to assets held for sale	(364)	(42)	(19)	(9)	(7)	–	(441)
At 31 December 2012	5,077	466	729	258	207	394	7,131
Exchange differences	(122)	(6)	(25)	(8)	(12)	(11)	(184)
Additions – internal development	–	38	–	–	–	–	38
Additions – purchased	–	24	–	–	–	–	24
Disposals	–	(50)	–	–	–	–	(50)
Acquisition through business combination	(133)	–	190	–	3	7	67
Disposal through business disposal	(6)	–	–	–	–	(1)	(7)
Reclassifications	–	–	(10)	(1)	–	11	–
Transfer to PPE	–	(3)	–	–	–	–	(3)
Transfer to assets held for sale	(150)	–	(29)	(12)	–	(2)	(193)
At 31 December 2013	4,666	469	855	237	198	398	6,823

Notes to the consolidated financial statements continued

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2012	–	(296)	(168)	(63)	(128)	(133)	(788)
Exchange differences	–	9	8	3	5	7	32
Charge for the year	–	(54)	(90)	(27)	(20)	(46)	(237)
Disposals	–	8	–	–	–	–	8
Acquisition through business combination	–	(7)	–	–	–	–	(7)
Disposal through business disposal	–	–	45	1	–	–	46
Transfer from PPE	–	(4)	–	–	–	–	(4)
Transfer to assets held for sale	–	32	1	–	4	–	37
At 31 December 2012	–	(312)	(204)	(86)	(139)	(172)	(913)
Exchange differences	–	6	10	4	6	7	33
Charge for the year	–	(59)	(78)	(21)	(15)	(54)	(227)
Disposals	–	49	–	–	–	–	49
Disposal through business disposal	–	–	–	–	–	1	1
Transfer to assets held for sale	–	–	23	10	–	2	35
At 31 December 2013	–	(316)	(249)	(93)	(148)	(216)	(1,022)
Carrying amounts							
At 1 January 2012	5,199	132	513	190	85	223	6,342
At 31 December 2012	5,077	154	525	172	68	222	6,218
At 31 December 2013	4,666	153	606	144	50	182	5,801

Goodwill

The goodwill carrying value of £4,666m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

Other intangible assets

Other intangibles acquired include content, technology and software rights.

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

Amortisation of £15m (2012: £10m) is included in the income statement in cost of goods sold and £210m (2012: £218m including an impairment of £21m relating to Pearson in Practice) in operating expenses. In 2013 £2m (2012: £9m) of amortisation relates to discontinued operations.

11. Intangible assets continued

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

Class of intangible asset	2013
	Useful economic life
Acquired customer lists, contracts and relationships	3–20 years
Acquired trademarks and brands	2–20 years
Acquired publishing rights	5–20 years
Other intangibles acquired	2–20 years

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

Class of intangible asset	2013			
	One to five years	Six to ten years	More than ten years	Total
All figures in £ millions				
Acquired customer lists, contracts and relationships	357	166	83	606
Acquired trademarks and brands	78	41	25	144
Acquired publishing rights	46	4	–	50
Other intangibles acquired	148	33	1	182

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

All figures in £ millions	2013	2012
US Education Publishing	2,225	2,384
US School Assessment and Information	750	773
Canada	173	188
International – Emerging Markets	423	463
International – UK	444	450
International – Rest of World	253	267
Professional Publishing	14	15
Professional Assessment and Training	334	334
Pearson Education total	4,616	4,874
Financial Times	50	51
Continuing operations	4,666	4,925
Mergermarket	–	152
Discontinued operations	–	152
Total	4,666	5,077

Notes to the consolidated financial statements continued

11. Intangible assets continued

Impairment tests for cash-generating units containing goodwill continued

The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

Key assumptions

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five-year period. The key assumptions used by management in the value in use calculations were:

Discount rates The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates used are in the range of 10.7% to 13.8% for the Pearson Education businesses (2012: 9.8% to 12.7%) and 11.3% for the Financial Times (2012: 11.5%).

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 2013 (2012: 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

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2013	2012
Associates	1,089	7
Joint ventures	3	8
Total	1,092	15

The amounts recognised in the income statement are as follows:

All figures in £ millions	2013	2012
Associates	56	23
Joint ventures	(2)	(14)
Total	54	9

12. Investments in joint ventures and associates continued

Investment in associates

The Group has the following material associates:

	Principal place of business	% Ownership interest	Nature of relationship	Measurement method
Penguin Random House	Global	47	Note 1	Equity*
The Economist Newspaper Ltd	UK	50	Note 2	Equity*

*Neither associate has a quoted market price.

Note 1 – On 1 July 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. The shareholder agreement includes protection rights for Pearson as the minority shareholder including rights to dividends.

Note 2 – The Group has a 50% interest in The Economist Newspaper Ltd, publisher of one of the world's leading weekly business and current affairs magazines.

The summarised financial information of the material associates is detailed below:

	2013		2012
	Penguin Random House	Economist	Economist
<i>All figures in £ millions</i>			
Assets			
Current assets	1,210	103	120
Non-current assets	1,361	163	160
Liabilities			
Current liabilities	(905)	(190)	(202)
Non-current liabilities	(455)	(60)	(78)
Net assets	1,211	16	–
Sales	1,315	340	348
Profit from continuing operations	66	52	46
Other comprehensive (expense)/income	(34)	9	(6)
Total comprehensive income	32	61	40
Dividends received from associate	43	21	21

The information above reflects the amounts presented in the financial statements of the associates, adjusted for fair value and similar adjustments.

Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

A reconciliation of the summarised financial information to the carrying value of the material associates is shown below:

All figures in £ millions	2013		2012
	Penguin Random House	Economist	Economist
Opening net assets	–	–	–
Exchange differences	(68)	–	(1)
Profit for the period	66	52	46
Other comprehensive income	(34)	9	(6)
Dividends	(91)	(41)	(41)
Additions	1,338	–	–
Distribution from associate in excess of carrying value	–	–	2
Reversal of distribution from associate in excess of carrying value	–	(4)	–
Closing net assets	1,211	16	–
Share of net assets	569	8	–
Goodwill	501	–	–
Carrying value of associate	1,070	8	–

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2013	2012
Loss from continuing operations	(1)	–
Other comprehensive income	–	–
Total comprehensive expense	(1)	–

Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2013 was £44m.

The Group also has a current asset receivable of £14m from Penguin Random House arising from the provision of services. Included in other income (note 4) is £28m of service fees.

Investment in joint ventures

Information on joint ventures, all of which are individually immaterial, is detailed below:

All figures in £ millions	2013	2012
Loss from continuing operations	(2)	(14)
Other comprehensive income	–	–
Total comprehensive expense	(2)	(14)

13. Deferred income tax

All figures in £ millions	2013	2012
Deferred income tax assets	250	229
Deferred income tax liabilities	(612)	(601)
Net deferred income tax	(362)	(372)

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. At 31 December 2013 the Group has unrecognised deferred income tax assets of £4m (2012: £13m) in respect of UK losses, £11m (2012: £14m) in respect of US losses and approximately £36m (2012: £30m) in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them. The US losses relate to state taxes and therefore have expiry periods of between 5 and 20 years.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

All figures in £ millions	Notes	2013	2012 Restated
At beginning of year		(372)	(333)
Exchange differences		9	14
Income statement benefit/(charge)	7	47	(13)
Acquisition through business combination	30	(37)	(67)
Disposal through business disposal	31	–	11
Tax charge to other comprehensive income or equity		(35)	34
Transfer to current tax		25	–
Transfer to assets held for sale		1	(18)
At end of year		(362)	(372)

Included in the income statement above for 2013 is a £2m charge (2012: £4m charge) relating to discontinued operations.

Notes to the consolidated financial statements continued

13. Deferred income tax continued

The movement in deferred income tax assets and liabilities during the year is as follows:

All figures in £ millions	Trading losses	Goodwill and intangibles	Returns provisions	Retirement benefit obligations	Other	Total Restated
Deferred income tax assets						
At 1 January 2012	14	–	89	19	165	287
Exchange differences	–	–	(3)	(1)	(5)	(9)
Acquisition through business combination	19	–	–	–	–	19
Income statement charge	(13)	–	(16)	(1)	(33)	(63)
Tax benefit/(charge) to other comprehensive income or equity	–	–	–	39	(6)	33
Transfer to assets held for sale	(2)	–	(25)	(9)	(2)	(38)
At 31 December 2012	18	–	45	47	119	229
Exchange differences	–	–	(1)	(1)	(4)	(6)
Acquisition through business combination	21	–	–	–	–	21
Income statement (charge)/benefit	(24)	–	(5)	25	22	18
Tax charge to other comprehensive income or equity	–	–	–	(36)	–	(36)
Transfer to current tax	–	–	–	–	25	25
Transfer from assets held for sale	–	–	–	7	(7)	–
Transfer to assets held for sale	–	–	–	–	(1)	(1)
At 31 December 2013	15	–	39	42	154	250

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 2012	(464)	(156)	(620)
Exchange differences	18	5	23
Acquisition through business combination	(65)	(21)	(86)
Disposal through business disposal	11	–	11
Income statement benefit	15	35	50
Tax benefit to other comprehensive income or equity	–	1	1
Transfer to assets held for sale	10	10	20
At 31 December 2012	(475)	(126)	(601)
Exchange differences	13	2	15
Acquisition through business combination	(61)	3	(58)
Income statement (charge)/benefit	(61)	90	29
Tax benefit to other comprehensive income or equity	–	1	1
Transfer to assets held for sale	–	2	2
At 31 December 2013	(584)	(28)	(612)

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

14. Classification of financial instruments

The accounting classification of each class of the Group's financial assets and financial liabilities, together with their fair values, is as follows:

All figures in £ millions	Notes	2013								
		Fair value				Amortised cost			Total carrying value	Total market value
		Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Other liabilities	Loans and receivables	Other liabilities			
Investments in unlisted securities – continuing operations	15	94	–	–	–	–	–	94	94	
Cash and cash equivalents – continuing operations	17	–	–	–	–	729	–	729	729	
Cash and cash equivalents classified within assets held for sale	32	–	–	–	–	36	–	36	36	
Marketable securities		6	–	–	–	–	–	6	6	
Derivative financial instruments	16	–	4	120	–	–	–	124	124	
Trade receivables – continuing operations	22	–	–	–	–	882	–	882	882	
Trade receivables classified within assets held for sale		–	–	–	–	25	–	25	25	
Total financial assets		100	4	120	–	1,672	–	1,896	1,896	
Derivative financial instruments	16	–	(16)	(32)	–	–	–	(48)	(48)	
Trade payables – continuing operations	24	–	–	–	–	–	(316)	(316)	(316)	
Trade payables classified within liabilities held for sale		–	–	–	–	–	(1)	(1)	(1)	
Bank loans and overdrafts – continuing operations	18	–	–	–	–	–	(47)	(47)	(47)	
Borrowings due within one year	18	–	–	–	–	–	(508)	(508)	(514)	
Borrowings due after more than one year	18	–	–	–	–	–	(1,671)	(1,671)	(1,683)	
Total financial liabilities		–	(16)	(32)	–	–	(2,543)	(2,591)	(2,609)	

Notes to the consolidated financial statements continued

14. Classification of financial instruments continued

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

14. Classification of financial instruments continued

Certain of the Group's derivative financial instruments are classified as held for trading either as they do not meet the hedge accounting criteria specified in IAS 39 'Financial Instruments: Recognition and Measurement' or the Group has chosen not to seek hedge accounting for these instruments. None of these derivatives are held for speculative trading purposes. Transactions in derivative financial instruments are only undertaken to manage risks arising from underlying business activity, in accordance with the Group's treasury policy as described in note 19.

The Group designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The Group also designates certain of its borrowings and derivative financial instruments as hedges of its investments in foreign operations (net investment hedges). Movements in the fair value of these financial instruments (to the extent they are effective) are recognised in other comprehensive income.

None of the Group's financial assets or liabilities are designated at fair value through the income statement upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies. The Group's approach to managing risks in relation to financial instruments is described in note 19.

15. Other financial assets

All figures in £ millions	2013	2012
At beginning of year	31	26
Exchange differences	–	(2)
Acquisition of investments	63	10
Disposal of investments	–	(2)
Transfer to assets held for sale	–	(1)
At end of year	94	31

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:

All figures in £ millions	2013			2012		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,439	81	(32)	1,465	143	–
Interest rate derivatives – not in a hedge relationship	634	4	(16)	61	1	–
Cross-currency rate derivatives – in a net investment hedge relationship	220	39	–	220	34	–
Total	2,293	124	(48)	1,746	178	–
Analysed as expiring:						
In less than one year	312	13	–	215	4	–
Later than one year and not later than five years	1,377	111	–	701	69	–
Later than five years	604	–	(48)	830	105	–
Total	2,293	124	(48)	1,746	178	–

Notes to the consolidated financial statements continued

16. Derivative financial instruments continued

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

At the end of 2013, 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 £(151)m, sterling £243m and South African rand £(16)m (2012: US dollar £(59)m, sterling £257m and South African rand £(20)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2013 range from 1.10% to 9.28% (2012: 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.

Derivative financial assets and liabilities subject to offsetting arrangements are as follows:

	2013			2012		
	Gross derivative assets £m	Gross derivative liabilities £m	Net derivative assets/ liabilities £m	Gross derivative assets £m	Gross derivative liabilities £m	Net derivative assets/ liabilities £m
All figures in £ millions						
Counterparties in an asset position	122	(12)	110	178	—	178
Counterparties in a liability position	2	(36)	(34)	—	—	—
Total as presented in the balance sheet	124	(48)	76	178	—	178

All of the Group's derivative financial instruments are subject to enforceable netting arrangements with individual counterparties, allowing net settlement in the event of default of either party. Offset arrangements in respect of cash balances are shown in note 17.

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2013	2012
Cash at bank and in hand	521	372
Short-term bank deposits	208	690
Continuing operations	729	1,062
Cash at bank and in hand classified within assets held for sale	36	115
	765	1,177

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

At the end of 2013 the currency split of cash and cash equivalents was US dollar 28% (2012: 47%), sterling 18% (2012: 25%), euro 5% (2012: 3%) and other 49% (2012: 25%).

Cash and cash equivalents have fair values that approximate to their carrying value due to their short-term nature.

Cash and cash equivalents include the following for the purpose of the cash flow statement:

All figures in £ millions	2013	2012
Cash and cash equivalents – continuing operations	729	1,062
Cash at bank and in hand classified within assets held for sale	36	115
Bank overdrafts – continuing operations	(25)	(33)
Bank overdrafts classified within liabilities held for sale	–	(7)
	740	1,137

The Group has the following cash pooling arrangements in US dollars, sterling and euro, where both the company and the bank have a legal right of offset.

All figures in £ millions	2013			2012		
	Offset asset	Offset liability	Net offset asset/liability	Offset asset	Offset liability	Net offset asset/liability
US dollars	298	(299)	(1)	39	(37)	2
Sterling	1,018	(1,027)	(9)	982	(1,057)	(75)
Euro	6	(5)	1	11	(11)	–
Total for continuing operations as presented in the balance sheet			(9)			(73)

In addition to the above, the Group had offset US dollar, sterling and euro asset balances of £1m, £16m and £nil respectively in respect of discontinued operations at the end of 2013. At the end of 2012, the Group had a sterling offset asset of £74m in respect of discontinued operations.

Offset arrangements in respect of derivatives are shown in note 16.

Notes to the consolidated financial statements continued

18. Financial liabilities – Borrowings

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

All figures in £ millions	2013	2012
Non-current		
5.7% US Dollar Bonds 2014 (nominal amount \$400m)	–	264
7.0% Sterling Bonds 2014 (nominal amount £250m)	–	256
6.0% Sterling Bonds 2015 (nominal amount £300m)	299	298
4.0% US Dollar Notes 2016 (nominal amount \$350m)	221	229
6.25% Global Dollar Bonds 2018 (nominal amount \$550m)	375	402
4.625% US Dollar Notes 2018 (nominal amount \$300m)	202	217
3.75% US Dollar Notes 2022 (nominal amount \$500m)	283	315
3.25% US Dollar Notes 2023 (nominal amount \$500m)	286	–
Bank loans and overdrafts	22	22
Finance lease liabilities	5	7
	1,693	2,010
Current		
Due within one year or on-demand:		
5.5% Global Dollar Bonds 2013 (nominal amount \$350m)	–	219
5.7% US Dollar Bonds 2014 (nominal amount \$400m)	248	–
7.0% Sterling Bonds 2014 (nominal amount £250m)	254	–
Bank loans and overdrafts	25	33
Finance lease liabilities	6	10
	533	262
Total borrowings – continuing operations	2,226	2,272
Bank overdrafts classified within liabilities held for sale	–	7
Total borrowings	2,226	2,279

Included in the non-current borrowings above is £9m of accrued interest (2012: £11m). Included in the current borrowings above is £4m of accrued interest (2012: £2m).

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

All figures in £ millions	2013	2012
Between one and two years	303	524
Between two and five years	821	552
Over five years	569	934
	1,693	2,010

18. Financial liabilities – Borrowings continued

The carrying amounts and market values of borrowings are as follows:

All figures in £ millions	2013			2012	
	Effective interest rate	Carrying value	Market value	Carrying value	Market value
Bank loans and overdrafts	n/a	47	47	55	55
5.5% Global Dollar Bonds 2013	5.76%	–	–	219	218
5.7% US Dollar Bonds 2014	5.88%	248	246	264	260
7.0% Sterling Bonds 2014	7.20%	254	262	256	274
6.0% Sterling Bonds 2015	6.27%	299	325	298	337
4.0% US Dollar Notes 2016	4.26%	221	223	229	233
6.25% Global Dollar Bonds 2018	6.46%	375	376	402	410
4.625% US Dollar Notes 2018	4.69%	202	195	217	209
3.75% US Dollar Notes 2022	3.94%	283	286	315	313
3.25% US Dollar Notes 2023	3.36%	286	273	–	–
Finance lease liabilities	n/a	11	11	17	17
Continuing operations		2,226	2,244	2,272	2,326
Bank overdrafts classified within liabilities held for sale	n/a	–	–	7	7
		2,226	2,244	2,279	2,333

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	2013	2012
US dollar	1,645	1,684
Sterling	559	573
Other	22	22
	2,226	2,279

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

All figures in £ millions	2013	2012
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,057	1,077
	1,057	1,077

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	2013	2012
Finance lease liabilities – minimum lease payments		
Not later than one year	6	10
Later than one year and not later than two years	4	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	11	17

The present value of finance lease liabilities is as follows:

All figures in £ millions	2013	2012
Not later than one year	6	10
Later than one year and not later than five years	5	7
Later than five years	–	–
	11	17

The carrying amounts of the Group's lease obligations approximate their fair value.

19. Financial risk management

The Group's approach to the management of financial risks together with sensitivity analyses of its financial instruments is set out below.

Treasury policy

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. The Group borrows principally in US dollars and sterling, at both floating and fixed rates of interest, using derivative financial instruments ('derivatives'), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised overleaf. All the treasury policies remained unchanged throughout, except for revisions to the Group's bank counterparty risk limits and related approval processes and a change to permitted investment instruments for some operating companies.

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 2013 the fixed to floating hedging ratio, on the above basis, was approximately 45%:55%. A simultaneous 1% change on 1 January 2014 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £11m 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 2013 the average maturity of gross borrowings was 4.2 years (2012: 3.9 years) of which bonds represented 97% (2012: 97%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. 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. In January 2014 Moody's changed the outlook on their short-term and long-term ratings from 'Stable' to 'Negative'. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group 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 2013 the committed facilities amounted to £1,057m and their weighted average maturity was 1.9 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	2013	2012
Cash and cash equivalents	729	1,062
Marketable securities	6	6
Derivative financial instruments	76	178
Bank loans, overdrafts and loan notes	(47)	(55)
Bonds	(2,168)	(2,200)
Finance lease liabilities	(11)	(17)
Continuing operations	(1,415)	(1,026)
Cash and cash equivalents classified within assets held for sale	36	115
Bank loans, overdrafts and loan notes classified within liabilities held for sale	–	(7)
Net debt	(1,379)	(918)

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

All figures in £ millions	2013	2012
Fixed rate	612	499
Floating rate	767	419
Total	1,379	918

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

All figures in £ millions	2013	2012
US dollar	1,849	1,883
Sterling	339	353
Other	38	43
Total	2,226	2,279

As at 31 December 2013 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	533	1,124	569	2,226
Effect of rate derivatives	1,026	(422)	(604)	–
Total	1,559	702	(35)	2,226

19. Financial risk management continued

The maturity of contracted cash flows associated with the Group's financial liabilities are as follows:

All figures in £ millions				2013
	USD	GBP	Other	Total
Not later than one year	434	316	113	863
Later than one year and not later than five years	1,000	106	–	1,106
Later than five years	648	–	–	648
Total	2,082	422	113	2,617
Analysed as:				
Bonds	1,918	604	–	2,522
Rate derivatives – inflows	(350)	(248)	–	(598)
Rate derivatives – outflows	359	1	16	376
Trade payables	155	65	97	317
Total	2,082	422	113	2,617

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

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 £1,631m, sterling £202m and South African rand £(21)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	2013				2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value								
Derivative financial assets	–	124	–	124	–	178	–	178
Marketable securities	–	6	–	6	–	6	–	6
Available for sale financial assets								
Investments in unlisted securities – continuing operations	–	–	94	94	–	–	30	30
Investments in unlisted securities classified within assets held for sale	–	–	–	–	–	–	1	1
Financial liabilities at fair value								
Derivative financial liabilities	–	(48)	–	(48)	–	–	–	–
Other financial liabilities – put options over non-controlling interest	–	–	–	–	–	–	(68)	(68)
Total	–	82	94	176	–	184	(37)	147

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

All figures in £ millions	2013		2012	
	Investments in unlisted securities	Other financial liabilities	Investments in unlisted securities	Other financial liabilities
At beginning of year	31	(68)	26	(86)
Exchange differences	–	9	(2)	5
Additions	63	–	10	–
Fair value movements	–	(8)	–	(25)
Transfer to assets classified as held for sale	–	–	(1)	–
Disposals	–	67	(2)	38
At end of year	94	–	31	(68)

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. In 2012, the fair value of other financial liabilities represents the present value of the estimated future liability.

Notes to the consolidated financial statements continued

19. Financial risk management continued

Financial instruments – sensitivity analysis

As at 31 December 2013 the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in unlisted securities – continuing operations	94	–	–	(9)	10
Cash and cash equivalents – continuing operations	729	–	–	(56)	68
Cash and cash equivalents classified within assets held for sale	36	–	–	(2)	2
Marketable securities	6	–	–	–	–
Derivative financial instruments	76	(54)	59	15	(18)
Bonds	(2,168)	58	(62)	147	(179)
Other borrowings – continuing operations	(58)	–	–	5	(5)
Other net financial assets – continuing operations	566	–	–	(43)	53
Other net financial assets classified within assets and liabilities held for sale	24	–	–	(1)	1
Total financial instruments	(695)	4	(3)	56	(68)

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. The class 'Other net financial assets' comprises trade assets less trade liabilities.

The sensitivities of derivative instruments are calculated using established estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%. A large proportion of the movements shown above would impact equity rather than the income statement, due to the location and functional currency of the entities in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

20. Intangible assets – Pre-publication

All figures in £ millions	2013	2012
Cost		
At beginning of year	1,876	1,965
Exchange differences	(46)	(74)
Additions	364	364
Disposal through business disposal	(29)	–
Disposals	(234)	(188)
Acquisition through business combination	2	14
Transfer to property, plant and equipment	–	(3)
Transfer to assets classified as held for sale	–	(202)
At end of year	1,933	1,876
Amortisation		
At beginning of year	(1,210)	(1,315)
Exchange differences	46	55
Charge for the year	(308)	(316)
Disposal through business disposal	23	–
Disposals	234	188
Acquisition through business combination	(1)	(8)
Transfer to assets classified as held for sale	–	186
At end of year	(1,216)	(1,210)
Carrying amounts		
At end of year	717	666

Included in the above are pre-publication assets amounting to £480m (2012: £431m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold. In 2013 £nil (2012: £33m) relates to discontinued operations.

21. Inventories

All figures in £ millions	2013	2012
Raw materials	15	13
Work in progress	13	11
Finished goods	196	237
	224	261

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 £472m (2012: £512m). In 2013 £53m (2012: £71m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

Notes to the consolidated financial statements continued

22. Trade and other receivables

All figures in £ millions	2013	2012
Current		
Trade receivables	863	868
Royalty advances	23	16
Prepayments and accrued income	101	81
Other receivables	186	139
	1,173	1,104
Non-current		
Trade receivables	19	15
Royalty advances	8	13
Prepayments and accrued income	33	33
Other receivables	10	18
	70	79

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	2013	2012
At beginning of year	(55)	(102)
Exchange differences	5	4
Income statement movements	(27)	(21)
Utilised	18	53
Acquisition through business combination	–	(1)
Transfer to assets classified as held for sale	1	12
At end of year	(58)	(55)

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	2013	2012
Within due date	783	774
Up to three months past due date	194	231
Three to six months past due date	36	43
Six to nine months past due date	22	10
Nine to 12 months past due date	9	7
More than 12 months past due date	1	5
Total trade receivables	1,045	1,070
Less: provision for sales returns	(163)	(187)
Net trade receivables	882	883

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historic payment profiles. Management believe all the remaining receivable balances are fully recoverable.

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2013	64	26	15	43	148
Exchange differences	(1)	–	–	(1)	(2)
Charged to income statement	–	6	67	55	128
Released to income statement	–	(4)	–	(1)	(5)
Deferred consideration on acquisition	2	–	–	–	2
Utilised	(4)	(17)	(15)	(66)	(102)
Transfer from liabilities held for sale	–	–	–	24	24
Transfer to liabilities held for sale	(3)	–	–	(1)	(4)
At 31 December 2013	58	11	67	53	189

Analysis of provisions:

All figures in £ millions	2013				
	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	5	10	67	30	112
Non-current	53	1	–	23	77
	58	11	67	53	189
2012					
Current	6	12	15	5	38
Non-current	58	14	–	38	110
	64	26	15	43	148

Deferred consideration primarily relates to the formation of a venture in the US Professional business in 2011. Disposals and closures include retirement benefit obligations and other liabilities related to the disposal of Penguin. Legal and other includes litigation in relation to ebooks which was settled in full during 2013, as well as other provisions in relation to legal claims, contract disputes and potential contract losses.

24. Trade and other liabilities

All figures in £ millions	2013	2012
Trade payables	316	337
Social security and other taxes	23	30
Accruals	478	440
Deferred income	698	714
Interest payable	22	21
Put options over non-controlling interest	–	68
Other liabilities	225	228
	1,762	1,838
Less: non-current portion		
Accruals	25	18
Deferred income	155	147
Interest payable	21	13
Put options over non-controlling interest	–	25
Other liabilities	56	79
	257	282
Current portion	1,505	1,556

Notes to the consolidated financial statements continued

24. Trade and other liabilities continued

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

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

The put options over non-controlling interest in 2012 are the fair value of options held by the non-controlling interests in the Group's Southern African and Indian businesses.

25. Retirement benefit and other post-retirement obligations

Background

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world.

The largest plan is the Pearson Group Pension Plan (UK Group plan) in the UK, which is sectionalised to provide both defined benefit and defined contribution pension benefits. The defined benefit section was closed to new members from 1 November 2006. The defined contributions section, opened in 2003, is open to new and existing employees. Finally, there is a separate section within the UK Group plan set up for auto-enrolment. The defined benefit section of the UK Group plan is a final salary pension plan which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends on the length of service and final pensionable pay. The UK Group plan is funded with benefit payments from trustee administered funds. The UK Group plan is administered in accordance with the Trust Deed and Rules in the interests of its beneficiaries by Pearson Group Pension Trustee Limited.

At 31 December 2013 the UK Group plan has approximately 26,500 members, analysed in the following table:

%	Active	Deferred	Pensioners	Total
Defined benefit	3	25	32	60
Defined contribution	17	23	–	40
Total	20	48	32	100

The other major defined benefit plans are based in the US. These are also final salary pension plans which provide benefits to members in the form of a guaranteed pension payable for life, with the level of benefits dependent on length of service and final pensionable pay. The majority of the US plans are funded.

The Group also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

The defined benefit schemes expose the Group to actuarial risks, such as life expectancy, inflation risks, and investment risk including asset volatility and changes in bond yields. The Group is not exposed to any unusual, entity specific or plan specific risks.

25. Retirement benefit and other post-retirement obligations continued

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.

%	2013			2012		
	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.4	2.5	2.5	3.0	2.5	2.5
Rate used to discount plan liabilities	4.4	4.4	4.4	4.4	3.6	3.6
Expected rate of increase in salaries	3.9	3.9	4.0	3.5	3.9	–
Expected rate of increase for pensions in payment and deferred pensions	2.3 to 5.1	–	–	2.3 to 5.1	–	–
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 corporate bond yields adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.4% 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 2.6% has been used.

The expected rate of increase in salaries has been set at 3.9% for 2013 with a short-term assumption of 3.0% for three years.

For the UK plan, the mortality base table assumptions have been derived from the SAPS 'all pensioners' tables for males and the SAPS 'normal health pensioners' tables for females, adjusted to reflect the observed experience of the plan, with CMI model improvement factors. A 1.5% long term rate improvement on the CMI model is applied for males, and 1.25% for females.

For the US plans, the RP2000 table projected to 2020 is used, reflecting the mortality assumption most prevalent in the US.

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	
	2013	2012	2013	2012
Male	24.3	23.0	19.2	19.2
Female	24.4	24.2	21.1	21.1

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

	UK		US	
	2013	2012	2013	2012
Male	25.9	25.1	19.2	19.2
Female	25.9	26.1	21.1	21.1

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Financial statement information

The amounts recognised in the income statement are as follows:

All figures in £ millions	2013					
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	22	3	25	72	4	101
Curtailments	–	–	–	–	(4)	(4)
Administration expenses	4	–	4	–	–	4
Total operating expense	26	3	29	72	–	101
Interest on plan assets	(95)	(6)	(101)	–	–	(101)
Interest on plan liabilities	94	7	101	–	3	104
Net finance (income)/expense	(1)	1	–	–	3	3
Net income statement charge	25	4	29	72	3	104

All figures in £ millions	2012 Restated					
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	23	3	26	78	4	108
Administration expenses	4	–	4	–	–	4
Total operating expense	27	3	30	78	4	112
Interest on plan assets	(98)	(6)	(104)	–	–	(104)
Interest on plan liabilities	96	7	103	–	3	106
Net finance (income)/expense	(2)	1	(1)	–	3	2
Net income statement charge	25	4	29	78	7	114

Included within the 2013 results are discontinued operations consisting of a £2m charge (2012: £4m charge) relating to defined benefit schemes and a £6m charge (2012: £9m charge) relating to defined contribution schemes.

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2013				2012			
	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
Fair value of plan assets	2,353	156	–	2,509	2,162	165	–	2,327
Present value of defined benefit obligation	(2,267)	(171)	(20)	(2,458)	(2,181)	(196)	(24)	(2,401)
Net pension asset/(liability)	86	(15)	(20)	51	(19)	(31)	(24)	(74)
Other post-retirement medical benefit obligation				(77)				(89)
Other pension accruals				(30)				(35)
Net retirement benefit obligations				(56)				(198)
Analysed as:								
Retirement benefit assets				86				–
Retirement benefit obligations				(142)				(198)

25. Retirement benefit and other post-retirement obligations continued

Included within the 2012 retirement benefit obligation is a liability of £26m which relates to Penguin and is classified as held for sale. During 2013 this was transferred back from held for sale to pension liabilities.

The following gains/(losses) have been recognised in other comprehensive income:

All figures in £ millions	2013	2012 Restated
Amounts recognised for defined benefit plans	70	(95)
Amounts recognised for post-retirement medical benefit plans	9	(5)
Total recognised in year	79	(100)

The fair value of plan assets comprises the following:

%	2013			2012		
	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
Equities	28	2	30	32	2	34
Bonds	40	3	43	38	3	41
Property	9	–	9	9	1	10
Other	17	1	18	14	1	15

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

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

%	2013		2012	
	Quoted market price	No quoted market price	Quoted market price	No quoted market price
UK equities	6	1	6	1
Non-UK equities	20	3	25	3
Fixed-interest securities	19	–	21	–
Index-linked securities	24	–	19	–
Property	–	9	–	10
Other	–	18	1	14
Total	69	31	72	28

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

%	2013	2012
Liquid – call <1 month	72	73
Less liquid – call 1–3 months	2	2
Illiquid – call > 3 months	26	25

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

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

All figures in £ millions	2013			2012 Restated		
	UK Group plan	Other plans	Total	UK Group plan	Other plans	Total
Fair value of plan assets						
Opening fair value of plan assets	2,162	165	2,327	2,008	149	2,157
Exchange differences	–	(2)	(2)	–	(5)	(5)
Interest on plan assets	95	6	101	98	6	104
Return on plans assets excluding interest	103	6	109	48	9	57
Contributions by employer	77	5	82	72	2	74
Contributions by employee	2	–	2	2	–	2
Benefits paid	(86)	(24)	(110)	(78)	(11)	(89)
Acquisition through business combination	–	–	–	12	15	27
Closing fair value of plan assets	2,353	156	2,509	2,162	165	2,327
Present value of defined benefit obligation						
Opening defined benefit obligation	(2,181)	(220)	(2,401)	(1,983)	(197)	(2,180)
Exchange differences	–	4	4	–	7	7
Current service cost	(22)	(3)	(25)	(23)	(3)	(26)
Administration expenses	(4)	–	(4)	(4)	–	(4)
Interest cost	(94)	(7)	(101)	(96)	(7)	(103)
Actuarial gains/(losses) – experience	5	1	6	44	2	46
Actuarial gains/(losses) – demographic	–	1	1	(14)	–	(14)
Actuarial gains/(losses) – financial	(55)	9	(46)	(170)	(14)	(184)
Contributions by employee	(2)	–	(2)	(2)	–	(2)
Benefits paid	86	24	110	78	11	89
Acquisition through business combination	–	–	–	(11)	(19)	(30)
Closing defined benefit obligation	(2,267)	(191)	(2,458)	(2,181)	(220)	(2,401)

The weighted average duration of the defined benefit obligation is 15.8 years for the UK and 9.4 years for the US.

25. Retirement benefit and other post-retirement obligations continued

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

All figures in £ millions	2013	2012
Opening defined benefit obligation	(89)	(85)
Exchange differences	1	4
Current service cost	(4)	(4)
Curtailments	4	–
Interest cost	(3)	(3)
Actuarial gains/ (losses) – experience	–	2
Actuarial gains/ (losses) – financial	9	(7)
Benefits paid	5	4
Closing defined benefit obligation	(77)	(89)

Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group in trust. The trustee of the plan is required to act in the best interest of the plan's beneficiaries. Assets of the plan are divided into two elements; matching assets, which are assets that produce cashflows that can be expected to match the cashflows for a proportion of the membership, and include UK and overseas bonds, inflation linked property and infrastructure; return seeking assets, which are assets invested with a longer term horizon to generate the returns needed to provide the remaining expected cashflows for the beneficiaries, and include equities, property and alternative asset classes. The benchmark allocation is 60% matching and 40% return seeking assets.

The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2012 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by June 2017. In 2013 the Group contributed £56m (2012: £48m) towards the funding shortfall. Following the completion of the triennial funding valuation the Group has agreed to contribute £41m per annum until 2017 in excess of regular contributions. In addition, a mechanism has been agreed for the Group to make supplementary payments up to a maximum of £15m per annum if certain conditions are met. If such payments are made they are expected to accelerate the end date for extinguishing the deficit. Regular contributions to the plan in respect of the defined benefit sections are estimated to be £18m for 2014.

The Group expects to contribute \$12m in 2014 and \$12m in 2015 to its US defined benefit pension plans.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Sensitivities

The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows:

All figures in £ millions	2013	
	1% increase	1% decrease
Effect:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(316.0)	390.5
(Decrease)/increase in defined benefit obligation – US plan	(16.1)	20.0

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

All figures in £ millions	2013	
	1 year increase	1 year decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	79.2	(76.2)
Increase/(decrease) in defined benefit obligation – US plan	4.2	(4.8)

The effect of a half percentage point increase and decrease in the inflation rate is as follows:

All figures in £ millions	2013	
	0.5% increase	0.5% decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	106.1	(99.5)
Increase/(decrease) in defined benefit obligation – US plan	0.2	(0.3)

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant, although in practice this is unlikely to occur and changes in some assumptions may be correlated. When calculating these sensitivities the same method has been applied to calculate the defined benefit obligation as has been applied when calculating the liability recognised in the balance sheet. This methodology is the same as prior periods.

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	2013	2012
Pearson plans	35	28

Share-based payment charges included in discontinued operations amounted to £2m (2012: £4m).

The Group operates the following equity-settled employee option and share plans:

Worldwide Save for Shares Plan Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

Employee Stock Purchase Plan In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six-month periods. At the end of the period, the employee has the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

Long-Term Incentive Plan This plan was first introduced in 2001, renewed in 2006 and again in 2011. The plan consists of restricted shares.

The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in May and October 2013, and May 2012 vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2013 and 2012 vest depending on continuing service over a three-year period.

Annual Bonus Share Matching Plan This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis of up to one matching share for every invested share i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares.

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

	2013		2012	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	3,373	8.24	3,203	7.15
Granted during the year	763	9.14	1,321	9.09
Exercised during the year	(820)	7.12	(840)	5.59
Forfeited during the year	(516)	8.75	(294)	7.84
Expired during the year	(8)	5.75	(17)	5.60
Outstanding at end of year	2,792	8.73	3,373	8.24
Options exercisable at end of year	35	6.95	106	5.58

Notes to the consolidated financial statements continued

26. Share-based payments continued

Options were exercised regularly throughout the year. The weighted average share price during the year was £12.42 (2012: £12.01). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

The options outstanding at the end of the year have weighted average remaining contractual lives and exercise prices as follows:

Range of exercise prices £	2013		2012	
	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	–	–	–	–
5 – 10	2,792	2.31	3,373	2.56
>10	–	–	–	–
	2,792	2.31	3,373	2.56

In 2013 and 2012 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

	2013 Weighted average	2012 Weighted average
Fair value	£2.27	£2.38
Weighted average share price	£11.71	£11.51
Weighted average exercise price	£9.14	£9.09
Expected volatility	22.05%	23.62%
Expected life	3.8 years	3.8 years
Risk free rate	0.53%	0.74%
Expected dividend yield	3.84%	3.65%
Forfeiture rate	3.3%	3.3%

The expected volatility is based on the historic volatility of the company's share price over the previous three to seven years depending on the vesting term of the options.

The following shares were granted under restricted share arrangements:

	2013		2012	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	3,482	11.52	4,503	11.56
Annual Bonus Share Matching Plan	99	12.06	237	11.52

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.

26. Share-based payments continued

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions are taken into consideration by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2012	815,626	204	2,544
Issue of ordinary shares – share option schemes	1,417	–	11
At 31 December 2012	817,043	204	2,555
Issue of ordinary shares – share option schemes	1,537	1	13
At 31 December 2013	818,580	205	2,568

The ordinary shares have a par value of 25p per share (2012: 25p per share). All issued shares are fully paid. All shares have the same rights.

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings.

The Group reviews its capital structure on a regular basis and will balance its overall capital structure through payments of dividends, new share issues as well as the issue of new debt or the redemption of existing debt in line with the financial risk policies outlined in note 19.

28. Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2012	14,665	149
Purchase of treasury shares	–	–
Release of treasury shares	(4,563)	(46)
At 31 December 2012	10,102	103
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
At 31 December 2013	9,282	98

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.1% (2012: 1.2%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £2.3m (2012: £2.5m).

At 31 December 2013 the market value of Pearson plc treasury shares was £124.4m (2012: £120.0m).

Notes to the consolidated financial statements continued

29. Other comprehensive income

All figures in £ millions	2013				
	Attributable to equity holders of the company				
	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
Items that may be reclassified to the income statement					
Net exchange differences on translation of foreign operations – Group	(202)	–	(202)	(4)	(206)
Net exchange differences on translation of foreign operations – associate	(11)	–	(11)	–	(11)
Currency translation adjustment disposed – subsidiaries	(18)	–	(18)	–	(18)
Attributable tax	–	6	6	–	6
Items that are not reclassified to the income statement					
Remeasurement of retirement benefit obligations – Group	–	79	79	–	79
Remeasurement of retirement benefit obligations – associate	–	–	–	–	–
Attributable tax	–	(23)	(23)	–	(23)
Other comprehensive expense for the year	(231)	62	(169)	(4)	(173)

All figures in £ millions	2012 Restated				
	Attributable to equity holders of the company				
	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
Items that may be reclassified to the income statement					
Net exchange differences on translation of foreign operations – Group	(236)	–	(236)	(2)	(238)
Attributable tax	–	1	1	–	1
Items that are not reclassified to the income statement					
Remeasurement of retirement benefit obligations – Group	–	(100)	(100)	–	(100)
Remeasurement of retirement benefit obligations – associate	–	(3)	(3)	–	(3)
Attributable tax	–	50	50	–	50
Other comprehensive expense for the year	(236)	(52)	(288)	(2)	(290)

30. Business combinations

There were no significant acquisitions in 2013. Adjustments have been made in respect of prior year acquisitions in 2013 and include the recognition of intangibles of £185m on the EmbanetCompass acquisition. The acquisition was made in late 2012 and was provisionally accounted for as at 31 December 2012.

30. Business combinations continued

Provisional values for the assets and liabilities arising from acquisitions completed in the year together with adjustments to prior year acquisitions are as follows:

All figures in £ millions	Notes	2013			2012
		Current year	Prior year	Total fair value	Total fair value
Property, plant and equipment	10	1	–	1	10
Intangible assets	11	7	193	200	280
Intangible assets – Pre-publication	20	1	–	1	6
Inventories		–	1	1	1
Trade and other receivables		8	1	9	34
Cash and cash equivalents (excluding overdrafts)		2	–	2	34
Net deferred income tax assets/(liabilities)	13	2	(39)	(37)	(67)
Retirement benefit obligations		–	–	–	(2)
Provisions for other liabilities and charges		–	–	–	(1)
Trade and other liabilities		(6)	(1)	(7)	(111)
Current income tax liabilities		–	–	–	(1)
Net assets acquired at fair value		15	155	170	183
Goodwill	11	19	(152)	(133)	505
Fair value of previously held interest arising on stepped acquisition		(7)	–	(7)	–
Total		27	3	30	688
Satisfied by:					
Cash		(25)	(6)	(31)	(682)
Deferred consideration		(2)	–	(2)	(6)
Net prior year adjustments		–	3	3	–
Total consideration		(27)	(3)	(30)	(688)

The goodwill arising on these acquisitions results from cost and revenue synergies and from benefits that cannot be separately recognised.

A provisional value of £6m of goodwill arising on 2013 acquisitions is expected to be deductible for tax purposes (2012: £nil).

Intangible assets acquired in 2012 and recognised in 2013 have the following useful economic lives:
 EmbanetCompass: customer lists, contracts and relationships 3–17 years; trademarks and brands two years.
 Intangible assets acquired in 2013 are classified as other intangible assets and have useful lives of 3–10 years.

Notes to the consolidated financial statements continued

30. Business combinations continued

All figures in £ millions	2013	2012
Cash flow on acquisitions		
Cash – Current year acquisitions	(25)	(682)
Deferred payments for prior year acquisitions and other items	(6)	(31)
Cash and cash equivalents acquired	2	34
Acquisition costs and other acquisition liabilities paid	(19)	(37)
Net cash outflow	(48)	(716)

In total, acquisitions of subsidiaries completed in the year contributed an additional £15m of sales but did not contribute a material amount to operating profit. There would not have been a material difference to either sales or profits had these acquisitions completed on 1 January 2013.

31. Disposals including business closures

All figures in £ millions	2013			2012
	Penguin	Other	Total	
Disposal of subsidiaries				
Property, plant and equipment	(39)	(3)	(42)	(3)
Intangible assets	(43)	–	(43)	(45)
Investment in joint ventures and associates	(22)	–	(22)	–
Other financial assets	(1)	–	(1)	–
Intangible assets – Pre-publication	(20)	(6)	(26)	–
Inventories	(91)	(3)	(94)	–
Trade and other receivables	(447)	(6)	(453)	–
Cash and cash equivalents (excluding overdrafts)	(34)	(3)	(37)	–
Net deferred income tax (assets)/liabilities	(22)	–	(22)	11
Retirement benefit obligations	–	4	4	–
Provisions for other liabilities and charges	7	–	7	–
Trade and other liabilities	224	10	234	–
Non-controlling interest	3	–	3	–
Attributable goodwill	(370)	(6)	(376)	(50)
Cumulative translation adjustment	18	–	18	–
Net assets disposed	(837)	(13)	(850)	(87)
Cash received	–	3	3	–
Fair value of associate acquired	1,160	–	1,160	–
Costs	(121)	(14)	(135)	(26)
Gain/(loss) on disposal	202	(24)	178	(113)

The gain on disposal of Penguin arises from the measurement at fair value of the associate investment acquired in Penguin Random House.

31. Disposals including business closures continued

All figures in £ millions	2013	2012
Cash flow from disposals		
Cash – current year disposals	3	–
Cash and cash equivalents disposed	(37)	–
Costs and other disposal liabilities paid	(98)	(11)
Net cash outflow	(132)	(11)

The disposal in 2012 includes the write down of assets resulting from the closure of Pearson in Practice.

32. Held for sale

Assets classified as held for sale in 2012 relate to Penguin and in 2013 to Mergermarket.

All figures in £ millions	Notes	2013	2012
Property, plant and equipment	10	2	40
Intangible assets	11	158	404
Investments in joint ventures and associates		–	27
Deferred income tax assets	13	1	38
Other financial assets	15	–	1
Trade and other receivables		26	451
Intangible assets – Pre-publication	20	–	16
Inventories		–	80
Cash and cash equivalents (excluding overdrafts)	17	36	115
Assets classified as held for sale		223	1,172
Financial liabilities – Borrowings	18	–	(7)
Deferred income tax liabilities	13	(2)	(20)
Retirement benefit obligations	25	–	(26)
Provisions for other liabilities and charges	23	(4)	(29)
Trade and other liabilities		(71)	(234)
Current income tax liabilities		(5)	–
Liabilities directly associated with assets classified as held for sale		(82)	(316)
Net assets classified as held for sale		141	856

33. Transactions with non-controlling interest

In 2013 the Group purchased non-controlling interests in the Southern African business for £65m, and in the Indian business for £11m. In 2012 the Group increased its investments in its subsidiaries in China at a cost of £4m.

Notes to the consolidated financial statements continued

34. Cash generated from operations

All figures in £ millions	Notes	2013	2012
Profit		539	314
Adjustments for:			
Income tax		90	163
Depreciation	10	82	80
Intangible charges	11	168	183
Amortisation of other intangible assets	11	59	54
Net finance costs		75	96
Share of results of joint ventures and associates	12	(54)	(9)
(Profit)/loss on disposals		(187)	113
Acquisition costs		12	21
Costs on formation of Penguin Random House		–	32
Net foreign exchange adjustment from transactions		(40)	(21)
Share-based payment costs	26	37	32
Pre-publication		(77)	(55)
Inventories		18	49
Trade and other receivables		(50)	(94)
Trade and other liabilities		72	–
Retirement benefit obligations		(57)	(37)
Provisions for other liabilities and charges		(3)	(5)
Net cash generated from operations		684	916
Dividends from joint ventures and associates		64	27
Purchase of property, plant and equipment		(118)	(78)
Purchase of intangible assets		(64)	(73)
Proceeds from sale of property, plant and equipment		28	1
Proceeds from sale of intangible assets		2	3
Finance lease principal payments		(8)	(8)
Operating cash flow		588	788
Operating tax paid		(191)	(65)
Net operating finance costs paid		(73)	(66)
Operating free cash flow		324	657
Non-operating tax paid		(55)	–
Free cash flow		269	657
Dividends paid (including to non-controlling interests)		(372)	(348)
Net movement of funds from operations		(103)	309
Acquisitions and disposals (net of tax)		(326)	(780)
Loans advanced (including to related parties)		(49)	–
Purchase of treasury shares		(47)	–
New equity		14	11
Other movements on financial instruments		(9)	–
Net movement of funds		(520)	(460)
Exchange movements on net debt		59	41
Total movement in net debt		(461)	(419)

34. Cash generated from operations continued

Net cash generated from operations is translated at an exchange rate approximating to the rate at the date of cash flow. The difference between this rate and the average rate used to translate profit gives rise to a currency adjustment in the reconciliation between net profit and net cash generated from operations. This adjustment reflects the timing difference between recognition of profit and the related cash receipts or payments.

Operating cash flow, operating free cash flow and total free cash flow are non-GAAP measures and have been disclosed as they are part of Pearson's corporate and operating measures.

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

All figures in £ millions	2013	2012
Net book amount	19	1
Profit on sale of property, plant and equipment	9	–
Proceeds from sale of property, plant and equipment	28	1

35. Contingencies

There are contingent Group liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries, joint ventures and associates. In addition there are contingent liabilities of the Group in respect of legal claims, contract disputes, royalties, copyright fees, permissions and other rights. None of these claims are expected to result in a material gain or loss to the Group.

36. Commitments

There were no commitments for capital expenditure contracted for at the balance sheet date but not yet incurred.

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £183m (2012: £169m).

The future aggregate minimum lease payments in respect of operating leases are as follows:

All figures in £ millions	2013	2012
Not later than one year	161	186
Later than one year and not later than two years	149	174
Later than two years and not later than three years	133	158
Later than three years and not later than four years	118	137
Later than four years and not later than five years	105	124
Later than five years	737	899
	1,403	1,678

Notes to the consolidated financial statements continued

37. Related party transactions

Joint ventures and associates

Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. Apart from transactions with the Group's joint ventures and associates, there were no other material related party transactions.

Key management personnel

Key management personnel are deemed to be the members of the board of directors of Pearson plc. It is this board which had responsibility for planning, directing and controlling the activities of the Group in 2013. Key management personnel compensation is disclosed in the directors' remuneration report.

There were no other material related party transactions.

No guarantees have been provided to related parties.

38. Events after the balance sheet date

On 4 February 2014, the Group completed the sale of Mergermarket for £382m. On 11 February 2014, the Group acquired 100% of Grupo Multi, the leading English Language Training company in Brazil, for approximately £435m in cash plus the assumption of £57m of debt.

39. Accounts and audit exemptions

The Pearson plc subsidiary companies listed below are exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479A.

	Company number		Company number
Aldwych Finance Ltd	04720439	Pearson Education Ltd	00872828
ASET Ltd	04231636	Pearson Funding Four plc	07970304
ASET Group Ltd	03964551	Pearson Funding One plc	02911143
ASET Management Ltd	03139404	Pearson Funding Two plc	07210654
ASET Solutions Ltd	03849880	Pearson Heinemann Ltd	03099304
Blue Wharf Ltd	04344573	Pearson in Practice ATA Ltd	07679091
Burmedia Investments Ltd	03060487	Pearson in Practice Holdings Ltd	06337129
Edexcel Ltd	04496750	Pearson in Practice Skills Based Learning Ltd	03755464
Education Development International plc	03914767	Pearson in Practice Technology Ltd	03786989
Embankment Finance Ltd	04460625	Pearson International Finance Ltd	02496206
eNVQ Ltd	03985948	Pearson Loan Finance No.2 Unltd	05632021
EQL Assessment Ltd	05224778	Pearson Loan Finance No.3 Ltd	05052661
Escape Studios Ltd	04399042	Pearson Loan Finance No.4 Ltd	02635107
Financial Times (ASC) Ltd	00519261	Pearson Loan Finance Unltd	05144467
Financial Times Group Ltd	00879531	Pearson Management Services Ltd	00096263
Fronter UK Ltd	05737591	Pearson Overseas Holdings Ltd	00145205
FT Business Information Ltd	00758738	Pearson PRH Holdings Ltd	08561316
FT Labs Ltd	04701650	Pearson Professional Holdings Ltd	00149375
FT Personal Finance Ltd	03855520	Pearson Services Ltd	01341060
Goal Ltd	03566588	Pearson Shared Services Ltd	04623186
Green Wharf Ltd	07009228	Peter Honey Publications Ltd	03754757
Icodeon Ltd	05068195	Sector Training Ltd	05342448
Joint Examining Board Ltd	03278422	St Clements Press (1988) Ltd	02174119
Longman Group (Overseas Holdings) Ltd	00690236	Testchange Ltd	02496240
Midlands Educational Technology Ltd	01448842	The Coaching Space Ltd	05333023
Pearson Affordable Learning Fund Ltd	08038068	The Financial Times (Benelux) Ltd	01613899
Pearson Amsterdam Finance Ltd	03041245	The Financial Times (France) Ltd	00867316
Pearson Australia Finance Unltd	05578463	The Financial Times (Japan) Ltd	01613900
Pearson Books Ltd	02512075	The Financial Times (M-M UK) Ltd	01398449
Pearson Canada Finance Unltd	05578491	The Financial Times (Spain) Ltd	01214411
Pearson College Ltd	07967446	The Financial Times Ltd	00227590
Pearson Dollar Finance plc	05111013	TQ Catalis Ltd	07307943
Pearson Dollar Finance Two plc	06507766	TQ Clapham Ltd	07307925
Pearson Education Holdings Ltd	00210859	TQ Global Ltd	07802458
Pearson Education Investments Ltd	08444933	TQ Holdings Ltd	06294307

Notes to the consolidated financial statements continued

39. Accounts and audit exemptions continued

The Pearson plc subsidiary companies listed below are exempt from the requirements of the Companies Act 2006 to prepare individual accounts by virtue of section 394A.

	Company number		Company number
Exec-Appointments Ltd	04010964	Medley Global Advisors Ltd	00931507
FDI Intelligence Ltd	N1040129	The Financial News Ltd	00607228
Financial Times Business Ltd	00202281	The Financial Times (Switzerland) Ltd	01613901
Financial Times Electronic Publishing Ltd	02749250	The Financial Times (Zhongwen) Ltd	01900030
Financial Times Investor Ltd	04005565	Throgmorton Publications Ltd	00905696
Mandatewire Ltd	03855296		

Company balance sheet

As at 31 December 2013

All figures in £ millions	Notes	2013	2012
Assets			
Non-current assets			
Investments in subsidiaries	2	8,537	9,108
Amounts due from subsidiaries		2,009	2,021
Financial assets – Derivative financial instruments	6	111	174
		10,657	11,303
Current assets			
Amounts due from subsidiaries		380	578
Amounts due from related parties		44	–
Prepayments		–	4
Current income tax assets		24	–
Financial assets – Derivative financial instruments	6	13	4
Cash and cash equivalents (excluding overdrafts)	4	394	643
		855	1,229
Total assets		11,512	12,532
Liabilities			
Non-current liabilities			
Amounts due to subsidiaries		(3,553)	(4,227)
Financial liabilities – Borrowings	5	(202)	(473)
Financial liabilities – Derivative financial instruments	6	(48)	–
		(3,803)	(4,700)
Current liabilities			
Amounts due to subsidiaries		(1,256)	(1,953)
Current income tax liabilities		–	(13)
Financial liabilities – Borrowings	5	(766)	(618)
Provisions for other liabilities and charges	7	(42)	–
		(2,064)	(2,584)
Total liabilities		(5,867)	(7,284)
Net assets		5,645	5,248
Equity			
Share capital	8	205	204
Share premium	8	2,568	2,555
Treasury shares	9	(22)	(27)
Special reserve		447	447
Retained earnings		2,447	2,069
Total equity attributable to equity holders of the company		5,645	5,248

These financial statements have been approved for issue by the board of directors on 10 March 2014 and signed on its behalf by

Robin Freestone Chief financial officer
10 March 2014

Company statement of changes in equity

Year ended 31 December 2013

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2013	204	2,555	(27)	447	2,069	5,248
Profit for the year	–	–	–	–	802	802
Issue of ordinary shares under share option schemes*	1	13	–	–	–	14
Purchase of treasury shares	–	–	(47)	–	–	(47)
Release of treasury shares	–	–	52	–	(52)	–
Dividends	–	–	–	–	(372)	(372)
At 31 December 2013	205	2,568	(22)	447	2,447	5,645

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2012	204	2,544	(94)	447	1,450	4,551
Profit for the year	–	–	–	–	1,011	1,011
Issue of ordinary shares under share option schemes*	–	11	–	–	–	11
Contributions from subsidiaries for treasury shares	–	–	21	–	–	21
Release of treasury shares	–	–	46	–	(46)	–
Dividends	–	–	–	–	(346)	(346)
At 31 December 2012	204	2,555	(27)	447	2,069	5,248

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 (2012: £131m) relating to profit on intra-group disposals that is not distributable.

*Full details of the share-based payment plans are disclosed in note 26 to the consolidated financial statements.

Company cash flow statement

Year ended 31 December 2013

All figures in £ millions	Notes	2013	2012
Cash flows from operating activities			
Net profit		802	1,011
Adjustments for:			
Income tax		(51)	(39)
Net finance costs		167	103
Amounts due to subsidiaries		(1,053)	(427)
Net cash (used in)/generated from operations		(135)	648
Interest paid		(82)	(93)
Tax received		14	43
Net cash (used in)/generated from operating activities		(203)	598
Cash flows from investing activities			
Disposal of subsidiaries, net of cash disposed		482	–
Interest received		10	1
Net cash received from investing activities		492	1
Cash flows from financing activities			
Proceeds from issue of ordinary shares	8	14	11
Net purchase of treasury shares		(48)	–
Loans to related parties		(44)	–
Repayment of borrowings		–	(1)
Dividends paid to company's shareholders		(372)	(346)
Net cash used in financing activities		(450)	(336)
Effects of exchange rate changes on cash and cash equivalents		18	(4)
Net (decrease)/increase in cash and cash equivalents		(143)	259
Cash and cash equivalents at beginning of year		25	(234)
Cash and cash equivalents at end of year	4	(118)	25

Notes to the company financial statements

1. Accounting policies

The financial statements on pages 195 to 203 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	2013	2012
At beginning of year	9,108	9,056
Subscription for share capital in subsidiaries	424	110
Disposals/liquidations	(985)	–
Currency revaluations	(10)	(58)
At end of year	8,537	9,108

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 £47m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £50m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £126m, while a 10% decrease in the value of sterling would increase the carrying value by £129m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

3. Financial risk management continued

The maturity of contracted cash flows on the company's borrowings and all of its derivative financial instruments are as follows:

All figures in £ millions				2013
	USD	GBP	Other	Total
Not later than one year	(20)	233	16	229
Later than one year and not later than five years	287	(212)	–	75
Later than five years	(39)	–	–	(39)
Total	228	21	16	265
Analysed as:				
Bonds	219	268	–	487
Rate derivatives – inflows	(350)	(248)	–	(598)
Rate derivatives – outflows	359	1	16	376
Total	228	21	16	265

All figures in £ millions				2012
	USD	GBP	Other	Total
Not later than one year	(26)	3	1	(22)
Later than one year and not later than five years	105	21	21	147
Later than five years	155	–	–	155
Total	234	24	22	280
Analysed as:				
Bonds	232	285	–	517
Rate derivatives – inflows	(326)	(264)	–	(590)
Rate derivatives – outflows	328	3	22	353
Total	234	24	22	280

All 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.

Notes to the company financial statements continued

4. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2013	2012
Cash at bank and in hand	269	1
Short-term bank deposits	125	642
	394	643

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

At the end of 2013 the currency split of cash and cash equivalents was US dollar 76% (2012: 63%) and sterling 24% (2012: 37%).

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	2013	2012
Cash and cash equivalents	394	643
Bank overdrafts	(512)	(618)
	(118)	25

5. Financial liabilities – Borrowings

All figures in £ millions	2013	2012
Non-current		
7.0% Sterling Bonds 2014 (nominal amount £250m)	–	256
4.625% US Dollar Notes 2018 (nominal amount \$300m)	202	217
	202	473
Current		
Due within one year or on-demand:		
7.0% Sterling Bonds 2014 (nominal amount £250m)	254	–
Bank loans and overdrafts	512	618
	766	618
Total borrowings	968	1,091

Included in non-current borrowings above is £nil of accrued interest (2012: £3m). Included in current borrowings above is £3m of accrued interest (2012: £nil).

5. Financial liabilities – Borrowings continued

The maturity of the company's non-current borrowings is as follows:

All figures in £ millions	2013	2012
Between one and two years	–	256
Between two and five years	202	–
Over five years	–	217
	202	473

As at 31 December 2013 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows:

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	766	202	–	968
Amounts due to subsidiaries	1,256	2,731	822	4,809
Effect of rate derivatives	1,026	(422)	(604)	–
	3,048	2,511	218	5,777

The carrying amounts and market values of borrowings are as follows:

All figures in £ millions	Effective interest rate	2013		2012	
		Carrying amount	Market value	Carrying amount	Market value
Bank loans and overdrafts	n/a	512	512	618	618
7.0% Sterling Bonds 2014	7.20%	254	262	256	274
4.625% US dollar Notes 2018	4.69%	202	195	217	209
		968	969	1,091	1,101

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	2013	2012
US dollar	202	255
Sterling	762	826
Euro	4	10
	968	1,091

Notes to the company financial statements continued

6. Derivative financial instruments

The company's outstanding derivative financial instruments are as follows:

All figures in £ millions	2013			2012		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	231	22	–	234	35	–
Interest rate derivatives – not in a hedge relationship	1,842	63	(48)	1,292	109	–
Cross-currency derivatives	220	39	–	220	34	–
Total	2,293	124	(48)	1,746	178	–
Analysed as expiring:						
In less than one year	312	13	–	215	4	–
Later than one year and not later than five years	1,377	111	–	701	69	–
Later than five years	604	–	(48)	830	105	–
Total	2,293	124	(48)	1,746	178	–

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

7. Provisions for other liabilities and charges

Provisions in the year comprise liabilities assumed on the closure of the business of a group subsidiary. It is anticipated that the provision will be utilised in less than one year.

8. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2012	815,626	204	2,544
Issue of ordinary shares – share option schemes	1,417	–	11
At 31 December 2012	817,043	204	2,555
Issue of ordinary shares – share option schemes	1,537	1	13
At 31 December 2013	818,580	205	2,568

The ordinary shares have a par value of 25p per share (2012: 25p per share). All issued shares are fully paid. All shares have the same rights.

9. Treasury shares

	Number of shares 000s	£m
At 1 January 2012	14,665	94
Purchase of treasury shares	–	–
Contribution from subsidiaries	–	(21)
Release of treasury shares	(4,563)	(46)
At 31 December 2012	10,102	27
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
At 31 December 2013	9,282	22

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £2.3m (2012: £2.5m). At 31 December 2013 the market value of the company's treasury shares was £124.4m (2012: £120.0m).

10. Contingencies

There are contingent liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries. In addition there are contingent liabilities in respect of legal claims. None of these claims are expected to result in a material gain or loss to the company.

11. Audit fees

Statutory audit fees relating to the company were £35,000 (2012: £35,000).

12. Related party transactions

Subsidiaries

The company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the company balance sheet.

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £144m (2012: £171m) and interest receivable from subsidiaries for the year of £59m (2012: £64m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £55m (2012: £47m). Dividends received from subsidiaries were £1,363m (2012: £1,124m).

Associates

Amounts due from related parties, disclosed on the face of the company balance sheet, relate to loans to Penguin Random House, an associate of the Group. These loans are unsecured and interest is calculated based on market rates.

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 2013 are listed below. They operate mainly in the countries of incorporation or registration. The investments are in equity share capital and they are all 100% owned.

	Country of incorporation or registration
Pearson Education	
Pearson Education Inc.	US
Pearson Education Ltd	England
NCS Pearson Inc.	US
FT Group	
The Financial Times Ltd	England

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	2009	2010	2011 Restated	2012 Restated	2013
Sales					
North American Education	2,470	2,640	2,584	2,658	2,779
International Education	1,035	1,234	1,424	1,568	1,539
Professional	275	333	382	390	410
Education	3,780	4,207	4,390	4,616	4,728
FT Group	288	325	338	343	341
Continuing	4,068	4,532	4,728	4,959	5,069
Discontinued	1,556	1,427	1,134	1,153	621
Total sales	5,624	5,959	5,862	6,112	5,690
Adjusted operating profit					
North American Education	403	469	493	536	406
International Education	141	171	194	214	140
Professional	43	51	66	37	57
Education	587	691	753	787	603
FT Group	19	41	53	22	29
Penguin Random House	–	–	–	–	50
Continuing	606	732	806	809	682
Discontinued	252	206	132	123	54
Total adjusted operating profit	858	938	938	932	736
Operating margin – continuing	14.9%	16.2%	17.0%	16.3%	13.5%
Adjusted earnings					
Total adjusted operating profit	858	938	938	932	736
Net finance costs	(97)	(85)	(55)	(65)	(72)
Income tax	(194)	(215)	(196)	(200)	(97)
Non-controlling interest	(44)	(17)	1	(3)	(1)
Adjusted earnings	523	621	688	664	566
Weighted average number of shares (millions)	799.3	801.2	800.2	804.3	807.8
Adjusted earnings per share	65.4p	77.5p	86.0p	82.6p	70.1p

2011 and 2012 have been restated to reflect the adoption of IAS 19 revised. Prior periods have not been restated.

Five-year summary continued

All figures in £ millions	2009	2010	2011 Restated	2012 Restated	2013
Cash flow					
Operating cash flow	913	1,057	983	788	588
Operating cash conversion	106%	113%	105%	85%	80%
Operating free cash flow	723	904	772	657	324
Operating free cash flow per share	90.5p	112.8p	96.5p	81.7p	40.1p
Total free cash flow	723	904	772	657	269
Total free cash flow per share	90.5p	112.8p	96.5p	81.7p	33.3p
Net assets	4,636	5,605	5,962	5,710	5,706
Net debt	1,092	430	499	918	1,379
Return on invested capital (gross basis)					
Total adjusted operating profit	858	938	938	932	736
Cash tax paid	(103)	(85)	(151)	(65)	(191)
Return	755	853	787	867	545
Average invested capital	8,504	8,315	8,731	9,578	10,130
Return on invested capital	8.9%	10.3%	9.0%	9.1%	5.4%
Dividend per share	35.5p	38.7p	42.0p	45.0p	48.0p

Corporate and operating measures

Pearson's corporate and operating measures include the results of Mergermarket throughout 2013 as the business was wholly-owned during that period.

Sales – underlying and constant exchange rate movement

Sales movement excluding Penguin and excluding the impact of acquisitions and disposals and movements in exchange rates.

All figures in £ millions	2013
Underlying increase	29
Portfolio changes	70
Exchange differences	19
Total sales increase	118
Underlying increase	1%
Constant exchange rate increase	2%

Adjusted income statement

Reconciliation of the consolidated income statement to the adjusted numbers presented as non-GAAP measures in the financial statements.

All figures in £ millions	2013							
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	458	54	16	12	196	–	–	736
Net finance costs	(76)	–	–	–	–	4	–	(72)
Profit before tax	382	54	16	12	196	4	–	664
Income tax	(87)	(18)	32	(2)	(51)	(1)	30	(97)
Profit for the year from continuing operations	295	36	48	10	145	3	30	567
Profit for the year from discontinued operations	244	(36)	(209)	–	2	(1)	–	–
Profit for the year	539	–	(161)	10	147	2	30	567
Non-controlling interest	(1)	–	–	–	–	–	–	(1)
Earnings	538	–	(161)	10	147	2	30	566

Corporate and operating measures continued

Adjusted income statement continued

	2012							
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/ costs	Tax amortisation benefit	Adjusted income statement
Operating profit	487	123	123	20	179	–	–	932
Net finance costs	(96)	–	–	–	–	31	–	(65)
Profit before tax	391	123	123	20	179	31	–	867
Income tax	(138)	(38)	–	(5)	(54)	(1)	36	(200)
Profit for the year from continuing operations	253	85	123	15	125	30	36	667
Profit for the year from discontinued operations	61	(85)	20	1	3	–	–	–
Profit for the year	314	–	143	16	128	30	36	667
Non-controlling interest	(3)	–	–	–	–	–	–	(3)
Earnings	311	–	143	16	128	30	36	664

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	2013
Underlying decrease	(222)
Portfolio changes	30
Exchange differences	(4)
Total adjusted operating profit decrease	(196)
Underlying decrease	(23)%
Constant exchange rate decrease	(21)%

The underlying and constant exchange rate decreases above primarily reflect the impact of restructuring charges booked during 2013. Excluding the impact of these restructuring charges, underlying and constant exchange rate operating profits have decreased 9% and 6% respectively.

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	2013	2012
Adjusted operating profit	736	932
Cash conversion	80%	85%
Operating cash flow	588	788
Operating tax paid	(191)	(65)
Net operating finance costs paid	(73)	(66)
Total operating free cash flow	324	657
Non-operating tax paid	(55)	–
Total free cash flow	269	657
Weighted average number of shares in issue (millions)	807.8	804.3
Operating free cash flow per share	40.1p	81.7p
Total free cash flow per share	33.3p	81.7p

Return on invested capital

All figures in £ millions	Invested capital	
	2013	2012
Total adjusted operating profit	736	932
Operating tax paid	(191)	(65)
Return	545	867
Average goodwill and other intangibles	8,903	8,550
Average net operating assets	1,227	1,028
Average invested capital	10,130	9,578
Return on invested capital	5.4%	9.1%

Return on invested capital is calculated as total adjusted operating profit less operating cash tax paid expressed as a percentage of average invested capital. Invested capital includes the original unamortised goodwill and intangibles.