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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON March 26, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 20-F

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
or
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2014
or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from to
or
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report
Commission file number 1-16055

PEARSON PLC

(Exact name of Registrant as specified in its charter)

England and Wales
(Jurisdiction of incorporation or organization)

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Each Exchange on Which Registered
*Ordinary Shares, 25p par value	New York Stock Exchange
American Depositary Shares, each Representing One Ordinary Share, 25p per Ordinary Share	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the SEC.

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock at the close of the period covered by the annual report:

Ordinary Shares, 25p par value 819,882,967

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note — Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer", in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing

US GAAP International financial Reporting Standards as Issued Other
by the International Accounting Standards Board

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow: Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No



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INTRODUCTION

In this Annual Report on Form 20-F (the “Annual Report”) references to “Pearson”, the “Company” or the “Group” are references to Pearson plc, its predecessors and its consolidated subsidiaries, except as the context otherwise requires. “Ordinary Shares” refer to the ordinary share capital of Pearson of par value 25p each. “ADSs” refer to American Depositary Shares which are Ordinary Shares deposited pursuant to the Deposit Agreement dated March 21, 1995, amended and restated as of August 8, 2000 among Pearson, The Bank of New York Mellon as depositary (the “Depositary”) and owners and holders of ADSs (the “Deposit Agreement”). ADSs are represented by American Depositary Receipts (“ADRs”) delivered by the Depositary under the terms of the Deposit Agreement.

We have prepared the financial information contained in this Annual Report in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) which in respect of the accounting standards applicable to the Group do not differ from IFRS as adopted by the European Union (“EU”). Unless we indicate otherwise, any reference in this Annual Report to our consolidated financial statements is to the consolidated financial statements and the related notes, included elsewhere in this Annual Report.

We publish our consolidated financial statements in sterling. We have included, however, references to other currencies. In this Annual Report:

- references to “sterling”, “pounds”, “pence” or “£” are to the lawful currency of the United Kingdom,
- references to “euro” or “€” are to the euro, the lawful currency of the participating Member States in the Third Stage of the European Economic and Monetary Union of the Treaty Establishing the European Commission, and
- references to “US dollars”, “dollars”, “cents” or “\$” are to the lawful currency of the United States.

For convenience and except where we specify otherwise, we have translated some sterling figures into US dollars at the rate of £1.00 = \$1.56, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2014. We do not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On February 27, 2015 the noon buying rate for sterling was £1.00 = \$1.54.

The Group currently consists of its education business, plus a 47% interest in the consumer publishing business Penguin Random House. See “Item 4. Information on the Company — Overview of operating divisions”.



FORWARD-LOOKING STATEMENTS

You should not rely unduly on forward-looking statements in this Annual Report. This Annual Report, including the sections entitled “Item 3. Key Information — Risk Factors”, “Item 4. Information on the Company” and “Item 5. Operating and Financial Review and Prospects”, contains forward-looking statements that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terms such as “may”, “will”, “should”, “expect”, “intend”, “plan”, “anticipate”, “believe”, “estimate”, “predict”, “potential”, “continue” or the negative of these terms or other comparable terminology. Examples of these forward-looking statements include, but are not limited to, statements regarding the following:

- operations and prospects,
- growth strategy,
- funding needs and financing resources,
- expected financial position,
- market risk,
- currency risk,
- US federal and state spending patterns,
- debt levels, and
- general market and economic conditions.

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. In evaluating them, you should consider various factors, including the risks outlined under “Item 3. Key Information — Risk Factors”, which may cause actual events or our industry’s results to differ materially from those expressed or implied by any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.



PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected consolidated financial data

The table below shows selected consolidated financial data under IFRS as issued by the IASB. The selected consolidated income statement data for the years ended December 31, 2014, 2013 and 2012 and the selected consolidated balance sheet data as at December 31, 2014 and 2013 have been derived from our audited consolidated financial statements included in “Item 18. Financial Statements” in this Annual Report.

In October 2012, Pearson and Bertelsmann entered into an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction completed on July 1, 2013 and from that point, Pearson no longer controlled the Penguin Group of companies. Pearson accounts for its 47% associate interest in Penguin Random House on an equity basis. The loss of control resulted in the Penguin business being classified as held for sale on the Pearson balance sheet at December 31, 2012. The results of Penguin have been included in discontinued operations for all years through to 2012 and the first six months of 2013. The share of profit after tax from our associate interest in the Penguin Random House venture from July 1, 2013 is included in operating profit from continuing operations.

On November 29, 2013, Pearson announced the sale of the Mergermarket group which completed on February 4, 2014. The anticipated loss of control as at December 31, 2013 resulted in the Mergermarket business being classified as held for sale on the Pearson balance sheet at December 31, 2013. The results of the Mergermarket business have been included in discontinued operations for all the years through 2014.

The results of the Interactive Data Corporation (Interactive Data) in which Pearson held a 61% interest and which was disposed in July 2010, have been included in discontinued operations for 2010.

The selected consolidated financial information should be read in conjunction with “Item 5. Operating and Financial Review and Prospects” and our consolidated financial statements and the related notes appearing elsewhere in this Annual Report. The information provided below is not necessarily indicative of the results that may be expected from future operations.

Following the publication of SEC Release No 33-8879 “Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to US GAAP”, the Group no longer provides a reconciliation between IFRS and US GAAP.



For convenience, we have translated the 2014 amounts into US dollars at the rate of £1.00 = \$1.56, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2014.

	Year Ended December 31					
	2014	2014	2013	2012	2011	2010
	\$	£	£	£	£	£
(In millions, except for per share amounts)						
Consolidated Income Statement data						
Sales operating	7,603	4,874	5,069	4,959	4,728	4,532
Profit	621	398	458	487	1,099	625
Profit after taxation from continuing operations	378	242	295	253	864	447
Profit for the financial year	733	470	539	314	945	1,300
Consolidated Earnings data per share						
Basic earnings per equity share(1)	0.91	58.1p	66.6p	38.7p	118.2p	161.9p
Diluted earnings per equity share(2)	0.90	58.0p	66.5p	38.6p	118.0p	161.5p
Basic earnings from continuing operations per equity share(1)	0.47	30.0p	36.4p	31.1p	108.1p	56.4p
Diluted earnings from continuing operations per equity share(2)	0.47	29.9p	36.3p	31.0p	107.9p	56.3p
Dividends per ordinary share	0.80	51.0p	48.0p	45.0p	42.0p	38.7p
Consolidated Balance Sheet data at period end						
Total assets (non-current assets plus current assets)	17,779	11,397	10,931	11,348	11,244	10,668
Net assets	9,337	5,985	5,706	5,710	5,962	5,605
Long-term obligations(3)	(5,031)	(3,225)	(2,829)	(3,175)	(3,192)	(2,821)
Capital stock	320	205	205	204	204	203
Number of equity shares outstanding (millions of ordinary shares)	820	820	819	817	816	813

Notes:

- (1) Basic earnings per equity share is based on profit for the financial period and the weighted average number of ordinary shares in issue during the period.
- (2) Diluted earnings per equity share is based on diluted earnings for the financial period and the diluted weighted average number of ordinary shares in issue during the period. Diluted earnings comprise earnings adjusted for the tax benefit on the conversion of share options by employees and the weighted average number of ordinary shares adjusted for the dilutive effect of share options.
- (3) Long-term obligations comprise any liabilities with a maturity of more than one year, including medium and long-term borrowings, derivative financial instruments, pension obligations and deferred income tax liabilities.

Dividend information

We pay dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. Our board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. Our board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders' approval at our annual general meeting. At our annual general meeting on April 24, 2015 our shareholders will be asked to approve a final dividend of 34.0p per ordinary share for the year ended December 31, 2014.



The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in The City of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2014 fiscal year will be paid on May 1, 2015 (subject to shareholder approval),

<u>Fiscal year</u>	<u>Interim</u> (Pence per ordinary share)	<u>Final</u> (Pence per ordinary share)	<u>Total</u> (Pence per ordinary share)	<u>Interim</u> (Cents per ordinary share)	<u>Final</u> (Cents per ordinary share)	<u>Total</u> (Cents per ordinary share)
2014	17.0	34.0	51.0	27.6	53.0*	80.6
2013	16.0	32.0	48.0	25.4	54.0	79.4
2012	15.0	30.0	45.0	24.3	46.7	71.0
2011	14.0	28.0	42.0	22.1	45.2	67.3
2010	13.0	25.7	38.7	20.3	42.2	62.5

* As the 2014 final dividend had not been paid by the filing date, the dividend has been translated into cents using the noon buying rate for sterling at December 31, 2014.

Future dividends will be dependent on our future earnings, financial condition and cash flow, as well as other factors affecting the Group.

Exchange rate information

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in The City of New York on each day during a monthly period and on the last day of each month during an annual period. On December 31, 2014 the noon buying rate for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes for sterling was £1.00 = \$1.56. On February 27, 2015 the noon buying rate for sterling was £1.00 = \$1.54.

<u>Month</u>	<u>High</u>	<u>Low</u>
February 2015	\$1.55	\$1.50
January 2015	\$1.54	\$1.50
December 2014	\$1.57	\$1.55
November 2014	\$1.60	\$1.56
October 2014	\$1.62	\$1.59
September 2014	\$1.65	\$1.61
<u>Year Ended December 31</u>	<u>Average rate</u>	
2014	\$1.65	
2013	\$1.57	
2012	\$1.59	
2011	\$1.61	
2010	\$1.54	



Risk factors

You should carefully consider the risk factors described below, as well as the other information included in this Annual Report. Our business, financial condition or results from operations could be materially adversely affected by any or all of these risks, or by other risks that we presently cannot identify.

The pace and scope of our business transformation initiatives increase the execution risk that benefits may not be fully realized, that related costs may increase or that our business as usual activities do not perform in line with expectations.

In parallel with the business transformation as we respond to the digital revolution and shift from a product to a services business, we will continue to look at opportunities to develop new business models and further refine organization structures. The pace and scope of change increases the risk that not all of these changes will deliver the expected benefits within anticipated timeframes, or that the costs of these changes may increase. In addition, as a result of the increased pressure of transformational change, our business as usual activities may not perform in line with plans or our levels of customer service may not meet expectations.

Global economic conditions may adversely impact our financial performance.

With the continued pressure and uncertainty in the worldwide economies, there remains a risk of a weakening in trading conditions, which could adversely impact our future financial performance. The effect of continued deterioration or lack of recovery in the global economy will vary across our different businesses and will depend on the depth, length and severity of any economic downturn. Specific economic risks by business are described more fully in the other risk factors below.

A significant deterioration in Group profitability and/or cash flow caused by prolonged economic instability could reduce our liquidity and/or impair our financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate our banking covenants.

To the extent the economic difficulties continue, or worldwide economic conditions materially deteriorate, the Group's revenues, profitability and cash flows could be significantly reduced as customers would be unable to purchase products and services in the expected quantities and/or pay for them within normal agreed terms. A liquidity shortfall may delay certain development initiatives or may expose the Group to a need to negotiate further funding. While we anticipate that our existing cash and cash equivalents, together with availability under our existing credit facility, cash balances and cash from operations, will be sufficient to fund our operations for at least the next 12 months, we may need to raise additional capital to fund operations in the future or to finance acquisitions. If we seek to raise additional capital in order to meet various objectives, including developing future technologies and services, increasing working capital, acquiring businesses and responding to competitive pressures, capital may not be available on favorable terms or may not be available at all.

Our access to capital is influenced by, among other factors, the ratings assigned to our debt by the credit rating agencies. Our long-term ratings are rated Baa1 by Moody's and BBB+ by Standard & Poor's, and the short-term ratings are P2 and A2 respectively. In January 2014, Moody's lowered the outlook, for both their ratings, from "stable" to "negative".

If the global economy weakens further and/or the global financial markets collapse, we may not have access to or could lose our bank deposits. Lack of sufficient capital resources could significantly limit our ability to take advantage of business and strategic opportunities. Any additional capital raised through the sale of equity or debt securities with an equity component would dilute our stock ownership. If adequate additional funds are not available, we may be required to delay, reduce the scope of, or eliminate material parts of our business strategy, including potential additional acquisitions or development of new products, services and technologies.



Our business will be impacted by the rate of and state of technological change, including the digital revolution and other disruptive technologies.

A common trend facing all our businesses is the digitization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration brings the need for change in product and content distribution, consumers' perception of value and the publisher's position between retailers and authors.

We face competitive threats both from large media players and from smaller businesses, online and mobile portals and operators in the digital arena that provide alternative sources of content, news and information. New distribution channels, e.g. digital format, the internet, online retailers, growing delivery platforms (e.g., e-readers or tablets), pose both threats and opportunities to our traditional publishing business models, potentially impacting both sales volumes and pricing.

If we do not adapt rapidly to these changes we may lose business to 'faster' more 'agile' competitors, who increasingly are non-traditional competitors, making their identification all the more difficult. We may be required to invest significant resources to further adapt to the changing competitive environment.

Our US and UK educational solutions and assessment businesses may be adversely affected by changes in government funding resulting from either general economic conditions, changes in government educational funding, programs, policy decisions, legislation and/or changes in the procurement processes.

The results and growth of our US educational solutions and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. State, local and municipal finances have been adversely affected by the US recession. Although there are signs of recovery, including increasing US state tax receipts, education funding pressures remain. Competition from low price and disruptive new business models continues and open source is promoted as a way for to keep costs down for our customers. The current challenging environment could impact our ability to collect on education-related debt.

Government changes and decisions can also affect the funding available for educational expenditure, which include the impact of education reform. Similarly, changes in the government procurement process for textbooks, learning material and student tests, and vocational training programs can also affect our markets. Changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year. For our UK examination and assessment businesses, changes in UK Government policy could have a significant impact on our present business.

There are multiple competing demands for educational funds and there is no guarantee that new textbooks or testing or training programs will be funded, or that we will win this business.

If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit our ability to grow.

Our products and services largely comprise intellectual property delivered through a variety of media, including newspapers, books, the internet and other growing delivery platforms. We rely on trademark, copyright and other intellectual property laws to establish and protect our proprietary rights in these products and services.

Our intellectual property rights in countries such as the US and the UK, jurisdictions covering the largest proportion of our operations, are well established. However, we also conduct business in other countries where the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. We cannot guarantee that our intellectual property rights will provide competitive advantages to us; our intellectual property rights will be enforced in jurisdictions where competition may be



intense or where legal protection may be weak; any of the intellectual property rights that we may employ in our business will not lapse or be invalidated, circumvented, challenged, or abandoned; or that we will not lose the ability to assert our intellectual property rights against others. Moreover, despite trademark and copyright protection, third parties may copy, infringe or otherwise profit from our proprietary rights without our authorization. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance.

A control breakdown or service failure in our school assessment and qualification businesses could result in financial loss and reputational damage.

There are inherent risks associated with our school assessment and qualification businesses, both in the US and the UK. A service failure caused by a breakdown in our testing and assessment processes could lead to a mis-grading of student tests and/or late delivery of test results to students and their schools. In either event we may be subject to legal claims, penalty charges under our contracts, non-renewal of contracts and/or the suspension or withdrawal of our accreditation to conduct tests. It is also possible that such events would result in adverse publicity, which may affect our ability to retain existing contracts and/or obtain new customers.

Our professional services and school assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed or face increased competitive pressures.

Our services and assessment businesses are characterized by contracts spread over several years. As in any contracting business, there are inherent risks associated with the bidding process, start-up, operational performance and contract compliance (including penalty clauses) which could adversely affect our financial performance and/or reputation. Failure to retain these contracts at the end of the contract term could adversely impact our future revenue growth.

Our investment into inherently riskier emerging markets is growing and the returns may be lower than anticipated.

To take advantage of international growth opportunities and to reduce our reliance on our US and UK markets we are increasing our investments in a number of emerging markets, some of which are inherently more risky than our traditional markets. Political, regulatory, economic and legal systems in emerging markets may be less predictable than in countries with more developed institutional structures. Political, regulatory, economic, currency, reputational and corporate governance and compliance risks (including fraud, bribery and corruption) as well as unmanaged expansion are all factors which could limit our returns on investments made in these markets.

Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations, could lead to goodwill and intangible asset impairments.

We continually acquire and dispose of businesses to achieve our strategic objectives. In early 2014 we acquired Grupo Multi, a provider of private language schools in Brazil. Acquired goodwill and intangible assets could be impaired if we are unable to generate the anticipated revenue growth, synergies and/or cost savings associated with these or other acquisitions.

In July 2013, Pearson and Bertelsmann completed the combination of their respective consumer publishing businesses to create Penguin Random House, in which we hold a 47% equity interest. Although Penguin Random House is the world's leading consumer publishing company, our investment and associated return are subject to the continuing success of this venture, in a competitive global market.



We operate in markets that are dependent on Information Technology (IT) systems and technological change.

All our businesses, to a greater or lesser extent, are dependent on information technology. We either provide software and/or internet services to our customers or we use complex IT systems and products to support our business activities, including customer-facing systems, back-office processing and infrastructure. We face several technological risks associated with software product development and service delivery, information technology security (including virus and cyber-attacks), e-commerce, enterprise resource planning system implementations and upgrades. Although plans and procedures are in place to reduce such risks, from time to time we have experienced verifiable attacks on our systems by unauthorized parties. To date such attacks have not resulted in any material damage to us, but our businesses could be adversely affected if our systems and infrastructure experience a significant failure or interruption.

Failure to comply with data privacy regulations and standards or weakness in information security, including a failure to prevent or detect a malicious attack on our systems, could result in a major data privacy breach causing reputational damage to our brands and financial loss.

Across our businesses we hold large volumes of personal data including that of employees, customers, students and citizens. Despite our implementation of security measures, individuals may try to gain unauthorized access to our data in order to misappropriate such information for potentially fraudulent purposes. Any perceived or actual unauthorized disclosure of personally-identifiable information, whether through breach of our network by an unauthorized party, employee theft, misuse or error or otherwise, could harm our reputation, impair our ability to attract and retain our customers, or subject us to claims or litigation arising from damages suffered by individuals, and thereby harm our business and operating results. Failure to adequately protect personal data could lead to penalties, significant remediation costs, reputational damage, potential cancellation of some existing contracts and inability to compete for future business. In addition, we could incur significant costs in complying with the relevant laws and regulations regarding the unauthorized disclosure of personal information.

Our reported earnings and cash flows may be adversely affected by changes in our pension costs and funding requirements.

We operate a number of pension plans throughout the world, the principal ones being in the UK and the US. The major plans are self-administered with the plans' assets held independently of the Group. Regular valuations, conducted by independent qualified actuaries, are used to determine pension costs and funding requirements. As these assets are invested in the capital markets, which are often volatile, the plans may require additional funding from us, which could have an adverse impact on our results.

It is our policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. Our earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in our defined benefit plans. Our greatest exposure relates to our UK defined benefit pension plan, which is valued once every three years. Pension fund deficits may arise because of inadequate investment returns, increased member life expectancy, changes in actuarial assumptions and changes in pension regulations, including accounting rules and minimum funding requirements.

Operational disruption to our business caused by our third party providers, a major disaster and/or external threats could restrict our ability to supply products and services to our customers.

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers, and educational and office facilities, as well as relationships with third party print sites. We have also outsourced some support functions, including information technology and warehousing, to third party providers. The failure of third parties to whom we have outsourced business functions could adversely affect our reputation and financial condition. Failure to recover from a major disaster, (e.g. fire, flood etc.) at a key facility or the disruption of supply from a key third party vendor or partner (e.g. due to bankruptcy) could restrict our ability to service our customers. Similarly external threats, such as a flu pandemic, terrorist attacks, strikes, weather etc., could all affect our business and employees, disrupting our daily business activities.



Changes in students' buying and distribution behavior put downward pressure on price.

Students are seeking cheaper sources of content, e.g. online discounters, file sharing, use of pirated copies, and rentals, along with open source. This change in behavior puts downward pressure on textbook prices in our major markets, and this could adversely impact our results.

Changes in tax law or perceptions on tax planning strategies may lead to higher effective tax rate or negative reputational impact.

Changes in corporate tax rates and/or other relevant tax laws in the UK, US or other jurisdictions could have a material impact on our future reported tax rate and/or our future tax payments. We have been subject to audit by tax authorities. Although we believe our tax provision is reasonable, the final determination of our tax liability could be materially different from our historical income tax provisions, which could have a material effect on our financial position, results of operations or cash flows.

Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders, in line with our broader fiduciary duties. We are committed to complying with all statutory obligations, to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy.

We generate a substantial proportion of our revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuations could adversely affect our earnings and the strength of our balance sheet.

As with any international business our earnings can be materially affected by exchange rate movements. We are particularly exposed to movements in the US dollar to sterling exchange rate as approximately 60% of our total revenue is generated in US dollars. In addition, we are increasingly exposed to a range of international currencies. Sales for 2014, translated at 2013 average rates, would have been £272m or 6% higher.

The inherent volatility of advertising could adversely affect the profitability of our news business.

Advertising revenue is susceptible to fluctuations in economic cycles. Certain of our products, such as the *Financial Times*, are more advertising-driven than our other products. Consequently, these products are more affected by decreases in advertising revenue. As the internet continues to grow as a global medium for information, communication and commerce, advertisers are increasingly shifting advertising dollars from print to online media. Any downturn in corporate and financial advertising spend due to the economic slowdown will negatively impact the results.

If we fail to attract, retain and develop appropriately skilled employees, our business may be harmed.

Our success depends on the skill, experience and dedication of our employees. If we are unable to attract, retain and develop sufficiently experienced and capable personnel, especially in technology, product development, sales and management, our business and financial results may suffer. When talented employees leave, we may have difficulty replacing them, and our business may suffer. There can be no assurance that we will be able to successfully retain and attract the personnel that we need.

Social, environmental and ethical risks may also adversely impact our business.

We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. These include journalistic/author integrity, ethical business behavior, intellectual copyright protection, compliance with UN Global Compact standards, environmental impact, people and data privacy.



Failure to adequately protect employees and learners could have negative financial, legal and reputational impacts.

We take very seriously the health, safety, well-being and protection of our employees, learners and customers and implement appropriate policies, standards and procedures. However, there may be accidents or incidents that occur, causing injury or harm to individuals. This may include our direct delivery businesses where we are operating, either ourselves or in partnership, schools, colleges, universities, testing and assessment centers.

Our business depends on a strong brand, and any failure to maintain, protect and enhance our brand would hurt our ability to retain or expand our business.

We have developed a strong brand that we believe has contributed significantly to the success of our business. Maintaining, protecting and enhancing the Pearson brand is critical to expanding our business and will depend largely on our ability to maintain our customers' trust in our solutions and in the quality and integrity of our products and services. If we do not successfully maintain a strong brand, our business could be harmed.

ITEM 4. INFORMATION ON THE COMPANY

Pearson plc

Pearson plc, (Pearson) is an international education and media company with its principal operations in the education, business information and consumer publishing markets. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names, to inform, educate and entertain. We deliver our content in a variety of forms and through a variety of channels, including books, newspapers and online services. We offer services as well as content, from test creation, administration and processing to teacher development and school software. Though we operate in more than 70 countries around the world, today our largest markets are the US (58% of sales) and Europe (20% of sales) on a continuing basis.

Pearson was incorporated and registered in 1897 under the laws of England and Wales as a limited company and re-registered under the UK Companies Act as a public limited company in 1981. We conduct our operations primarily through our subsidiaries and other affiliates. Our principal executive offices are located at 80 Strand, London WC2R 0RL, United Kingdom (telephone: +44 20 7010 2000).

Overview

Pearson consists of its worldwide education business, including the FT Group plus a 47% interest in Penguin Random House.

Pearson education is a leading provider of educational materials and learning technologies. It provides test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. It publishes across the curriculum and provides a range of education services including teacher development, educational software and system-wide solutions, and also owns and operates schools. In February 2013, the Group launched a transformation program which is now largely complete. Over the course of two years, Pearson carried out as much restructuring, in terms of activity and costs incurred, as had been undertaken in the previous six years.

From 1 January 2014 the Group has been run as one global education company, organized around three geographical operating segments (North America, Core and Growth), and three lines of business corresponding to the key stages of learning, (schools, higher education and professional, which includes the FT Group). The lines of business, are responsible for the global strategy, investment priorities, product strategy and product portfolio for respective learner age and stage. The geographies are responsible for customer relationships, sales and marketing, and delivery of education products in their markets. Supporting this structure are the global functions which partner with the geographies and lines of business and operate as integrated global functions to achieve scale economies.



Pearson owns a 47% interest in Penguin Random House, which was formed on July 1, 2013, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House. Pearson accounts for its interest in Penguin Random House on the equity basis.

Our strategy

Pearson's goal is to help people make measurable progress in their lives through all kinds of learning. Over the past decade, through a major program of organic investment and acquisitions, Pearson has become one of the leading education companies in the world, with unique geographic reach, product breadth and professional depth.

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

The transformation programme we launched in February 2013 is now complete. The programme has been all about setting Pearson up to be able to demonstrate the impact of what we do in education around the world. It is about enabling us to do right across Pearson the thing that we have done increasingly well in many parts of the company. That is, we stand at the intersection of new technology (with its ability to engage, personalize and diagnose) and new, more effective ways of teaching. This position allows us to develop products and services that enable the benefits of richer, deeper learning to be more widely felt.

In 2015 the five priorities outlined below are guiding our work:

- A business model focused on helping more people achieve better learning outcomes — our efficacy initiative, first outlined in last year's report is no longer just a framework. Efficacy is now at the centre of our business model and a major part of how we create value. This year, we will embed it even more deeply into the fabric of everything we do so that it reaches more products, influences more people and transforms more processes. As our customers become more focused on achieving better returns on education related spending, Pearson is at the forefront of a great global growth opportunity, and it enables us to put our social impact at the very heart of our business. This applies to our Project Literacy campaign and the renewed investment in our Pearson Affordable Learning Fund, just as it does to the research and development of new products and services and the way we engage with our customers each day. It is the means by which we ensure that education is more accessible, impactful and affordable, and delivers those outcomes to people regardless of location.
- New digital products — to further this work we will be launching new global products to meet the need for much better learning outcomes. They connect content with assessment and feedback. They use analytics and big data to personalize learning — making it a far more collaborative and effective experience for students and teachers. They all draw on world-class research into the science of teaching and learning. In the end they will all be mobile first and device neutral. And they are all designed to take full account of just how 'messy' education can be, how important it is to be able to deliver large and complex projects, and how to deal with 'last mile' issues. Our customers all know that the real problem in education is not finding a great teacher or a really good school, but being able to replicate that excellence at scale. All our new digital products are focused on meeting that need.
- A more focused company — we are building these products in a modular and scalable way, and deploying them on a smaller number of global platforms. This improves the customer experience, makes it much easier to share assets and resources across the whole company, and is also much more cost effective. It is one example as to how we are simplifying our company. We have already reduced the number of applications and systems used across the company by 10%, and we will continue that work this year. We have already sold a number of businesses where either we lacked scale or we saw limited scope for us to have a more direct impact on learning outcomes. This work will continue, as we



focus our resources and energy on the biggest education challenges we see around the world. It is where we can make the biggest impact, and where, by running Pearson as one company we see the biggest opportunity.

- A more consistently high performing culture — At its best, Pearson has always championed high performance; we are now taking a whole series of action (including how we recruit, appraise and reward everyone who works for Pearson) to make this a feature of everything we do. We have reaffirmed, and amplified, our long held values of “brave, imaginative and decent”, which are particularly important at a time of great change. (Of the top 100 executives in the company, 70 are, in the last two years, new to their roles in the company.) We have also added “accountable” as a fourth core value. This is important to ensure that, in our new more “matrix” style organization, we all actively help each other to achieve our collective goals. It also recognises how important it is to be accountable to the public trust for all we do in education around the world.
- A stronger brand — this accountability extends to our willingness to engage in the public debate. Education is one of the most important areas of public life and evokes strong emotions and opinions in a field where data and evidence as to ‘what works’ can be difficult to come by. Our focus on educational impact and learning outcomes — and our openness and transparency in holding ourselves to account in achieving these goals — is vital to address these concerns. Today, public awareness of Pearson, as the world’s leading learning company, is still relatively limited. If we are going to achieve our full potential, we need to build Pearson, as a global education brand that is known for our work in empowering more people to progress in their lives through learning. This means, for example, that we need to be much less muted in our engagement in the some circa 78 million-voice strong “global conversation” that our research tells us is currently taking place around the topics of ‘education’ and ‘learning’. And we also need to organize our product marketing so that we position Pearson, especially online and through social media, in a much more coherent way.

As we succeed in our strategy, we will grow our market opportunity and help many more people make progress in their lives through learning. As a result, we will start to grow again in 2015, and more importantly, will set us up to be a faster-growing, leaner, more profitable and cash-generative company for years to come. We will be a company deploying less capital, and capable of earning higher returns.

Operating divisions

Pearson is one of the leading providers of educational materials and learning technologies. We provide test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. We publish across the curriculum and provide a range of education services including teacher development, educational software and system-wide solutions.

We report Pearson’s performance in three segments: North America, Growth, and Core.

North America

Our North American business serves educators and students in the US and Canada from early education through elementary, middle and high schools and into higher education with a wide range of products and services: curriculum textbooks and other learning materials; student assessments and testing services; and education technologies. Pearson has a leading position in each of these areas and a distinctive strategy of connecting those parts to support institutions and personalize learning. Our largest market is North America, and across the US we are working with states, schools and colleges to help make education more effective, accessible and affordable for a diverse community of learners.

Our North America school business offers early learning solutions that help educators and families teach fundamental math and literacy skills; elementary and secondary imprints publish leading school programs in



reading, literature, math, science, and social studies; and digital instructional solutions for pre K-12, such as enVisionMATH and Miller-Levine Biology. We are partnering with industry leaders like Microsoft and Apple to provide school districts with tablets pre-loaded with the latest digital curriculum, including the Pearson System of Courses, a complete tablet-based teaching and learning system. Nearly 50% of US schools use one of our tools to aid professional development and help teachers and administrators improve their effectiveness. Through our Connections Education business we provide school management services and operate virtual and blended schools.

Testing plays an integral role in determining educator and student success and we are the largest provider of educational assessment services in the US. We mark large-scale school examinations for the US federal government and more than 25 American states, scoring billions of machine-scorable test questions and evaluating more than 111 million essays, portfolios and open-ended test questions every year. Working with educators and education advocates, our experts are helping to lead the development of Next-Generation Assessments that feature technology-enhanced items, performance-based assessments, and adaptive learning to foster problem-solvers and critical thinkers ready to compete in the global economy.

Our solutions include learning assessments to help gauge how students learn, talent assessments to help growing companies develop their workforce, and clinical assessments to help psychologists and speech/language/hearing/occupational and physical therapists diagnose and monitor patients.

Our North America Higher Education business offers learning services for students, colleges and universities in the US. We provide learning tools and technologies, and about three million US College students are currently pursuing their studies online using Pearson Higher Education's products. Our custom content and curriculum solutions offer educators the opportunity to tailor their programs based on the needs of students. We also offer workforce education products and flexible workforce development solutions to fill the growing skills gap and increased demand for quality certification prep training. College and career readiness is a K-20 issue, and it requires effective strategies employed in both K-12 and higher education. Our solutions are designed to help institutions retain students and prepare them for success in college and beyond.

More than 11 million US college students have used our learning technologies to pursue their studies. The growing trend provides a wealth of data and analytics to improve the performance of individual students. Our advance capabilities in data, analytics and adaptive learning, and our leading efficacy research, enable us to design a smart learning path for every student.

The demand for online learning is steadily rising, and Pearson On Line Services runs fully online undergraduate and graduate learning programmes, such as the programmes at Arizona State University Online and University of Florida Online.

See "Item 5. Operating and Financial Review and Prospects — Results of Operations — Year ended December 31, 2014 compared to year ended December 31, 2013 — Sales and operating profit by division — North America" for a discussion of developments during 2014 with respect to this segment.

Growth Markets

Our aim is to take educational products and services and apply them at scale in countries such as Brazil, South Africa, China, India and other fast-growing economies. Around one third of our employees now work in these countries. We reach around two million students directly through our English language schools in China, Brazil and elsewhere, our partner schools in Brazil and India, and our vocational and higher education institutions from Saudi Arabia to South Africa, as well as millions more with our textbooks and educational software.

In Brazil we are leading primary and secondary education with our 'sistemas' or learning systems which include COC, Dom Bosco, Pueri Domus and NAME. In South Africa we run thirteen of our CTI and MGI



campuses throughout the country. We have over 13,000 students enrolled in courses ranging from undergraduate degrees in IT and sociology, to business diplomas and Masters courses in psychology. Our campuses prioritise digital learning with over 10,000 of our students accessing their courses through tablet devices, and focus on learning outcomes that prepare students for employment opportunities in their chosen careers.

See “Item 5. Operating and Financial Review and Prospects — Results of Operations — Year ended December 31, 2014 compared to year ended December 31, 2013 — Sales and operating profit by division — Growth” for a discussion of developments during 2014 with respect to this segment.

Core Markets

Our biggest core markets are the UK, Australia, Germany, France, the Benelux countries and Italy. These are countries where we work closely with educators and policy makers to improve learning through creating curriculum, designing assessments and developing digital learning systems. Additionally we have around 100 other ‘Partner’ markets, where we do not have scale ourselves, so we collaborate with others who share our values and commitment to efficacy to maximize reach and impact.

In the UK school market, we are the largest awarding organization offering academic and vocational qualifications that are globally recognised and benchmarked, with educational excellence rooted in names like Edexcel, BTEC and LCCI. Learners take our qualifications in more than 80 countries worldwide. We use our online marking technology to mark over 97% of examination papers and our ResultsPlus service provides detailed analysis of every learner’s examination results. We are also driving innovation through digital products such as Bug Club and ActiveLearn, and supporting skills for employability for progression in study, work and life.

Through Pearson College we are the only FTSE 100 company delivering degrees in the UK. Our students get the chance to learn from leading employers as well as experienced academics and subject experts, in the heart of a 21st Century business.

See “Item 5. Operating and Financial Review and Prospects — Results of Operations — Year ended December 31, 2014 compared to year ended December 31, 2013 — Sales and operating profit by division — Core” for a discussion of developments during 2014 with respect to this segment.

The details below describe our professional line of business, which is geographically spread over the three above segments.

The Financial Times (FT) is one of the world’s leading news organisations, recognised globally for its authority, integrity and accuracy. The FT provides a broad range of essential services, including news, comment, data and analysis, to a growing audience of internationally minded professionals. The FT is comprised of the FT newspaper and FT.com, Financial Publishing, FT Chinese, FT Labs, and Medley Global Advisors. The FT Group also has a number of associates and joint ventures including a 50% interest in The Economist Group, a publisher of one of the world’s leading weekly business and current affairs magazines.

Our professional testing business, Pearson VUE (VUE), is a global leader in electronic testing for regulatory and certification boards, providing a full suite of services from test development to test delivery and data management. Pearson VUE offers exams through an extensive network of over 7,200 test centres across 194 countries, delivering the NCLEX exam for the National Council of State Boards of Nursing, the GMAT for the Graduate Management Admissions Council and numerous IT exams such as Cisco and CompTIA. In the UK Pearson VUE works with the DVSA to deliver the Driver Theory Test and the Construction Industry Training Board (CITB).

Pearson VUE also includes Certiport, the world-leader in IT performance-based exams delivered through a global network of academic test centres, and GED Testing Service, a joint venture with the American Council on Education to deliver a leading high school equivalency exam.



Pearson's English assets make the company the world's largest English language learning business. More than 1.5 million teachers and 35 million students use our English language learning resources and tools each year. The businesses in Pearson's English division include: Wall Street English (centre-based learning for consumers); ELT (institutional English language publications including brands such as Longman) and Pearson English Business Solutions (online business English learning solutions).

In 2014 Pearson English released the Global Scale of English, the world's first common, global benchmark of English language learning. It measures English language progress on a numeric scale in a way that is consistent, granular and actionable for governments, corporates, academics, institutions and learners. The Scale has been created as the Open Standard for English that meets a global need.

Penguin Random House

For the first six months of 2013, Pearson wholly owned Penguin, one of the most famous brands in book publishing. On July 1, 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% respectively.

Penguin Random House comprises the adult and children's fiction and nonfiction print and digital book publishing businesses of Penguin and Random House in the US, UK, Canada, Australia, New Zealand and India, Penguin's publishing activity in Asia and South Africa, as well as Dorling Kindersley worldwide, and Random House's companies in Spain, Mexico, Argentina, Uruguay, Columbia and Chile.

Penguin Random House employs more than 10,000 people globally across almost 250 editorially and creatively independent imprints and publishing houses that collectively publish more than 15,000 new titles annually. Its publishing list include more than 70 Nobel Prize laureates and hundreds of the world's most widely read authors.

Penguin Random House sells directly to bookshops and through wholesalers. Retail bookshops normally maintain relationships with both publishers and wholesalers and use the channel that best serves the specific requirements of an order. It also sells through online retailers such as Amazon.com, as well as its own websites and direct to the customer via digital sales agents.

In 2014, our share of Penguin Random House profit after tax as of December 31, 2014 was £35m.

See "Item 5. Operating and Financial Review and Prospects — Results of Operations — Year ended December 31, 2014 compared to year ended December 31, 2013 — Sales and operating profit by division — Consumer Publishing" for a discussion of developments during 2014 with respect to Penguin Random House.

Operating cycles

Pearson determines a normal operating cycle separately for each entity/cash generating unit within the Group with distinct economic characteristics. The "normal operating cycle" for each of the Group's education businesses is primarily based on the expected period over which the educational programs and titles will generate cash flows, and also takes account of the time it takes to produce the educational programs.

Particularly for the North American businesses, there are well established cycles operating in the market:

- The School market is primarily driven by an adoption cycle in which major state education boards 'adopt' programs and provide funding to schools for the purchase of these programs. There is an established and published adoption cycle with new adoptions taking place on average every 5 years for a particular subject. Once adopted, a program will typically sell over the course of the subsequent 5 years. The Company renews its pre-publication assets to meet the market adoption cycles. Therefore the operating cycle naturally follows the market cycle.
- The Higher Education market has a similar pattern, with colleges and professors typically refreshing their courses and selecting revised programs on a regular basis, often in line with the release of new



editions or new technology offerings. The Company renews its pre-publication assets to meet the typical demand for new editions of, or revisions to, educational programs. Analysis of historical data shows that the average life cycle of Higher Education content is up to 5 years. Again the operating cycle mirrors the market cycle.

A development phase of typically 12 to 18 months for Higher Education and up to 24 months for School precedes the period during which the Company receives and delivers against orders for the products it has developed for the program.

The Core and Growth markets operate in a similar way although often with less formal 'adoption' processes.

The operating cycles in respect of our professional line of business are more specialized in nature as they relate to educational or heavy reference products released into smaller markets (e.g. the financial training, IT and travel sectors). Nevertheless, in these markets, there is still a regular cycle of product renewal, in line with demand which management monitor. Typically the life cycle is 5 years for Professional content. Elsewhere in the Group operating cycles are typically less than one year.

Competition

Pearson's businesses operate in highly competitive environments.

Pearson competes with other publishers and creators of educational materials and services. These companies include publishers such as Cengage Learning, McGraw-Hill and Houghton Mifflin Harcourt, and services companies, such as K-12 Inc and ETS, alongside smaller niche players that specialize in a particular academic discipline or focus on a learning technology. Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the school boards, educators and government officials making purchasing decisions.

In addition, the FT Group competes with newspapers and other information sources, such as The Wall Street Journal, by offering timely and expert journalism and market intelligence. It competes for advertisers with other forms of media based on the ability to offer an effective means for advertisers to reach their target audience.

Intellectual property

Our principal intellectual property assets consist of our trademarks and other rights in our brand names, particularly the *Financial Times* and the various imprints of our educational materials, as well as all copyrights for our content and our patents held in the testing business in the name of NCS Pearson. We believe we have taken all appropriate available legal steps to protect our intellectual property in all relevant jurisdictions.

Raw materials

Paper is the principal raw material used by Pearson. We purchase most of our paper through our Global Sourcing department located in the United States. We have not experienced and do not anticipate difficulty in obtaining adequate supplies of paper for our operations, with sourcing available from numerous suppliers. While local prices fluctuate depending upon local market conditions, we have not experienced extensive volatility in fulfilling paper requirements. In the event of a sharp increase in paper prices, we have a number of alternatives to minimize the impact on our operating margins, including modifying the grades of paper used in production.

Government regulation

The manufacture of certain of our products in various markets is subject to governmental regulation relating to the discharge of materials into the environment. Our operations are also subject to the risks and uncertainties



attendant to doing business in numerous countries. Some of the countries in which we conduct these operations maintain controls on the repatriation of earnings and capital and restrict the means available to us for hedging potential currency fluctuation risks. The operations that are affected by these controls, however, are not material to us. Accordingly, these controls have not significantly affected our international operations. Regulatory authorities may have enforcement powers that could have an impact on us. We believe, however, that in light of the nature of our business the risk of these sanctions does not represent a material threat to us.

The US Iran Threat Reduction and Syria Human Rights Act of 2012 requires US-listed companies to disclose information relating to certain transactions with Iran, even when such transactions were in accordance with applicable laws. In 2014, certain non-US Group companies in compliance with applicable law provided subscriptions to the Financial Times newspaper to Iranian individuals, a subscription to an FT Group publication to an Iranian bank and accepted advertising in an FT Group publication from several Iranian banks. The gross revenues to the Group from these activities were approximately £54,000, and we estimate the net profit was approximately £6,000. In 2014, certain non-US Group companies in compliance with applicable law incurred approximately £65,000 of cost in relation to journalistic activities and the establishment of a news bureau. The Group may undertake similar activities in future periods in accordance with applicable law.

Licenses, patents and contracts

We are not dependent upon any particular licenses, patents or new manufacturing processes that are material to our business or profitability. Likewise, we are not materially dependent upon any contracts with suppliers or customers, including contracts of an industrial, commercial or financial nature.

Legal Proceedings

We and our subsidiaries are from time to time the subject of legal proceedings incidental to the nature of our and their operations. These may include private litigation or arbitrations, governmental proceedings and investigations by regulatory bodies. We do not currently expect that the outcome of pending proceedings or investigations, either individually or in aggregate, will have a significant effect on our financial position or profitability nor have any such proceedings had such effect in the recent past. To our knowledge, there are no material proceedings in which any member of senior management or any of our affiliates is a party adverse to us or any of our subsidiaries or in respect of which any of those persons has a material interest adverse to us or any of our subsidiaries.

Recent developments

There were no material events after the balance sheet date.

Organizational structure

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries and associates as at December 31, 2014, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

<u>Name</u>	<u>Country of incorporation/residence</u>	<u>Percentage interest/voting power</u>
Pearson Education Inc.	United States (Delaware)	100%
Pearson Education Ltd.	England and Wales	100%
NCS Pearson Inc.	United States (Minnesota)	100%
The Financial Times Ltd.	England and Wales	100%
Penguin Random House LLC.	United States (Delaware)	47%
Penguin Random House Ltd.	England and Wales	47%



Property, plant and equipment

Our headquarters are located at leasehold premises in London, England. We own or lease approximately 1,150 properties, including approximately 700 testing/teaching centers in over 60 countries worldwide, the majority of which are located in the United Kingdom, the United States and China.

The properties owned and leased by us consist mainly of offices, distribution centers and computer testing/teaching centers.

The vast majority of our printing is carried out by third party suppliers. We operate a small digital print operation as part of our Pearson Assessment & Testing businesses which provides short-run and print-on-demand products, typically custom client applications.

We own the following principal properties at December 31, 2014:

<u>General use of property</u>	<u>Location</u>	<u>Area in square feet</u>
Office	Iowa City, Iowa, USA	312,760
Warehouse/Office	Old Tappan, New Jersey, USA	212,041
Warehouse/Office	Cedar Rapids, Iowa, USA	205,000
Office	Southwark, London, UK	155,000
Office	Hadley, Massachusetts, USA	137,070
Printing	Owatonna, Minnesota, USA	128,000

We lease the following principal properties at December 31, 2014:

<u>General use of property</u>	<u>Location</u>	<u>Area in square feet</u>
Warehouse/Office	Lebanon, Indiana, USA	1,091,435
Warehouse/Office	Cranbury, New Jersey, USA	886,747
Warehouse/Office	Indianapolis, Indiana, USA	737,850
Office	Upper Saddle River, New Jersey, USA	474,801
Office	Hoboken, New Jersey, USA	422,686
Office	New York City, New York, USA	313,285
Office	London, UK	282,923
Warehouse/Office	Newmarket, Ontario, Canada	278,912
Warehouse/Office	San Antonio, Texas, USA	228,285
Warehouse/Office	Austin, Texas, USA	226,076
Office	Boston, Massachusetts, USA	225,299
Office	Noida, India	192,122
Office	Glenview, Illinois, USA	187,500
Warehouse/Office	Bedfordshire, UK	186,570
Office	Bloomington, Minnesota, USA	167,218
Warehouse/Office	Cape Town, South Africa	160,387
Warehouse/Office	Uttar Pradesh, India	145,041
Office	Manchester, UK	139,680
Office	Boston, Massachusetts, USA	138,112
Office	Harlow, UK	137,857
Office	Chandler, Arizona, USA	135,460
Warehouse	Sao Paulo, Brazil	132,331
Teaching Centre	Midrand, South Africa	130,117
Warehouse/Office	Cedar Rapids, Iowa, USA	119,682
Office	Centennial, Colorado, USA	117,554
Warehouse	Naucalpan, Mexico	113,638
Teaching Centre	Pretoria, South Africa	105,241
Call Center/Office	Lawrence, Kansas, USA	105,000



Capital Expenditures

See “Item 5. Operating and Financial Review and Prospects — Liquidity and Capital Resources” for description of the Company’s capital expenditure.

ITEM 4A. UNRESOLVED STAFF COMMENTS

The Company has not received, 180 days or more before the end of the 2014 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis is based on and should be read in conjunction with the consolidated financial statements, including the related notes, appearing elsewhere in this Annual Report. The financial statements have been prepared in accordance with IFRS as issued by the IASB.

Where this discussion refers to constant currency comparisons, these are estimated by re-calculating the current year results using the exchange rates prevailing for the prior period. The increase or reduction in the value calculated is the estimate of impact of exchange rates. We believe this presentation provides a more useful period to period comparison as changes due solely to changes in exchange rates are eliminated.

General overview

Introduction

From January 1, 2014 Pearson has reorganised and is reporting new segments to reflect the new structure and operating model. The primary segments for management and reporting are geographical as follows: North America, comprising the School, Higher Education and Professional businesses in US and Canada; Growth, comprising the School, Higher Education and Professional businesses in emerging markets which are investment priorities, including Brazil, China, India and South Africa; and Core, comprising the School, Higher Education and Professional businesses in more mature markets, including the UK, Australia and Italy. In addition Pearson separately reports on an equity basis the results from its Penguin Random House (PRH) associate.

All figures for 2013 have been restated to reflect the new segments. Revenue figures only have been restated in 2012 and it is impracticable to restate profit figures for this year. The change in management structure was anticipated in 2013 and systems and reporting were updated for the proposed change, however the information is not available for reporting 2012 results under the new management structure.

Our discussion in “Item 5. Operating and Financial Review and Prospects — Results of Operations — Year ended December 31, 2014 compared to year ended December 31, 2013 — Sales and operating profit by division” discusses results under the new management and segmental reporting structure for both years. Our discussion in “Item 5. Operating and Financial Review and Prospects — Results of Operations — Year ended December 31, 2013 compared to year ended December 31, 2012 — Sales and operating profit by division” addresses a comparison of overall results, divisional revenue and a discussion on performance of divisions based on products and geographies that approximate the new segments.

In July 2013, Pearson and Bertelsmann completed a transaction to create a new consumer publishing business by combining Penguin and Random House, and from that point, Pearson no longer controlled the Penguin Group of companies. Pearson accounts for its 47% associate interest in the new Penguin Random House venture on the equity basis. The results for Penguin in 2012 and the first half of 2013 have been included in discontinued operations. The share of results from the associate interest in the Penguin Random House venture arising in the second half of 2013, and in 2014 has been included in operating profits in continuing operations.



On November 29, 2013 Pearson announced the sale of the Mergermarket Group to BC Partners. The sale was completed on February 4, 2014 and the Mergermarket business was classified as held for sale on the balance sheet at December 31, 2013. Mergermarket's results for 2014, 2013 and 2012 have been included in discontinued operations.

Sales from continuing operations declined from £5,069m in 2013 to £4,874m in 2014, a decrease of £195m or 4%. This year on year decline was largely due to currency movements, primarily the strength of sterling relative to the US dollar during the year. In 2014 currency movements decreased sales by £272m when compared to the equivalent figures at constant 2013 rates. When measured at 2013 constant exchange rates, our sales grew 2%.

Reported operating profit (from continuing operations) decreased by £60m or 13% from £458m in 2013 to £398m in 2014. In 2014 our operating profit included a £77m write down of the balance sheet value of intangibles in our Indian business, a £38m loss on disposal of our stake in Nook Media and a £40m gain on the disposal of our stakes in Safari Books Online and CourseSmart. Gross restructuring costs in 2014 were £84m compared with £176m in 2013, offset by estimated net benefits in-year of £40m in 2014 and £41m in 2013. Currency movements adversely affected operating profit, and we estimate that operating profit would have been approximately £36m higher if translated at constant 2013 exchange rates.

Profit before taxation in 2014 of £305m compared to a profit before taxation of £382m in 2013. The decrease of £77m reflects the £60m decrease on reported operating profit identified above, plus an increase in net finance costs of £17m from £76m in 2013 to £93m in 2014. The Group's net interest payable decreased from £72m in 2013 to £64m in 2014, mainly due to the impact of foreign exchange translation and additional interest receivable on cash balances held overseas which offset the effect of higher average net debt levels in the period. Also included in net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2014 the total of these items was a loss of £29m compared to a loss of £4m in 2013. Both the losses in 2014 and 2013 mainly relate to foreign exchange differences on un-hedged cash and cash equivalents, and other financial instruments.

Net cash generated from operations increased to £704m in 2014 from £684m in 2013. The principal reasons for the increased cash flow were due to improved working capital from deferred revenue growth, partly offset by increased investment levels and ongoing restructuring charges. Our average working capital to sales ratio improved by 1.1 percentage points to 12.3% reflecting lower inventory levels and the absence of Penguin. Average working capital comprises the average of the monthly carrying values over the relevant 12 month period for inventory, pre-publication costs, debtors and creditors, including deferred revenue. Net interest paid at £73m in 2014 was in line with the £73m paid in 2013. Tax paid in 2014 was £163m compared to £246m in 2013. Tax paid in 2013 was unusually high as a result of the permitted deferral of US tax payments in 2012 following Hurricane Sandy. These payments were subsequently made in 2013 and were accompanied by additional payments arising from settlements with tax authorities including £55m relating to prior year disposals. Net capital expenditure on property, plant and equipment after proceeds from sales decreased to £66m in 2014 from £90m in 2013. The net cash outflow in respect of businesses and investments acquired was £463m in 2014, the majority of which related to the acquisition of Grupo Multi, and £122m in 2013. The net cash inflow in respect of businesses and investments disposed was £375m in 2014, primarily in respect of the Mergermarket sale, and was an outflow of £128m in 2013 due to the cash disposed with the Penguin business and the transaction costs on the formation of the venture. Dividends from joint ventures and associates increased from £64m in 2013 to £120m in 2014 due to dividends received only in the second half of 2013 from the Penguin Random House venture compared to a full year in 2014. Dividends paid of £398m in 2014 (including £1m paid to non-controlling interests) compares to £372m in 2013 (no amounts paid to non-controlling interests). Overall the Group's net borrowings rose from £1,379m at the end of 2013 to £1,639m at the end of 2014. The increase in net debt was due to the strengthening of the US dollar relative to sterling and the acquisition of Grupo Multi, partly offset by the disposal of Mergermarket, fewer restructuring charges, improved working capital, the growth in deferred revenue and an increased dividend from Penguin Random House.



Outlook

In 2014 we completed the major restructuring and product investment programme, initiated in 2013, designed to accelerate Pearson’s shift towards significant growth opportunities in digital, services and fast-growing economies. We believe this will provide Pearson with a significantly larger market opportunity, a sharper focus on the fastest-growing markets and stronger financial returns. In 2015, we are returning to more normal levels of restructuring expenditure. We will benefit from the absence of £44m of exceptional net restructuring charges expensed in 2014 and we still expect to generate £45m of incremental cost savings in 2015. These benefits will be partly offset by normal levels of net restructuring of approximately £30m in 2015.

We continue to expect that cyclical and policy related factors stabilise in 2015. In North America, our largest market, we expect growth in online higher education services and VUE (our professional assessments business) and, with more stable college enrollments and a slower new edition year, learning services to be broadly level. In school, while the possibility of further policy related disruption remains, we expect greater stability in learning services and assessments with growth in virtual schools.

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

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

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

Pearson has initiated a process to explore a possible sale of PowerSchool and our other Student Information Systems businesses including PowerSchool SMS, Gradespeed, and eSIS Forms. This process is at an early stage and there is no certainty that it will lead to a transaction.

Sales information by segment

The following table shows sales information for each of the past three years segment:

	Year Ended December 31		
	2014	2013	2012
	£m	£m	£m
North America	2,974	3,073	2,942
Core	1,154	1,258	1,323
Growth	746	738	694
Total continuing operations	4,874	5,069	4,959
Discontinued operations	9	621	1,153
Total	<u>4,883</u>	<u>5,690</u>	<u>6,112</u>



Sales information by geographic market supplied

The following table shows sales information for each of the past three years by geographic region:

	Year Ended December 31		
	2014	2013	2012
	£m	£m	£m
Continuing operations			
European countries	957	1,015	1,055
North America	2,936	3,041	2,900
Asia Pacific	598	624	633
Other countries	383	389	371
Total continuing operations	4,874	5,069	4,959
Discontinued operations			
European countries	4	146	279
North America	4	393	704
Asia Pacific	1	74	153
Other countries	—	8	17
Total discontinued operations	9	621	1,153
Total	4,883	5,690	6,112

In the table above sales are allocated based on the country in which the customer is located.

Exchange rate fluctuations

We earn a significant proportion of our sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was £1:\$1.65 in 2014, £1:\$1.57 in 2013 and £1:\$1.59 in 2012. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. In 2014, Pearson generated 58% of its continuing sales in the US (2013: 57%; 2012: 56%). In 2014 we estimate that a five cent change in the average exchange rate between the US dollar and sterling would have had an impact on our reported earnings per share of 1.3p and a five cent change in the closing exchange rate between the US dollar and sterling would have had an impact on shareholders' funds of approximately £143m. See "Item 11. Quantitative and Qualitative Disclosures about Market Risk" for more information. The year-end US dollar rate for 2014 was £1:\$1.56 compared to £1:\$1.66 for 2013 and £1:\$1.63 for 2012. The total impact on shareholders' funds of foreign exchange translation was a gain of £175m in 2014 compared to a loss of £217m in 2013. These net movements are principally due to movements in the US dollar as a significant portion of the Group's operations are in the US.

Critical accounting policies

Our consolidated financial statements, included in "Item 18. Financial Statements", are prepared based on the accounting policies described in note 1 to the consolidated financial statements.

Certain of our accounting policies require the application of management judgment in selecting assumptions when making significant estimates about matters that are inherently uncertain. Management bases its estimates on historical experience and other assumptions that it believes are reasonable. These policies are described in note 1a(3) in "Item 18. Financial Statements".



Results of operations

Year ended December 31, 2014 compared to year ended December 31, 2013

Consolidated results of operations

Sales

Our total sales from continuing operations decreased by £195m, or 4%, from £5,069m in 2013, to £4,874m in 2014. The overall decrease reflected growth on a constant exchange rate basis of 2% together with additional contributions from acquisitions, which was more than offset by the impact of currency movements. The 2014 sales, translated at 2013 average exchange rates, would have been £272m more at £5,146m.

North America sales declined by £99m or 3% from £3,073m to £2,974m, due to the strengthening of sterling against the US dollar. We estimate that after excluding acquisitions and disposals and the impact of exchange, North America sales growth was 2% in 2014 compared to 2013. North America continued to be the most significant source of our sales and as a proportion of sales contributed 61% in both 2014 and 2013. Revenue growth in Connections Education, VUE, Clinical and Higher Education was partially offset by declines in School learning services and State assessments.

Core sales declined by £104m or 8% from £1,258m in 2013 to £1,154m in 2014. We estimate that after excluding acquisitions and disposals and the impact of exchange, Core sales declined by 5%. Modest growth in Italy and good growth at VUE was offset by declines in UK assessment revenues, due to the impact of policy changes on our UK school qualifications business and reduction in partner market revenues, due to divestments and a move to distributor models implemented in 2013. FT revenues were broadly level at constant exchange rates, with digital content growth offset by declines in print content and advertising.

Growth sales increased by £8m or 1% from £738m in 2013 to £746m in 2014, despite the strength of sterling against key emerging market currencies. We estimate that after excluding both the impact of exchange rates sales grew by 11%, benefiting from the acquisition of Grupo Multi, and after excluding the impact of exchange rates and acquisitions and disposals declined by 1% primarily due to the phasing of purchasing and a stronger school textbook adoption in South Africa in 2013. Growing English Language Learning enrolments in China and college enrolments in Saudi Arabia and South Africa were offset by a smaller school textbook market in South Africa, lower revenues in Brazil from sistemas, and ELT and higher education textbooks.

Cost of goods sold and operating expenses

The following table summarizes our cost of sales and net operating expenses:

	Year Ended December 31	
	2014	2013
	£m	£m
Cost of goods sold	2,202	2,312
Operating expenses		
Distribution costs	87	90
Selling, marketing and product development costs . . .	963	1,027
Administrative and other expenses	1,315	1,162
Restructuring costs	84	176
Other net gains and losses	(2)	16
Other income	(122)	(118)
Total operating expenses	<u>2,325</u>	<u>2,353</u>

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and



testing business and the cost of teaching and facilities in direct delivery businesses. Our cost of sales decreased by £110m, or 5%, from £2,312m in 2013, to £2,202m in 2014. The decrease corresponds primarily to the decrease in sales, with cost of sales at 45.2% of sales in 2014 compared to 45.6% in 2013.

Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs decreased due to the shift to digital and services products.

Selling, marketing and product development costs. Our selling, marketing and product development costs decreased by £64m or 6% from £1,027m in 2013 to £963m in 2014. As a percentage of sales these costs were relatively consistent at 19.8% in 2014 and 20.3% in 2013, reflecting some benefits of restructuring and the effect of foreign exchange.

Administrative and other expenses. Our administrative and other expenses increased by £153m or 13% from £1,162m in 2013 to £1,315m in 2014 due to increased intangible amortisation and an impairment of £77m on the balance sheet value of our Indian business.

Restructuring costs. Restructuring costs related to the transformation and restructure of Pearson in 2014 were £84m compared with £176m in 2013.

Other net gains and losses. Included in other net gains and losses in 2014 are gains on the sale of joint venture interests in Safari Books Online and CourseSmart totaling £40m and a loss on the disposal of an investment in Nook Media of £38m. Included in 2013 is a loss on the disposal of the Japanese school and local publishing assets.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions, together with the service fee income from Penguin Random House. Other operating income increased to £122m in 2014 compared to £118m in 2013 due to a full year of Penguin Random House service fee income of £41m in 2014 compared with a half year of income of £28m in 2013, offset by a decrease in gains on minor asset disposals in 2014 compared with 2013.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates decreased by £3m to £51m in 2014 from £54m in 2013. The increase in contribution from Penguin Random House was more than offset by intangible amortisation and a decrease in the Economist contribution.

Operating profit

Operating profit decreased by £60m or 13% from £458m in 2013 to £398m in 2014. In 2014 our operating profit included a £77m write down of the balance sheet value of intangibles in our Indian business, a £38m loss on disposal of our stake in Nook Media and a £40m gain on the disposal of our stake in Safari Books Online and CourseSmart. Gross restructuring costs in 2014 were £84m compared with £176m in 2013, offset by estimated net benefits in-year of £40m in 2014 and £41m in 2013. Currency movements adversely affected operating profit, and we estimate that operating profit would have been approximately £36m higher if translated at constant 2013 exchange rates.

Net finance costs

Net finance costs increased from £76m in 2013 to £93m in 2014. Net interest payable decreased from £72m in 2013 to £64m in 2014. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) fell by 0.1% to 0.2%. This decrease in floating market interest rates, along with the impact of foreign exchange translation and additional interest receivable on cash balances held overseas, more than offset the effect



of higher levels of average net debt in the period. These factors contributed to the overall decrease in the Group's average net interest payable from 4.8% to 3.6%. The Group's average net debt rose by £260m, largely as a result of net acquisition activity and the translation of our predominantly US dollar debt.

Other net finance costs are finance income and costs on retirement benefits, finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2014 the total of these items was a loss of £29m compared to a loss of £4m in 2013. Both the losses in 2014 and 2013 mainly relate to foreign exchange differences on un-hedged cash and cash equivalents and other financial instruments. For a more detailed discussion of our borrowings and interest expenses see “— Liquidity and Capital Resources — Capital Resources” and “— Borrowings” below and “Item 11. Quantitative and Qualitative Disclosures about Market Risk”.

Taxation

The total tax charge in 2014 of £63m represents 20.7% of pre-tax profits compared to a charge of £87m or 22.8% of pre-tax profits in 2013. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 21.5% in 2014 and 23.25% in 2013). The decrease in the tax rate is mainly due to tax benefits arising on the increase in intangible charges partly offset by adjustment arising from settlements with tax authorities.

Non-controlling interest

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

Discontinued operations

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

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

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

On November 29, 2013 we announced the sale of the Mergermarket Group to BC Partners. The sale was completed on February 4, 2014 and resulted in a gain of £198m after tax. The Mergermarket business has been classified as held for sale on the balance sheet at December 31, 2013 and the gain and the results for 2012, 2013 and 2014 have been included in discontinued operations.

Profit for the year

The profit for the financial year in 2014 was £470m compared to a profit in 2013 of £539m. The 2014 profit includes a gain on sale of Mergermarket of £198m and the 2013 profit includes a gain on the sale of Penguin of £202m, as described above.



Earnings per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 58.1p in 2014 compared to 66.6p in 2013 based on a weighted average number of shares in issue of 810.9m in 2014 and 807.8m in 2013. The decrease in earnings per share was due to the decrease in profit for 2014 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 58.0p in 2014 and 66.5p in 2013 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

Exchange rate fluctuations

Currency movement reduced sales by £272m and reduced operating profit by £36m. See “Item 11. Quantitative and Qualitative Disclosures about Market Risk” for a discussion regarding our management of exchange rate risks.

Sales and operating profit by segment

The following tables summarize our sales and adjusted operating profit for each of Pearson’s business segments. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments.

In our adjusted operating profit we have excluded other net gains and losses, acquisition costs and amortization and impairment of acquired intangibles. The intangible charges relate to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. Neither of these charges are considered to be fully reflective of the underlying performance of the Group. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as they distort the performance of the Group.

Adjusted operating profit enables management to more easily track the underlying operational performance of the Group. A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

£m	Year Ended December 31, 2014						
	North America	Core	Growth	PRH	Continuing	Discontinued	Total
Sales	2,974	1,154	746	—	4,874	9	4,883
	61%	24%	15%	—	100%		
Total operating profit	354	129	(100)	15	398	2	400
	89%	32%	(25%)	4%	100%		
Add back:							
Other net gains and losses	(2)	—	—	—	(2)	—	(2)
Acquisition costs	2	1	3	—	6	—	6
Intangible charges	110	22	132	54	318	—	318
Adjusted operating profit: continuing operations	464	152	35	69	720	—	720
Adjusted operating profit: discontinued operations	—	—	—	—	—	2	2
Total adjusted operating profit	464	152	35	69	720	2	722
	64%	21%	5%	10%	100%	0%	100%



£m	Year Ended December 31, 2013						
	North America	Core	Growth	PRH	Continuing	Discontinued	Total
Sales	3,073	1,258	738	—	5,069	621	5,690
	61%	25%	14%	—	100%		
Total operating profit	366	74	(2)	20	458	52	510
	80%	16%	0%	4%	100%		
Add back:							
Other net gains and losses	—	16	—	—	16	—	16
Acquisition costs	2	3	7	—	12	—	12
Intangible charges	106	27	33	30	196	2	198
Adjusted operating profit: continuing operations	474	120	38	50	682	—	682
Adjusted operating profit: discontinued operations	—	—	—	—	—	54	54
Total adjusted operating profit	474	120	38	50	682	54	736
	65%	16%	5%	7%	93%	7%	100%

North America

North America sales declined by £99m, or 3%, from £3,073m in 2013, to £2,974m in 2014 and adjusted operating profit decreased by £10m, or 2%, from £474m in 2013 to £464m in 2014. The decline in headline terms was a result of currency movements due to the strengthening of sterling against the US dollar. At constant exchange and after taking account of the contribution from acquisitions, sales grew by 2% and adjusted profits by 5% reflecting revenue mix, lower returns provision, reduced US pension costs and lower restructuring charges.

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

Overall adjusted operating margins in the North America business were consistent in 2014 at 15.6% compared to 15.4% in 2013.

North America — School

In school, good growth in Connections Education, our virtual schools business, was offset by declines in our State Assessments business due to the impact of legislative change in Texas and California, and in learning services due to some loss of market share, revenue deferral on blended programmes and softness in the Open Territories.

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

In State and National Assessments, high stakes online test volumes grew strongly, up 40% on 2013 to 11 million, as customers transitioned to computer-based testing. Paper-based high stakes test volumes declined 17% to 32 million, in part due to the growth of computer-based testing, but also the impact of legislative changes in Texas and California. We were awarded contract to administer Partnership for Assessment of Readiness for



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College and Careers (PARCC) assessments in 11 states and extended our contracts to administer Virginia Standards of Learning (SOL) Assessments and the Maryland High School Assessment. We will continue to administer the Florida Comprehensive Assessment Test (FCAT) until summer 2016.

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

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

North America — Higher Education

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

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

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

North America — Professional

At VUE, global test volumes grew 9% year-on-year to almost 13 million boosted by continued growth in IT, State Regulatory and Professional certifications. New contracts include a deal to administer the Microsoft



Certified Professional (MCP) Program globally, which significantly expands our existing partnership with Microsoft through Certiport's Microsoft Office Specialist (MOS) and Microsoft Technology Associate (MTA) exams.

Core

Sales in our Core markets decreased by £104m, or 8%, from £1,258m in 2013 to £1,154 in 2014 while adjusted operating profit increased by £32m, or 27%, from £120m in 2013 to £152m in 2014. At constant exchange and after taking account of the contribution from acquisitions there was decline in sales of 5%. At constant exchange and after taking account of the contribution from acquisitions there was growth in profits of 31% driven by the benefits of restructuring actions taken over the last two years in all markets and by profit growth at the FT. Overall adjusted operating margins in the Core markets increased from 9.5% in 2013 to 13.2% in 2014.

Core — School

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

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

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

Core — Higher Education

In the UK, our learning services revenues declined, primarily due to enrolment contraction following policy changes in the vocational markets. We continue to invest to build Pearson College and graduated our first 32 students during the year. Pearson College was one of only four private colleges to pass Quality Assurance Agency review the first time.

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

Core — Professional

At VUE, test volumes grew strongly following the successful launch of a new contract with CPA Australia to deliver Professional exams and continued good growth in the UK Driving Theory test volumes. We will



continue to deliver our UK contract to administer the Driving Theory test for DVSA until September 2016. VUE entered into ten year partnerships with the Chartered Institute of Management Accountants (CIMA) and the Association of Chartered Certified Accountants (ACCA) in the UK to transform a selection of their exams from pen and paper to computer-based testing.

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

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

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

Growth

Growth sales increased by £8m, or 1%, to £746m in 2014 from £738m in 2013. Adjusted operating profit decreased by £3m or 8% to £35m in 2014, from £38m in 2013. This reflected a benefit from the acquisition of Grupo Multi offset by a slower adoption year in South Africa, launch costs associated with our new vocational colleges and a contract provision in Saudi Arabia, and weaker revenues and restructuring costs in Brazil.

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

Overall adjusted operating margins in the Growth markets were lower at 4.7% in 2014 compared to 5.1% in 2013.

Growth — School

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

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

Growth — Higher Education

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



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

In India, higher education revenues declined due to higher levels of returns.

Growth — Professional

In Pearson English, good growth in direct delivery in China and inside services in Brazil due to the acquisition of Grupo Multi was partly offset by declines in learning services in Brazil and Mexico. Global student registrations for MyEnglishLab grew 15% to more than 460,000 with strong growth in Latin America.

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

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

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

Penguin Random House

In the twelve months to December 31, 2014 our share of Penguin Random House adjusted operating profits were £69m, compared with the six months from July 1, 2013 to December 31, 2013 of £50m.

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

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

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

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

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



Results of operations

Year ended December 31, 2013 compared to year ended December 31, 2012

Consolidated results of operations

Sales

Our total sales from continuing operations increased by £110m, or 2%, to £5,069m in 2013, from £4,959m in 2012. The increase reflected growth, on a constant exchange rate basis of 2% together with additional contributions from acquisitions. The year on year growth wasn't significantly impacted by movements in exchange rates and 2013 sales, translated at 2012 average exchange rates, would have been £5,051m.

In 2013 in the North America business we generated good growth in our digital and services businesses, which benefited from Common Core curriculum purchasing. Market conditions remained tough, with ongoing state budget pressures and the transition to the Common Core affecting our School assessment business. Lower enrolments affected Higher Education with the career college enrolments, where we have a strong market position, being particularly weak. There was reduced demand in our assessment business as states prepared for new Common Core testing.

Our business in the Core and Growth markets achieved another strong underlying performance in emerging markets, particularly South Africa and China. This growth was offset by weak textbook sales in developed markets; currency weakness against sterling; the exit from certain publishing businesses primarily in Australia, Japan, Germany, France and the UK; increased customization resulting from the Kirtsaeng ruling in the US (which allows third parties to now import into the United States for resale certain international editions of our US textbooks published abroad); and policy changes affecting qualifications and text book publishing in the UK. The Professional division performed well, with good sales growth in testing and training partly offset by declines in publishing.

FT Group sales were in line with 2012. The FT Group experienced strong growth in digital and content businesses and improved print circulation margins which more than offset weak advertising.

Cost of goods sold and operating expenses

The following table summarizes our cost of sales and net operating expenses:

	Year Ended December 31	
	<u>2013</u>	<u>2012</u>
	<u>£m</u>	<u>£m</u>
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 operating expenses	<u>2,353</u>	<u>2,181</u>

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and testing business and the cost of teaching and facilities in direct delivery businesses. Our cost of sales increased by £125m, or 6%, to £2,312m in 2013, from £2,187m in 2012. The increase corresponds primarily to the increase in sales, with cost of sales at 45.6% of sales in 2013 compared to 44.1% in 2012.



Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs increased due to the provision of distribution services to Penguin Random House for the six months from July 1, 2013 that are recovered through the service fee detailed below.

Selling, marketing and product development costs. Our selling, marketing and product development costs increased by £102m or 11% from £925m in 2012 to £1,027m in 2013. As a percentage of sales these costs increased from 18.7% in 2012 to 20.3% in 2013, reflecting the increased investment in product development and the sales force.

Administrative and other expenses. Our administrative and other expenses decreased by £80m or 6% from £1,242m in 2012 to £1,162m in 2013 due to cost saving initiatives and the benefits of the restructuring programme.

Restructuring costs. Restructuring costs related to the transformation and restructure of Pearson in 2013 were £176m.

Other net gains and losses. Included in other net gains and losses in 2013 is a loss on the disposal of the Japanese school and local publishing assets and in 2012 is an impairment loss on a joint venture.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions, together with the service fee income from Penguin Random House. Other operating income increased to £118m in 2013 compared to £78m in 2012 largely due to Penguin Random House service fee income of £28m included in 2013.

Loss on closure of subsidiary

The charge in 2012 of £113m relates to the loss on the closure of the Pearson in Practice business.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased from £9m in 2012 to £54m in 2013. Included in 2013 are the results of the first six months of the Penguin Random House venture. In addition in 2013 the Economist Group's results were up 3% on 2012.

Operating profit

The total operating profit decreased by £29m, or 6%, to £458m in 2013 from £487m in 2012. In 2013 net restructuring charges of £135m (£176m of restructuring costs with an estimated benefit of £41m) were taken which were partly offset by the absence of the loss on closure of the Pearson in Practice business which reduced 2012 operating profit by £113m.

Net finance costs

Net finance costs decreased from £96m in 2012 to £76m in 2013. Net interest payable increased from £65m in 2012 to £72m in 2013. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) fell by 0.2% to 0.3%. This decrease in floating market interest rates was offset by an increase in the Group's average net debt which was the main driver behind the Group's higher interest charge. These factors combined with lower levels of cash and deposits and the impact of new notes issued in 2013 created a decrease in the



Group's average net interest payable from 7.0% to 4.8%. The Group's average net debt rose by £561m, largely reflecting acquisition activity, cash costs relating to the formation of the Penguin Random House venture and cash paid in respect of the closure of Pearson in Practice in 2012 together with an increase in tax and dividend payments which more than offset cash generated from operations.

Net finance costs relating to post-retirement plans were £3m in 2013 compared to £2m in 2012. Also included in net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2013 the total of these items was a loss of £1m compared to a loss of £29m in 2012. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2013 losses relating to put options were largely offset by foreign exchange gains on a proportion of unhedged US dollar assets. For a more detailed discussion of our borrowings and interest expenses see "— Liquidity and Capital Resources — Capital Resources" and "— Borrowings" below and "Item 11. Quantitative and Qualitative Disclosures about Market Risk".

Taxation

The total tax charge in 2013 of £87m represents 23% of pre-tax profits compared to a charge of £138m or 35% of pre-tax profits in 2012. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 23.25% in 2013 and 24.5% in 2012). The decrease in the tax rate in 2013 is largely due to the lack of tax relief on the loss on closure of Pearson in Practice in 2012 together with the effect of the associate accounting treatment of our investment in Penguin Random House — tax on the profits of Penguin Random House are netted against profits in the presentation of the associate interest and are not included in the income tax in the consolidated income statement.

Non-controlling interest

There are non-controlling interests in the Group's businesses in the US, South Africa and China although none of these are material to the Group numbers. Some of the minorities in South Africa and the minorities in India were bought out in the year.

Discontinued operations

In October 2012, Pearson and Bertelsmann announced an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction completed on July 1, 2013 and resulted in a gain on the disposal of the Penguin assets of £202m. The gain arises as Pearson no longer has control of the Penguin Group of companies. The 47% interest in the new Penguin Random House venture has been accounted for as an equity investment from July 1, 2013.

The loss of control resulted in the Penguin business being classified as held for sale on the Pearson balance sheet at December 31, 2012 and the results for 2011, 2012 and the first six months of 2013 have been included in discontinued operations. The share of profit from associate interest in the Penguin Random House venture arising in the second half of the year has been included in operating profit in continuing operations.

On November 29, 2013 we announced the sale of the Mergermarket Group to BC Partners. The sale was completed on February 4, 2014 and the Mergermarket business has been classified as held for sale on the balance sheet at December 31, 2013. The results for 2011, 2012 and 2013 have been included in discontinued operations.

Profit for the year

The profit for the financial year in 2013 was £539m compared to a profit in 2012 of £314m. The 2013 profit includes a gain on the sale of Penguin as described above of £202m.



Earnings per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 66.6p in 2013 compared to 38.7p in 2012 based on a weighted average number of shares in issue of 807.8m in 2013 and 804.3m in 2012. The increase in earnings per share was due to the increase in profit for 2013 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 66.5p in 2013 and 38.6p in 2012 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

Exchange rate fluctuations

Currency movement increased sales by £18m (with a £49m benefit primarily from a stronger dollar partly offset by a £31m reduction from non-dollar currency depreciation relative to sterling, primarily in emerging markets) but reduced operating profit by £7m (with an estimated £5m benefit from a stronger dollar more than offset by a £12m reduction from non-dollar currency depreciation). See "Item 11. Quantitative and Qualitative Disclosures about Market Risk" for a discussion regarding our management of exchange rate risks.

Sales and operating profit by segment

The following tables summarize our sales and adjusted operating profit for each of Pearson's business segments. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments.

In our adjusted operating profit we have excluded other net gains and losses, acquisition costs and amortization and impairment of acquired intangibles. The intangible charges relate to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. Neither of these charges are considered to be fully reflective of the underlying performance of the Group. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as they distort the performance of the Group.

Adjusted operating profit enables management to more easily track the underlying operational performance of the Group. A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

£m	Year Ended December 31, 2013						
	North America	Core	Growth	PRH	Continuing	Discontinued	Total
Sales	3,073	1,258	738	—	5,069	621	5,690
	61%	25%	14%	—	100%		
Total operating profit	366	74	(2)	20	458	52	510
	80%	16%	0%	4%	100%		
Add back:							
Other net gains and losses	—	16	—	—	16	—	16
Acquisition costs	2	3	7	—	12	—	12
Intangible charges	106	27	33	30	196	2	198
Adjusted operating profit: continuing operations	474	120	38	50	682	—	682
Adjusted operating profit: discontinued operations	—	—	—	—	—	54	54
Total adjusted operating profit	474	120	38	50	682	54	736
	65%	16%	5%	7%	93%	7%	100%



£m	Year Ended December 31, 2012						
	North America	Core	Growth	PRH	Continuing	Discontinued	Total
Sales	2,942	1,323	694	—	4,959	1,153	6,112
	59%	27%	14%	—	100%		
Total operating profit					487	86	573
Add back:							
Other net gains and losses					123	32	155
Acquisition costs					20	1	21
Intangible charges					179	4	183
Adjusted operating profit: continuing operations					809	—	809
Adjusted operating profit: discontinued operations	—	—	—	—	—	123	123
Total adjusted operating profit					809	123	932
					87%	13%	100%

All figures for 2013 have been restated to reflect the new segments. Revenue figures only have been restated in 2012 and it is impracticable to restate profit figures for this year. The change in management structure was anticipated in 2013 and systems and reporting were updated for the proposed change, however the information is not available for reporting 2012 results under the new management structure.

North America

North American sales were £2,972m in 2012 compared with £3,073m in 2013, and adjusted operating profit for 2013 was £474m.

In 2013, we generated good growth in our digital and services businesses, where we continue to invest to build scale and volume, and solid growth in our school curriculum business, which benefited from Common Core curriculum purchasing. Market conditions remained tough, with on-going state budget pressures and the transition to the Common Core affecting our School assessment business. Lower enrolments affected Higher Education with the career college enrolments, where we have a strong market position, being particularly weak. In addition to these market pressures, our North American margins were further affected by £49m of net restructuring charges, reduced demand in our assessment business as states prepared for new Common Core testing and curriculum related investment and amortisation, the launch costs related to major multi-year service-based contracts in higher education, and increased returns provisions.

In Higher Education, total enrolments fell 1.9%, with career enrolments in two-year public (community) and four-year for-profit declining 4.4%, affected by rising employment rates, state budget pressures and regulatory change affecting the for-profit and developmental learning sectors. The publishing market was broadly level with 2012 on a gross basis, according to the Association of American Publishers, while our higher education revenues grew 5% with an underlying decline more than offset by the contribution from Embanet.

We introduced adaptive learning capabilities in over 200 MyLab and Mastering products across eleven subjects. Student registrations in North America grew 9% to almost 11 million. Usage continues to grow strongly with graded submissions up 15% to almost 370 million across the globe. Evaluation studies show that the use of MyLab programmes, as part of a broader course redesign, can significantly improve student test scores and institutional efficiency. We acquired Learning Catalytics, which allows faculty to obtain real-time responses to open-ended or critical thinking questions, to determine which areas require further explanation, and enables earlier intervention to help improve retention and outcomes.

Enterprise-wide partnerships with Arizona State University Online, Ocean Community College, Indiana Wesleyan University and Rutgers, where we run fully-online learning programmes and earn revenues based on



the success of the students and the institution, gained more than 64,000 student registrations, up 45% on 2012. Embanet increased new student enrolments by 8% to almost 12,000 and total student enrolment by 6.5% to more than 27,000; adding sixteen new programmes, launching three new key academic partners with Adelphi University, Villanova University and University of Maryland; and expanding partnerships with existing customers such as Maryville and Northeastern. More than 200 colleges are working with Pearson to build online learning programmes that improve access to high quality undergraduate and graduate degree programmes.

We partnered with West Virginia University Parkersburg Online to redesign its Developmental Education curriculum using Competency-Based Education (CBE) modules. Our CourseConnect CBE products will enhance up to 220 existing courses and will be delivered through OpenClass where we will also provide access to eTextbooks, tutoring and media resources. Other CBE partnerships include Texas A&M University-Commerce, South Texas College, Kentucky Community & Technical College System and Northern Arizona University.

We partnered with The Boy Scouts of America, the largest youth organisation in the US with 2.7 million young members and more than 1 million adult volunteers, to create and implement its new digital curriculum.

For our School businesses, State funding pressures, the Federal sequester and the transition to Common Core assessments continued to make market conditions difficult. Revenues grew modestly in 2013 with declines in State assessment contracts and learning assessments more than offset by gains in national assessment contracts for the PARCC consortium (as defined below) and the federal government's NAEP programme, (as defined below), as well as demand for Connections Education's virtual charter schools and Common Core reading/language arts and math programmes.

Schoolnet won significant contracts including two new Race to the Top State Instructional Improvement System contracts in New York and New Jersey, which takes the total number of state system contracts to seven; and new district contracts for Schoolnet assessment, educator development and learning management solutions in Dallas, Texas; Palm Beach, Florida; Philadelphia, Pennsylvania; and New York City. PowerSchool won new contracts in Charlotte-Mecklenberg, North Carolina; Grand Erie District School Board, Ontario; and San Diego, California and its mobile app connecting teachers, students and parents was downloaded by almost 3.4 million users. PowerSchool now supports almost 13 million students (in 70 countries), up more than 5% on 2012 while Schoolnet supports more than 9 million students, up 7% on 2012.

The Partnership for Assessment of Readiness for College and Careers (PARCC), a consortium of 18 states, awarded Pearson several contracts to deliver test item tryouts, develop field tests and to provide the online delivery platform using our cloud-based, mobile-ready TestNav 8 system for new English and mathematics assessments. The assessments are based on what students need to be ready for college and careers, and will measure and track their progress along the way. We helped Kentucky and New York deliver the first Common Core aligned state assessments, and we won new online assessment programs in Colorado, Minnesota and Mississippi. We continued to produce strong growth in secure online testing. We delivered almost 12 million secure online tests, up 33% on 2012. Legislative changes in Texas and California reduced the scope of assessments ahead of Common Core implementation.

We renewed our contract with the US Department of Education to administer the National Assessment of Educational Progress (NAEP) for the 2013-2017 assessment cycles and won a number of state contract extensions in Georgia, Puerto Rico, Tennessee, Maryland, Arizona, South Dakota and Oklahoma. We were selected by the National Board of Professional Teaching Standards (NBPTS) as their partner to develop their next-generation programmes, and deliver and support NBPTS through 2025.

ACT Aspire, a college and career readiness assessment aligned to the Common Core State Standards, successfully launched its first field test on the new TestNav 8 assessment system. ACT Aspire is a joint venture between Pearson and ACT, Inc. Alabama is the first state to adopt the ACT Aspire system for measuring the Common Core State Standards.

Pearson Clinical Assessment launched Q-interactive, a portable digital tool that enables mental health professionals to automatically manage the administration of clinical assessments, digital stimuli, response



recording through stylus notes and audio. It serves 1,500 users within hospitals, private practice, and schools in five countries (US, UK, Australia, Canada and Netherlands). Paid test administrations have increased ten-fold since launch.

In Learning Services, we performed well in new adoptions, taking a market leading 33% of the total new adoption market (\$390m), with number one positions in maths, science and social studies and a number two position in Reading/Language Arts. We were selected by the two largest school districts in the US, Los Angeles Unified School District and New York City, to implement Common Core instructional programmes. New York City adopted our new K-5 Common Core English Language Arts programme, Ready Gen, and our middle school math offering, Connected Math. In Los Angeles Unified School District, we partnered with Apple to deliver our innovative next generation digital learning Common Core System of Courses across K-12 Mathematics and English Language Arts, initially to 30,000 students. In both districts, we are providing professional development to thousands of teachers. Learners using our *OnRamp to Algebra* supplemental programme, which targets struggling maths students, significantly out-gained peers using other supplemental maths programmes, achieving 20% increase in their percentile rank while their peers increased by only 3%. In addition, students of all ability levels using *OnRamp to Algebra* exceeded the gains of their peers.

Connections Education, which operates K-12 managed virtual public schools, managed blended public schools, and a private school, served almost 51,000 students in December 2013, up more than 20% from 2012, and operated 33 managed public schools in 23 states and an international private virtual school. Connections Education also provides virtual and blended services to school districts and other schools seeking to incorporate virtual learning into their programmes. Connections Academy Schools have consistently high performance ratings, particularly in states focused on measuring growth in student learning.

Professional testing continued to see good revenue and profit with growth test volumes at Pearson VUE up 25% on 2012 to almost 12 million. Key contract renewals included tests for the American Board of Internal Medicine, the Association of Social Work Boards and the Pharmacy Technician Certification Board.

Professional publishing revenues and profits declined, with good profit growth in the US, underpinned by a strong performance in our direct ecommerce sales and at Safari Books Online, our joint-venture with O'Reilly Media.

Core and Growth

Revenue in the Core market declined from £1,323m in 2012 to £1,258m in 2013, but in the Growth markets grew from £694m in 2012 to £738m in 2013, adjusted operating profit for 2013 was £120m in Core and £38m in Growth.

Our business in the Core and Growth markets achieved another strong underlying performance in emerging markets, particularly in South Africa and China. This growth was offset by weak textbook sales in developed markets; currency weakness against sterling; the exit from certain publishing businesses primarily in Australia, Japan, Germany, France and the UK; increased customisation undertaken in response to the US Supreme Court's decision in the *Kirtsaeng* case; and policy changes affecting qualifications and textbook publishing in the UK. More than 1.3 million students registered for our MyLab digital learning, homework and assessment programmes, an increase of 17%, with good growth in school, ELT and institutional selling in higher education.

Our Growth market revenues expanded strongly, boosted by curriculum change in South Africa, strong enrolment growth at CTI Education Group and Midrand Graduate Institute, and continued good growth in China; partly offset by weaker currencies against sterling, particularly in South Africa and enrolment declines in our public sistemas in Brazil.



In China, student enrolments at Wall Street English increased 7% to 65,000, boosted by good underlying demand. Our students rapidly acquire high-level English skills with average grade levels achieved rising by 14% during 2013. Enrolments at Global Education, our test preparation services for English language and vocational qualifications, increased 24% to more than 1.3 million, through 82 owned and 426 franchised learning centres with investment in learning centres and digital learning platforms enabling us to better meet learner demands and be a premier brand in test preparation. Around 70% of the high-end course students achieve IELTS 7.0 which demonstrates a high level of proficiency in English and a key grade when studying abroad.

In South Africa our market leading school publishing brands, Maskew Miller Longman and Heinemann, performed strongly in a year of significant curriculum reform. Student enrolments grew strongly at CTI/MGI, our universities, up 15% to 11,700 across 13 campuses.

In Brazil, we ended 2013 with 497,000 students (533,000 in 2012) in our public and private sistemas (or learning systems). In 2013, we added 24,000 net students in our three private sistemas, COC, Dom Bosco and Pueri Domus, up 7% on 2012. Tough market conditions for public sistemas resulted in lower enrolments in this post-election year but our NAME (Nucleo de Apoio a Municipali Zacao do Ensino) sistema includes the number one performing lower secondary school in Brazil based on the 2011 IDEB (national public test) scores of 3,067 municipalities. 90% of our municipal customers tested 20% above the national standard and 70% of the municipalities that adopted NAME showed improvement in their IDEB scores.

In Mexico, our fully accredited online university partnership, UTEL (La Universidad Technologic Latinoamericana en Linea), reached 6,000 active students in 20 undergraduate and 2 graduate programmes and through its services arm, Scala, signed its first 3 agreements to help campus based universities make the transition to online. 5,400 students have completed short duration courses in programmes developed to address corporate and government work force training needs.

In India, trading was challenging as we increased customisation in response to the Kirtsaeng ruling in the US. Our 32 schools admitted more than 5,000 new students with enrolments now totalling more than 27,000, up 23% on 2012; we delivered our first large scale assessment for the Central Board of Secondary Education (CBSE) for 2.4 million students across 12,000 schools; we launched PowerSchool, adding 10,000 students; and our multimedia teaching solution Digiclass is now installed in approximately 22,000 classrooms, up more than 20% on 2012.

In the Middle East, we won a five year contract with the UAE's Ministry of Education to provide leadership training and professional development for 700 current and future Emirati school principals, in partnership with the UK's National College for Teaching and Leadership. We partnered with: Taibah University in Saudi Arabia to implement Foundation Level MyLabsPlus across four subjects for 16,000 students; Riyadh's Princess Noura University in Saudi Arabia, the world's largest female university, to provide 12,000 new students with IT course content (through our MyLabs e-learning technology) for tablets; and Qatar University to implement MyLabsPlus for 5,000 students.

Our Core market revenues declined significantly, affected by curriculum change in the UK and the exit from publishing operations in Australia, Japan and Continental Europe.

In the UK, revenues declined due to a softer school curriculum and vocational qualifications (BTEC) market anticipating curriculum change. This was partly offset by a strong performance in the GCSE and A/AS level qualifications market. In higher education, we partnered with Leeds Metropolitan University to develop a suite of online learning business education courses. In assessment, we marked almost 6 million GCSE, A/AS Level and other examinations with more than 93% using onscreen technology. We marked 2.7 million test scripts for over half a million pupils taking National Curriculum Tests at Key Stage Two in 2013 and were selected to administer the test until 2016. 2013 also saw the first delivery of the Next generation BTEC qualifications to over 100,000 students, with a further 365,000 students to date enrolled for 2014/15 delivery.



In Italy, revenues declined, with market conditions tough due to a one year government mandated pause in new adoptions.

In Japan, GlobalEnglish and the FT Group partnered with Nikkei Inc on a 'GlobalEnglish Nikkei edition,' an English language learning service to serve English students in the Japanese business community. We sold our school textbook publishing business, Kirihara Shoten, to management.

In Australia, market conditions were very tough, particularly in higher education where we exited the vocational publishing market. We continue to make good progress developing our digital and services business including significant sales of Secondary School Australian Curriculum ebooks. In higher education, we partnered with Monash University with an enterprise implementation of the MyLab suite of products for 6,500 students including faculty training, and to provide learning services and solutions for online graduate programmes including course development, marketing, student recruitment and retention, and faculty training.

In English Language Learning (ELL), Wall Street English (WSE), Pearson's worldwide chain of English language centres for professionals, opened a new centre in Ho Chi Minh City in Vietnam (and is now present in 28 countries), and has 107 owned and 338 franchised centres. Our students rapidly acquire high-level English skills with average grade levels achieved rising by 8% during 2013. Student numbers grew slightly to 192,000. Registered users for ELL digital products grew 45% to 610,000 with MyEnglishLabs registrations up 51% to 400,000 and Our Discovery Island registrations, an online adventure aimed at Primary education, up almost 77% to 104,000.

In the Professional line of business, the UK training business Pearson in Practice had a significant negative impact on the 2012 performance. We will continue to deliver our UK contract to administer the Driving Theory test for the DVSA until September 2016. We won a number of new contracts for computer-based testing including the Charter of Financial Analysts, Saudi Commission of Health Specialties and the Korean Productivity Centre.

In Professional training, TQ grew strongly and was awarded a five-year contract by Saudi Arabia's Colleges of Excellence to develop and operate three vocational colleges in Saudi Arabia, providing high quality vocational skills and qualifications. The three colleges opened in the second half of 2013 with an expected initial intake of 1,100 students, rising to 8,000 students over time.

At the Financial Times Group sales decreased however adjusted operating profit from continuing operations increased. The increase in adjusted operating profit was driven by strong growth in digital and content businesses and improved print circulation margins which more than offset weak advertising. Digital and services revenues accounted for 55% of FT Group revenues (50% in 2012). Content revenues comprised 63% of revenues (61% in 2012), while advertising accounted for 37% of FT Group revenues (39% in 2012).

The FT's total circulation grew 8% year-on-year to 652,000 across print and online, the highest paying readership in its 125-year history. FT.com digital subscriptions grew 31% to 415,000, more than offsetting planned reductions in print circulation. Digital subscribers now represent almost two-thirds of the FT's total paying audience and corporate users grew nearly 60% to more than 260,000. We continue to invest to shift resources from analogue to digital and have further reduced leased printing capacity globally since 31 December 2012 from 20 to 16 sites.

Advertising continued to be short-term and generally weak, but the FT increased its market share with luxury and financial sectors showing good growth in digital.

Mobile is an increasingly important channel for the FT, driving 62% of subscriber consumption, 45% of total traffic and almost a quarter of new digital subscriptions. The FT's flagship web app now has more than 5 million users and new FT apps on Google Newsstand and Flipboard have strengthened our mobile offering.



Other innovations, including launching 24-hour news service fastFT, redesigns to mobile apps and improvements to FT.com, have helped significantly increase overall digital engagement.

The FT continues to expand its executive education business. FT in Education products, including annotation tool FT Newlines, are now used by almost 300 education institutions, including 37 of the world's top 50 business schools. The FT launched its Non-Executive Director (NED) Diploma in Hong Kong. More than a third of NED enrolments are now outside the UK.

The Economist Group, in which Pearson owns a 50% stake, had a record operating profit after tax, up 3% on 2012. Content revenues accounted for 60% of total revenues (44% in 2008) and digital and services revenues comprised 39% of total revenues (29% in 2010). Global print and digital circulation at *The Economist* reached a record high of 1.6 million.

Penguin Random House

In the six months to June 30, 2013 the Penguin Group (included in discontinued operations) had sales of £513m and adjusted operating profit of £28m. In the six months from July 1, 2013 to December 31, 2013 our share of Penguin Random House adjusted operating profits were £50m.

Penguin Random House traded well in the second half of the year, with a strong bestseller performance in all major territories. Penguin Random House results were reported on a post tax basis following completion of the merger on July 1, 2013 and resulted in a £23m reduction in the contribution to our operating income with an equal benefit to our tax charge. Market share normalised, following the unprecedented success of E L James' *50 Shades of Grey* trilogy for Random House in 2012.

The integration of the two companies has commenced in each of its territories. Divisional structures are being combined, systems integration is underway, and the US business has announced a plan to consolidate distribution operations. Key highlights from 2013 include:

In the US, on a full year basis, Penguin and Random House published 480 *New York Times* bestsellers, including three out of the top five Bookscan Adult Fiction bestsellers for the year: Dan Brown's *Inferno*, John Grisham's *Sycamore Row* and Khaled Hosseini's *And The Mountains Echoed*. Other *New York Times* bestsellers included, in Adult Nonfiction: Sheryl Sandberg's *Lean in*; Charles Krauthammer's *Things That Matter*; and in Children's Fiction: John Green's #1 bestselling *The Fault in Our Stars*.

In the UK, on a full year basis, Penguin and Random House published 102 Bookscan bestsellers including: Dan Brown's *Inferno*; David Jason's *My Life*; Jamie Oliver's *Save with Jamie*; Rachel Joyce's *The Unlikely Pilgrimage of Harold Fry*; Helen Fielding's *Bridget Jones: Mad About the Boy*; and strong ongoing overall performance from Jeff Kinney's *Diary of a Wimpy Kid* series, and from its newest volume *Hard Luck*.

In Australia, where market conditions remain challenging, Penguin Random House had 4 out of the top 5 bestsellers for the year: Jeff Kinney's *Hard Luck: Diary of a Wimpy Kid*; Jamie Oliver's *Jamie's 15 Minute Meals* and *Save with Jamie*; and Dan Brown's *Inferno*.

In Brazil, Companhia das Letras (of which Penguin Random House has a 45% stake) posted strong revenue growth driven by an expanded publishing program. In a challenging market, Penguin Random House India had more than 40 titles pro forma on the 2013 *Hindustan Times* Nielsen top ten in combined categories. In China, our local-publishing programme continued to grow, with notable bestsellers, including *My Life* by Li Na. DK achieved significant growth through its co-edition model with Chinese publishers. In South Africa, Penguin Random House completed the purchase of the Times Media Group's majority stake in Random House Struik, cementing our market leading position, but lost a significant agency contract during the year.



DK performed well, boosted by the exceptional performance of Brady Games® GTA V Strategy Guide™, which sold over 800,000 copies, and the ongoing success of the DK LEGO® properties, which sold almost 10 million units in 2013.

The full year eBook share of Penguin Random House global revenue is 20%. eBook growth for Penguin continued but at a slower rate, while Random House e-book sales declined significantly year on year due to much lower sales for the Fifty Shades trilogy. Digital innovations included the launch of Bookscout, a dedicated app created for and with Facebook which enables sharing personalised reading recommendations among friends and online communities.

Penguin Random House's authors won numerous major literary prizes around the world, including the 2013 Nobel Prize for Literature (Alice Munro); The National Book Award for Fiction in the US (James McBride's *The Good Lord Bird*); and an unprecedented four US Pulitzer Prizes.

In self-publishing, Author Solutions performed well, growing significantly over 2012, and continuing to launch and plan for self-publishing imprints in conjunction with Penguin in such territories as India and South Africa.

For 2014, Penguin Random House has a strong publishing list with major new books from authors such as: Isabel Allende, Martin Amis, Lee Child, John Cleese, Harlan Coben, Steve Coogan, Lena Dunham, Janet Evanovich, Ken Follett, Stephen Fry, Robert Gates, Ina Garten, John Grisham, Deborah Harkness, Carl Hiaasen, Jan Karon, Sue Monk Kidd, Jeff Kinney, Michael Lewis, David Mitchell, Haruki Murakami, Jamie Oliver, James Patterson, Jodi Picoult, Nora Roberts, Danielle Steel, Colm Toibin, Jacqueline Wilson; and movie tie-in paperbacks of John Green's *The Fault in Our Stars*; Gillian Flynn's *Gone Girl*; and Laura Hillenbrand's *Unbroken*.

Liquidity and capital resources

Cash flows and financing

Net cash generated from operations increased by £20m (or 3%) to £704m in 2014 from £684m in 2013 reflecting some stabilization in the underlying trading environment with some offset from continued product investment ahead of the transition to Common Core in North America. Cash spend on restructuring was level with 2013. Net cash generated from operations decreased by £232m (or 25%) to £684m in 2013 from £916m in 2012. This decrease reflected restructuring activity undertaken in 2013 and additional investment (particularly in North America) ahead of the transition to Common Core and to enhance the Group's technology capabilities in advance of the next generation of digital products. The average working capital to sales ratio improved to 12.3% in 2014 from 13.4% in 2013 and 13.8% in 2012 reflecting the impact of the sale in mid-2013 of Penguin, which had higher working capital levels. Average working capital is the average month end balance in the year of inventory (including pre-publication), receivables and payables.

Net interest paid in 2014 was level with 2013 at £73m with higher average net debt levels and debt issue costs offset by currency translation gains. Net interest paid increased to £73m in 2013 from £66m in 2012 due to higher average net debt levels following acquisitions completed in late 2012.

Capital expenditure on property, plant and equipment and software intangibles was £182m in 2014, £182m in 2013 and £151m in 2012. Expenditure has been prioritized towards information technology and software to support the digital capability of the Group, so while overall capital expenditure has stayed relatively stable, the percentage relating to software investment has increased.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £460m in 2014 against £58m in 2013 and £755m in 2012. The major acquisition in 2014 was of Grupo Multi for £437m. There



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were no major acquisitions in 2013, with the cash outflow relating to various minor acquisitions and costs associated with prior period acquisitions. The expenditure in 2012 reflects the re-shaping of the portfolio following the sales of Interactive Data and FTSE International. The principal acquisitions in 2012 were of EmbanetCompass for £411m, Certiport for £88m, Author Solutions, Inc for £69m and GlobalEnglish Corporation for £63m.

The sale of subsidiaries and associates produced a net cash inflow of £366m in 2014 against an outflow of £130m in 2013 and an outflow of £11m in 2012. The cash inflow in 2014 primarily relates to the proceeds on sale of Mergermarket of £375m, less associated costs. The cash outflow in 2013 primarily relates to the cash disposed with Penguin upon formation of Penguin Random House. The cash outflow in 2012 primarily related to expenses incurred in advance of the formation of Penguin Random House.

The cash outflow from financing of £533m in 2014 reflects a further 7% increase in the dividend, the repayment of a \$400m US dollar Bond and a £250m sterling bond, offset in part by proceeds from the issue of a €500m Euro Note. The cash outflow from financing of £395m in 2013 reflects a further 7% increase in the dividend, the repayment of a \$350m US Dollar Note during the year and the buy-out of various non-controlling interests, with some offset from the proceeds of a \$500m US Dollar Note issued in the year. The cash outflow from financing of £23m in 2012 reflects a further 9% increase in the dividend, offset by the proceeds from a \$500m US Dollar Note issued during the year.

Capital resources

Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements in the educational materials business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December. Based on a review of historical trends in working capital requirements and of forecast monthly balance sheets for the next 12 months, we believe that we have sufficient funds available for the Group's present requirements, with an appropriate level of headroom given our portfolio of businesses and current plans. Our ability to expand and grow our business in accordance with current plans and to meet long-term capital requirements beyond this 12-month period will depend on many factors, including the rate, if any, at which our cash flow changes and the availability of public and private debt and equity financing, including our ability to secure bank lines of credit. We cannot be certain that additional financing, if required, will be available on terms favorable to us, if at all.

At December 31, 2014, our net debt was £1,639m compared to net debt of £1,379m at December 31, 2013. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash, cash equivalents and liquid resources. Cash equivalents comprise short-term deposits with a maturity of up to 90 days, while liquid resources comprise short-term deposits with maturities of more than 90 days and other marketable instruments which are readily realizable and held on a short-term basis. Total Short-term, medium-term and long-term borrowing amounted to £2,225m at December 31, 2014, compared to £2,226m at December 31, 2013 reflecting repayment of a \$400m US dollar Bond and a £250m sterling bond, offset by the issue of a €500m Euro Note and exchange movements (primarily the strengthening of the US dollar against sterling). At December 31, 2014, total cash and liquid resources were £530m, compared to £765m at December 31, 2013. This decrease is due to cash in operating companies being repatriated to head office and used to repay debt.



Contractual obligations

The following table summarizes the maturity of our borrowings, our obligations under non-cancelable leases, and pension funding obligations, exclusive of anticipated interest payments. Due to the variability of future interest payments, these have been excluded from the table below.

	At December 31, 2014				
	Total	Less than one year	One to two years	Two to five years	After five years
	£m	£m	£m	£m	£m
Gross borrowings:					
Bank loans, overdrafts and commercial paper	42	37	5	—	—
Bonds	2,173	300	231	600	1,042
Finance lease obligations	10	5	3	2	—
Operating lease obligations	1,375	161	150	363	701
UK Pension funding obligations	103	41	41	21	—
Total	<u>3,703</u>	<u>544</u>	<u>430</u>	<u>986</u>	<u>1,743</u>

At December 31, 2014 the Group had capital commitments for fixed assets, including finance leases already under contract, of £13m (2013: £11m). There are contingent liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities in respect of legal and royalty claims. None of these claims or guarantees is expected to result in a material gain or loss.

In 2014, the Group negotiated a new \$1,750m committed revolving credit facility which matures in August 2019. The Group is committed to an annual fee of 0.1225% payable quarterly, on the unused amount of this facility.

Off-Balance sheet arrangements

The Group does not have any off-balance sheet arrangements, as defined by the SEC Final Rule 67 (FR-67), “Disclosure in Management’s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations”, that have or are reasonably likely to have a material current or future effect on the Group’s financial position or results of operations.

Borrowings

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.

We have in place a committed revolving credit facility of \$1.75bn, which matures in August 2019. At December 31, 2014, the full \$1.75bn was available under this facility. This credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

We must maintain the ratio of our profit before interest, tax and amortization to our net interest payable at no less than 3:1; and

We must maintain the ratio of our net debt to our EBITDA, which we explain below, at no more than 4:1.

“EBITDA” refers to earnings before interest, taxes, depreciation and amortization. We are currently in compliance with these covenants.

See note 18 of “Item 18. Financial Statements” for information on our longer term loans from banks and capital markets.



Treasury policy

Our treasury policy is described in note 19 of “Item 18. Financial Statements”. For a more detailed discussion of our borrowing and use of derivatives, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk”.

Related parties

There were no significant or unusual related party transactions in 2014, 2013 or 2012. Refer to note 37 in “Item 18. Financial Statements”.

Accounting principles

For a description of our principal accounting policies used refer to note 1 in “Item 18. Financial Statements”.



ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and senior management

We are managed by a board of directors and a chief executive who reports to the board and manages through an executive committee. We refer to the board of directors, the chairman of the board of directors and the executive committee as our “senior management”.

The following table sets forth information concerning directors, as of February 28, 2015.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Glen Moreno	71	Chairman
John Fallon	52	Chief Executive
David Arculus	68	Non-executive Director
Elizabeth Corley, CBE	58	Non-executive Director
Vivienne Cox	55	Senior Independent Director
Robin Freestone	56	Chief Financial Officer
Ken Hydon	70	Non-executive Director
Josh Lewis	52	Non-executive Director
Linda Lorimer	62	Non-executive Director
Harish Manwani	61	Non-executive Director
Tim Score	54	Non-executive Director

On February 27, 2015 Pearson announced the appointment of Coram Williams as its new chief financial officer. Coram will join Pearson as CFO designate on 1 July, and succeed Robin Freestone as CFO on August 1st, when he will also replace Robin on the Pearson Board as an executive director.

Glen Moreno

Appointed October 1, 2005. Chairman of the nomination committee and member of the remuneration committee

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

John Fallon

Appointed October 3, 2012.

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



David Arculus

Appointed on February 28, 2006. Chairman of the remuneration committee and member of the audit and nomination committees.

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

Elizabeth Corley, CBE

Appointed May 1, 2014. Member of the nomination and remuneration committees.

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

Vivienne Cox

Appointed on January 1, 2012. Chairman of the reputation & responsibility committee and member of the audit, nomination and remuneration committees.

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

Robin Freestone

Appointed on June 12, 2006.

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

Ken Hydon

Appointed on February 28, 2006. Chairman of the audit committee and member of the nomination and remuneration committees.



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

Josh Lewis

Appointed on March 1, 2011. Member of the nomination and remuneration committees.

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

Linda Lorimer

Appointed July 1, 2013. Member of the audit, nomination and reputation & responsibility committees.

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

Harish Manwani

Appointed October 1, 2013. Member of the nomination and reputation & responsibility committees.

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

Tim Score

Appointed January 1, 2015. Member of the audit and nomination committees.

Tim has been chief financial officer of ARM Holdings plc, the world's leading semiconductor IP company, for 13 years, with extensive experience of the technology sector and in both developed and emerging markets, particularly China. He is an experienced non-executive director and currently sits on the board of The British



Land Company plc. He served on the board of National Express Group plc from 2005 to 2014, including time as interim chairman and six years as the senior independent director. Earlier in his career Tim held senior finance roles with Rebus Group, William Baird, BTR plc and others.

The following table sets forth information concerning the executive committee, as of February 28, 2015

<u>Name</u>	<u>Position</u>
Sir Michael Barber	Chief Education Adviser
Tim Bozik	President, Higher Education
Rod Bristow	President, Core Markets
Luyen Chou	Chief Product Officer
Albert Hitchcock	Chief Information Officer
Phil Hoffman	Chief Corporate Finance & Strategic Development Officer
Kate James	Chief Corporate Affairs Officer
Don Kilburn	President, North America
Douglas Kubach	President, School
Tamara Minick-Scokalo	President, Growth Markets
John Ridding	President, Professional & MD, FT Group
Melinda Wolfe	Chief Human Resources Officer

Sir Michael Barber

Sir Michael is Chief Education Advisor at Pearson and is a leading authority on education systems and reform. He leads Pearson’s worldwide programme of research into education policy and efficacy, advising on and supporting the development of products and services that deliver efficacy and build on research findings. He leads Pearson’s strategy for developing innovative educational models for low-income families in the developing world. Sir Michael is a Distinguished Visiting Fellow at Harvard and holds an honorary doctorate from the University of Exeter. His publications include Oceans of Innovation and An Avalanche is Coming.

Tim Bozik

Tim is President, Higher Education and has extensive knowledge of all aspects of higher education as well experience in moving Pearson towards being a more digital, data and services-led business. Tim joined Pearson in 1983 as a sales representative and has since held several leadership roles in product development and general management, including his most recent post as chief executive of US higher education. His work has included a focus on the role of technology, data and analytics to improve access, achievement and affordability.

Rod Bristow

Rod is President, Core Markets and has wide-ranging expertise in K-12 schools, higher and professional education, assessment, qualifications, and learning technology having been involved in education throughout his entire career. He was previously the President of Pearson UK. Rod is a Fellow of the Royal Society of Arts, a former President of the Publishers Association, a trustee of the Education and Employers Taskforce and a member of the President’s Committee of the Confederation of British Industry.

Luyen Chou

Luyen is the Chief Product Officer at Pearson. Luyen joined Pearson in 2011 through the acquisition of Schoolnet, where he served as chief product officer. Earlier in his career Luyen held executive roles at Columbia University, Learn Technologies Interactive, and the Dalton School, and served as a high school history and social studies teacher. Luyen is co-founder and board chair of Brooklyn Prospect charter school, and has served on the board of directors of MOUSE, The Teachers Network and Black Rock Forest; and on advisory boards for the New York City Department of Education and Harlem Day Charter School.



Albert Hitchcock

Albert joined Pearson in March 2014 as Chief Information Officer. He leads the IT organization across Pearson globally and has overall responsibility for implementing the group's technology strategy to enable competitive advantage. He previously held the position of Group Chief Information Officer at Vodafone and prior to this was Global CIO at Nortel. Albert is a Fellow of the Institute of Engineering and Technology and a Chartered Engineer.

Phil Hoffman

Phil is Chief Corporate Finance & Strategic Development Officer and heads the Corporate Finance, Strategy and Legal teams. He is also Company Secretary of Pearson plc. Phil has held various senior positions in his 26 years with the group including Chairman and CEO of Learning Network, President of Pearson Inc., CFO of Pearson North America and CFO and COO of Penguin Group. Phil is a director and chairman of the audit committee of Penguin Random House, eScrip and GED Testing Service and is a director of the Economist Group.

Kate James

Kate joined Pearson in January 2014 as Chief Corporate Affairs Officer. She has a background in international government relations, corporate communications, brand management and sustainability. Prior to joining Pearson, Kate was Chief Communications Officer at the Bill & Melinda Gates Foundation. Kate is a member of the board of Vital Voices.

Don Kilburn

Don is President, North America and has broad product-service experience in Higher Ed and K-12. He is responsible for accelerating shift-to-services and digital and transforming North American business by putting learner outcomes at the centre of Pearson. Previously, he was vice chairman of Pearson Higher Education North America and chief executive of Pearson Learning Solutions. Don joined Pearson in 1998 and has extensive general-manager experience in a variety of companies including Viacom and Xerox.

Douglas Kubach

Doug is President, School and has expert knowledge of K-12 instructional resources, learning assessment, state and national testing, teacher licensure testing, clinical and talent assessment and early childhood programs. Doug joined Pearson's education business in 2000 as senior vice president strategy and chief technology officer for Pearson Education, and became head of Pearson's US assessment business in 2004. Doug is a board member of ACT and a board observer on Metametrics.

Tamara Minick-Scokalo

Tamara is President, Growth Markets and has responsibility for developing Pearson's business in growth markets globally. Tamara joined Pearson in March 2012 as President, Europe, Middle East & Africa bringing a wealth of experience in marketing, strategy development, change management and operational management from her 25 + years in fast-moving consumer goods companies.

John Ridding

John is President, Professional & MD, FT Group. He started his Pearson career in the FT's editorial department, working through a series of editing and international reporting roles before becoming Managing Editor and Deputy Editor. John set up the FT's operation in Asia and launched FTChinese.com, the Chinese



language edition of the FT. He was appointed President of Pearson Asia in 2003 and CEO of the FT in 2006. Since then he has led the transformation strategy and digital development of the FT. John is a board member of the Economist Group and of Room to Read, the US-based charity focused on driving literacy, especially for girls, in developing countries.

Melinda Wolfe

Melinda is Chief Human Resources Officer, having joined Pearson in September 2013. Her extensive human resources expertise includes business alignment, talent management, succession planning, diversity, leadership, change management, culture, employee engagement, team building, health and wellness and non-profit leadership. Melinda previously worked in Human Resources at Bloomberg LP and served as an adjunct professor at Columbia University's School of International and Public Affairs, on Mayor Bloomberg's Commission on Women as well as Planned Parenthood of NTC, the National Council for Research on Women, Auburn Seminary, the Dalton School and the advisory boards of Barnard, Duke University and Washington University.

Compensation of senior management

It is the role of the remuneration committee (the committee) to approve the remuneration and benefits packages of the executive directors and other members of the Pearson Executive.

The principal duties of the remuneration committee (the committee) are to:

- a. Determine and regularly review the remuneration policy for the executive directors, the presidents of the principal geographic markets and lines of business and other members of the Pearson executive who report directly to the CEO (Executive Management). This policy includes base salary, annual and long-term incentives, pension arrangements, any other benefits and termination of employment.
- b. Regularly review the implementation and operation of the remuneration policy for Executive Management and approve the individual remuneration and benefits packages of the executive directors.
- c. Approve the design of, and determine targets for, any performance-related pay plans operated by the company and approve the total payments to be made under such plans.
- d. Review the design of the company's long-term incentive and other share plans for approval by the board and shareholders.
- e. Advise and decide on general and specific arrangements in connection with the termination of employment of executive directors.
- f. Review and approve corporate goals and objectives relevant to CEO remuneration and evaluate the CEO's performance in light of those goals and objectives.
- g. Have delegated responsibility for determining the remuneration and benefits package of the chairman of the board.
- h. Appoint and set the terms of engagement for any remuneration consultants who advise the committee and monitor the cost of such advice.

The committee also takes note of the remuneration arrangements for the company's senior leadership group representing approximately 100 executives and managers.

Remuneration policy

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



Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives. Base salary helps to recruit, reward and retain people and reflects competitive market level, role, skills, experience and individual contribution. Allowances and benefits help to recruit and retain people and reflect the local competitive market. Retirement benefits help to recruit and retain people and recognize their long-term commitment to the company. Annual incentives motivate the achievement of annual strategic goals and personal objectives, provide focus on key financial metrics and reward individual contribution to the success of the company. Long-term incentives help to recruit, reward and retain people, drive long-term earnings, share price growth and value creation, align interests of executives and shareholders, encourage long-term shareholding and commitment to the company and link management's long-term reward and wealth to corporate performance in a flexible way.

For benchmarking purposes, we review remuneration by reference to different comparator groups. We look at survey data from: FTSE 100 companies with significant international exposure, excluding financial services; the FTSE 20-50, excluding financial services; a broad media industry group of US companies; select UK human capital-intensive businesses; and UK and US media convergence companies with a focus on media, information services and technology. These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Towers Watson, use to make comparisons on remuneration takes this variation in size into account. We also look at publicly disclosed and proxy data for global media convergence comparators with a focus on media and technology. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual and long-term incentives. The committee will continue to review the mix of fixed and performance-linked remuneration on an annual basis, consistent with its overall philosophy.

Base salary

Base salaries are normally reviewed annually for the following year, taking into account general economic and market conditions, the level of increases made across the company as a whole, particular circumstances such as changes in role, responsibilities or organization, the remuneration of executives in similar positions in comparable companies and individual performance.

Allowances and benefits

Allowances and benefits include *inter alia* cash allowances and non-cash benefits such as health, welfare and car benefits. Allowances and benefits do not form part of pensionable earnings. The provision and level of allowances and benefits are competitive and appropriate in the context of the market.

Retirement benefits

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

Under the Money Purchase 2003 section of the Pearson Group Pension Plan in the UK, normal retirement is age 62 but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the company and the employee make contributions into a pension fund. Company contributions amount to up to 16% of pensionable salary (double the amount of the employee contribution, which is limited according to certain age bands). Account balances are used to provide benefits at retirement. Pensions for a member's spouse, dependent children and/or nominated financial dependents are payable on death.

Under the 401(k) plan in the US, which is a defined contribution plan, account balances will be used to provide benefits at retirement. Company contributions amount to 100% of the first 3% of eligible compensation



contributed by the employee and 50% of the next 3%, plus a basic annual company contribution of 1.25% of eligible compensation. Pearson Inc. Pension Plan participants who were at least age 40 at December 31, 2001 can receive an additional 0.5% — 1.5% of pay. In the event of death before retirement, the account balances will be used to provide benefits for designated beneficiaries.

Depending on when they joined the company, directors may participate in the defined benefit Pearson Inc. Pension Plan in the US or the Final Pay section of the Pearson Group Pension Plan in the UK, both of which are closed to new members.

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

In the US, the defined benefit Pearson Inc. Pension Plan provides a lump sum benefit that is convertible to an annuity on retirement. The lump sum benefit accrued at an age dependent percentage of capped compensation until December 31, 2001 when further benefit accruals ceased for most employees. Employees who satisfied criteria of age and service as of November 30, 1998 continue to earn benefits under an alternative formula that provides for 1.5% of final average earnings, adjusted for US Social Security. The benefit paid to these employees is the maximum of the lump sum benefit converted to an annuity and the benefit earned under the alternative final average earnings formula.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit was abolished by the Finance Act 2004. However the Pearson Group Pension Plan has retained its own 'cap', which will increase annually in line with the UK Government's Index of Retail Prices (All Items). The cap was £145,800 effective April 6, 2014, and £149,400 effective April 6, 2015.

As a result of the UK Government's A-Day changes effective from April 2006, UK executive directors and other members of the Pearson Group Pension Plan who are, or become, affected by the lifetime allowance are provided with a cash supplement as an alternative to further accrual of pension benefits on a basis that is broadly cost neutral to the company. Effective from April 6, 2011, the annual allowance (i.e. the maximum amount of pension saving that benefits from tax relief each year) reduced from £255,000 to £50,000. Since April 6, 2012, the lifetime allowance (i.e. the maximum amount of pension and/or lump sum that can benefit from tax relief) has been £1.5m and reduced to £1.25m on April 6, 2014.

The pension entitlements of each director are as follows:

John Fallon	Member of the Pearson Group Pension Plan. His pension accrual rate is 1/30th of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.
Robin Freestone	Member of the Money Purchase 2003 section of the Pearson Group Pension Plan. Company contributions are 16% of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.



Annual incentives

The purpose of annual incentives is to motivate the achievement of annual strategic goals and personal objectives, provide a focus on key financial metrics, and reward individual contribution to the success of the company.

Measures and performance targets are set by the committee at the start of the year with payment made after year end following the committee's assessment of performance relative to targets.

The plans are designed to incentivize and reward underlying performance and actual results are adjusted for the effect of foreign exchange and for portfolio changes (acquisitions and disposals) and other factors that the committee considers relevant in the performance year.

Annual incentive plans are discretionary. The committee reserves the right to adjust payments up or down before they are made if it believes exceptional factors warrant doing so. The committee may in exceptional circumstances make a special award where it is satisfied that the normal operation of the annual incentive does not provide an appropriate incentive or reward to participants.

The committee also reserves the right as a form of malus to adjust payments before they are made if special circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company. The committee also reserves, in the same special circumstances, a right to reclaim or claw back payments or awards that have already been made.

Annual incentives will not exceed 200% of base salary.

For the chief executive, the individual maximum opportunity that will apply for 2015 is 180% of base salary (which is the same as applied for 2014).

For other executive directors and other members of the Pearson Executive, individual incentive opportunities take into account their membership of that committee and the relative contribution of their businesses or roles to the company's overall goals. The individual maximum opportunity that will apply for 2015 varies by individual but will be no more than 170% of base salary.

For the chief executive, other executive directors and other members of the Pearson Executive, there is normally no pay-out for performance at threshold.

The committee has the discretion to select the performance measures, targets and relative weightings from year to year to ensure continuing alignment with strategy and to ensure targets are sufficiently stretching. The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the annual incentive pays out in full.

For 2014, the funding of annual incentives was related to the performance against targets for Pearson's adjusted earnings per share, sales, and operating cash flow.

Individual annual incentive pay-outs also take into account individual performance against personal objectives. Personal objectives are agreed with the chief executive (or, in the case of the chief executive, the chairman) and may be functional, operational, strategic and non-financial and include *inter alia* objectives relating to environmental, social and governance issues.

Legacy arrangements under annual bonus share matching plan

Up to and including 2013 in respect of annual incentives for 2012, awards were made under the annual bonus share matching plan. This plan encouraged executive directors and other senior managers to acquire and



hold Pearson shares and aligned the interests of executives and shareholders. Senior managers across the company were invited to invest up to 50% of their after-tax annual incentive in Pearson shares purchased in the market and hold these shares for three years, in return for the opportunity to earn additional free matching shares and dividend shares, depending on performance against a real growth in earnings per share performance condition. Where matching shares vest, participants also receive additional shares representing the gross value of dividends that would have been paid on the matching shares during the performance period and reinvested. The maximum matching award is equal to the number of shares that could have been acquired with the amount of pre-tax annual bonus invested in Pearson shares (i.e. one matching share for every one invested share, grossed up for tax).

Long-term incentives

The purpose of long-term incentives is to help to recruit, reward and retain, drive long-term earnings, share price growth and value creation, align the interests of executives and shareholders, encourage long-term shareholding and commitment to the company, and link management's long-term reward and wealth to corporate performance in a flexible way.

Awards of restricted shares are made on an annual basis.

Awards of restricted shares for executive directors and other members of the Pearson Executive vest on a sliding scale based on performance against stretching corporate performance targets measured at the end of the three-year performance period.

For performance-related awards for members of the Pearson Executive, performance will continue to be tested over 3 years and 75% of the vested shares will continue to be released at that point. Starting with awards made in 2014, there is a mandatory restriction on participants' ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further 2 years. Furthermore, participants' rights to the release of the 25% of the vested shares are subject to continued employment over the same period.

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

The plan permits awards of restricted shares to be made that are not subject to performance conditions to satisfy reward and retention objectives. However, other than in exceptional circumstances on recruitment, it is the company's policy not to award restricted shares to executive directors and other members of the Pearson Executive without performance conditions.

The long-term incentive plan also provides for the grant of stock options. Whilst it is not the committee's intention to grant stock options in 2015 or the foreseeable future, the committee believes that it should retain the flexibility of granting stock options in addition to, or instead of, restricted stock awards in the right circumstances. Any decision by the committee to grant stock options in the future would take account of best practice prevailing at the time. The committee would consult with shareholders before granting stock options to executive directors.

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

The committee reserves the right to adjust pay-outs up or down before they are released taking into account exceptional factors that distort underlying business performance or if it believes exceptional factors warrant doing so. In making such adjustments, the committee is guided by the principle of aligning shareholder and management interests.

The committee also reserves the right as a form of malus to adjust pay-outs before they are released if exceptional circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.



The committee also reserves, in the same special circumstances, a right to reclaim or claw back pay-outs or awards that have already been released.

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

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

The committee has the discretion to determine the performance measures, weightings and targets governing an award of restricted shares prior to grant to ensure continuing alignment with strategy and to ensure that targets are sufficiently stretching.

The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the award pays out in full.

Awards are normally subject to the achievement of targets for growth in earnings per share, return on invested capital and relative total shareholder return.

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

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

Shareholding policy

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership. Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children plus any shares vested but held pending release under a restricted share plan. In 2014, the target holding was increased to 300% of salary for the chief executive and 200% of salary for the other executive directors. Mandatory guidelines were also extended to other members of the Pearson Executive at 100% of salary. Details of individual directors' shareholding are set out at the end of this section.

Service agreements

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

There are no special provisions for notice or compensation in the event of a change of control of Pearson.

It is the company's policy that the company may terminate the chairman's and executive directors' service agreements by giving no more than 12 months' notice.

As an alternative, for executive directors the company may at its discretion pay in lieu of that notice. Payment-in-lieu of notice may be made in equal monthly installments from the date of termination to the end of any unexpired notice period. In the case of the CEO, payment-in-lieu of notice in installments may also be subject to mitigation and reduced taking into account earnings from alternative employment.



For executive directors, pay in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. For the chairman, pay in lieu of notice comprises 100% of the annual fees at the date of termination. In limited circumstances, in addition to making a full payment in lieu of notice, the company may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective hand-over and/or allow time for a successor to be appointed.

The company may, depending on the circumstances of the termination, determine that it will not pay the director in lieu of notice and may instead terminate a director's contract in breach and make a damages payment, taking into account as appropriate the director's ability to mitigate his or her loss.

On cessation of employment, save as otherwise provided for under the rules of Pearson's discretionary share plans, executive directors' entitlements to any unvested awards lapse automatically. In the case of injury, disability, ill-health or redundancy (as determined by the committee), where a participant's employing company ceases to be part of Pearson, or any other reason if the committee so decides in its absolute discretion:

- awards that are subject to performance conditions will stay in force as if the participant had not ceased employment and shall vest on the original vesting date
- awards that are not subject to a performance condition will be released on cessation of employment
- the number of shares that are released shall be prorated for the period of the participant's service in the restricted period (although the committee may in its absolute discretion waive or vary the prorating)

On cessation of employment, executive directors, having been notified of participation in an annual incentive plan for the relevant financial year, may retain entitlement to a pro rata annual incentive for their period of service in the financial year to their leaving date. Such pay-out will normally be calculated in good faith on the same terms and paid at the same time as for continuing executive directors.

Eligibility for allowances and benefits including retirement benefits normally ceases on retirement or on the termination of employment for any other reason.

Executive directors' non-executive directorships

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

Where executive directors served as non-executive directors elsewhere, they either waived or did not receive fees.

Chairman's and non-executive directors' remuneration

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

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

The chairman's fees were last reviewed in 2010 and increased with effect from April 1, 2011 with a commitment to review again in 2014. Fees for the non-executive directors were last increased with effect from July 1, 2010.



The chairman's and non-executive directors' fees were reviewed for 2014.

The structure of non-executive directors' fees is as follows:

	<u>With effect from May 1, 2014</u>
Non-executive director	£70,000
Chairmanship of audit committee	£27,500
Chairmanship of remuneration committee	£22,000
Chairmanship of reputation and responsibility committee	£10,000
Membership of audit committee	£15,000
Membership of remuneration committee	£10,000
Membership of reputation and responsibility committee	£ 5,000
Senior independent director	£22,000

Notes:

- (1) The fee paid to the chairman remains unchanged at £500,000.
- (2) A minimum of 25% of the basic fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.
- (3) Non-executive directors serve Pearson under letters of appointment and do not have service contracts. There is no entitlement to compensation on the termination of their directorships.

Remuneration of senior management

The remuneration received by executive directors in respect of the financial year ending December 31, 2014 was as follows:

	<u>Base Salary/ Fees</u>	<u>Allowances & Benefits(1)</u>	<u>Annual Incentives</u>	<u>Long-term Incentives</u>	<u>Retirement Benefits</u>	<u>Total</u>
	£000	£000	£000	£000	£000	£000
Chairman						
Glen Moreno	500	—	—	—	—	500
Executive directors						
John Fallon	761	83	692	74	285	1,895
Robin Freestone	553	15	365	63	166	1,162
Senior management as a group	<u>1,814</u>	<u>98</u>	<u>1,057</u>	<u>137</u>	<u>451</u>	<u>3,557</u>

Notes:

- (1) Benefits include company car, car allowance, private use of a driver, healthcare, additional life cover and long-term disability insurance.



Share options for senior management

This table sets forth for each director the number of share options held as of December 31, 2014 as well as the exercise price, rounded to the nearest whole pence/cent, and the range of expiration dates of these options.

<u>Director</u>	<u>Number of Options</u>	<u>Exercise Price</u>	<u>Earliest Exercise Date</u>	<u>Expiry Date</u>
	1,930	805.6p	08/01/15	02/01/16
John Fallon	1,109	811.2p	08/01/17	02/01/18
	990	909.0p	08/01/15	02/01/16
Robin Freestone	1,109	811.2p	08/01/17	02/01/18

Notes:

- (1) No share option awards were vested or were exercised in the year.
- (2) These awards were made under the worldwide save for shares plan.
- (3) No variations to the terms and conditions of share options were made during the year.
- (4) The acquisition of shares under the worldwide save for shares plan is not subject to a performance condition.
- (5) All share options that become exercisable during the year are included in the single figure of total remuneration for that year. The value included in the single figure of total remuneration is the number of options multiplied by the difference between the value on grant and the market value on the earliest exercise date. No share options were exercisable during 2014 and so there is nothing to include in the single figure of total remuneration for 2014.
- (6) The market price on December 31, 2014 was 1,190.0p per share and the range during the year was 998.0p to 1,340.0p.

Share ownership of senior management

The table overleaf shows the number of ordinary shares and conditional shares held by continuing directors and their connected persons as at December 31, 2014.

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

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

Additional information with respect to share options held by, and bonus awards for, these persons is set out above in "Remuneration of Senior Management" and "Share Options of Senior Management". The total number of ordinary shares held by senior management as of December 31, 2014 was 1,034,377.

<u>As at 31 December 2014</u>	<u>Ordinary shares(1)</u>	<u>Conditional Shares</u>
Glen Moreno	200,000	—
John Fallon	282,147	13,752
Robin Freestone	504,283	11,460
David Arculus	17,117	—
Elizabeth Corley	468	—
Vivienne Cox	2,123	—
Ken Hydon	18,634	—
Josh Lewis	6,632	—
Linda Lorimer	1,581	—
Harish Manwani	1,392	—



Notes:

- (1) Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals investing part of their own after-tax annual bonus in Pearson shares under the annual bonus share matching plan.
- (2) The register of directors' interests (which is open to inspection during normal office hours) contains full details of directors' shareholdings and options to subscribe for shares. The market price on December 31, 2014 was 1,190.0p per share and the range during the year was 998.0p to 1,340.0p.
- (3) Ordinary shares do not include any shares vested but held pending release under a restricted share plan.
- (4) There were no movements in ordinary shares between 1 January 2015 and a month prior to the sign-off of this report.

The total remuneration of the executive committee is set out in the table below:

<u>All figures in £ millions</u>	<u>2014</u>
Short-term employee benefits	10
Retirement benefits	1
Share-based payment costs	2
Total	<u>13</u>

Employee share ownership plans

In 1998, we introduced a worldwide save for shares plan. Under this plan, our employees around the world have the option to save a portion of their monthly salary over periods of three or five years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the commencement of the employee's participation in the plan.

In 2014, shareholders approved the renewal and extension of the life of the UK plan by a further ten years, until 2024 and the renewal of the directors' authority to continue to operate equivalent arrangements for non-UK employees. As part of this renewal, the savings limit for the UK HMRC-approved part of the plan (which forms the basis of the plan in the rest of the world outside the US) was increased from £250 to £500 per month.

In the United States, this plan operates as a stock purchase plan under Section 423 of the US Internal Revenue Code of 1986. This plan was introduced in 2000 following Pearson's listing on the New York Stock Exchange. Under it, participants save a portion of their monthly salary over six month periods, at the end of which they have 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. The maximum employee contribution under the plan is \$1,000 per month.

Board practices

Our board currently comprises the chairman, two executive directors and eight non-executive directors. Our articles of association provide that at every annual general meeting, one-third of the board of directors, or the number nearest to one-third, shall retire from office. The directors to retire each year are the directors who have been longest in office since their last election or appointment. A retiring director is eligible for re-election. If at any annual general meeting, the place of a retiring director is not filled, the retiring director, if willing, is deemed to have been re-elected, unless at or prior to such meeting it is expressly resolved not to fill the vacated office, or unless a resolution for the re-election of that director has been put to the meeting and lost. Our articles of association also provide that every director be subject to re-appointment by shareholders at the next annual general meeting following their appointment.



However in accordance with the UK Corporate Governance Code, the board has resolved that all directors should offer themselves for re-election on an annual basis at the company's annual general meeting. Accordingly, with the exception of Ken Hydon and David Arculus who will retire from the board at the 2015 annual general meeting, all of the directors will offer themselves for re-election, (or re-appointment in the case of directors who were appointed since the last meeting), at the forthcoming annual general meeting on April 24, 2015.

Pearson is listed on the New York Stock Exchange ("NYSE"). As a listed non-US issuer, we are required to comply with some of the NYSE's corporate governance rules, and otherwise must disclose on our website any significant ways in which our corporate governance practices differ from those followed by US companies under the NYSE listing standards. At this time, the Company believes that it is in compliance in all material respects with all the NYSE rules except that it is the full board, not the Nomination Committee, that develops and recommends corporate governance principles.

The board of directors has established the following formal committees, all of which report to the board. Each committee has its own written terms of reference setting out its authority and duties. These can be found on our website (www.pearson.com/governance).

Audit committee

This committee provides the board with a vehicle to appraise our financial management and reporting and to assess the integrity of our accounting procedures and financial controls. Ken Hydon chairs this committee and its other members are David Arculus, Vivienne Cox, Linda Lorimer and Tim Score. Ken Hydon is also the designated audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission. Our internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee.

Remuneration committee

This committee meets regularly to decide the remuneration and benefits of the executive directors and the executive committee. The committee also recommends the chairman's remuneration to the board of directors for its decision and reviews management development and succession plans. David Arculus chairs this committee and its other members are Elizabeth Corley, Vivienne Cox, Ken Hydon, Josh Lewis and Glen Moreno.

Nomination committee

This committee meets from time to time as necessary to consider the appointment of new directors. The committee is chaired by Glen Moreno and comprises all of the non-executive directors.

Reputation and responsibility committee

This committee meets regularly to oversee Pearson's strategy and plans to build and protect its corporate reputation. It provides advice and guidance to management on these plans. The committee was formalized on May 1, 2014, having been introduced and operated on an informal basis in 2013. Vivienne Cox chairs this committee and its other members are Linda Lorimer and Harish Manwani.



Employees

The average number of persons employed by us in continuing operations during each of the three fiscal years ended 2014 were as follows:

- 40,876 in fiscal 2014,
- 42,115 in fiscal 2013, and
- 42,135 in fiscal 2012.

We, through our subsidiaries, have entered into collective bargaining agreements with employees in various locations. Our management has no reason to believe that we would not be able to renegotiate any such agreements on satisfactory terms. We encourage employees to contribute actively to the business in the context of their particular job roles and believe that the relations with our employees are generally good.

The table set forth below shows for 2014, 2013 and 2012 the average number of persons employed in each of our segments.

<u>Average number employed</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
North America	21,204	22,146	20,830
Core	7,887	8,807	9,890
Growth	11,603	10,975	11,258
Other	182	187	157
Continuing operations	<u>40,876</u>	<u>42,115</u>	<u>42,135</u>

The average number employed in discontinued operations was 73 in 2014, 3,592 in 2013, and 5,387 in 2012.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

As at February 28, 2015, the company had received no notifications under the Financial Conduct Authority’s Disclosure and Transparency Rules of any significant voting rights in its shares.

On February 28, 2015, record holders with registered addresses in the United States held 52,107,482 ADRs, which represented 6.35% of our outstanding ordinary shares. Some of these ADRs are held by nominees and so these numbers may not accurately represent the number of beneficial owners in the United States.

Loans and equity advanced to joint ventures and associates during the year and as at December 31, 2014 are shown in note 12 in “Item 18. Financial Statements.” Dividends receivable from joint ventures and associates are set out in note 12 in “Item 18. Financial Statements”. There were no other related party transactions in 2014.

ITEM 8. FINANCIAL INFORMATION

The financial statements filed as part of this Annual Report are included on pages F-1 through F-69 hereof.

Other than those events described in note 38 in “Item 18. Financial Statements” of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to our financial condition or results of operations since December 31, 2014. Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements of the educational book business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December.

Our policy with respect to dividend distributions is described in response to “Item 3. Key Information” above.



ITEM 9. THE OFFER AND LISTING

The principal trading market for our ordinary shares is the London Stock Exchange. Our ordinary shares also trade in the United States in the form of ADSs evidenced by ADRs under a sponsored ADR facility with The Bank of New York Mellon, as depositary. We established this facility in March 1995 and most recently amended it in August 2014 in connection with our New York Stock Exchange listing. Each ADS represents one ordinary share.

The ADSs trade on the New York Stock Exchange under the symbol “PSO”.

The following table sets forth the highest and lowest middle market quotations, which represent the average of closing bid and asked prices, for the ordinary shares, as derived from the Daily Official List of the London Stock Exchange and the average daily trading volume on the London Stock Exchange:

- on an annual basis for our five most recent fiscal years,
- on a quarterly basis for our most recent quarter and two most recent fiscal years, and
- on a monthly basis for the six most recent months.

Reference period	Ordinary shares		Average daily trading volume (Ordinary shares)
	High (In pence)	Low	
<i>Five most recent fiscal years</i>			
2014	1341	998	2,499,900
2013	1365	1119	2,065,900
2012	1294	1111	2,174,000
2011	1222	983	2,012,900
2010	1051	855	2,424,600
<i>Most recent quarter and two most recent fiscal years</i>			
2014 Fourth quarter	1241	1113	2,255,400
Third quarter	1240	1087	2,242,500
Second quarter	1175	1008	2,424,400
First quarter	1341	998	3,086,800
2013 Fourth quarter	1365	1225	1,663,400
Third quarter	1350	1162	1,816,400
Second quarter	1265	1119	2,254,100
First quarter	1238	1145	2,554,800
<i>Most recent six months</i>			
February 2015	1420	1357	2,644,700
January 2015	1361	1140	2,919,900
December 2014	1227	1118	2,002,500
November 2014	1239	1160	2,017,500
October 2014	1241	1113	2,711,100
September 2014	1240	1103	2,978,600

ITEM 10. ADDITIONAL INFORMATION

Articles of association

We summarize below the material provisions of our articles of association, as amended, which have been filed as an exhibit to our annual report on Form 20-F for the year ended December 31, 2014. The summary below is qualified entirely by reference to the Articles of Association. We have multiple business objectives and



purposes and are authorized to do such things as the board may consider fit to further our interests or incidental or conducive to the attainment of our objectives and purposes.

Directors' powers

Our business shall be managed by the board of directors and the board may exercise all such of our powers as are not required by law or by the Articles of Association or by any directions given by the Company by special resolution, to be exercised in a general meeting.

Interested directors

For the purposes of section 175 of the Companies Act 2006 the board may authorize any matter proposed to it which would, if not so authorized, involve a breach of duty by a Director under that section, including, without limitation, any matter which relates to a situation in which a Director has, or can have, an interest which conflicts, or possibly may conflict, with the interests of the Company. Any such authorization will be effective only if:

- (a) any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
- (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

The board may (whether at the time of the giving of the authorization or subsequently) make any such authorization subject to any limits or conditions it expressly imposes but such authorization is otherwise given to the fullest extent permitted. The board may vary or terminate any such authorization at any time.

Provided that he has disclosed to the board the nature and extent of his interest, a Director notwithstanding his office:

- (a) may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise (directly or indirectly) interested;
- (b) may act by himself or his firm in a professional capacity for the Company (otherwise than as auditor) and he or his firm shall be entitled to remuneration for professional services as if he were not a Director;
- (c) may be a director or other officer of, or employed by, or a party to a transaction or arrangement with, or otherwise interested in, any body corporate in which the Company is otherwise (directly or indirectly) interested.

A Director shall not, by reason of his office, be accountable to the Company for any remuneration or other benefit which he derives from any office or employment or from any transaction or arrangement or from any interest in any body corporate:

- (a) the acceptance, entry into or existence of which has been approved by the board (subject, in any such case, to any limits or conditions to which such approval was subject); or
- (b) which he is permitted to hold or enter into by virtue of paragraph (a), (b) or (c) above;

nor shall the receipt of any such remuneration or other benefit constitute a breach of his duty under section 176 of the Act.



A Director shall be under no duty to the Company with respect to any information which he obtains or has obtained otherwise than as a director of the Company and in respect of which he owes a duty of confidentiality to another person. However, to the extent that his relationship with that other person gives rise to a conflict of interest or possible conflict of interest, which has been approved by the board: the director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he fails:

- (a) to disclose any such information to the board or to any Director or other officer or employee of the Company; and/or
- (b) to use or apply any such information in performing his duties as a Director of the Company.

Where the existence of a Director's relationship with another person has been approved by the board and his relationship with that person gives rise to a conflict of interest or possible conflict of interest, the Director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he:

- (a) absents himself from meetings of the board at which any matter relating to the conflict of interest or possible conflict of interest will or may be discussed or from the discussion of any such matter at a meeting or otherwise; and/or
- (b) makes arrangements not to receive documents and information relating to any matter which gives rise to the conflict of interest or possible conflict of interest sent or supplied by the Company and/or for such documents and information to be received and read by a professional adviser, for so long as he reasonably believes such conflict of interest or possible conflict of interest subsists.

Except as stated below, a Director shall not vote in respect of any contract or arrangement or any other proposal whatsoever in which he has an interest which is, to his knowledge, a material interest, otherwise than by virtue of his interests in shares or debentures or other securities of or otherwise in or through the Company. A Director shall not be counted in the quorum at a meeting of the Board in relation to any resolution on which he is debarred from voting.

Notwithstanding the foregoing, a director will be entitled to vote, and be counted in the quorum, on any resolution concerning any of the following matters:

- the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of or for the benefit of the Company or any of its subsidiaries;
- the giving of any guarantee, security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which he himself has assumed responsibility in whole or in part and whether alone or jointly with others under a guarantee or indemnity or by the giving of security;
- any proposal relating to the Company or any of its subsidiary undertakings where it is offering securities in which offer a Director is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which a Director is to participate;
- any proposal relating to another company in which he and any persons connected with him do not to his knowledge hold an interest in shares (as that term is used in sections 820 to 825 of the Companies Act 2006) representing one per cent or more of either any class of the equity share capital, or the voting rights, in such company;
- any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; and
- any proposal concerning insurance that we propose to maintain or purchase for the benefit of directors or for the benefit of persons, including directors.



Where proposals are under consideration concerning the appointment of two or more directors to offices or employment with us or any company in which we are interested, these proposals may be divided and considered separately and each of these directors, if not prohibited from voting under the provisions of the eighth paragraph before this one, will be entitled to vote and be counted in the quorum with respect to each resolution except that concerning his or her own appointment.

Borrowing powers

The board of directors may exercise all powers to borrow money and to mortgage or charge our undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as collateral security for any of our or any third party's debts, liabilities or obligations. The board of directors must restrict the borrowings in order to secure that the aggregate amount of undischarged monies borrowed by us (and any of our subsidiaries), but excluding any intra-group debts, shall not at any time (without the previous sanction of the Company in the form of an ordinary resolution) exceed a sum equal to twice the aggregate of the adjusted capital and reserves.

Other provisions relating to directors

Under the articles of association, directors are paid out of our funds for their services as we may from time to time determine by ordinary resolution and, in the case of non-executive directors, up to an aggregate of £750,000 or such other amounts as resolved by the shareholders at a general meeting. Directors currently are not required to hold any share qualification. From April 6, 2007 under the Companies Act 2006, the maximum age limit for directors of PLCs, which was 70, has been removed.

Annual general meetings

In every year the Company must hold an annual general meeting ('AGM') (within a period of not more than 15 months after the date of the preceding AGM) at a place and time determined by the board. The following matters are usually considered at an annual general meeting:

- approving final dividends;
- consideration of the accounts and balance sheet;
- ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;
- as holders of ordinary shares vote for the election of one-third of the members of the board of directors at every annual general meeting, the appointment or election of directors in the place of those retiring by rotation or otherwise;
- appointment or reappointment of, and determination of the remuneration of, the auditors; and
- the renewal, limitation, extension, variation or grant of any authority to the board in relation to the allotment of securities.

The board may call a general meeting whenever it thinks fit. If at any time there are not within the United Kingdom sufficient directors capable of acting to form a quorum, any director or any two members may convene a general meeting in the same manner as nearly as possible as that in which meetings may be convened by the board.

No business shall be dealt with at any general meeting unless a quorum is present when the meeting proceeds to business. Three members present in person and entitled to vote shall be a quorum for all purposes. A corporation being a member shall be deemed to be personally present if represented by its duly authorized representative.



If a quorum for a meeting convened at the request of shareholders is not present within fifteen minutes of the appointed time, the meeting will be dissolved. In any other case, the general meeting will be adjourned to the same day in the next week, at the same time and place, or to a time and place that the chairman fixes. If at that rescheduled meeting a quorum is not present within fifteen minutes from the time appointed for holding the meeting, the shareholders present in person or by proxy will be a quorum. The chairman or, in his absence, the deputy chairman or any other director nominated by the board, will preside as chairman at every general meeting. If no director is present at the general meeting or no director consents to act as chairman, the shareholders present shall elect one of their number to be chairman of the meeting.

Share Certificates

Every person whose name is entered as a member in the Company's Register of Members shall be entitled to one certificate in respect of each class of shares held. (The law regarding this does not apply to stock exchange nominees). Subject to the terms of issue of the shares, certificates are issued following allotment or receipt of the form of transfer bearing the appropriate stamp duty by our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom, telephone number +44 121-415-7062.

Share capital

Any share may be issued with such preferred, deferred or other special rights or other restrictions as we may determine by way of a shareholders' vote in general meeting. Subject to the Companies Act 2006, any shares may be issued on terms that they are, or at our or the shareholders' option are, liable to be redeemed on such terms and in such manner as we, before the issue of the shares, may determine by special resolution of the shareholders.

There are no provisions in the Articles of Association which discriminate against any existing or prospective shareholder as a result of such shareholder owning a substantial number of shares.

Subject to the terms of the shares which have been issued, the directors may from time to time make calls upon the shareholders in respect of any moneys unpaid on their shares, provided that (subject to the terms of the shares so issued) no call on any share shall be payable at less than fourteen clear days from the last call. The directors may, if they see fit, receive from any shareholder willing to advance the same, all and any part of the moneys uncalled and unpaid upon any shares held by him.

Changes in capital

We may from time to time, by ordinary resolution:

- consolidate and divide our share capital into shares of a larger amount than its existing shares; or
- sub-divide all of or any of our existing shares into shares of smaller amounts, subject to the Companies Act 2006; or
- cancel any shares which, at the date of passing of the resolution, have not been taken, or agreed to be taken, by any person and diminish the amount of our share capital by the amount of the shares so cancelled.

We may, from time to time, by ordinary resolution increase our share capital and, subject to the consents and incidents required by the Companies Act 2006, may by special resolution decrease our share capital, capital redemption reserve fund and any share premium account in any way.

***Voting rights***

Every holder of ordinary shares present in person at a meeting of shareholders has one vote on a vote taken by a show of hands. On a poll, every holder of ordinary shares who is present in person or by proxy has one vote for every ordinary share of which he or she is the holder. Voting at any meeting of shareholders is by a show of hands unless a poll is properly demanded before the declaration of the results of a show of hands. A poll may be demanded by:

- the chairman of the meeting;
- at least three shareholders present in person or by proxy and entitled to vote;
- any shareholder or shareholders present in person or by proxy representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting; or
- any shareholder or shareholders present in person or by proxy holding shares conferring a right to vote at the meeting being shares on which the aggregate sum paid up is equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

Dividends

Holders of ordinary shares are entitled to receive dividends out of our profits that are available by law for distribution, as we may declare by ordinary resolution, subject to the terms of issue thereof. However, no dividends may be declared in excess of an amount recommended by the board of directors. The board may pay interim dividends to the shareholders as it deems fit. We may invest or otherwise use all dividends left unclaimed for six months after having been declared for our benefit, until claimed. All dividends unclaimed for a period of twelve years after having been declared will be forfeited and revert to us.

The directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid, in whole or in part, instead of cash in respect of such dividend.

The directors may deduct from any dividend payable to any shareholder all sums of money (if any) presently payable by that shareholder to us on account of calls or otherwise in relation to our shares.

Liquidation rights

In the event of our liquidation, after payment of all liabilities, our remaining assets would be used to repay the holders of ordinary shares the amount they paid for their ordinary shares. Any balance would be divided among the holders of ordinary shares in proportion to the nominal amount of the ordinary shares held by them.

Other provisions of the articles of association

Whenever our capital is divided into different classes of shares, the special rights attached to any class may, unless otherwise provided by the terms of the issue of the shares of that class, be varied or abrogated, either with the written consent of the holders of three-fourths of the issued shares of the class or with the sanction of a special resolution passed at a separate meeting of these holders. In the event that a shareholder or other person appearing to the board of directors to be interested in ordinary shares fails to comply with a notice requiring him or her to provide information with respect to their interest in voting shares pursuant to section 820 of the Companies Act 2006, we may serve that shareholder with a notice of default. After service of a default notice, that shareholder shall not be entitled to attend or vote at any general meeting or at a separate meeting of holders of a class of shares or on a poll until he or she has complied in full with our information request.



If the shares described in the default notice represent at least one-fourth of 1% in nominal value of the issued ordinary shares, then the default notice may additionally direct that in respect of those shares:

- we will not pay dividends (or issue shares in lieu of dividends); and
- we will not register transfers of shares unless the shareholder is not himself in default as regards supplying the information requested and the transfer, when presented for registration, is in such form as the board of directors may require to the effect that after due and careful inquiry, the shareholder is satisfied that no person in default is interested in any of the ordinary shares which are being transferred or the transfer is an approved transfer, as defined in our articles of association.

No provision of our articles of association expressly governs the ordinary share ownership threshold above which shareholder ownership must be disclosed. Under the Companies Act 2006, any person who acquires, either alone or, in specified circumstances, with others:

- a material interest in our voting share capital equal to or in excess of 3%; or
- a non-material interest equal to or in excess of 10%,

comes under an obligation to disclose prescribed particulars to us in respect of those ordinary shares. A disclosure obligation also arises where a person's notifiable interests fall below the notifiable percentage, or where, above that level, the percentage of our voting share capital in which a person has a notifiable interest increases or decreases.

Limitations affecting holders of ordinary shares or ADSs

Under English law and our memorandum and articles of association, persons who are neither UK residents nor UK nationals may freely hold, vote and transfer ordinary shares in the same manner as UK residents or nationals.

With respect to the items discussed above, applicable UK law is not materially different from applicable US law.

Material contracts

Pearson has not entered into any contracts outside the ordinary course of business during the two year period immediately preceding the date of this annual report. The Indenture entered into in 2013 with respect to \$500.0 million aggregate principal amount of 3.250% guaranteed notes due 2023 and the Trust Deed entered into in 2014 with respect to \$500.0 million aggregate principal amount of 1.875% guaranteed notes due 2021, in each case, issued by a subsidiary and guaranteed by Pearson, are filed as Exhibits 2.9 and 2.10 of this report, respectively.

Executive employment contracts

We have entered into agreements with each of our executive directors pursuant to which such executive director is employed by us. These agreements describe the duties of such executive director and the compensation to be paid by us. See "Item 6. Directors, Senior Management and Employees — Compensation of Senior Management".

It is the company's policy that the company may terminate the executive directors' service agreements by giving no more than 12 months' notice. As an alternative, the company may at its discretion pay in lieu of that notice. Payment-in-lieu of notice may be made in equal monthly installments from the date of termination to the end of any unexpired notice period. In the case of the CEO, payment-in-lieu of notice in installments may also be subject to mitigation and reduced taking into account earnings from alternative employment. For executive



directors, pay in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. In limited circumstances, in addition to making a full payment in lieu of notice, the company may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective hand-over and/or allow time for a successor to be appointed. The company may, depending on the circumstances of the termination, determine that it will not pay the director in lieu of notice and may instead terminate a director's contract in breach and make a damages payment, taking into account as appropriate the director's ability to mitigate his or her loss.

Exchange controls

There are no UK government laws, decrees, regulations or other legislation which restrict or which may affect the import or export of capital, including the availability of cash and cash equivalents for use by us or the remittance of dividends, interest or other payments to nonresident holders of our securities, except as otherwise described under "— Tax Considerations" below.

Tax considerations

The following is a discussion of the material US federal income tax considerations and UK tax considerations arising from the acquisition, ownership and disposition of ordinary shares and ADSs by a US holder. A US holder is:

- an individual citizen or resident of the US, or
- a corporation created or organized in or under the laws of the US or any of its political subdivisions, or
- an estate or trust the income of which is subject to US federal income taxation regardless of its source.

This discussion deals only with ordinary shares and ADSs that are held as capital assets by a US holder, and does not address tax considerations applicable to US holders that may be subject to special tax rules, such as:

- dealers or traders in securities or currencies,
- financial institutions or other US holders that treat income in respect of the ordinary shares or ADSs as financial services income,
- insurance companies,
- tax-exempt entities,
- persons acquiring shares or ADSs in connection with employment,
- US holders that hold the ordinary shares or ADSs as a part of a straddle or conversion transaction or other arrangement involving more than one position,
- US holders that own, or are deemed for US tax purposes to own, 10% or more of the total combined voting power of all classes of our voting stock,
- US holders that have a principal place of business or "tax home" outside the United States, or
- US holders whose "functional currency" is not the US dollar.

For US federal income tax purposes, holders of ADSs will be treated as the owners of the ordinary shares represented by those ADSs. In practice, HM Revenue & Customs (HMRC) will also regard holders of ADSs as the beneficial owners of the ordinary shares represented by those ADSs, although case law has cast some doubt on this. The discussion below assumes that HMRC's position is followed.

In addition, the following discussion assumes that The Bank of New York Mellon will perform its obligations as depositary in accordance with the terms of the depositary agreement and any related agreements.



Because US and UK tax consequences may differ from one holder to the next, the discussion set out below does not purport to describe all of the tax considerations that may be relevant to you and your particular situation. Accordingly, you are advised to consult your own tax advisor as to the US federal, state and local, UK and other, including foreign, tax consequences of investing in the ordinary shares or ADSs. Except where otherwise indicated, the statements of US and UK tax law set out below are based on the laws, interpretations and tax authority practice in force or applicable as of February 28, 2015, being the last practicable date before the date of this Annual Report, and are subject to any changes occurring after that date, possibly with retroactive effect.

UK income taxation of distributions

The UK does not impose dividend withholding tax on dividends paid by the Company.

A US holder that is not resident in the UK for UK tax purposes and does not carry on a trade, profession or vocation in the UK through a branch or agency (or in the case of a company a permanent establishment) to which the ordinary shares or ADSs are attributable will not generally be liable to pay UK tax on dividends paid by the Company.

US income taxation of distributions

Distributions that we make with respect to the ordinary shares or ADSs, other than distributions in liquidation and distributions in redemption of stock that are treated as exchanges, will be taxed to US holders as ordinary dividend income to the extent that the distributions do not exceed our current and accumulated earnings and profits. The amount of any distribution will equal the amount of the cash distribution. Distributions, if any, in excess of our current and accumulated earnings and profits will constitute a non-taxable return of capital to a US holder and will be applied against and reduce the US holder's tax basis in its ordinary shares or ADSs. To the extent that these distributions exceed the tax basis of the US holder in its ordinary shares or ADSs, the excess generally will be treated as capital gain.

Dividends that we pay will not be eligible for the dividends received deduction generally allowed to US corporations under Section 243 of the Code.

In the case of distributions in pounds, the amount of the distributions generally will equal the US dollar value of the pounds distributed, determined by reference to the spot currency exchange rate on the date of receipt of the distribution by the US holder in the case of shares or by The Bank of New York Mellon in the case of ADSs, regardless of whether the US holder reports income on a cash basis or an accrual basis. The US holder will realize separate foreign currency gain or loss only to the extent that this gain or loss arises on the actual disposition of pounds received. For US holders claiming tax credits on a cash basis, taxes withheld from the distribution are translated into US dollars at the spot rate on the date of the distribution; for US holders claiming tax credits on an accrual basis, taxes withheld from the distribution are translated into US dollars at the average rate for the taxable year.

A distribution by the Company to noncorporate shareholders will be taxed as net capital gain at a maximum rate of 20%, provided certain holding periods are met, to the extent such distribution is treated as a dividend under US federal income tax principles. In addition, a 3.8% Medicare tax will generally be imposed on the net investment income, which generally would include distributions treated as dividends under US federal income tax principles, of noncorporate taxpayers whose adjusted gross income exceeds a threshold amount.

UK taxation of capital gains

A US holder that is not resident in the UK for UK tax purposes and who does not carry on a trade, profession or vocation in the UK through a branch or agency (or in the case of a company a permanent



establishment) to which the ordinary shares or ADSs are attributable will not generally be liable for UK taxation on capital gains or eligible for relief for allowable losses, realized on the sale or other disposal of the ordinary shares or ADSs.

A US holder who is an individual who has been resident for tax purposes in the UK but who ceases to be so resident or becomes regarded as resident outside the UK for the purposes of any double tax treaty ("Treaty Non-resident") and continues to not be resident in the UK, or continues to be Treaty Non-resident, for a period of five years or less (or, for departures before 6 April 2013, ceases to be resident or ordinarily resident or becomes Treaty Non-resident for a period of less than five tax years) and who disposes of his ordinary shares or ADSs during that period may also be liable on his return to the UK to UK tax on capital gains, subject to any available exemption or relief, even though he is not resident in the UK, or is Treaty Non-resident, at the time of the disposal.

US income taxation of capital gains

Upon a sale or exchange of ordinary shares or ADSs to a person other than Pearson, a US holder will recognize gain or loss in an amount equal to the difference between the amount realized on the sale or exchange and the US holder's adjusted tax basis in the ordinary shares or ADSs. Any gain or loss recognized will be capital gain or loss and will be long-term capital gain or loss if the US holder has held the ordinary shares or ADSs for more than one year. Long-term capital gain of a noncorporate US holder is generally taxed at a maximum rate of 20%. In addition, a 3.8% Medicare tax will generally be imposed on the net investment income, which generally would include capital gains, of noncorporate taxpayers whose adjusted gross income exceeds a threshold amount.

Gain or loss realized by a US holder on the sale or exchange of ordinary shares or ADSs generally will be treated as US-source gain or loss for US foreign tax credit purposes.

Estate and gift tax

The current Estate and Gift Tax Convention, or the Convention, between the US and the UK generally relieves from UK Inheritance Tax (the equivalent of US Estate and Gift Tax) the transfer of ordinary shares or of ADSs where the transferor is domiciled in the US for the purposes of the Convention. This relief will not apply if the ordinary shares or ADSs are part of the business property of an individual's permanent establishment in the UK or pertain to the fixed base in the UK of a person providing independent personal services. If no relief is given under the Convention, inheritance tax may be charged on death and also on the amount by which the value of an individual's estate is reduced as a result of any transfer made by way of gift or other gratuitous or undervalue transfer, in general within seven years of death, and in certain other circumstances. In the unusual case where ordinary shares or ADSs are subject to both UK Inheritance Tax and US Estate or Gift Tax, the Convention generally provides for tax paid in the UK to be credited against tax payable in the US or for tax paid in the US to be credited against tax payable in the UK based on priority rules set forth in the Convention.

Stamp duty

No stamp duty or stamp duty reserve tax (SDRT) will generally be payable in the UK on the purchase or transfer of an ADS, provided that the ADS, and any separate instrument or written agreement of transfer, remain at all times outside the UK and that the instrument or written agreement of transfer is not executed in the UK. Subject to the following paragraph, UK legislation does however provide for SDRT or (in the case of transfers) stamp duty to be chargeable at the rate of 1.5% of the amount or value of the consideration or, in some circumstances, the value of the ordinary shares (rounded up to the next multiple of £5 in the case of stamp duty), where ordinary shares are issued or transferred to a person whose business is or includes issuing depository receipts, or to a nominee or agent for such a person, or issued or transferred to a person whose business is or includes the provision of clearance services or to a nominee or agent for such a person. Following litigation, HM Revenue & Customs (HMRC) has accepted that it will no longer seek to apply the 1.5% SDRT charge when new



shares are issued to a clearance service or depositary receipt system on the basis that the charge is not compatible with EU law. HMRC's view is that the 1.5% SDRT or stamp duty charge will continue to apply to transfers of shares into a clearance service or depositary receipt system, unless they are an integral part of an issue of share capital. This view is currently being challenged in further litigation. **Accordingly, specific professional advice should be sought before paying the 1.5% SDRT or stamp duty charge in any circumstances.**

A transfer for value of the underlying ordinary shares will generally be subject to either stamp duty or SDRT, normally at the rate of 0.5% of the amount or value of the consideration (rounded up to the next multiple of £5 in the case of stamp duty). A transfer of ordinary shares from a nominee to its beneficial owner, including the transfer of underlying ordinary shares from the Depositary to an ADS holder, under which no beneficial interest passes will not be subject to stamp duty or SDRT.

Close company status

We believe that the close company provisions of the UK Corporation Tax Act 2010 do not apply to us.

Documents on display

Copies of our Memorandum and Articles of Association and filed as exhibits to this Annual Report and certain other documents referred to in this Annual Report are available for inspection at our registered office at 80 Strand, London WC2R 0RL (c/o the Company Secretary), or, in the US, at the registered office of Pearson Inc. at 330 Hudson Street, New York, New York, during usual business hours upon reasonable prior request.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Introduction

Our principal market risks are changes in interest rates and currency exchange rates. Following an evaluation of these positions, we selectively enter into derivative financial instruments to manage our risk exposure. For this purpose, we primarily use interest rate swaps, interest rate caps and collars, forward rate agreements, currency swaps and forward foreign exchange contracts. Managing market risks is the responsibility of the chief financial officer, who acts pursuant to policies approved by the board of directors. The Audit Committee receives regular reports on our treasury activities.

We have a policy of not undertaking any speculative transactions, and we do not hold our derivative and other financial instruments for trading purposes.

We have formulated policies for hedging exposures to interest rate and foreign exchange risk, and have used derivatives to ensure compliance with these policies. Although a proportion of our derivative contracts were transacted without regard to existing IFRS requirements on hedge accounting, during 2014 and 2013 we qualified for hedge accounting under IFRS on a number of our key derivative contracts.

The following discussion addresses market risk only and does not present other risks that we face in the normal course of business, including country risk, credit risk and legal risk.

Interest rates

The Group's financial exposure to interest rates arises primarily from its borrowings. The Group manages its exposure by borrowing at fixed and variable rates of interest, and by entering into derivative transactions. Objectives approved by the board concerning the proportion of debt outstanding at fixed rates govern the use of these financial instruments.



The Group's objectives are applied to core net debt, which is measured at the year-end and comprises borrowings net of cash and other liquid funds. Our objective is to maintain a proportion of forecast core net debt in fixed or capped form for the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% each year.

The principal method of hedging interest rate risk is to enter into an agreement with a bank counterparty to pay a fixed rate and receive a variable rate, known as a swap. Under interest rate swaps, the Group agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and variable-rate amounts calculated by reference to an agreed notional principal amount. The majority of the Group's swap contracts are US dollar denominated, and some of them have deferred start dates, in order to maintain the desired risk profile as other contracts mature. The variable rates received are normally based on three-month or six-month LIBOR, and the dates on which these rates are set do not necessarily exactly match those of the hedged borrowings. Management believes that our portfolio of these types of swaps is an efficient hedge of our portfolio of variable rate borrowings.

In addition, from time to time, the Group issues bonds or other capital market instruments to refinance existing debt. To avoid the fixed rate on a single transaction unduly influencing our overall net interest expense, our typical practice has been to enter into a related derivative contract effectively converting the interest rate profile of the bond transaction to a variable interest rate. In some cases, the bond issue is denominated in a different currency to the Group's desired borrowing risk profile and the Group enters into a related cross currency interest rate swap in order to maintain this risk profile, which is predominantly borrowings denominated in US dollars.

The Group's accounting objective in its use of interest rate derivatives is to minimize 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 significantly the income statement impact of changes in the market value of a derivative). The Group then divides the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimized.

Currency exchange rates

Although the Group is based in the UK, it has significant investments in overseas operations. The most significant currency in which the Group trades is the US dollar.

The Group's policy is to align approximately the currency composition of its core net borrowings with its forecast operating profit before depreciation and amortization. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. This policy applies only to currencies that account for more than 15% of group operating profit, which currently only includes the US dollar. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. In addition, the Group's policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit. Also, the chief financial officer may request the inclusion of currencies that account for less than 15% of Group operating profit before depreciation and amortization in the above hedging process. Only one hedging transaction, denominated in South African rand, has been undertaken under that authority. The South African rand transaction matured in 2014.

At December 31, 2014 the Group's net borrowings/(cash) in our main currencies (taking into account the effect of cross currency rate swaps) were: US dollar £2,005m and sterling £36m.

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 reporting under IFRS.

Investments in overseas operations are consolidated for accounting purposes by translating values in one currency to another currency, in particular from US dollars to sterling. Fluctuations in currency exchange rates affect the currency values recorded in our accounts, although they do not give rise to any realized gain or loss, nor to any currency cash flows.

The Group is also exposed to currency exchange rates in its cash transactions and its investments in overseas operations. Cash transactions — typically for purchases, sales, interest or dividends — require cash conversions between currencies. Fluctuations in currency exchange rates affect the cash amounts that the Group pays or receives.

Forward foreign exchange contracts

The Group sometimes uses forward foreign exchange contracts where a specific major project or forecasted cash flow, including acquisitions and disposals, arises from a business decision that has used a specific foreign exchange rate. The Group's policy is to effect routine transactional conversions between currencies, for example to collect receivables or settle payables, at the relevant spot exchange rate.

The Group seeks to offset purchases and sales in the same currency, even if they do not occur simultaneously. In addition, its debt and cash portfolios management gives rise to temporary currency shortfalls and surpluses. Both of these activities require using short-dated foreign exchange swaps between currencies.

Although the Group prepares its consolidated financial statements in sterling, significant sums have been invested in overseas assets, particularly in the US. Therefore, fluctuations in currency exchange rates, particularly between the US dollar and sterling, and to a lesser extent between the euro and sterling, are likely to affect shareholders' funds and other accounting values.

Derivatives

Under IFRS, the Group is required to record all derivative instruments on the balance sheet at fair value. Derivatives not classified as hedges are adjusted to fair value through earnings. Changes in the fair value of derivatives that the Group has designated and that qualify as effective hedges are either recorded in reserves or are offset in earnings by the corresponding movement in the fair value of the underlying hedged item. Any ineffective portion of derivatives that are classified as hedges is immediately recognized in earnings.

In 2014 and 2013 the Group met the prescribed designation requirements and hedge effectiveness tests under IFRS for some of its derivative contracts. As a result, the movements in the fair value of the effective portion of fair value hedges and net investment hedges have been offset in earnings and reserves respectively by the corresponding movement in the fair value of the underlying hedged item.

In line with the Group's treasury policy, none of these instruments were considered trading instruments and each instrument was transacted solely to match an underlying financial exposure.

Quantitative information about market risk

The sensitivity of the Group's derivative portfolio to changes in interest rates is found in note 19 of "Item 18. Financial Statements".



ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

AMERICAN DEPOSITARY SHARES

Fees paid by ADR holders

Our ordinary shares trade in the United States under a sponsored ADR facility with The Bank of New York Mellon as depositary.

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal, or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

The following table summarizes various fees currently charged by The Bank of New York Mellon:

<u>Person depositing or withdrawing shares must pay to the depositary:</u>	<u>For:</u>
\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	<ul style="list-style-type: none"> • Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property • Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
\$0.05 (or less) per ADS	<ul style="list-style-type: none"> • Any cash distribution to ADS registered holders
A fee equivalent to the fee that would be payable if securities distributed had been shares and the shares had been deposited for issuance of ADSs	<ul style="list-style-type: none"> • Distribution of securities by the depositary to ADS registered holders of deposited securities
\$0.05 (or less) per ADS per calendar year	<ul style="list-style-type: none"> • Depositary services
Registration of transfer fees	<ul style="list-style-type: none"> • Transfer and registration of shares on the share register to or from the name of the depositary or its agent when shares are deposited or withdrawn
Expenses of the depositary	<ul style="list-style-type: none"> • Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement) • Converting foreign currency to US dollars
Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes	<ul style="list-style-type: none"> • As necessary
Any charges incurred by the depositary or its agents for servicing the deposited securities	<ul style="list-style-type: none"> • As necessary

Fees incurred in past annual period and fees to be paid in the future

The Company received payments from the depositary with respect to 2014 of \$400,000 for standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing the



annual and interim financial of reports, printing and distributing dividend cheques, electronic filing of US Federal tax information, mailing required the forms, stationary, postage, facsimile and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees. In addition, the Company received a payment from the depository of \$68,979 as reimbursement of the 2014 continuing annual stock exchange listing fees.

The depository has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS programme. The depository has agreed to reimburse the Company for its continuing annual stock exchange listing fees. The depository has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consists of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend cheques, electronic filing of US Federal tax information, mailing required tax forms, stationery, postage, facsimile and telephone calls. It has also agreed to reimburse the Company annually for certain investor relationship programmes or special investor relations promotional activities. In certain instances, the depository has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depository will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depository collects from investors.

The depository collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal, or from intermediaries acting for them. The depository collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depository may collect its annual fee for depository services by deduction from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depository may generally refuse to provide fee-attracting services until its fees for those services are paid.



PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure controls and procedures

An evaluation of the effectiveness our disclosure controls and procedures as of December 31, 2014 was carried out by management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a- 15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as at December 31, 2014 at a reasonable assurance level. A controls system, no matter how well designed and operated, cannot provide absolute assurance to achieve its objectives.

Management's annual report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, and effected by the Company' board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management has assessed the effectiveness of internal control over financial reporting as of December 31, 2014 based on the framework in *Internal Control — Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as a December 31, 2014 based on criteria in *Internal Control — Integrated Framework* (2013) issued by the COSO.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the effectiveness of the Company's internal control over financial reporting as of December 31, 2014, as stated in their report which appears on page F-2.

Change in internal control over financial reporting

During the period covered by this Annual Report on Form 20-F, the Company has made no changes to its internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

The members of the Board of Directors of Pearson plc have determined that Ken Hydon is an audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission.



ITEM 16B. CODE OF ETHICS

Pearson has adopted a code of ethics (the Pearson code of conduct) which applies to all employees including the chief executive officer and chief financial officer and other senior financial management. This code of ethics is available on our website (www.pearson.com/social-impact/policies — downloads.html). The information on our website is not incorporated by reference into this report.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

In line with best practice, our relationship with PricewaterhouseCoopers LLP (PwC) is governed by our external auditor policy, which is reviewed and approved annually by the audit committee. The policy establishes procedures to ensure the auditors’ independence is not compromised as well as defining those non-audit services that PwC may or may not provide to Pearson. These allowable services are in accordance with relevant UK and US legislation.

The audit committee approves all audit and non-audit services provided by PwC. Certain categories of allowable non-audit services have been pre-approved by the audit committee subject to the authorities below:

- Pre-approved non-audit services can be authorized by the chief financial officer up to £100,000 per project, subject to a cumulative limit of £500,000 per annum;
- Tax compliance and related activities up to the greater of £1,000,000 per annum or 50% of the external audit fee; and
- For tax advisory services we use the most appropriate advisor, usually after a tender process. Where we decide to use our independent auditor, authority, up to £100,000 per project subject to a cumulative limit of £500,000 per annum, has been delegated by the audit committee to management.

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

The following table sets forth remuneration paid to PwC for 2013 and 2014:

<u>Auditors’ Remuneration</u>	<u>2014</u>	<u>2013</u>
	£m	£m
Audit fees	7	6
Tax fees	1	4
All other fees	1	1

Audit fees include £35,000 (2013: £35,000) of audit fees relating to the audit of the parent company.

Fees for the audit of the effectiveness of the Group’s internal control over financial reporting are allocated to audit fees paid.

Tax services include services related to tax compliance and advisory services.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.



ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASES

<u>Period</u>	<u>Total number of shares purchased</u>	<u>Average price paid per share</u>	<u>Total number of units purchased as part of publicly announced plans or programs</u>	<u>Maximum number of shares that may yet be purchased under the plans or programs</u>
February 1, 2013 – February 28, 2013	1,000,000	£11.64	N/A	N/A
April 1, 2013 – April 30, 2013	1,000,000	£11.53	N/A	N/A
June 1, 2013 – June 30, 2013	1,972,725	£11.61	N/A	N/A
September 1, 2013 – September 30, 2013	139,192	£12.57	N/A	N/A
April 1, 2014 – April 30, 2014	906,892	£10.18	N/A	N/A

Purchases of shares were made to satisfy obligations under Pearson employee share award programs. All purchases were made in open-market transactions. None of the foregoing share purchases was made as part of a publicly announced plan or program.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING AUDITOR

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

Pearson is listed on the New York Stock Exchange (“NYSE”). As a listed non-US issuer, we are required to comply with some of the NYSE’s corporate governance rules, and otherwise must disclose on our website any significant ways in which our corporate governance practices differ from those followed by US companies under the NYSE listing standards. At this time, the Company believes that it is in compliance in all material respects with all the NYSE rules except that the Nomination Committee is not composed entirely of independent directors, and that it is the full board, not the Nomination Committee, that develops and recommends corporate governance principles.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.



PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

The financial statements filed as part of this Annual Report are included on pages F-1 through F-69 hereof.

ITEM 19. EXHIBITS

- 1.1 Articles of Association of Pearson plc.
- 2.1 Indenture dated June 23, 2003 between Pearson plc and The Bank of New York, as trustee *
- 2.2 Indenture dated March 26, 2009 among Pearson Funding One plc, as the Issuer, Pearson plc, Guarantor, and The Law Debenture Trust Corporation P.L.C., as trustee. ∞
- 2.3 Indenture dated May 6, 2008 among Pearson Dollar Finance Two plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York, as trustee, Paying Agent and Calculation Agent. ∞
- 2.4 Indenture dated May 17, 2010 between Pearson Funding Two plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. λ
- 2.5 Indenture dated May 8, 2012 between Pearson Funding Four plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. φ
- 2.6 Indenture dated May 8, 2013 between Pearson Funding Five plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. θ
- 2.7 Trust Deed dated May 19, 2014 between Pearson Funding Five plc, as the Issuer, Pearson plc, Guarantor, and The Law Debenture Trust Corporation P.L.C, as trustee.
- 8.1 List of Significant Subsidiaries.
- 12.1 Certification of Chief Executive Officer.
- 12.2 Certification of Chief Financial Officer.
- 13.1 Certification of Chief Executive Officer.
- 13.2 Certification of Chief Financial Officer.
- 15 Consent of PricewaterhouseCoopers LLP.

* Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2003 and filed May 7, 2004.

∞ Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2009 and filed March 31, 2010.

λ Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2010 and filed March 25, 2011.

φ Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2012 and filed March 22, 2013.

θ Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2013 and filed March 27, 2014.



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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Pearson plc

In our opinion, the accompanying consolidated balance sheets and the related consolidated income statements, statements of comprehensive income, statements of changes in equity and cash flow statements present fairly in all material respects, the financial position of Pearson plc and its subsidiaries at December 31, 2014 and December 31, 2013 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with International Financial Reporting Standards as adopted by the European Union. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in "Internal Control — Integrated Framework" (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in "Management's Annual Report on Internal Control Over Financial Reporting" appearing under Item 15 of this Form 20-F. Our responsibility is to express opinions on these financial statements and on the Group's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and International Standards on Auditing. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control base on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/PricewaterhouseCoopers LLP

**London
United Kingdom
March 26, 2015**



Consolidated income statement
Year ended 31 December 2014

<u>All figures in £ millions</u>	Notes	<u>2014</u>	<u>2013</u>	<u>2012</u>
Sales	2	4,874	5,069	4,959
Cost of goods sold	4	(2,202)	(2,312)	(2,187)
Gross profit		2,672	2,757	2,772
Operating expenses	4	(2,325)	(2,353)	(2,181)
Loss on closure of subsidiary		—	—	(113)
Share of results of joint ventures and associates	12	51	54	9
Operating profit	2	398	458	487
Finance costs	6	(141)	(111)	(115)
Finance income	6	48	35	19
Profit before tax		305	382	391
Income tax	7	(63)	(87)	(138)
Profit for the year from continuing operations		242	295	253
Profit for the year from discontinued operations	3	228	244	61
Profit for the year		470	539	314
Attributable to:				
Equity holders of the company		471	538	311
Non-controlling interest		(1)	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	58.1p	66.6p	38.7p
– diluted	8	58.0p	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	30.0p	36.4p	31.1p
– diluted	8	29.9p	36.3p	31.0p



Consolidated statement of comprehensive income
Year ended 31 December 2014

<u>All figures in £ millions</u>	<u>Notes</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Profit for the year		470	539	314
Items that may be reclassified to the income statement				
Net exchange differences on translation of foreign operations – Group		150	(206)	(238)
Net exchange differences on translation of foreign operations – associates		25	(11)	—
Currency translation adjustment disposed – Group		(2)	(18)	—
Attributable tax	7	(6)	6	1
Items that are not reclassified to the income statement				
Remeasurement of retirement benefit obligations – Group	25	23	79	(100)
Remeasurement of retirement benefit obligations – associates . . .		(15)	—	(3)
Attributable tax	7	(1)	(23)	50
Other comprehensive income/(expense) for the year		<u>174</u>	<u>(173)</u>	<u>(290)</u>
Total comprehensive income for the year		<u>644</u>	<u>366</u>	<u>24</u>
Attributable to:				
Equity holders of the company		645	369	23
Non-controlling interest		(1)	(3)	1



Consolidated balance sheet
As at 31 December 2014

All figures in £ millions

	Notes	2014	2013
Assets			
Non-current assets			
Property, plant and equipment	10	334	342
Intangible assets	11	6,310	5,801
Investments in joint ventures and associates	12	1,118	1,092
Deferred income tax assets	13	295	250
Financial assets – derivative financial instruments	16	90	111
Retirement benefit assets	25	190	86
Other financial assets	15	54	94
Trade and other receivables	22	82	70
		<u>8,473</u>	<u>7,846</u>
Current assets			
Intangible assets – pre-publication	20	820	717
Inventories	21	224	224
Trade and other receivables	22	1,310	1,173
Financial assets – derivative financial instruments	16	24	13
Financial assets – marketable securities	14	16	6
Cash and cash equivalents (excluding overdrafts)	17	530	729
		<u>2,924</u>	<u>2,862</u>
Assets classified as held for sale	32	—	223
Total assets		<u>11,397</u>	<u>10,931</u>
Liabilities			
Non-current liabilities			
Financial liabilities – borrowings	18	(1,883)	(1,693)
Financial liabilities – derivative financial instruments	16	(73)	(48)
Deferred income tax liabilities	13	(714)	(612)
Retirement benefit obligations	25	(163)	(142)
Provisions for other liabilities and charges	23	(82)	(77)
Other liabilities	24	(310)	(257)
		<u>(3,225)</u>	<u>(2,829)</u>
Current liabilities			
Trade and other liabilities	24	(1,601)	(1,505)
Financial liabilities – borrowings	18	(342)	(533)
Financial liabilities – derivative financial instruments	16	(1)	—
Current income tax liabilities		(190)	(164)
Provisions for other liabilities and charges	23	(53)	(112)
		<u>(2,187)</u>	<u>(2,314)</u>
Liabilities directly associated with assets classified as held for sale	32	—	(82)
Total liabilities		<u>(5,412)</u>	<u>(5,225)</u>
Net assets		<u>5,985</u>	<u>5,706</u>



<u>All figures in £ millions</u>	<u>Notes</u>	<u>2014</u>	<u>2013</u>
Equity			
Share capital	27	205	205
Share premium	27	2,579	2,568
Treasury shares	28	(75)	(98)
Translation reserve		70	(103)
Retained earnings		3,200	3,128
Total equity attributable to equity holders of the company		5,979	5,700
Non-controlling interest		6	6
Total equity		5,985	5,706

These financial statements have been approved for issue by the board of directors on 9 March 2015 and signed on its behalf by

Robin Freestone Chief financial officer



Consolidated statement of changes in equity
Year ended 31 December 2014

All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2014	205	2,568	(98)	(103)	3,128	5,700	6	5,706
Profit for the year	—	—	—	—	471	471	(1)	470
Other comprehensive income	—	—	—	173	1	174	—	174
Total comprehensive income	—	—	—	173	472	645	(1)	644
Equity-settled transactions	—	—	—	—	32	32	—	32
Tax on equity-settled transactions	—	—	—	—	(3)	(3)	—	(3)
Issue of ordinary shares under share option schemes	—	11	—	—	—	11	—	11
Purchase of treasury shares	—	—	(9)	—	—	(9)	—	(9)
Release of treasury shares	—	—	32	—	(32)	—	—	—
Changes in non-controlling interest	—	—	—	—	—	—	2	2
Dividends	—	—	—	—	(397)	(397)	(1)	(398)
At 31 December 2014	205	2,579	(75)	70	3,200	5,979	6	5,985

All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2013	204	2,555	(103)	128	2,902	5,686	24	5,710
Profit for the year	—	—	—	—	538	538	1	539
Other comprehensive expense	—	—	—	(231)	62	(169)	(4)	(173)
Total comprehensive income	—	—	—	(231)	600	369	(3)	366
Equity-settled transactions	—	—	—	—	37	37	—	37
Tax on equity-settled transactions	—	—	—	—	—	—	—	—
Issue of ordinary shares under share option schemes	1	13	—	—	—	14	—	14
Purchase of treasury shares	—	—	(47)	—	—	(47)	—	(47)
Release of treasury shares	—	—	52	—	(52)	—	—	—
Changes in non-controlling interest	—	—	—	—	13	13	(15)	(2)
Dividends	—	—	—	—	(372)	(372)	—	(372)
At 31 December 2013	205	2,568	(98)	(103)	3,128	5,700	6	5,706



Equity attributable to equity holders of the company

All figures in £ millions	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
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)
Total comprehensive income	—	—	—	(236)	259	23	1	24
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	<u>204</u>	<u>2,555</u>	<u>(103)</u>	<u>128</u>	<u>2,902</u>	<u>5,686</u>	<u>24</u>	<u>5,710</u>

The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments. Changes in non-controlling interest in 2014 relate to the disposal of a non-controlling interest in a Chinese business. In 2013, the group purchased non-controlling interests in the South African and Indian businesses. In 2012, the group purchased a non-controlling interest in a Chinese business.

**Consolidated cash flow statement**
Year ended 31 December 2014All figures in £ millions

	Notes	2014	2013	2012
Cash flows from operating activities				
Net cash generated from operations	34	704	684	916
Interest paid		(86)	(82)	(75)
Tax paid		(163)	(246)	(65)
Net cash generated from operating activities		455	356	776
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	30	(448)	(48)	(716)
Acquisition of joint ventures and associates		(12)	(10)	(39)
Purchase of investments		(3)	(64)	(10)
Purchase of property, plant and equipment		(75)	(118)	(78)
Purchase of intangible assets		(107)	(64)	(73)
Disposal of subsidiaries, net of cash disposed	31	327	(132)	(11)
Proceeds from sale of associates		39	2	—
Proceeds from sale of investments		9	2	—
Proceeds from sale of property, plant and equipment	34	9	28	1
Proceeds from sale of intangible assets		2	2	3
Proceeds from sale of liquid resources		12	13	23
Loans to related parties		(10)	(44)	—
Loans advanced		(2)	(5)	—
Investment in liquid resources		(22)	(14)	(19)
Interest received		13	9	9
Dividends received from joint ventures and associates		120	64	27
Net cash used in investing activities		(148)	(379)	(883)
Cash flows from financing activities				
Proceeds from issue of ordinary shares	27	11	14	11
Purchase of treasury shares	28	(9)	(47)	—
Proceeds from borrowings		404	319	327
Liquid resources acquired		—	—	(1)
Repayment of borrowings		(538)	(225)	—
Finance lease principal payments		(4)	(8)	(8)
Dividends paid to company's shareholders	9	(397)	(372)	(346)
Dividends paid to non-controlling interest		(1)	—	(2)
Purchase of non-controlling interest	33	—	(76)	(4)
Net cash used in financing activities		(534)	(395)	(23)
Effects of exchange rate changes on cash and cash equivalents		(2)	21	(24)
Net decrease in cash and cash equivalents		(229)	(397)	(154)
Cash and cash equivalents at beginning of year		740	1,137	1,291
Cash and cash equivalents at end of year	17	511	740	1,137

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

Loans to related parties have been reclassified from net cash used in financing activities to net cash used in investing activities as this best represents the substance of the cashflows.



Notes to the consolidated financial statements

General information

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 9 March 2015.

1. Accounting policies

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

a. Basis of preparation

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

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

1. Interpretations and amendments to published standards effective 2014 The following amendments and interpretations were adopted in 2014:

- Amendments to IFRS 10, IFRS 12 and IAS 27, 'Investment Entities', effective for annual reporting periods beginning on or after 1 January 2014. These amendments provide an exemption from consolidation of subsidiaries for entities which meet the definition of an investment entity.
- Amendments to IAS 39, 'Novation of Derivatives and Continuation of Hedge Accounting', effective for annual reporting periods beginning on or after 1 January 2014. The amendments mean there would be no need to discontinue hedge accounting if a hedge derivative was novated and certain criteria met.
- Amendments to IAS 32, 'Financial Instruments: Presentation', effective for annual reporting periods beginning on or after 1 January 2014. The amendments clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet.
- IFRIC 21 'Levies', effective for annual reporting periods beginning on or after 1 January 2014. This details the accounting for an obligation to pay a levy that is not income tax.

The adoption of these new pronouncements from 1 January 2014, does not have a material impact on the consolidated financial statements.



Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

2. *Standards, interpretations and amendments to published standards that are not yet effective* The Group has not early adopted the following new pronouncements that are not yet effective:

- IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities. The Group is yet to assess the full impact of IFRS 9.
- IFRS 15 'Revenue from Contracts with Customers', effective for annual reporting periods beginning on or after 1 January 2017. The new standard specifies how and when an entity will recognise revenue, and requires more detailed disclosure. Adoption of the new standard is likely to have an impact on the Group and management is currently assessing the impact.

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

Consolidation: Business combinations – determination of fair values
Consolidation: Business combinations – classification of investments
Intangible assets: Goodwill
Intangible assets: Pre-publication assets
Taxation
Employee benefits: Pensions
Revenue recognition

b. Consolidation

1. *Business combinations* The acquisition method of accounting is used to account for business combinations.

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

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

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



Notes to the consolidated financial statements continued

1. Accounting policies continued

b. Consolidation continued

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

Management exercises judgement in determining the classification of its investments in its businesses, in line with the following:

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

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

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

The Group's share of its joint ventures' and associates' post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves.

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

5. Contribution of a subsidiary to an associate or joint venture The gain or loss resulting from the contribution or sale of a subsidiary to an associate or a joint venture is recognised in full. Where such transactions do not involve cash consideration, significant judgements and estimates are used in determining the fair values of the consideration received.

c. Foreign currency translation

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

2. Transactions and balances Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the



Notes to the consolidated financial statements continued

1. Accounting policies continued

c. Foreign currency translation continued

settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying net investment hedges.

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

- i) Assets and liabilities are translated at the closing rate at the date of the balance sheet
- ii) Income and expenses are translated at average exchange rates
- iii) All resulting exchange differences are recognised as a separate component of equity.

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

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.65 (2013: \$1.57) and the year end rate was \$1.56 (2013: \$1.66).

d. Property, plant and equipment

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

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

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

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

e. Intangible assets

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



Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

of associates and joint ventures represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets acquired. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

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

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

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

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

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

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

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

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

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



Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

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

f. Other financial assets

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

g. Inventories

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

h. Royalty advances

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

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors.

The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non-current assets.

i. 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.



Notes to the consolidated financial statements continued

1. Accounting policies continued

j. Share capital continued

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

k. Borrowings

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

l. Derivative financial instruments

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

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

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.



Notes to the consolidated financial statements continued

1. Accounting policies continued

m. Taxation continued

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

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

When the calculation results in a potential asset, the recognition of that asset is limited to the asset ceiling – that is the present value of any economic benefits available in the form of refunds from the plan or a reduction in future contributions. Management use judgement to determine the level of refunds available from the plan in recognising an asset.

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

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

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

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



Notes to the consolidated financial statements continued

1. Accounting policies continued

n. Employee benefits continued

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

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

o. Provisions

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

The Group recognises a provision for deferred consideration at fair value. Where this is contingent on future performance or a future event, judgement is exercised in establishing the fair value.

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

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

p. Revenue recognition

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

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

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

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials or online access with textbooks and multiple deliverables within testing or service contracts, revenue is recognised for each element as if it were an individual contractual arrangement.

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related



Notes to the consolidated financial statements continued

1. Accounting policies continued

p. Revenue recognition continued

expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Percentage of completion is calculated on a cost basis using the proportion of the total estimated costs incurred to date. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

On certain contracts, where the Group acts as agent, only commissions and fees receivable for services rendered are recognised as revenue. Any third-party costs incurred on behalf of the principal that are rechargeable under the contractual arrangement are not included in revenue.

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

q. Leases

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

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

r. Dividends

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

s. Assets and liabilities held for sale

Assets and liabilities are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is highly probable that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale. Amounts relating to non-current assets and liabilities held for sale are classified as discontinued operations in the income statement where appropriate.

t. Trade receivables

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



Notes to the consolidated financial statements continued

2. Segment information

From 1 January 2014 the Group has reorganised and is reporting new segmental analyses to reflect the new structure and operating model. The primary segments for management and reporting are geographies as outlined below. In addition, the group separately discloses the results from the Penguin Random House (PRH) associate.

Continuing operations:

North America School, Higher Education and Professional businesses in US and Canada.

Growth School, Higher Education and Professional businesses in emerging markets which are investment priorities, including Brazil, China, India and South Africa.

Core School, Higher Education and Professional businesses in more mature markets including UK, Australia and Italy.

In addition the Group separately discloses the results of the Penguin Random House (PRH) associate.

The results of the Mergermarket business to 4 February 2014 are shown as discontinued in the relevant years. The results of the Penguin business to 30 June 2013 are also shown as discontinued in 2013.

Figures for 2013 have been restated to reflect the new segments. Revenue figures only have been restated in 2012 and it is impracticable to restate profit figures for this year. The change in management structure was anticipated in 2013 and systems and reporting were updated for the proposed change, however the information is not available for reporting 2012 results under the new management structure.

All figures in £ millions	Notes	2014						Group
		North America	Core	Growth	PRH	Corporate	Discontinued operations	
Continuing operations								
Sales		2,974	1,154	746	—	—	—	4,874
Operating profit/(loss)		354	129	(100)	15	—	—	398
Finance costs	6							(141)
Finance income	6							48
Profit before tax								305
Income tax	7							(63)
Profit for the year from continuing operations								242
Segment assets		6,646	1,566	1,407	—	660	—	10,279
Joint ventures	12	1	9	3	—	—	—	13
Associates	12	1	9	—	1,095	—	—	1,105
Total assets		6,648	1,584	1,410	1,095	660	—	11,397
Other segment items								
Share of results of joint ventures and associates	12	—	19	(3)	35	—	—	51
Capital expenditure	10, 11	97	48	49	—	—	—	194
Pre-publication investment	20	209	77	72	—	—	—	358
Depreciation	10	41	17	16	—	—	—	74
Amortisation	11, 20	309	112	121	—	—	—	542
Impairment	11	—	—	77	—	—	—	77



Notes to the consolidated financial statements continued

2. Segment information continued

All figures in £ millions	Notes	2013						Discontinued operations	Group
		North America	Core	Growth	PRH	Corporate			
Continuing operations									
Sales		3,073	1,258	738	—	—	—	5,069	
Operating profit/(loss)		366	74	(2)	20	—	—	458	
Finance costs	6							(111)	
Finance income	6							35	
Profit before tax								382	
Income tax	7							(87)	
Profit for the year from continuing operations								295	
Segment assets		6,326	1,450	981	—	859	223	9,839	
Joint ventures	12	1	—	2	—	—	—	3	
Associates	12	1	18	—	1,070	—	—	1,089	
Total assets		6,328	1,468	983	1,070	859	223	10,931	
Other segment items									
Share of results of joint ventures and associates	12	1	26	(4)	31	—	—	54	
Capital expenditure	10, 11	95	46	33	—	—	1	175	
Pre-publication investment	20	202	90	72	—	—	—	364	
Depreciation	10	46	19	16	—	—	1	82	
Amortisation	11, 20	287	143	103	—	—	2	535	
Impairment		—	—	—	—	—	—	—	

All figures in £ millions	Notes	2012						Discontinued operations	Group
		North America	Core	Growth	PRH	Corporate			
Continuing operations									
Sales		2,942	1,323	694	—	—	—	4,959	

Operating profit in 2014 is stated after the following restructuring charges: North America £37m, with estimated in year benefits of £21m; Core £22m, with estimated in year benefits of £10m; Growth £6m, with estimated in year benefits of £2m; Penguin Random House £19m, with estimated in year benefits of £7m.

Operating profit in 2013 is stated after the following restructuring charges: North America £77m, with estimated in year benefits of £24m; Core £63m, with estimated in year benefits of £13m; Growth £36m, with estimated in year benefits of £4m.

In 2014, sales from the provision of goods were £2,711m (2013: £2,867m; 2012: £2,946m) and sales from the provision of services were £2,163m (2013: £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. There were no material inter-segment sales.

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



Notes to the consolidated financial statements continued

2. Segment information continued

Property, plant and equipment and intangible assets acquired through business combination were £263m (2013: £202m; 2012: £296m) (see note 30). In 2013, capital expenditure, depreciation and amortisation included amounts relating to discontinued operations.

The Group operates in the following main geographic areas:

All figures in £ millions	Sales			Non-current assets		
	2014	2013	2012	2014	2013	2012
Continuing operations						
UK	610	649	678	1,056	1,068	803
Other European countries	347	366	377	180	200	234
US	2,826	2,913	2,756	5,243	5,026	4,496
Canada	110	128	144	288	301	307
Asia Pacific	598	624	633	416	495	524
Other countries	383	389	371	661	215	275
Total continuing	4,874	5,069	4,959	7,844	7,305	6,639
Discontinued operations						
UK	4	97	187	—	—	—
Other European countries	—	49	92	—	—	—
US	4	369	647	—	—	—
Canada	—	24	57	—	—	—
Asia Pacific	1	74	153	—	—	—
Other countries	—	8	17	—	—	—
Total discontinued	9	621	1,153	—	—	—
Total	4,883	5,690	6,112	7,844	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	2014			2013			2012		
	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total
Sales	—	9	9	513	108	621	1,053	100	1,153
Operating profit	—	2	2	28	24	52	62	24	86
Finance income	—	—	—	1	—	1	—	—	—
Profit before tax	—	2	2	29	24	53	62	24	86
Income tax	—	(1)	(1)	(9)	(9)	(18)	(19)	(6)	(25)
Profit after tax	—	1	1	20	15	35	43	18	61
Profit on disposal of Penguin	29	—	29	202	—	202	—	—	—
Attributable tax benefit	—	—	—	15	—	15	—	—	—
Profit on disposal of									
Mergermarket	—	244	244	—	—	—	—	—	—
Attributable tax expense	—	(46)	(46)	—	—	—	—	—	—
Mergermarket transaction costs	—	—	—	—	(8)	(8)	—	—	—
Profit for the year from discontinued operations	29	199	228	237	7	244	43	18	61
Operating cash flows	—	2	2	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	—	2	2	22	(9)	13	12	(4)	8

Included within the cost of disposal of Penguin in 2013 are amounts in respect of the settlement of litigation related to the agency arrangement for eBooks. Also included in cost of disposal for Penguin for 2013 was a provision for amounts payable to Bertelsmann upon settlement of the transfer of Penguin's UK past service pension liabilities to the new PRH venture. During 2014, it was decided that this transfer would not go ahead as planned and the costs have been credited back in the £29m gain reported against the disposal in 2014.

4. Operating expenses

All figures in £ millions	2014	2013	2012
By function:			
Cost of goods sold	2,202	2,312	2,187
Operating expenses			
Distribution costs	87	90	82
Selling, marketing and product development costs	963	1,027	925
Administrative and other expenses	1,315	1,162	1,242
Restructuring costs	84	176	—
Other net gains and losses	(2)	16	10
Other income	(122)	(118)	(78)
Total net operating expenses	2,325	2,353	2,181
Total	4,527	4,665	4,368



Notes to the consolidated financial statements continued

4. Operating expenses continued

Included in other income is service fee income from Penguin Random House of £41m (2013: £28m, 2012: £nil).
Included in administrative and other expenses are research and efficacy costs of £22m (2013: £5m, 2012: £2m).

<u>All figures in £ millions</u>	Notes	<u>2014</u>	<u>2013</u>	<u>2012</u>
By nature:				
Royalties expensed		242	256	245
Other product costs		686	735	865
Employee benefit expense	5	1,978	2,100	1,866
Contract labour		185	194	137
Employee related expense		146	177	168
Promotional costs		169	167	155
Depreciation of property, plant and equipment	10	74	81	72
Amortisation of intangible assets – pre-publication	20	292	308	283
Amortisation of intangible assets – software	11	63	59	49
Amortisation of intangible assets – other	11	187	166	179
Impairment of intangible assets	11	77	—	—
Property and facilities		218	229	188
Technology and communications		139	104	80
Professional and outsourced services		264	259	253
Other general and administrative costs		128	119	38
Capitalised costs		(203)	(199)	(162)
Acquisition costs		6	12	20
Other net gains and losses		(2)	16	10
Other income		(122)	(118)	(78)
Total		<u>4,527</u>	<u>4,665</u>	<u>4,368</u>

Included in other net gains and losses in continuing operations in 2014 are gains on the sale of joint venture interests in Safari Books Online and CourseSmart (£40m) and a loss on disposal of an investment in Nook Media (£38m). Included in other net gains and losses in 2013 is a loss on the disposal of the Japanese school and local publishing assets.

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
The audit of parent company and consolidated financial statements	5	4	4
The audit of the company's subsidiaries	2	2	2
Total audit fees	<u>7</u>	<u>6</u>	<u>6</u>
Other assurance services	1	1	1
Total other assurance services	<u>1</u>	<u>1</u>	<u>1</u>
Tax compliance services	1	2	1
Tax advisory services	—	2	1
Total tax services	<u>1</u>	<u>4</u>	<u>2</u>
Total non-audit services	<u>2</u>	<u>5</u>	<u>3</u>
Total	<u>9</u>	<u>11</u>	<u>9</u>



Notes to the consolidated financial statements continued

4. Operating expenses continued

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	7	6	6
Non-audit fees	2	5	3
Total	<u>9</u>	<u>11</u>	<u>9</u>

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

5. Employee information

<u>All figures in £ millions</u>	<u>Notes</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Employee benefit expense				
Wages and salaries (including termination benefits and restructuring costs) ..		1,728	1,836	1,610
Social security costs		134	136	129
Share-based payment costs	26	32	35	28
Retirement benefits – defined contribution plans	25	69	66	69
Retirement benefits – defined benefit plans	25	26	27	26
Other post-retirement benefits	25	(11)	—	4
Total		<u>1,978</u>	<u>2,100</u>	<u>1,866</u>

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

<u>Average number employed</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Employee numbers			
North America	21,204	22,146	20,830
Core	7,887	8,807	9,890
Growth	11,603	10,975	11,258
Other	182	187	157
Continuing operations	<u>40,876</u>	<u>42,115</u>	<u>42,135</u>

The employee benefit expense relating to discontinued operations was £5m (2013: £168m; 2012: £265m) and the average number employed was 73 (2013: 3,592; 2012: 5,387).



Notes to the consolidated financial statements continued

6. Net finance costs

<u>All figures in £ millions</u>	<u>Notes</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Interest payable		(82)	(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		(53)	—	(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		(6)	(17)	(2)
Finance costs		(141)	(111)	(115)
Interest receivable		18	10	10
Net finance income in respect of retirement benefits	25	1	—	—
Net foreign exchange gains		17	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		12	4	—
Finance income		48	35	19
Net finance costs		(93)	(76)	(96)
Analysed as:				
Net interest payable		(64)	(72)	(65)
Other net finance costs		(29)	(4)	(31)
Total net finance costs		(93)	(76)	(96)

Included in interest receivable is £1m (2013: £nil; 2012: £nil) of interest receivable from related parties. The net movement of £nil on fair value hedges in 2014 (2013: net gain of £1m; 2012: net loss of £1m) comprises a loss of £27m (2013: gain of £95m; 2012: gain of £7m) on the underlying bonds, offset by a gain of £27m (2013: loss of £94m; 2012: loss of £8m) on the related derivative financial instruments.



Notes to the consolidated financial statements continued

7. Income tax

<u>All figures in £ millions</u>	Notes	2014	2013	2012
Current tax				
Charge in respect of current year		(103)	(129)	(147)
Adjustments in respect of prior years		30	(7)	18
Total current tax charge		<u>(73)</u>	<u>(136)</u>	<u>(129)</u>
Deferred tax				
In respect of temporary differences		8	14	(45)
Other adjustments in respect of prior years		2	35	36
Total deferred tax credit/(charge)	13	<u>10</u>	<u>49</u>	<u>(9)</u>
Total tax charge		<u>(63)</u>	<u>(87)</u>	<u>(138)</u>

The adjustments in respect of prior years in both 2014 and 2013 mainly relate to changes in estimates arising from uncertain tax positions following settlements with tax authorities in the year.

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

<u>All figures in £ millions</u>	2014	2013	2012
Profit before tax	305	382	391
Tax calculated at UK rate (2014: 21.5%, 2013: 23.25%, 2012: 24.5%)	(66)	(89)	(96)
Effect of overseas tax rates	(12)	(13)	(51)
Joint venture and associate income reported net of tax	11	13	2
Net expense not subject to tax	(9)	(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	(19)	(7)	(6)
Adjustments in respect of prior years	32	28	54
Total tax charge	<u>(63)</u>	<u>(87)</u>	<u>(138)</u>
UK	(6)	(13)	(14)
Overseas	(57)	(74)	(124)
Total tax charge	<u>(63)</u>	<u>(87)</u>	<u>(138)</u>
Tax rate reflected in earnings	20.7%	22.8%	35.3%

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

<u>All figures in £ millions</u>	2014	2013	2012
Remeasurement of retirement benefit obligations	(1)	(23)	50
Net exchange differences on translation of foreign operations	(6)	6	1
	<u>(7)</u>	<u>(17)</u>	<u>51</u>

A tax charge of £3m (2013: tax charge £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.

<u>All figures in £ millions</u>	<u>Notes</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Profit for the year from continuing operations		242	295	253
Non-controlling interest		1	(1)	(3)
Earnings from continuing operations		243	294	250
Profit for the year from discontinued operations	3	228	244	61
Earnings		471	538	311
Weighted average number of shares (millions)		810.9	807.8	804.3
Effect of dilutive share options (millions)		1.0	1.1	1.3
Weighted average number of shares (millions) for diluted earnings		811.9	808.9	805.6
Earnings per share from continuing and discontinued operations				
Basic		58.1p	66.6p	38.7p
Diluted		58.0p	66.5p	38.6p
Earnings per share from continuing operations				
Basic		30.0p	36.4p	31.1p
Diluted		29.9p	36.3p	31.0p
Earnings per share from discontinued operations				
Basic		28.1p	30.2p	7.6p
Diluted		28.1p	30.2p	7.6p

9. Dividends

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Final paid in respect of prior year 32.0p (2013: 30.0p; 2012: 28.0p)	259	242	225
Interim paid in respect of current year 17.0p (2013: 16.0p; 2012: 15.0p)	138	130	121
	397	372	346

The directors are proposing a final dividend in respect of the financial year ended 31 December 2014 of 34.0p per share which will absorb an estimated £276m of shareholders' funds. It will be paid on 1 May 2015 to shareholders who are on the register of members on 7 April 2015. These financial statements do not reflect this dividend.



Notes to the consolidated financial statements continued

10. Property, plant and equipment

<u>All figures in £ millions</u>	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2013	352	597	18	967
Exchange differences	(5)	(14)	—	(19)
Additions	33	58	22	113
Disposals	(13)	(78)	—	(91)
Acquisition through business combination	—	3	—	3
Disposal through business disposal	(1)	(2)	—	(3)
Reclassifications	9	(1)	(8)	—
Transfer from software	—	3	—	3
Transfer from assets held for sale	—	9	—	9
Transfer to assets held for sale	—	(7)	—	(7)
At 31 December 2013	<u>375</u>	<u>568</u>	<u>32</u>	<u>975</u>
Exchange differences	11	17	—	28
Additions	10	58	19	87
Disposals	(9)	(46)	(2)	(57)
Acquisition through business combination	—	2	—	2
Disposal through business disposal	—	(1)	—	(1)
Reclassifications	1	3	(4)	—
Transfer to software	—	—	(16)	(16)
At 31 December 2014	<u>388</u>	<u>601</u>	<u>29</u>	<u>1,018</u>
Depreciation				
At 1 January 2013	(195)	(445)	—	(640)
Exchange differences	3	13	—	16
Charge for the year	(25)	(57)	—	(82)
Disposals	7	64	—	71
Acquisition through business combination	—	(2)	—	(2)
Transfer from assets held for sale	—	(1)	—	(1)
Transfer to assets held for sale	—	5	—	5
At 31 December 2013	<u>(210)</u>	<u>(423)</u>	<u>—</u>	<u>(633)</u>
Exchange differences	(7)	(15)	—	(22)
Charge for the year	(23)	(51)	—	(74)
Disposals	9	36	—	45
At 31 December 2014	<u>(231)</u>	<u>(453)</u>	<u>—</u>	<u>(684)</u>
Carrying amounts				
At 1 January 2013	157	152	18	327
At 31 December 2013	<u>165</u>	<u>145</u>	<u>32</u>	<u>342</u>
At 31 December 2014	<u>157</u>	<u>148</u>	<u>29</u>	<u>334</u>

Depreciation expense of £16m (2013: £24m; 2012: £23m) has been included in the income statement in cost of goods sold and £58m (2013: £57m; 2012: £49m) in operating expenses. In 2014 £nil (2013: £1m; 2012: £8m) relates to discontinued operations.



Notes to the consolidated financial statements continued

10. Property, plant and equipment continued

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £13m (2013: £11m).

11. Intangible assets

<u>All figures in £ millions</u>	<u>Goodwill</u>	<u>Software</u>	<u>Acquired customer lists, contracts and relationships</u>	<u>Acquired trademarks and brands</u>	<u>Acquired publishing rights</u>	<u>Other intangibles acquired</u>	<u>Total</u>
Cost							
At 1 January 2013	5,077	466	729	258	207	394	7,131
Exchange differences	(122)	(6)	(25)	(8)	(12)	(11)	(184)
Additions – internal development	—	38	—	—	—	—	38
Additions – purchased	—	24	—	—	—	—	24
Disposals	—	(50)	—	—	—	—	(50)
Acquisition through business combination	(133)	—	190	—	3	7	67
Disposal through business disposal	(6)	—	—	—	—	(1)	(7)
Reclassifications	—	—	(10)	(1)	—	11	—
Transfer to PPE	—	(3)	—	—	—	—	(3)
Transfer to assets held for sale	(150)	—	(29)	(12)	—	(2)	(193)
At 31 December 2013	<u>4,666</u>	<u>469</u>	<u>855</u>	<u>237</u>	<u>198</u>	<u>398</u>	<u>6,823</u>
Exchange differences	198	17	34	5	—	14	268
Impairment	(67)	—	—	—	—	—	(67)
Additions – internal development	—	54	—	—	—	—	54
Additions – purchased	—	53	—	—	—	—	53
Disposals	—	(7)	—	—	—	—	(7)
Acquisition through business combination	238	—	5	69	—	186	498
Disposal through business disposal	(5)	(5)	—	(3)	(1)	—	(14)
Transfer from PPE	—	16	—	—	—	—	16
At 31 December 2014	<u>5,030</u>	<u>597</u>	<u>894</u>	<u>308</u>	<u>197</u>	<u>598</u>	<u>7,624</u>



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 2013	—	(312)	(204)	(86)	(139)	(172)	(913)
Exchange differences	—	6	10	4	6	7	33
Charge for the year	—	(59)	(78)	(21)	(15)	(54)	(227)
Disposals	—	49	—	—	—	—	49
Disposal through business disposal	—	—	—	—	—	1	1
Transfer to assets held for sale	—	—	23	10	—	2	35
At 31 December 2013	—	(316)	(249)	(93)	(148)	(216)	(1,022)
Exchange differences	—	(13)	(11)	(3)	—	(12)	(39)
Impairment	—	—	(6)	(2)	—	(2)	(10)
Charge for the year	—	(63)	(83)	(25)	(12)	(67)	(250)
Disposals	—	5	—	—	—	—	5
Disposal through business disposal	—	1	—	1	—	—	2
At 31 December 2014	—	(386)	(349)	(122)	(160)	(297)	(1,314)
Carrying amounts							
At 1 January 2013	5,077	154	525	172	68	222	6,218
At 31 December 2013	4,666	153	606	144	50	182	5,801
At 31 December 2014	5,030	211	545	186	37	301	6,310

Goodwill

The goodwill carrying value of £5,030m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

Other intangible assets

Other intangibles acquired include content, technology and software rights.

Intangible assets are valued separately for each acquisition and the primary method of valuation used is the discounted cash flow method. The majority of acquired intangibles are amortised using an amortisation profile based on the projected cashflows underlying the acquisition date valuation of the intangible asset, which generally results in a larger proportion of amortisation being recognised in the early years of the assets' life. The Group keeps the expected pattern of consumption under review.



Notes to the consolidated financial statements continued

11. Intangible assets continued

Other intangible assets continued

Amortisation of £12m (2013: £15m; 2012: £10m) is included in the income statement in cost of goods sold and £238m (2013: £210m; 2012: £218m) in operating expenses. In 2014 £nil (2013: £2m; 2012: £9m) of amortisation relates to discontinued operations.

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

<u>Class of intangible asset</u>	<u>2014</u> <u>Useful economic life</u>
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:

<u>All figures in £ millions</u>	<u>2014</u>			<u>Total</u>
	<u>One to five years</u>	<u>Six to ten years</u>	<u>More than ten years</u>	
Class of intangible asset				
Acquired customer lists, contracts and relationships	340	148	57	545
Acquired trademarks and brands	97	54	35	186
Acquired publishing rights	34	3	—	37
Other intangibles acquired	219	72	10	301

Impairment tests for cash-generating units (CGUs) containing goodwill

Impairment tests have been carried out where appropriate as described below.

Following a reorganisation of the business effective 1 January 2014 goodwill was allocated to CGUs, or aggregation of CGUs where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs summarised below.

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
North America	3,422	3,239
Core	618	624
Growth (includes China, Brazil, India and South Africa)	612	447
Pearson VUE	327	306
Financial Times Group	51	50
Total	5,030	4,666

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

Following deterioration in the market conditions for the Group’s online tutoring business based in India, it was determined in the course of the impairment review that the value in use of the India CGU no longer supported the carrying value of the goodwill in that CGU. An impairment of £67m was booked, thereby bringing the carrying value of goodwill in the India CGU down to £nil. An impairment of £10m was also booked in respect of other



Notes to the consolidated financial statements continued

11. Intangible assets continued

Impairment tests for cash-generating units (CGUs) containing goodwill continued

acquired intangibles in that CGU, bringing their carrying value to £nil. The India CGU incorporates all the Group's trading operations in India. A pre-tax discount rate of 13.6% was used to determine the value in use of the India CGU. No previous assessment had been made of the value in use of that CGU as the Group's India operations, prior to the 1 January 2014 reorganisation, were previously part of a larger Emerging Markets aggregated CGU.

Key assumptions

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

Discount rates The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates range from 9.0% to 16.4%. Discount rates are lower for those businesses which operate in more mature markets with low inflation and higher for those operating in emerging markets with higher inflation.

Perpetuity growth rates A perpetuity growth rate of 2.0% (2013: 2.0%) was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 5.0% and 5.8% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historic growth rates in these markets.

The key assumptions used by management in setting the financial budgets for the initial five-year period were as follows:

Forecast sales growth rates Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key factors include the proportion of revenue expected to arise in emerging markets, the proportion of revenue expected to come from digital and services businesses relative to traditional print-based businesses and the changing product mix as a result of product investment. The five year sales forecasts use average nominal growth rates between 1.1% and 3.3% for mature markets and between 8.3% and 15.7% for emerging markets with high inflation.

Operating profits Operating profits are forecast based on historic experience of operating margins, adjusted for the impact of changes to product costs and cost saving initiatives, including the impact of the global restructuring programme undertaken in 2013 and 2014.

Cash conversion Cash conversion is the ratio of operating cash flow to operating profit. Management forecast cash conversion rates based on historic experience, adjusted for the impact of product investment priorities and the shift to digital and service based business.

Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates. Based on the Group's sensitivity analysis, a reasonably possible increase of 0.8% pts in the discount rate or a decrease of 1.0% pt in the perpetuity growth rate could cause an impairment in respect of Brazil.



Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Associates	1,105	1,089
Joint ventures	13	3
Total	<u>1,118</u>	<u>1,092</u>

The amounts recognised in the income statement are as follows:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Associates	54	56
Joint ventures	(3)	(2)
Total	<u>51</u>	<u>54</u>

Investment in associates

The Group has the following material associates:

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

*None of the associates has a quoted market price.

Note 1 – On 1 July 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. The shareholder agreement includes protection rights for Pearson as the minority shareholder including rights to dividends. Management considers ownership percentage, board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over Penguin Random House and Bertelsmann has the power to direct the relevant activities and therefore control.

Note 2 – The Group has a 50% interest in The Economist Newspaper Ltd, publisher of one of the world’s leading weekly business and current affairs magazines. The Economist has a unique structure of “A”, “B” and Trustee shares, which was established to ensure its independence from proprietorial control. Pearson, as holder of the “B” shares, has never controlled the Economist by virtue of its shareholding or influence, and management assesses that it has significant influence over the company.



Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

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

All figures in £ millions	2014		2013 restated	
	Penguin Random House	Economist	Penguin Random House	Economist
Assets				
Current assets	1,355	110	1,210	103
Non-current assets	1,429	166	1,382	163
Liabilities				
Current liabilities	(1,113)	(190)	(905)	(190)
Non-current liabilities	(424)	(86)	(455)	(60)
Net assets	<u>1,247</u>	<u>—</u>	<u>1,232</u>	<u>16</u>
Sales	2,416	320	1,315	340
Profit from continuing operations	74	42	66	52
Other comprehensive (expense)/income	(11)	(20)	(34)	9
Total comprehensive income	<u>63</u>	<u>22</u>	<u>32</u>	<u>61</u>
Dividends received from associate	95	21	43	21

The information above reflects the amounts presented in the financial statements of the associates, adjusted for fair value and similar adjustments. The tax on Penguin Random House LLC is settled by the partners. For the purposes of clear and consistent presentation, the tax has been shown in the associate line items in the consolidated income statement and consolidated balance sheet, recording the Group's share of profit after tax consistently for the Penguin Random House associates.

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

All figures in £ millions	2014		2013 restated	
	Penguin Random House	Economist	Penguin Random House	Economist
Opening net assets	1,232	16	—	—
Exchange differences	52	—	(68)	—
Profit for the period	74	42	66	52
Other comprehensive (expense)/income	(11)	(20)	(34)	9
Dividends, net of tax paid	(100)	(42)	(91)	(41)
Additions	—	—	1,359	—
Distribution from associate in excess of carrying value	—	4	—	—
Reversal of distribution from associate in excess of carrying value	—	—	—	(4)
Closing net assets	<u>1,247</u>	<u>—</u>	<u>1,232</u>	<u>16</u>
Share of net assets	586	—	579	8
Goodwill	509	—	491	—
Carrying value of associate	<u>1,095</u>	<u>—</u>	<u>1,070</u>	<u>8</u>

In 2013 the Group determined the fair value of the Penguin Random House venture for the purposes of accounting for the transaction. A valuation of the Penguin Random House ventures was determined during the



Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

negotiation of the transaction between Bertlesmann and Pearson. This valuation of the business was calculated using the income approach, discounting future cash flows to the present value. Cash flow projections were prepared for both businesses by country taking into account the front and backlist trends and extrapolated using long term growth rate assumptions. The cash flows were discounted using discount rates with risk premiums specific to each geographic region. A discount to the Group's share of the total value to reflect the Group's non-controlling minority ownership was applied.

The Group finalised its acquisition accounting for Penguin Random House in 2014 and an adjustment to the opening position with respect to deferred tax and goodwill was made. The overall carrying value of the associate in 2013 was unchanged however the additions and goodwill balances in the table above have been restated to reflect the final accounting.

Information on other individually immaterial associates is detailed below:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Loss from continuing operations	(2)	(1)
Other comprehensive income	—	—
Total comprehensive expense	<u>(2)</u>	<u>(1)</u>

Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2014 was £54m (2013: £44m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2014 was repaid in its entirety in January 2015.

The Group also has a current asset receivable of £41m (2013: £27m) from Penguin Random House arising from the provision of services. Included in other income (note 4) is £41m (2013: £28m) of service fees.

Investment in joint ventures

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Loss from continuing operations	(3)	(2)
Other comprehensive income	—	—
Total comprehensive expense	<u>(3)</u>	<u>(2)</u>

13. Deferred income tax

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Deferred income tax assets	<u>295</u>	<u>250</u>
Deferred income tax liabilities	<u>(714)</u>	<u>(612)</u>
Net deferred income tax	<u>(419)</u>	<u>(362)</u>

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



Notes to the consolidated financial statements continued

13. Deferred income tax continued

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. At 31 December 2014 the Group has unrecognised deferred income tax assets of £4m (2013: £4m) in respect of UK losses, £14m (2013: £11m) in respect of US losses and approximately £44m (2013: £36m) in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years.

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

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

<u>All figures in £ millions</u>	Notes	<u>2014</u>	<u>2013</u>
At beginning of year		(362)	(372)
Exchange differences		(22)	9
Income statement benefit	7	10	47
Acquisition through business combination	30	—	(37)
Disposal through business disposal		(1)	—
Tax charge to other comprehensive income or equity		(18)	(35)
Transfer to/from current tax		(26)	25
Transfer to assets held for sale		—	1
At end of year		<u>(419)</u>	<u>(362)</u>

Included in the income statement above for 2014 is a £nil charge (2013: £2m charge) relating to discontinued operations.

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

<u>All figures in £ millions</u>	Trading losses	Returns provisions	Retirement benefit obligations	Other	Total
Deferred income tax assets					
At 1 January 2013	18	45	47	119	229
Exchange differences	—	(1)	(1)	(4)	(6)
Acquisition through business combination	21	—	—	—	21
Income statement (charge)/benefit	(24)	(5)	25	22	18
Tax charge to other comprehensive income or equity	—	—	(36)	—	(36)
Transfer to current tax	—	—	—	25	25
Transfer from assets held for sale	—	—	7	(7)	—
Transfer to assets held for sale	—	—	—	(1)	(1)
At 31 December 2013	<u>15</u>	<u>39</u>	<u>42</u>	<u>154</u>	<u>250</u>
Exchange differences	1	2	4	5	12
Acquisition through business combination	2	—	—	—	2
Income statement benefit	10	3	7	35	55
Tax benefit/(charge) to other comprehensive income or equity	—	—	10	(7)	3
Transfer to current tax	—	—	—	(26)	(26)
Disposal through business disposal	—	—	(1)	—	(1)
At 31 December 2014	<u>28</u>	<u>44</u>	<u>62</u>	<u>161</u>	<u>295</u>



Notes to the consolidated financial statements continued

13. Deferred income tax continued

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 2013	(475)	(126)	(601)
Exchange differences	13	2	15
Acquisition through business combination	(61)	3	(58)
Income statement (charge)/benefit	(61)	90	29
Tax benefit to other comprehensive income or equity	—	1	1
Transfer to assets held for sale	—	2	2
At 31 December 2013	(584)	(28)	(612)
Exchange differences	(30)	(4)	(34)
Acquisition through business combination	(2)	—	(2)
Income statement benefit/(charge)	18	(63)	(45)
Tax charge to other comprehensive income or equity	—	(21)	(21)
At 31 December 2014	(598)	(116)	(714)

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

14. Classification of financial instruments

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

All figures in £ millions	Notes	2014							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 listed securities	15	9	—	—	—	—	—	9	9	
Investments in unlisted securities	15	45	—	—	—	—	—	45	45	
Cash and cash equivalents ..	17	—	—	—	—	530	—	530	530	
Marketable securities		16	—	—	—	—	—	16	16	
Derivative financial instruments	16	—	6	108	—	—	—	114	114	
Trade receivables	22	—	—	—	—	989	—	989	989	
Total financial assets		70	6	108	—	1,519	—	1,703	1,703	
Derivative financial instruments	16	—	(33)	(41)	—	—	—	(74)	(74)	
Trade payables	24	—	—	—	—	—	(329)	(329)	(329)	
Bank loans and overdrafts ..	18	—	—	—	—	—	(42)	(42)	(42)	
Borrowings due within one year	18	—	—	—	—	—	(305)	(305)	(319)	
Borrowings due after more than one year	18	—	—	—	—	—	(1,878)	(1,878)	(1,888)	
Total financial liabilities ..		—	(33)	(41)	—	—	(2,554)	(2,628)	(2,652)	



Notes to the consolidated financial statements continued

14. Classification of financial instruments continued

		2013								
		Fair value				Amortised cost		Total	Total	
All figures in £ millions		Notes	Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Other liabilities	Loans and receivables	Other liabilities	carrying value	market value
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		<u>100</u>	<u>4</u>	<u>120</u>	<u>—</u>	<u>1,672</u>	<u>—</u>	<u>1,896</u>	<u>1,896</u>	
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		<u>—</u>	<u>(16)</u>	<u>(32)</u>	<u>—</u>	<u>—</u>	<u>(2,543)</u>	<u>(2,591)</u>	<u>(2,609)</u>	

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

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

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



Notes to the consolidated financial statements continued

14. Classification of financial instruments continued

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
At beginning of year	94	31
Exchange differences	6	—
Acquisition of investments	12	63
Disposal of investments	(58)	—
At end of year	<u>54</u>	<u>94</u>

Other financial assets comprise listed securities of £9m (2013: £nil) and unlisted securities of £45m (2013:£94m).

16. Derivative financial instruments

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

<u>All figures in £ millions</u>	<u>2014</u>			<u>2013</u>		
	<u>Gross notional amounts</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Gross notional amounts</u>	<u>Assets</u>	<u>Liabilities</u>
Interest rate derivatives – in a fair value hedge relationship	1,607	84	(5)	1,439	81	(32)
Interest rate derivatives – not in a hedge relationship	673	—	(7)	634	4	(16)
Cross-currency rate derivatives – in a hedge relationship	889	24	(36)	220	39	—
Cross-currency rate derivatives – not in a hedge relationship	451	6	(26)	—	—	—
Total	<u>3,620</u>	<u>114</u>	<u>(74)</u>	<u>2,293</u>	<u>124</u>	<u>(48)</u>
Analysed as expiring:						
In less than one year	200	24	(1)	312	13	—
Later than one year and not later than five years	1,386	67	(8)	1,377	111	—
Later than five years	2,034	23	(65)	604	—	(48)
Total	<u>3,620</u>	<u>114</u>	<u>(74)</u>	<u>2,293</u>	<u>124</u>	<u>(48)</u>

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.



Notes to the consolidated financial statements continued

16. Derivative financial instruments continued

At the end of 2014, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross-currency rate derivatives, was US dollar £(607)m, sterling £214m, euro £430m, Brazilian real £4m and South African rand £nil (2013: US dollar £(151)m, sterling £243m, euro £nil, Brazilian real £nil and South African rand £(16)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2014 range from 1.10% to 14.48% (2013: 1.10% to 9.28%) and the floating rates are based on LIBOR in US dollar, euro and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19. Derivative financial assets and liabilities subject to offsetting arrangements are as follows:

All figures in £ millions	2014			2013		
	Gross derivative assets	Gross derivative liabilities	Net derivative assets/liabilities	Gross derivative assets	Gross derivative liabilities	Net derivative assets/liabilities
Counterparties in an asset position	94	(28)	66	122	(12)	110
Counterparties in a liability position	20	(46)	(26)	2	(36)	(34)
Total as presented in the balance sheet	114	(74)	40	124	(48)	76

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

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

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

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2014	2013
Cash at bank and in hand	483	521
Short-term bank deposits	47	208
Continuing operations	530	729
Cash at bank and in hand classified within assets held for sale	—	36
	530	765

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

At the end of 2014 the currency split of cash and cash equivalents was US dollar 18% (2013: 28%), sterling 13% (2013: 18%), euro 3% (2013: 5%), renminbi 28% (2013: 27%) and other 38% (2013: 22%).



Notes to the consolidated financial statements continued

17. Cash and cash equivalents (excluding overdrafts) continued

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:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Cash and cash equivalents – continuing operations	530	729
Cash at bank and in hand classified within assets held for sale	—	36
Bank overdrafts – continuing operations	(19)	(25)
	<u>511</u>	<u>740</u>

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.

<u>All figures in £ millions</u>	<u>2014</u>			<u>2013</u>		
	<u>Offset asset</u>	<u>Offset liability</u>	<u>Net offset asset/liability</u>	<u>Offset asset</u>	<u>Offset liability</u>	<u>Net offset asset/liability</u>
US dollars	267	(266)	1	298	(299)	(1)
Sterling	430	(427)	3	1,018	(1,027)	(9)
Euro	9	(8)	1	6	(5)	1
Total for continuing operations as presented in the balance sheet	<u>==</u>	<u>==</u>	<u>5</u>	<u>==</u>	<u>==</u>	<u>(9)</u>

At the end of 2013, the Group had offset US dollar, sterling and euro asset balances of £1m, £16m and £nil respectively in respect of discontinued operations.

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



Notes to the consolidated financial statements continued

18. Financial liabilities – borrowings

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Non-current		
6.0% Sterling bonds 2015 (nominal amount £300m)	—	299
4.0% US dollar notes 2016 (nominal amount \$350m)	231	221
6.25% Global dollar bonds 2018 (nominal amount \$550m)	390	375
4.625% US dollar notes 2018 (nominal amount \$300m)	210	202
1.875% Euro notes 2021 (nominal amount €500m)	408	—
3.75% US dollar notes 2022 (nominal amount \$500m)	319	283
3.25% US dollar notes 2023 (nominal amount \$500m)	315	286
Bank loans and overdrafts	5	22
Finance lease liabilities	5	5
	<u>1,883</u>	<u>1,693</u>
Current		
Due within one year or on-demand:		
5.7% US dollar bonds 2014 (nominal amount \$400m)	—	248
7.0% Sterling bonds 2014 (nominal amount £250m)	—	254
6.0% Sterling bonds 2015 (nominal amount £300m)	300	—
Bank loans and overdrafts	37	25
Finance lease liabilities	5	6
	<u>342</u>	<u>533</u>
Total borrowings	<u>2,225</u>	<u>2,226</u>

Included in the non-current borrowings above is £13m of accrued interest (2013: £9m). Included in the current borrowings above is £1m of accrued interest (2013: £4m).

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Between one and two years	239	303
Between two and five years	602	821
Over five years	1,042	569
	<u>1,883</u>	<u>1,693</u>



Notes to the consolidated financial statements continued

18. Financial liabilities – borrowings continued

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

All figures in £ millions	2014			2013	
	Effective interest rate	Carrying value	Market value	Carrying value	Market value
Bank loans and overdrafts	n/a	42	42	47	47
5.7% US dollar bonds 2014	5.88%	—	—	248	246
7.0% Sterling bonds 2014	7.20%	—	—	254	262
6.0% Sterling bonds 2015	6.27%	300	314	299	325
4.0% US dollar notes 2016	4.26%	231	233	221	223
6.25% Global dollar bonds 2018	6.46%	390	397	375	376
4.625% US dollar notes 2018	4.69%	210	205	202	195
1.875% Euro notes 2021	2.04%	408	407	—	—
3.75% US dollar notes 2022	3.94%	319	327	283	286
3.25% US dollar notes 2023	3.36%	315	314	286	273
Finance lease liabilities	n/a	10	10	11	11
		<u>2,225</u>	<u>2,249</u>	<u>2,226</u>	<u>2,244</u>

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

All figures in £ millions	2014	2013
US dollar	1,491	1,645
Sterling	303	559
Euro	408	—
Other	23	22
	<u>2,225</u>	<u>2,226</u>

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

All figures in £ millions	2014	2013
Floating rate		
– expiring within one year	—	—
– expiring beyond one year	1,122	1,057
	<u>1,122</u>	<u>1,057</u>

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:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Finance lease liabilities – minimum lease payments		
Not later than one year	5	6
Later than one year and not later than two years	3	4
Later than two years and not later than three years	1	1
Later than three years and not later than four years	1	—
Later than four years and not later than five years	—	—
Later than five years	—	—
Future finance charges on finance leases	—	—
Present value of finance lease liabilities	<u>10</u>	<u>11</u>

The present value of finance lease liabilities is as follows:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Not later than one year	5	6
Later than one year and not later than five years	5	5
Later than five years	—	—
	<u>10</u>	<u>11</u>

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

19. Financial risk management

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

Treasury policy

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

The audit committee receives regular reports on the Group’s treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.

Liquidity and refinancing risk management

The Group’s objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group’s policy objective is to



Notes to the consolidated financial statements continued

19. Financial risk management continued

Liquidity and refinancing risk management continued

maintain the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) to be between three and ten years. At the end of 2014 the average maturity of gross borrowings was 4.7 years (2013: 4.2 years) of which bonds represented 97% (2013: 97%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. All of the Group's credit ratings remained unchanged during the year, although in January 2014, Moody's changed the outlook on their short-term and long-term ratings from 'Stable' to 'Negative'. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group also uses a range of ratios to monitor and manage its finances internally. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2014 the committed facilities amounted to \$1,750m (£1,122m) and their weighted average maturity was 4.6 years.

Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates.

The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2014 the fixed to floating hedging ratio, on the above basis, was approximately 38%:62%. Steps will be taken in early 2015 to bring the Group back into compliance with this policy objective. A simultaneous 1% change on 1 January 2015 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have an £11m effect on profit before tax.

The policy described above creates a further group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group's accounting objective in relation to its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover the Group's total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.



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. The Group policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross-currency swaps) were: US dollar £2,005m and sterling £36m.

Use of currency debt and currency derivatives

The Group uses both currency denominated debt and derivative instruments to implement the above policy.

Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

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:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Cash and cash equivalents	530	729
Marketable securities	16	6
Derivative financial instruments	40	76
Bank loans, overdrafts and loan notes	(42)	(47)
Bonds	(2,173)	(2,168)
Finance lease liabilities	(10)	(11)
Continuing operations	(1,639)	(1,415)
Cash and cash equivalents classified within assets held for sale	—	36
Net debt	(1,639)	(1,379)



Notes to the consolidated financial statements continued

19. Financial risk management continued

Analysis of Group debt, including the impact of derivatives continued

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

All figures in £ millions	2014	2013
Fixed rate	597	612
Floating rate	1,042	767
Total	1,639	1,379

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

All figures in £ millions	2014	2013
US dollar	2,099	1,849
Sterling	104	339
Other	22	38
Total	2,225	2,226

As at 31 December 2014 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows:

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	342	842	1,041	2,225
Effect of rate derivatives	1,254	(225)	(1,029)	—
Total	1,596	617	12	2,225

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

All figures in £ millions	2014			Total
	USD	GBP	Other	
Not later than one year	398	160	99	657
Later than one year and not later than five years	877	—	—	877
Later than five years	1,126	—	—	1,126
Total	2,401	160	99	2,660
Analysed as:				
Bonds	1,711	318	439	2,468
Rate derivatives – inflows	(379)	(656)	(537)	(1,572)
Rate derivatives – outflows	893	444	98	1,435
Trade payables	176	54	99	329
Total	2,401	160	99	2,660



Notes to the consolidated financial statements continued

19. Financial risk management continued

Analysis of Group debt, including the impact of derivatives continued

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	<u>2,082</u>	<u>422</u>	<u>113</u>	<u>2,617</u>
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	<u>2,082</u>	<u>422</u>	<u>113</u>	<u>2,617</u>

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 instruments – fair value measurement

The following table provides an analysis of those financial instruments that are measured subsequently to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All figures in £ millions	2014				2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value								
Derivative financial assets	—	114	—	114	—	124	—	124
Marketable securities	—	16	—	16	—	6	—	6
Available for sale financial assets								
Investments in listed securities	—	9	—	9	—	—	—	—
Investments in unlisted securities	—	—	45	45	—	—	94	94
Financial liabilities at fair value								
Derivative financial liabilities	—	(74)	—	(74)	—	(48)	—	(48)
Total	<u>—</u>	<u>65</u>	<u>45</u>	<u>110</u>	<u>—</u>	<u>82</u>	<u>94</u>	<u>176</u>



Notes to the consolidated financial statements continued

19. Financial risk management continued

Financial instruments – fair value measurement continued

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

All figures in £ millions	2014		2013	
	Investments in unlisted securities	Other financial liabilities	Investments in unlisted securities	Other financial liabilities
At beginning of year	94	—	31	(68)
Exchange differences	6	—	—	9
Additions	3	—	63	—
Fair value movements	—	—	—	(8)
Disposals	(58)	—	—	67
At end of year	45	—	94	—

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets.

Financial instruments – sensitivity analysis

As at 31 December 2014 the sensitivity of the carrying value of the Group’s financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in listed securities	9	—	—	(1)	1
Investments in unlisted securities	45	—	—	(4)	5
Cash and cash equivalents	530	—	—	(67)	82
Marketable securities	16	—	—	—	—
Derivative financial instruments	40	(66)	85	16	(19)
Bonds	(2,173)	71	(84)	(170)	208
Other borrowings	(52)	—	—	6	(7)
Other net financial assets	660	—	—	(53)	64
Total financial instruments	(925)	5	1	(273)	334

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

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



Notes to the consolidated financial statements continued

20. Intangible assets – Pre-publication

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Cost		
At beginning of year	1,933	1,876
Exchange differences	80	(46)
Additions	358	364
Disposal through business disposal	—	(29)
Disposals	(234)	(234)
Acquisition through business combination	1	2
At end of year	<u>2,138</u>	<u>1,933</u>
Amortisation		
At beginning of year	(1,216)	(1,210)
Exchange differences	(60)	46
Charge for the year	(292)	(308)
Disposal through business disposal	—	23
Disposals	234	234
Acquisition through business combination	—	(1)
Transfer to receivables	16	—
At end of year	<u>(1,318)</u>	<u>(1,216)</u>
Carrying amounts		
At end of year	<u>820</u>	<u>717</u>

Included in the above are pre-publication assets amounting to £546m (2013: £480m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold. There was no amortisation within discontinued operations in either year.

21. Inventories

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Raw materials	9	15
Work in progress	10	13
Finished goods	205	196
	<u>224</u>	<u>224</u>

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £387m (2013: £472m). In 2014 £38m (2013: £53m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.



Notes to the consolidated financial statements continued

22. Trade and other receivables

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Current		
Trade receivables	963	863
Royalty advances	18	23
Prepayments and accrued income	107	101
Other receivables	222	186
	<u>1,310</u>	<u>1,173</u>
Non-current		
Trade receivables	26	19
Royalty advances	8	8
Prepayments and accrued income	30	33
Other receivables	18	10
	<u>82</u>	<u>70</u>

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:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
At beginning of year	(58)	(55)
Exchange differences	—	5
Income statement movements	(21)	(27)
Utilised	17	18
Acquisition through business combination	(11)	—
Transfer to assets classified as held for sale	—	1
At end of year	<u>(73)</u>	<u>(58)</u>

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:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Within due date	869	783
Up to three months past due date	203	194
Three to six months past due date	40	36
Six to nine months past due date	15	22
Nine to 12 months past due date	15	9
More than 12 months past due date	11	1
Total trade receivables	<u>1,153</u>	<u>1,045</u>
Less: provision for sales returns	<u>(164)</u>	<u>(163)</u>
Net trade receivables	<u>989</u>	<u>882</u>

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



Notes to the consolidated financial statements continued

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2014	58	11	67	53	189
Exchange differences	4	—	—	1	5
Charged to income statement	—	1	—	10	11
Released to income statement	—	(1)	(43)	(4)	(48)
Acquisition through business combination	—	—	—	14	14
Utilised	(5)	(4)	(4)	(23)	(36)
At 31 December 2014	57	7	20	51	135

Analysis of provisions:

All figures in £ millions	2014				
	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	7	4	20	22	53
Non-current	50	3	—	29	82
	<u>57</u>	<u>7</u>	<u>20</u>	<u>51</u>	<u>135</u>
	2013				
	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	5	10	67	30	112
Non-current	53	1	—	23	77
	<u>58</u>	<u>11</u>	<u>67</u>	<u>53</u>	<u>189</u>

Deferred consideration primarily relates to the formation of a venture in a North America business in 2011.

Disposals and closures include liabilities related to the disposal of Penguin. In 2013 a provision was established for amounts payable to Bertelsmann upon settlement of the transfer of Penguin's UK past service pension liabilities to the new Penguin Random House venture. During 2014 it was decided that this transfer would not go ahead as planned and therefore the provision has been released.

Legal and other includes legal claims, contract disputes and potential contract losses.



Notes to the consolidated financial statements continued

24. Trade and other liabilities

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Trade payables	329	316
Social security and other taxes	21	23
Accruals	501	478
Deferred income	801	698
Interest payable	28	22
Other liabilities	231	225
	<u>1,911</u>	<u>1,762</u>
Less: non-current portion		
Accruals	22	25
Deferred income	201	155
Interest payable	19	21
Other liabilities	68	56
	<u>310</u>	<u>257</u>
Current portion	<u>1,601</u>	<u>1,505</u>

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

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

25. Retirement benefit and other post-retirement obligations

Background

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

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

At 31 December 2014 the UK Group plan has approximately 26,500 members, analysed in the following table:

<u>%</u>	<u>Active</u>	<u>Deferred</u>	<u>Pensioners</u>	<u>Total</u>
Defined benefit	2	25	32	59
Defined contribution	18	23	—	41
Total	<u>20</u>	<u>48</u>	<u>32</u>	<u>100</u>

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.



Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Background continued

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

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

Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

%	2014			2013			2012		
	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.0	2.5	2.5	3.4	2.5	2.5	3.0	2.5	2.5
Rate used to discount plan liabilities	3.6	3.7	3.7	4.4	4.4	4.4	4.4	3.6	3.6
Expected rate of increase in salaries	3.5	3.9	4.0	3.9	3.9	4.0	3.5	3.9	—
Expected rate of increase for pensions in payment and deferred pensions	1.9 to 5.05	—	—	2.3 to 5.1	—	—	2.3 to 5.1	—	—
Initial rate of increase in healthcare rate	—	—	7.0	—	—	7.5	—	—	8.0
Ultimate rate of increase in healthcare rate	—	—	5.0	—	—	5.0	—	—	5.0

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.0% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.0% has been used.

The expected rate of increase in salaries has been set at 3.5% for 2014 with a short-term assumption of 2.0% for three years.

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

For the US plans, the mortality table (RP – 2014) and 2014 Improvement scale (MP – 2014) with no adjustments have been adopted for 2014, reflecting the mortality assumption most prevalent in the US. In 2013 the RP2000 table projected to 2020 was used.

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows:

	UK		US	
	2014	2013	2014	2013
Male	24.4	24.3	21.6	19.2
Female	24.5	24.4	23.8	21.1



Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Assumptions continued

The remaining average life expectancy in years of a pensioner retiring at age 65, 15 years after the balance sheet date, for the UK and US Group plans is as follows:

	UK		US	
	2014	2013	2014	2013
Male	26.6	25.9	23.3	19.2
Female	26.4	25.9	25.5	21.1

Although the Group anticipates that plan surpluses will be utilised during the life of the plan to address member benefits, the Group recognises its pension surplus in full in respect of the UK Group plan on the basis that it is management's judgement that there are no substantive restrictions on the return of residual plan assets in the event of a winding up of the plan after all member obligations have been met.

Financial statement information

The amounts recognised in the income statement are as follows:

All figures in £ millions	2014					
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	20	2	22	69	2	93
Curtailments	(5)	—	(5)	—	(13)	(18)
Administration expenses	4	—	4	—	—	4
Total operating expense	19	2	21	69	(11)	79
Interest on plan assets	(103)	(7)	(110)	—	—	(110)
Interest on plan liabilities	98	8	106	—	3	109
Net finance (income)/expense	(5)	1	(4)	—	3	(1)
Net income statement charge/(income)	14	3	17	69	(8)	78

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



Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

All figures in £ millions	2012					
	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 2014 results are discontinued operations consisting of a £5m credit (2013: £2m charge; 2012: £4m charge) relating to defined benefit schemes and a £nil m charge (2013: £6m charge; 2012: £9m charge) relating to defined contribution schemes.

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2014				2013			
	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
Fair value of plan assets	2,714	164	—	2,878	2,353	156	—	2,509
Present value of defined benefit obligation	(2,524)	(196)	(23)	(2,743)	(2,267)	(171)	(20)	(2,458)
Net pension asset/(liability)	190	(32)	(23)	135	86	(15)	(20)	51
Other post-retirement medical benefit obligation				(81)				(77)
Other pension accruals				(27)				(30)
Net retirement benefit asset/(obligation)				27				(56)
Analysed as:				190				86
Retirement benefit assets				(163)				(142)
Retirement benefit obligations								

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

All figures in £ millions	2014	2013	2012
Amounts recognised for defined benefit plans	36	70	(95)
Amounts recognised for post-retirement medical benefit plans	(13)	9	(5)
Total recognised in year	23	79	(100)

The fair value of plan assets comprises the following:

%	2014			2013		
	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
Equities	26	2	28	28	2	30
Bonds	42	3	45	40	3	43
Property	9	—	9	9	—	9
Other	17	1	18	17	1	18



Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

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

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

%	2014		2013	
	Quoted market price	No quoted market price	Quoted market price	No quoted market price
UK equities	5	1	6	1
Non-UK equities	20	2	20	3
Fixed-interest securities	19	—	19	—
Index-linked securities	26	—	24	—
Property	—	9	—	9
Other	—	18	—	18
Total	70	30	69	31

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

%	2014	2013
Liquid – call <1 month	72	72
Less liquid – call 1–3 months	2	2
Liquid – call > 3 months	26	26

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

All figures in £ millions	2014			2013		
	UK Group plan	Other plans	Total	UK Group plan	Other plans	Total
Fair value of plan assets						
Opening fair value of plan assets	2,353	156	2,509	2,162	165	2,327
Exchange differences	—	4	4	—	(2)	(2)
Interest on plan assets	103	7	110	95	6	101
Return on plans assets excluding interest	286	9	295	103	6	109
Contributions by employer	62	4	66	77	5	82
Contributions by employee	2	—	2	2	—	2
Benefits paid	(92)	(16)	(108)	(86)	(24)	(110)
Closing fair value of plan assets	2,714	164	2,878	2,353	156	2,509
Present value of defined benefit obligation						
Opening defined benefit obligation	(2,267)	(191)	(2,458)	(2,181)	(220)	(2,401)
Exchange differences	—	(5)	(5)	—	4	4
Current service cost	(20)	(2)	(22)	(22)	(3)	(25)
Administration expenses	(4)	—	(4)	(4)	—	(4)
Curtailments	5	—	5	—	—	—
Interest cost	(98)	(8)	(106)	(94)	(7)	(101)
Actuarial gains/(losses) – experience	11	(1)	10	5	1	6
Actuarial gains/(losses) – demographic	—	(8)	(8)	—	1	1
Actuarial gains/(losses) – financial	(241)	(20)	(261)	(55)	9	(46)
Contributions by employee	(2)	—	(2)	(2)	—	(2)
Benefits paid	92	16	108	86	24	110
Closing defined benefit obligation	(2,524)	(219)	(2,743)	(2,267)	(191)	(2,458)



Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

The weighted average duration of the defined benefit obligation is 16.5 years for the UK and 9.7 years for the US.

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Opening defined benefit obligation	(77)	(89)
Exchange differences	(4)	1
Current service cost	(2)	(4)
Curtailments	13	4
Interest cost	(3)	(3)
Actuarial gains/(losses) – demographic	(7)	–
Actuarial gains/(losses) – financial	(6)	9
Benefits paid	5	5
Closing defined benefit obligation	<u>(81)</u>	<u>(77)</u>

Funding

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

The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2012 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by June 2017. In 2014 the Group contributed £43m (2013: £56m) towards the funding shortfall. Following the completion of the triennial funding valuation the Group has agreed to contribute £41m per annum until 2017 in excess of regular contributions. In addition, a mechanism has been agreed for the Group to make supplementary payments up to a maximum of £15m per annum if certain conditions are met. If such payments are made they are expected to accelerate the end date for extinguishing the deficit. Regular contributions to the plan in respect of the defined benefit sections are estimated to be £17m for 2015.

The Group expects to contribute \$10m in 2015 and \$11m in 2016 to its US defined benefit pension plans.

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:

<u>All figures in £ millions</u>	<u>2014</u>	
	<u>1% increase</u>	<u>1% decrease</u>
Effect:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(371)	467
(Decrease)/increase in defined benefit obligation – US plan	(19)	22



Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Sensitivities continued

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

<u>All figures in £ millions</u>	2014	
	1 year increase	1 year decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	88	(85)
Increase/(decrease) in defined benefit obligation – US plan	7	(6)

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

<u>All figures in £ millions</u>	2014	
	0.5% increase	0.5% decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	111	(104)
Increase/(decrease) in defined benefit obligation – US plan	—	—

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

26. Share-based payments

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

<u>All figures in £ millions</u>	2014	2013	2012
Pearson plans	32	35	28

Share-based payment charges included in discontinued operations amounted to £nil (2013: £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 or five years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee’s participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

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

Long-Term Incentive Plan This plan was first introduced in 2001, renewed in 2006 and again in 2011. The plan consists of restricted shares. The vesting of restricted shares is normally dependent on continuing service over a



Notes to the consolidated financial statements continued

26. Share-based payments continued

three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in May 2014 and May 2013, vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. Restricted shares awarded to senior management in November 2014 vest dependent on earnings per share growth. Other restricted shares awarded in 2014 and 2013 vest depending on continuing service over a three-year period.

Annual Bonus Share Matching Plan This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis of up to one matching share for every invested share, i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares. Awards under this plan ceased in 2013.

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

	2014		2013	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	2,792	8.73	3,373	8.24
Granted during the year	1,985	8.11	763	9.14
Exercised during the year	(727)	8.24	(820)	7.12
Forfeited during the year	(538)	8.76	(516)	8.75
Expired during the year	(5)	7.43	(8)	5.75
Outstanding at end of year	3,507	8.48	2,792	8.73
Options exercisable at end of year	43	8.24	35	6.95

Options were exercised regularly throughout the year. The weighted average share price during the year was £11.41 (2013: £12.42). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

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

Range of exercise prices £	2014		2013	
	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	—	—	—	—
5 – 10	3,507	2.68	2,792	2.31
>10	—	—	—	—
	3,507	2.68	2,792	2.31

In 2014 and 2013 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.



Notes to the consolidated financial statements continued

26. Share-based payments continued

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

	2014 Weighted average	2013 Weighted average
Fair value	£ 2.41	£ 2.27
Weighted average share price	£ 11.09	£ 11.71
Weighted average exercise price	£ 8.11	£ 9.14
Expected volatility	21.27%	22.05%
Expected life	3.9 years	3.8 years
Risk free rate	1.3%	0.53%
Expected dividend yield	4.33%	3.84%
Forfeiture rate	3.4%	3.3%

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

The following shares were granted under restricted share arrangements:

	2014		2013	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	5,875	11.44	3,482	11.52
Annual Bonus Share Matching Plan	—	—	99	12.06

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Participants under both plans are entitled to dividends during the vesting period and therefore the share price is not discounted.

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

27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2013	817,043	204	2,555
Issue of ordinary shares – share option schemes	1,537	1	13
At 31 December 2013	818,580	205	2,568
Issue of ordinary shares – share option schemes	1,303	—	11
At 31 December 2014	819,883	205	2,579

The ordinary shares have a par value of 25p per share (2013: 25p per share). All issued shares are fully paid. All shares have the same rights.



Notes to the consolidated financial statements continued

27. Share capital and share premium continued

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

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

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

28. Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2013	10,102	103
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
At 31 December 2013	9,282	98
Purchase of treasury shares	907	9
Release of treasury shares	(2,997)	(32)
At 31 December 2014	<u>7,192</u>	<u>75</u>

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 0.9% (2013: 1.1%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £1.8m (2013: £2.3m).

At 31 December 2014 the market value of Pearson plc treasury shares was £85.6m (2013: £124.4m).

29. Other comprehensive income

All figures in £ millions	2014				
	Attributable to equity holders of the company			Non-controlling interest	
	Translation reserve	Retained earnings	Total	interest	Total
Items that may be reclassified to the income statement					
Net exchange differences on translation of foreign operations – Group	150	—	150	—	150
Net exchange differences on translation of foreign operations – associate	25	—	25	—	25
Currency translation adjustment disposed – subsidiaries	(2)	—	(2)	—	(2)
Attributable tax	—	(6)	(6)	—	(6)
Items that are not reclassified to the income statement					
Remeasurement of retirement benefit obligations – Group	—	23	23	—	23
Remeasurement of retirement benefit obligations – associate	—	(15)	(15)	—	(15)
Attributable tax	—	(1)	(1)	—	(1)
Other comprehensive expense for the year	<u>173</u>	<u>1</u>	<u>174</u>	<u>—</u>	<u>174</u>



Notes to the consolidated financial statements continued

29. Other comprehensive income continued

	2013				
	Attributable to equity holders of the company			Non-controlling interest	Total
	Translation reserve	Retained earnings	Total		
All figures in £ millions					
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)

	2012				
	Attributable to equity holders of the company			Non-controlling interest	Total
	Translation reserve	Retained earnings	Total		
All figures in £ millions					
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

On 11 February 2014, the Group acquired 100% of Grupo Multi, the leading adult English language training company in Brazil. Fair values for the assets and liabilities arising from the Grupo Multi acquisition and other smaller acquisitions completed in the year are set out below. There were no material adjustments to prior year acquisitions. There were no significant acquisitions in 2013. Adjustments were made in respect of prior year acquisitions in 2013 and included the recognition of intangibles of £185m on the EmbanetCompass acquisition.



Notes to the consolidated financial statements continued

30. Business combinations continued

Fair values for the assets and liabilities arising from acquisitions completed in the year are as follows:

All figures in £ millions	Notes	2014			2013
		Grupo Multi fair value	Other fair value	Total fair value	Total fair value
Property, plant and equipment	10	1	1	2	1
Intangible assets	11	254	6	260	200
Intangible assets – pre-publication	20	1	—	1	1
Inventories		4	—	4	1
Trade and other receivables		35	1	36	9
Cash and cash equivalents (excluding overdrafts)		3	—	3	2
Financial liabilities – borrowings		(49)	—	(49)	—
Net deferred income tax assets/(liabilities)	13	2	(2)	—	(37)
Provisions for other liabilities and charges	23	(13)	(1)	(14)	—
Trade and other liabilities		(21)	(3)	(24)	(7)
Current income tax liabilities		(20)	—	(20)	—
Net assets acquired at fair value		197	2	199	170
Goodwill	11	240	(2)	238	(133)
Fair value of previously held interest arising on stepped acquisition		—	—	—	(7)
Total		437	—	437	30
Satisfied by:					
Cash		(437)	—	(437)	(31)
Deferred consideration		—	—	—	(2)
Net prior year adjustments		—	—	—	3
Total consideration		(437)	—	(437)	(30)

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

Goodwill of £240m arising on 2014 acquisitions is expected to be deductible for tax purposes (2013: £6m).

Intangible assets acquired in 2014 have the following useful economic lives: customer lists, contracts and relationships four years; trademarks and brands 20 years, and other acquired intangibles 12 years. Intangible assets recognised in 2013 have the following useful economic lives: customer lists, contracts and relationships 3-17 years, and trademarks and brands two years.

All figures in £ millions	2014	2013	2012
Cash flow on acquisitions			
Cash – current year acquisitions	(437)	(25)	(682)
Deferred payments for prior year acquisitions and other items	(5)	(6)	(31)
Cash and cash equivalents acquired	3	2	34
Acquisition costs and other acquisition liabilities paid	(9)	(19)	(37)
Net cash outflow	(448)	(48)	(716)

In total, acquisitions completed in the year contributed an additional £70m of sales and £29m of adjusted operating profit. If the acquisitions had completed on 1 January 2014 then the Group estimates that sales for the year would have been £4,880m and total adjusted operating profit would have been £725m.



Notes to the consolidated financial statements continued

31. Disposals including business closures

All figures in £ millions	2014				2013			2012
	Mergermarket	Penguin	Other	Total	Penguin	Other	Total	Total
Disposal of subsidiaries								
Property, plant and equipment	(2)	—	(1)	(3)	(39)	(3)	(42)	(3)
Intangible assets	(12)	—	—	(12)	(43)	—	(43)	(45)
Investments in joint ventures and associates	—	—	—	—	(22)	—	(22)	—
Other financial assets	—	—	—	—	(1)	—	(1)	—
Intangible assets – pre-publication	—	—	—	—	(20)	(6)	(26)	—
Inventories	—	—	—	—	(91)	(3)	(94)	—
Trade and other receivables	(23)	—	(2)	(25)	(447)	(6)	(453)	—
Cash and cash equivalents (excluding overdrafts)	(19)	—	(11)	(30)	(34)	(3)	(37)	—
Net deferred income tax liabilities/(assets)	1	—	—	1	(22)	—	(22)	11
Retirement benefit obligations	—	—	—	—	—	4	4	—
Provisions for other liabilities and charges	4	—	—	4	7	—	7	—
Trade and other liabilities	69	—	12	81	224	10	234	—
Current income tax liabilities	6	—	—	6	—	—	—	—
Non-controlling interest	—	—	(2)	(2)	3	—	3	—
Attributable goodwill	(156)	—	(1)	(157)	(370)	(6)	(376)	(50)
Cumulative translation adjustment	2	—	—	2	18	—	18	—
Net assets disposed	(130)	—	(5)	(135)	(837)	(13)	(850)	(87)
Cash received	375	—	—	375	—	3	3	—
Deferred proceeds	—	—	6	6	—	—	—	—
Fair value of associate acquired	—	—	—	—	1,160	—	1,160	—
Costs	(1)	29	(2)	26	(121)	(14)	(135)	(26)
Gain/(loss) on disposal	244	29	(1)	272	202	(24)	178	(113)

The gain on disposal of Penguin in 2013 arises from the measurement at fair value of the associate investment acquired in Penguin Random House. Determination of fair value is described in note 12.

All figures in £ millions	2014	2013	2012
Cash flow from disposals			
Cash – current year disposals	375	3	—
Cash and cash equivalents disposed	(30)	(37)	—
Costs and other disposal liabilities paid	(18)	(98)	(11)
Net cash inflow/(outflow)	327	(132)	(11)

**Notes to the consolidated financial statements continued****32. Held for sale**

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

<u>All figures in £ millions</u>	Notes	2014	2013
Property, plant and equipment	10	—	2
Intangible assets	11	—	158
Deferred income tax assets	13	—	1
Trade and other receivables		—	26
Cash and cash equivalents (excluding overdrafts)	17	—	36
Assets classified as held for sale		<u>—</u>	<u>223</u>
Deferred income tax liabilities	13	—	(2)
Provisions for other liabilities and charges		—	(4)
Trade and other liabilities		—	(71)
Current income tax liabilities		—	(5)
Liabilities directly associated with assets classified as held for sale		<u>—</u>	<u>(82)</u>
Net assets classified as held for sale		<u>—</u>	<u>141</u>

33. Purchase of non-controlling interest

There were no purchases of non-controlling interests in 2014. In 2013 the Group purchased non-controlling interests in the South African business for £65m, and in the Indian business for £11m.

In 2012 the Group increased its investments in its subsidiaries in China at a cost of £4m.

34. Cash generated from operations

<u>All figures in £ millions</u>	Notes	2014	2013	2012
Profit		470	539	314
Adjustments for:				
Income tax		110	90	163
Depreciation	10	74	82	80
Amortisation and impairment of acquired intangibles and goodwill	11	264	168	183
Amortisation of software	11	63	59	54
Net finance costs		93	75	96
Share of results of joint ventures and associates	12	(51)	(54)	(9)
Profit on disposals		(272)	(187)	113
Acquisition costs		6	12	21
Costs on formation of Penguin Random House		—	—	32
Net foreign exchange adjustment from transactions		27	(40)	(21)
Share-based payment costs	26	32	37	32
Pre-publication		(52)	(77)	(55)
Inventories		6	18	49
Trade and other receivables		(69)	(50)	(94)
Trade and other liabilities		72	72	—
Retirement benefit obligations		(58)	(57)	(37)
Provisions for other liabilities and charges		(11)	(3)	(5)
Net cash generated from operations		<u>704</u>	<u>684</u>	<u>916</u>

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



Notes to the consolidated financial statements continued

34. Cash generated from operations continued

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:

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net book amount	12	19	1
(Loss)/profit on sale of property, plant and equipment	(3)	9	—
Proceeds from sale of property, plant and equipment	<u>9</u>	<u>28</u>	<u>1</u>

35. Contingencies

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

36. Commitments

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

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £157m (2013: £183m; 2012: £169m).

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

<u>All figures in £ millions</u>	<u>2014</u>	<u>2013</u>
Not later than one year	161	161
Later than one year and not later than two years	150	149
Later than two years and not later than three years	126	133
Later than three years and not later than four years	122	118
Later than four years and not later than five years	115	105
Later than five years	701	737
	<u>1,375</u>	<u>1,403</u>

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.



Notes to the consolidated financial statements continued

37. Related party transactions continued

Key management personnel

From 1 January 2014 the key management personnel are deemed to be the members of the Pearson Executive. It is this committee which had responsibility for planning, directing and controlling the activities of the Group in 2014. Key management personnel compensation is disclosed below:

<u>All figures in £ millions</u>	<u>2014</u>
Short-term employee benefits	10
Retirement benefits	1
Share-based payment costs	2
Total	<u>13</u>

There were no other material related party transactions. No guarantees have been provided to related parties.

38. Events after the balance sheet date

There were no material events after the balance sheet date.



SIGNATURES

The registrant hereby certifies that it meets the requirements for filing a Form 20-F and that it has caused and authorized the undersigned for sign this annual report on its behalf.

Pearson plc

/s/ Robin Freestone

Robin Freestone
Chief Financial Officer

Date: March 26, 2015