

# Governance report

## In this section

---

### Governance overview

62 Chairman's letter

---

### Leadership & effectiveness

64 Board of Directors  
66 Board governance and activities  
74 Nomination & Governance  
Committee report

---

### Accountability

76 Audit Committee report  
84 Risk governance and control

---

### Engagement

86 Reputation & Responsibility  
Committee report  
88 Stakeholder engagement

---

### Remuneration

90 Remuneration overview  
94 Our Executive remuneration framework  
96 2017 remuneration report

---

### Additional disclosures

106 Report of the Directors  
110 Statement of Directors' responsibilities

# Governance overview

Sidney Taurel  
Chairman



## In this Governance section

Leadership & effectiveness	p64–75 →
Accountability	p76–85 →
Engagement	p86–89 →
Remuneration	p90–105 →
Additional disclosures	p106–110 →

## UK Corporate Governance Code

This year, we are reporting against the 2016 edition of the UK Corporate Governance Code (the Code). The Board believes that during 2017 the company was in full compliance with all relevant provisions of the Code. A detailed account of the provisions of the Code can be found on the FRC's website at [www.frc.org.uk](http://www.frc.org.uk) and we encourage readers to view our compliance schedule on the company website at [www.pearson.com/governance](http://www.pearson.com/governance)

## Dear shareholders,

As I said last year, during times of change, good governance is paramount. As a Board we continue to organise our work around five major themes where we believe we can add value: governance and risk, strategy, performance, leadership and people, and shareholder engagement. A summary of the key items covered by the Board throughout the year appears on p68, and I have set out below further detail on our particular areas of focus during 2017.

Looking back on 2017, the Board is satisfied that external and internal expectations regarding performance have been met and that the company has achieved operational stability. We have been very focused throughout the year on the simplification of our portfolio and investment in our transformation programmes, including The Enabling Programme (TEP) and the Global Learning Platform (GLP). We are now in a position where, in addition to regularly monitoring performance and simplification, the Board can begin to pivot its attentions towards longer-term strategic opportunities through structural growth, digital transformation and in the lifelong learning sector.

## Leadership & effectiveness

[See full section on p64–75 →](#)

In my letter to shareholders at this time last year, I set out a number of priorities for the Board during 2017. I am pleased to report that good progress has been made on all fronts, summarised below, and with further detail given throughout this report:

- › monitor the company's strategic and tactical actions related to the refocusing of the business – the Board monitors financial and operational performance through a streamlined and effective dashboard, which is provided to the Directors on a monthly basis, enabling us to spend more time on strategic discussions during Board meetings
- › implement previously signposted portfolio decisions – in 2016 we indicated that we intended to reduce our exposure to large-scale direct delivery businesses to focus on more scalable online, virtual, and blended services. In line with this strategy, we completed the sale of our English test preparation business in China, Global Education (GEDU), in August 2017. We also announced the sale of our English language learning business, Wall Street English (WSE), which is expected to complete in the first half of 2018. In addition, we indicated in early 2017 our intention to exit from our stake in Penguin Random House. Following negotiations with our partner in Penguin Random House, Bertelsmann, we agreed to divest a 22% stake in Penguin Random House, retaining an interest of 25%, and to recapitalise that business
- › significantly drive down our cost structure – we announced in 2017 our plans to reduce Pearson's cost base by a further £300m exiting 2019. We are on track to deliver the planned savings, many of which will come through simplification of our technology architecture allowing the increased use of shared service centres enabling us to standardise processes and reduce headcount. This will facilitate further opportunities such as the greater centralisation of procurement and the reduction in the number of our office locations
- › reduce the dividend – in 2017, we took the decision to rebase our dividend policy to reflect portfolio changes, the challenging market environment, the pace of investment required to transform the

## Governance overview

business and the need to sustain a healthy balance sheet to ensure we have the financial flexibility to maintain a solid investment grade credit rating. Our policy reflects a sustainable and progressive dividend, comfortably covered by the earnings of our business and which can grow as our business expands into the opportunities in global education. For the 2017 financial year, we therefore propose to pay a total dividend of 17p per share – 5p per share at the interim, paid in September 2017, and 12p per share final dividend, subject to shareholder approval at the Annual General Meeting (AGM) in May 2018

effect an optimal capital allocation, particularly following the outcome of negotiations regarding our investment in Penguin Random House, to ensure long-term sustainability and to reward our shareholders. The proceeds from the sale of the Penguin Random House stake have been used as follows: we undertook a buyback programme to repurchase £300m of ordinary shares which completed on 16 February 2018; \$306m was utilised to pay down debt in the form of an early redemption of a US dollar denominated bond; and the remainder reinvested to build a strong balance sheet.

In the coming year, our main focus is to pivot towards our longer-term growth opportunities by delivering on the three strategic priorities described in this report and to continue to monitor progress against our dashboard and key milestones for 2018.

The Board continued to work closely with the Executive team to ensure ongoing leadership development throughout the year. At an Executive level, we recruited a Chief Strategy Officer, Jonathan Chocqueel-Mangan, and a new Chief Human Resources Officer, Anna Vikström Persson, both of whom joined the team in early 2018. The Board looks forward to working closely with Jonathan and Anna, who each have a key role to play in shaping Pearson as we continue to transform the business, hone our strategy and ensure we are able to attract and develop the talent that will lead the business forward.

The Board evaluation for 2017 was facilitated externally – the first external evaluation during my tenure as Chairman. I am pleased to report that there was unanimous agreement by all Directors that the Board is operating effectively. In times of transformation and disruption within Pearson itself and the wider sector in which we operate, it is imperative to ensure that our long-term strategy is appropriate, with shorter-term tactical actions that support delivery of that strategy. One particular theme arising from our evaluation was that the Board will spend even more time considering long-term strategy and ensure we are aligned on process and deliverables. Our Chief Strategy Officer will play an important role in this work during 2018.

Building on our 2016 evaluation, the Board and management gave consideration to the areas where we could particularly leverage external expertise and advice, and as a result Pearson established a Digital Advisory Network of external experts who are partnering with us to help maximise the opportunity from digital disruption. Lincoln Wallen was instrumental in the creation of this network, which held its inaugural meeting late in 2017. We are also pleased that Michael Lynton has been appointed as a Non-Executive Director with effect from 1 February 2018. Michael's experience leading businesses through times of digital disruption will further strengthen our capabilities in this area.

We recently announced that Harish Manwani, a Non-Executive Director of Pearson since 2013, is retiring from the Board at the forthcoming AGM, and will not be seeking re-election, in anticipation of his future commitments. The Board joins me in thanking Harish for his commitment and invaluable contribution to Pearson, and we wish him all the best in his future endeavours.

### Accountability

[See full section on p76–85](#) →

As a Board, we are accountable for Pearson's successes and addressing its challenges. We aim to communicate to you in a transparent manner the steps we have taken to ensure that we have a clear oversight of the business and the work we have undertaken in respect of Pearson's strategy throughout the year. Our Audit Committee, led by Tim Score, plays a key role in monitoring and evaluating our risk management processes, providing independent oversight of our external audit and internal control programmes, accounting policies, business transformation projects, such as TEP and GLP, and in assisting the Board in reporting in a fair, balanced and understandable manner to our shareholders.

### Engagement

[See full section on p86–89](#) →

The 2017 financial year has been one of significant engagement with our shareholders. I have enjoyed spending time throughout the year with many of you to ensure that we maintain an open, transparent dialogue, keep you updated on our strategy and receive your inputs. In common with most large, public companies, we have a wider range of stakeholders than just traditional investors, and our Reputation & Responsibility Committee has oversight of our sustainability and social impact initiatives, government and public affairs matters, and engagement with the education community. Board members also engage with the wider stakeholder population, including employees, customers and partners, both through formal Board events and by way of individual contributions to internal and external initiatives.

### Remuneration

[See full section on p90–105](#) →

Since our last AGM in May 2017, Elizabeth Corley, who chairs our Remuneration Committee, has led our work to engage with investors in connection with Pearson's remuneration policy and to listen to their concerns. It is clear that shareholders and other stakeholders would like our approach to remuneration to be simple, transparent, closely linked to our strategy and the company's performance. We have worked hard to develop an approach that the majority of our shareholders can support. Our approach is explained in more detail in the remuneration section of this report on p90–105.

### Conclusion

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



Sidney Taurel  
Chairman

# Board of Directors

## Chairman



**Sidney Taurel** Chairman  
aged 69, appointed 1 January 2016

Sidney has over 45 years of experience in business and finance, and is currently a board director and chairman of the compensation committee at IBM Corporation. Sidney is an advisory board member at pharmaceutical firm Almirall. He was chief executive officer of global pharmaceutical firm Eli Lilly and Company from 1998 until 2008, chairman from 1999 until 2008, and has been chairman emeritus since 2009. He was also a director at McGraw Hill Financial, Inc., a role which he held from 1996 until April 2016, and at ITT Industries from 1996 to 2001. Sidney has received three US presidential appointments to: the Homeland Security Advisory Council, the President's Export Council and the Advisory Committee for Trade Policy and Negotiations, and is an officer of the French Legion of Honour.

## Executive Directors



**John Fallon** Chief Executive  
aged 55, appointed 3 October 2012

John became Pearson's Chief Executive on 1 January 2013. Since 2008, he had been responsible for the company's education businesses outside North America and a member of the Pearson management committee. He joined Pearson in 1997 as Director of Communications and was appointed President of Pearson Inc. in 2000. In 2003 he was appointed CEO of Pearson's educational publishing businesses for Europe, Middle East & Africa. Prior to joining Pearson, John was director of corporate affairs at Powergen plc and 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, a member of the Council of the University of Hull, and trustee and director of the Oracle Cancer Trust.



**Coram Williams** Chief Financial Officer  
aged 44, appointed 1 August 2015

Coram joined Pearson in 2003 and has held a number of senior positions including Finance and Operations Director for Pearson's English Language Teaching business in Europe, Middle East & Africa, Interim President of Pearson Education Italia and Head of Financial Planning and Analysis for Pearson. In 2008, Coram became CFO of The Penguin Group and was latterly appointed CFO of Penguin Random House in 2013, where he oversaw the integration of the two businesses. Coram trained at Arthur Andersen, and subsequently worked in both the auditing and consulting practices of the firm. He is a non-executive director and chairman of the audit committee for the Guardian Media Group.

## Non-Executive Directors



**Linda Lorimer** Non-Executive Director  
aged 65, appointed 1 July 2013

Linda spent almost 40 years serving higher education. She retired from Yale in spring 2016 after 34 years at the university where she served in an array of senior positions including vice president for Global & Strategic Initiatives. She oversaw the development of Yale's burgeoning online education division and the expansion of Yale international programmes and centres. During her tenure, she was responsible for many administrative services, ranging from Yale's public communications and alumni relations to sustainability, human resources and the university press. Previously, Linda was president of Randolph-Macon Woman's College and chair of the board of the Association of American Colleges and Universities. She also served on the boards of several public companies, including as presiding director of the McGraw-Hill companies. She is a member of the Trilateral Commission and the Council on Foreign Relations.



**Harish Manwani** Non-Executive Director  
aged 64, appointed 1 October 2013

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 Holdings. He is also on the board of the Indian School of Business and the Economic Development Board (EDB) of Singapore, and is global executive advisor at Blackstone Private Equity.

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

### Executive experience of Chairman and Non-Executive Directors

Digital/technology experience

56%



Education/learning experience

33%



International markets experience

89%



Sustainable business practice experience

67%



# Board of Directors

## Non-Executive Directors



**Elizabeth Corley, CBE** Non-Executive Director aged 61, appointed 1 May 2014

Elizabeth was CEO of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016, and continues to act as a senior adviser to the firm as vice-chair. She was previously at Merrill Lynch Investment Managers and Coopers & Lybrand. In addition to Pearson, Elizabeth serves on two other company boards as a non-executive director – BAE Systems plc and Morgan Stanley. She has various financial services industry roles including as a member of the FICC Markets Standards Board, the ESMA stakeholder group and the TheCityUK Advisory Council. Additionally she is a member of the Committee of 200 and a trustee of the British Museum. Elizabeth currently chairs a group advising the UK government on social impact investing. She is also a crime fiction author.



**Vivienne Cox, CBE** Senior Independent Director aged 58, appointed 1 January 2012

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years in global roles including executive vice president and chief executive of BP's gas, power and renewables business and its alternative energy unit. She is non-executive director of Stena International and chairman of the supervisory board of Vallourec, a leader in the seamless steel pipe markets. She is also non-executive director at pharmaceutical company GlaxoSmithKline plc and an advisory board member of the African Leadership Institute.



**Josh Lewis** Non-Executive Director aged 55, appointed 1 March 2011

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 several enterprises in the fin-tech/data, education and other sectors.



**Tim Score** Non-Executive Director aged 57, appointed 1 January 2015

Tim has extensive experience of the technology sector in both developed and emerging markets, having served as chief financial officer of ARM Holdings plc, the world's leading semiconductor IP company, for 13 years. He is an experienced non-executive director and currently sits on the boards of The British Land Company plc and HM Treasury, in addition to being on the board of trustees of the Royal National Theatre and chairman of the group audit committee of the Football Association. 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, LucasVarity plc and BTR plc.



**Lincoln Wallen** Non-Executive Director aged 57, appointed 1 January 2016

Lincoln has extensive experience in the technology and media industries, having been CEO of DWA Nova, a software-as-a-service company spun out of DreamWorks Animation Studios in Los Angeles, a position he held until 2017. He worked at DreamWorks Animation for nine years in a variety of leadership roles including chief technology officer and head of animation technology. He was formerly CTO at Electronic Arts Mobile, leading EA's entry into the mobile gaming business internationally. He is currently a visiting associate in Computing and Mathematical Sciences at the California Institute of Technology (Caltech). Lincoln is also a non-executive director of the Smith Institute for Industrial Mathematics and Systems Engineering. Lincoln's early career involved 20 years of professional IT and mathematics research, including as a reader in Computer Science at Oxford.



**Michael Lynton** Non-Executive Director aged 58, appointed 1 February 2018

Michael served as CEO of Sony Entertainment from 2012 until 2017, overseeing Sony's global entertainment businesses. He also served as chairman and CEO of Sony Pictures Entertainment from 2004. Prior to this, he held senior roles within Time Warner and AOL, and earlier served as chairman and CEO of Penguin Group where he extended the Penguin brand to music and the internet. Michael is chairman of Snap, Inc., and currently serves on the boards of Pandora Media Inc., IEX and Ares Management, L.P. He is also a member on the Council on Foreign Relations, the Harvard Board of Overseers and serves on the boards of the Los Angeles County Museum of Art, the Tate and the Rand Corporation. Michael holds a B.A. in History and Literature from Harvard College, where he also received his M.B.A.

# Board governance and activities

## Board of Directors

**Composition of the Board** As at the date of this report, the Board consists of the Chairman, Sidney Taurel, two Executive Directors: the Chief Executive, John Fallon, and Chief Financial Officer, Coram Williams, and eight independent Non-Executive Directors. As previously disclosed, Harish Manwani will step down from the Board at the forthcoming AGM.

**Chairman and Chief Executive** There is a defined split of responsibilities between the Chairman and the Chief Executive. The roles and responsibilities of the Chairman and Chief Executive are clearly defined, set out in writing and reviewed and agreed by the Board on an annual basis.

**Chairman's significant commitments** On 1 January 2017, Mr Taurel stepped down from his role as a senior adviser at the global investment bank, Moelis & Co, and on 30 November 2017 he stepped down from his role on the advisory Board of Takeda Pharmaceutical.

## Roles and composition of the Board

Role	Name	Responsibility
<b>Chairman</b>	Sidney Taurel	The Chairman is primarily responsible for the leadership of the Board and ensuring its effectiveness. He ensures the Board upholds and promotes the highest standards of corporate governance, setting the Board's agenda and encouraging open, constructive debate of all agenda items for effective decision-making. He regularly meets the Chief Executive to stay informed. He also ensures that shareholders' views are communicated to the Board.
<b>Chief Executive</b>	John Fallon	The Chief Executive is responsible for the operational management of the business and for the development and implementation of the company's strategy as agreed by the Board and management. He is responsible for developing operational proposals and policies for approval by the Board, and promotes Pearson's culture and standards.
<b>Chief Financial Officer</b>	Coram Williams	The Chief Financial Officer is responsible for the preparation and integrity of Pearson's financial reporting and statements and also oversees other functional areas including tax, treasury, internal audit and corporate finance. He supports the Chief Executive in developing and implementing the strategy of the company as agreed by the Board and management.
<b>Senior Independent Director</b>	Vivienne Cox	The Senior Independent Director's role includes meeting regularly with the Chairman and Chief Executive to discuss specific issues, as well as being available to shareholders generally should they have concerns that have not been addressed through the normal channels. She also leads the evaluation of the Chairman on behalf of the other Directors.
<b>Committee Chairmen</b>	Elizabeth Corley Vivienne Cox Linda Lorimer Tim Score	The Committee Chairmen are responsible for leading the Board committees and ensuring their effectiveness. They set the Committees' agendas, in consultation with the company's management, and report to the Board on Committee proceedings. They lead on engagement with shareholders regarding matters within the remit of the Committees, alongside senior management.
<b>Non-Executive Directors</b>	Elizabeth Corley Vivienne Cox Josh Lewis Linda Lorimer Michael Lynton Harish Manwani Tim Score Lincoln Wallen	The Non-Executive Directors contribute to the development of our strategy and scrutinise and constructively challenge the performance of management in the execution of strategy and risk planning. They also engage with various stakeholders of the company and provide guidance and independent perspective to management.
<b>Company Secretary</b>	Stephen Jones	The Company Secretary acts as secretary to the Board and its committees, ensuring compliance with Board procedures and advising on governance matters. He is responsible, under the direction of the Chairman, for ensuring the Board receives accurate, timely and clear information. The Company Secretary supports the Chairman in delivery of the corporate governance agenda and organises Director inductions and ongoing training.

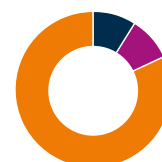
### Gender split of Board



### Nationality of Directors



### Ethnicity



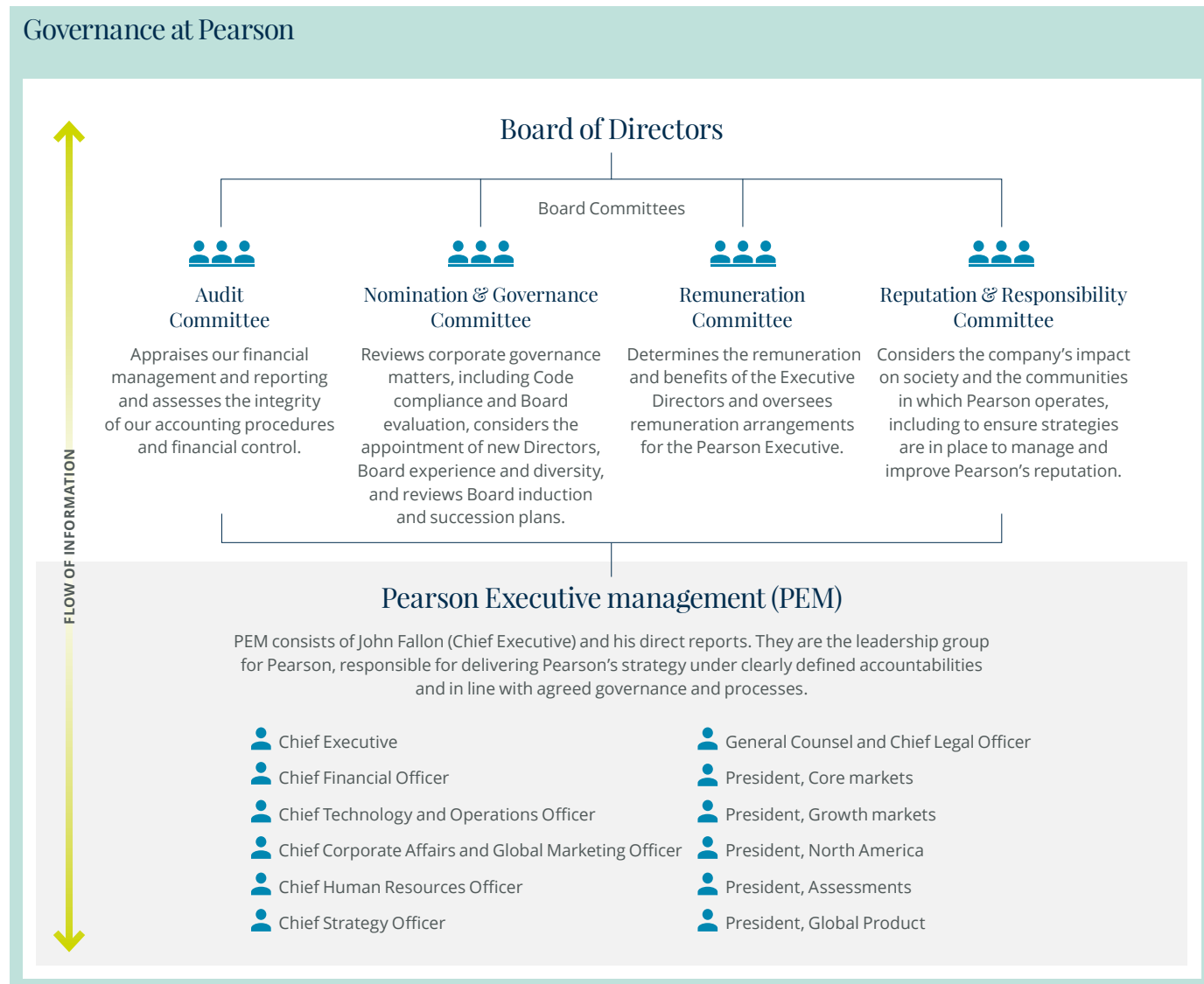
Asian – Indian (1)  
Mixed – White & Black Caribbean (1)  
White – English/Welsh/Scottish/Northern Irish/British (6)  
White – Any other White Background (3)

### Length of tenure of Non-Executive Directors





## Board governance and activities



There were no other changes to the Chairman's significant commitments during 2017.

**Independence of Chairman** In accordance with the Code, Sidney Taurel was considered to be independent upon his appointment as Chairman on 1 January 2016.

**Independence of Directors** All of the Non-Executive Directors who served during 2017 were considered by the Board to be independent for the purposes of the Code. The Board reviews the independence of each of the Non-Executive Directors annually. This includes reviewing their external appointments and any potential conflicts of interest as well as assessing their individual circumstances in order to ensure that there are no relationships or matters likely to affect their judgement. In addition to this review, each of the Non-Executive Directors is asked annually to complete an independence questionnaire to satisfy requirements arising from Pearson's US listing.

Josh Lewis and Vivienne Cox have served on the Board for more than six years. Accordingly, their performance has been subject

to a rigorous review, including with regard to their independence. The Board has determined that Josh Lewis and Vivienne Cox continue to be independent, notwithstanding their length of service, taking into account their valuable contribution to Board discussions and constructive challenge of management.

**Conflicts of interest** Under the Companies Act 2006 (the Act), Directors have a statutory duty to avoid conflicts of interest with the company. The company's Articles of Association (Articles) allow the Directors to authorise conflicts of interest. The company has established a procedure to identify actual and potential conflicts of interest, including all directorships or other appointments to, or relationships with, companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Once notified to the Chairman or Company Secretary, such potential conflicts are considered for authorisation by the Board at its next scheduled meeting. The relevant Director cannot vote on an authorisation resolution, or be counted in the quorum, in relation to the resolution relating to his/her conflict or potential conflict. The Board reviews any authorisations granted on an annual basis.

## Board governance and activities

### Board meetings

The Board had seven formal meetings in 2017, with discussions and debates focused on the key strategic issues facing the company. This included two meetings each of three days' duration in São Paulo, Brazil and Boston, USA at which the Board considered growth markets and strategy. Major items covered by the Board in 2017 are shown in the table below.

In addition to the formal meetings, the Board meets as necessary to consider matters of a time-sensitive nature.

#### São Paulo, Brazil

At a three-day meeting at São Paulo in June, the Board and Pearson Executive focused primarily on the Pearson business in Brazil, while also taking a wider look at our Growth geographic markets, including time focusing on India and South Africa. They engaged with the Brazilian leadership team and wider employee population throughout the visit, and spent time gaining an insight into the macro-economic environment in Brazil.

The Board participated in demonstrations for three products in the learning and assessment sectors. In two groups, the Board and Executive then visited schools where they met students and teachers, considered the school culture and classroom innovations, and discussed the students' perspectives on the value of learning.

#### Boston, USA

The Board and the Pearson Executive visited Boston in October for a three-day meeting where they were joined by members of the North American senior management team to consider leadership, culture and the change agenda in Pearson North America. The Board also spent time considering Pearson's vision and strategy, including a financial overview and consideration of synergies and our product investment portfolio, US higher education courseware and key strategic initiatives and opportunities, before taking some time to review organisational health.

The Board and Executive participated in a range of engagement opportunities with a variety of Pearson stakeholders, including an event on Employment in 2030 – The Future of Skills, and customer panel sessions. On the final day of the three-day meeting, the Board attended a facilitated breakfast meeting with top talent and new employees and gained insight into employees' views on Pearson's current challenges and opportunities. Read more about the Board's engagement with these stakeholders on p89.

### Board meeting focus during 2017

Area of responsibility	Activity
<b>Governance &amp; risk</b>	<ul style="list-style-type: none"> <li>› Training on Market Abuse Regulation</li> <li>› Compliance with UK Corporate Governance Code</li> <li>› Income statement and Going concern and viability</li> <li>› Shareholder activism and defence plan</li> <li>› Enterprise risk management review</li> <li>› Approval of division of responsibilities between Chairman and Chief Executive</li> <li>› Annual review of conflicts of interest</li> <li>› Pension scheme derisking</li> <li>› Approval of Committee terms of reference</li> </ul>
<b>Strategy</b>	<ul style="list-style-type: none"> <li>› Penguin Random House, WSE, GEDU and K-12 courseware – updates</li> <li>› Strategy meeting in São Paulo focusing on local Brazilian businesses and wider Growth strategy</li> <li>› Efficiency and simplification initiatives</li> <li>› US higher education courseware</li> <li>› Interactive product demonstrations</li> <li>› Communications strategy and positioning</li> <li>› Capital structure</li> <li>› Product, technology and operations strategies</li> <li>› Digital advisory network update</li> <li>› Operating and strategic plan updates</li> <li>› Tax update</li> </ul>
<b>Performance</b>	<ul style="list-style-type: none"> <li>› 2016 preliminary results and annual report and accounts</li> <li>› Interim results and trading updates</li> <li>› Monthly dashboard and milestone reports</li> <li>› 2017 operating plan</li> <li>› Final and interim dividend proposals</li> <li>› Draft 2018 operating plan and 2017 and 2018 goals</li> </ul>
<b>Leadership &amp; people</b>	<ul style="list-style-type: none"> <li>› Chief Executive's goals</li> <li>› Talent and succession planning</li> <li>› Organisational health including review of Pearson's culture</li> <li>› Dinner with senior local management and facilitated breakfasts with key talent at overseas strategy meetings. Read more on employee engagement on p27.</li> </ul>
<b>Shareholders &amp; engagement</b>	<ul style="list-style-type: none"> <li>› Share buyback programme</li> <li>› Investor relations strategy and share price performance</li> <li>› Major shareholders and share register analysis</li> <li>› Shareholder issues and voting</li> <li>› Focus on forthcoming AGM</li> </ul>



## Board governance and activities

### Board in action

#### US higher education courseware



Robin Baliszewski, Managing Director, Higher Education Sales, leads a panel of student ambassadors at the Board's meeting in Boston

At the Board's request, US higher education courseware was an area of focus at each Board meeting during 2017 as Pearson looked to respond to and proactively mitigate against challenges in that market sector. At each meeting, the Board was joined by the Presidents of North America and Global Product and by the Chief Technology and Operations Officer to review the market and associated financial model, changes in the trading environment, possible short- and longer-term implications of

those changes, and to consider and assess Pearson's strategic response, including the impact of the new digital and print rental models on both customer and competitor activity and on the traditional sales channel.

At its October meeting in Boston, the Board viewed an early stage product demonstration of the Global Learning Platform which would initially be focused on the higher education portfolio. The Board also engaged with panels of students and faculty members in order to gain a greater insight into how Pearson's higher education products and services are viewed by those that use them. Throughout the year, including between scheduled meetings, the Board also monitored progress through a monthly dashboard which enabled them to track Pearson's delivery of agreed strategic, performance and customer-focused metrics in the higher education courseware market.

Link to strategic priorities, ➔ See p14

1 Grow market share through digital transformation

#### Structural growth opportunities

Pearson considers Online Program Management (OPM) and virtual schools to be among its biggest growth opportunities. During the year, the Board considered Pearson's prospects in these areas, how to measure success, and what differentiates Pearson and provides real competitive advantage. The Board also considered what Pearson might look like in the medium term as these and other opportunities come to fruition, and the characteristics for these businesses in terms of revenues and profits. At its strategy meeting in October, the Board held a deep dive into each of these areas with the responsible Executives. In respect of OPM, the Board reviewed the global market opportunity, and considered how Pearson's expertise in courseware and assessment could continue to support partners in the development and delivery of online programmes that deliver demonstrable learner outcomes and superior student learning experience. The Board discussed how to deliver that strategy, and considered management's recommendations for next steps. Regular reporting to the Board of progress in this market has been introduced and OPM will be a particular item for the Board's ongoing consideration in 2018.

Link to strategic priorities, ➔ See p16

2 Invest in structural growth markets

#### Portfolio changes

Following the announcement of Pearson's strategy of reducing exposure to large-scale direct delivery businesses, the Board had considered its portfolio for strategic alignment, and had determined that its English test preparation business in China, Global Education (GEDU), and English language learning business, Wall Street English (WSE), were no longer aligned with Pearson's core strategy and accordingly that exits from these business would be explored. At a number of meetings during 2017, the Board considered input from the President, Growth markets, with responsibility for Pearson's business in China, and from the SVP Corporate Finance & Strategic Development, both of whom provided updates as the negotiations proceeded and the transactions took shape. The Board considered the potential terms of the transactions, the status of interested parties, and in light of all relevant factors – including the impact of the potential divestments on Pearson, its shareholders and wider stakeholders – gave approval for the sales of GEDU and WSE businesses in line with agreed terms.

Link to strategic priorities, ➔ See p18

3 Become simpler and more efficient

## Board governance and activities

### The role and business of the Board

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

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

The key responsibilities of the Board include:

- › Overall leadership of the company and setting the company's values and standards
- › Determining the company's strategy in consultation with management, reviewing performance against it and overseeing management execution thereof
- › Major changes to the company's corporate, capital, management and control structures
- › Approval of all transactions or financial commitments in excess of the authority limits delegated to the Chief Executive and other Executive management.

The Board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive meeting papers are circulated to the Board and committee members at least one week in advance of each meeting and the Board receives a monthly dashboard and key milestones report and regular updates from the Chief Executive and CFO. In addition to meeting papers, a library of current and historic corporate information is made available to Directors electronically to support the Board's decision-making process. Directors can obtain independent professional advice, at the company's expense, in the performance of their duties as Directors. All Directors have access to the advice and services of the Company Secretary.

### Standing Committee

A Standing Committee of the Board is established to approve certain operational and ordinary course of business items such as banking matters, guarantees, intra-group transactions and to make routine approvals relating to employee share plans.

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

### Culture and values

Pearson's core values – to be brave, imaginative, decent and accountable – go to the heart of our mission to improve learning outcomes, and the Board and employees are committed to demonstrating these characteristics throughout their work and deliberations. The Board monitors the culture of the company and levels of employee engagement and advocacy with the assistance of its Reputation & Responsibility Committee and through regular updates from the Chief Human Resources Officer. It aims to foster a culture of collaboration, diversity and inclusion at all levels, including by engaging with employees from across Pearson at various events throughout the year. Pearson's Code of Conduct outlines how we work to our mission and values in an ethical and responsible manner.

### Board attendance

Directors are expected to attend all Board and committee meetings but in certain exceptional circumstances, such as due to pre-existing business or personal commitments, Directors may be unable to attend. In these circumstances, Directors receive relevant papers and, where possible, will communicate any comments and observations in advance of the meeting for raising as appropriate during the meeting. They are updated on any developments after the meeting by the Chairman of the Board or committee, as appropriate. Individuals' attendance at Board and committee meetings is considered, as necessary, as part of the formal annual review of their performance. There was a high level of attendance by Directors at Board and committee meetings in 2017.

The following table sets out the attendance of the company's Directors at scheduled Board meetings during 2017:

	Board meetings attended
<b>Chairman</b>	
Sidney Taurel	7/7
<b>Executive Directors</b>	
John Fallon	7/7
Coram Williams	7/7
<b>Non-Executive Directors</b>	
Elizabeth Corley	7/7
Vivienne Cox	7/7
Josh Lewis	7/7
Linda Lorimer	7/7
Harish Manwani	7/7
Tim Score <sup>1</sup>	6/7
Lincoln Wallen	7/7

<sup>1</sup> Unable to attend one meeting due to pre-existing commitment. Ahead of the meeting, Mr Score communicated his comments on the business of the Board to the Chairman.

## Board governance and activities

### Succession planning

The Board considers oversight of succession planning as one of its prime responsibilities, assisted by the Nomination & Governance Committee. As well as Board and Executive management succession, the Board oversees the process for all key positions throughout the business with a particular focus on high potential talent.

The company has formal contingency plans in place for the temporary absence of the Chief Executive for health or other reasons. The matter of Chief Executive succession is a standing item for discussion and review by the Chairman and the Board annually. Succession planning for the Board and Chairman is also considered annually by the full Board and on an ongoing basis by the Nomination & Governance Committee. There is also discussion and oversight of key positions at Executive management level, including the recent appointments of Jonathan Chocqueel-Mangan as Chief Strategy Officer and Anna Vikström Persson as Chief Human Resources Officer.

### Directors' training and induction

All Directors receive training in the form of presentations about the company's operations, through Board meetings held at operational locations and by encouraging the Directors to visit local facilities and management as and when their schedule allows, including if they are travelling to a country or region on non-Pearson business. The Company Secretary and General Counsel, in conjunction with Pearson's advisers, monitor legal and governance developments and update the Board on such matters as agreed with the Chairman. In 2017, the Directors and other senior managers were briefed on:

- › The EU Market Abuse Regulation, including the impact of regulatory guidance introduced during the year
- › The latest regulatory framework, corporate governance reporting and Directors' remuneration report as part of a training session led by PwC
- › Regular market updates for the Remuneration Committee on industry practice and regulation received from external advisers.

Our Directors can also make use of external courses.

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

The induction programme for Michael Lynton, our most recently appointed Non-Executive Director, will take place in 2018. The initial phase will include meetings with other Board members, business area familiarisation with members of the Pearson Executive, a briefing on Directors' duties and sessions with the SVP Internal Audit, Compliance and Risk and SVP Investor Relations, with the remainder of the induction tailored to Michael's particular areas of interest and aligned with the Board's focus areas.

### Directors' indemnities

A qualifying third-party indemnity (QTPI), as permitted by the Articles and sections 232 and 234 of the Act, has been granted by the company to each of its Directors. Under the provisions of the QTPI, the company undertakes to indemnify each Director against liability to third-parties (excluding criminal and regulatory penalties) and to pay Directors' costs as incurred, provided that they are reimbursed to the company if the Director is found guilty, the court refuses to grant the relief sought or, in an action brought by the company, judgment is given against the Director. The indemnity has been in force for the financial year ended 31 December 2017 and is currently in force.

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

### Board Committees

The Board has established four formal Committees: Audit, Nomination & Governance, Remuneration, and Reputation & Responsibility. The chairmen and members of these committees are appointed by the Board on the recommendation (where appropriate) of the Nomination & Governance Committee and in consultation with each relevant committee chairman. In addition to these formal Board Committees, the Standing Committee also operates with Board-level input.

Learn more about Pearson's governance structure on p67 ➔

### More Committee information:

Audit Committee	p76 ➔
Nomination & Governance Committee	p74 ➔
Remuneration Committee	p90 ➔
Reputation & Responsibility Committee	p86 ➔
Standing Committee	p70 ➔

The Committees focus on their own areas of expertise, enabling the Board meetings to focus on governance and risk, strategy, performance, and leadership and people, thereby making the best use of the Board's time together as a whole. The Committee chairmen report to the full Board at each Board meeting immediately following their sessions, ensuring a good communication flow while retaining the ability to escalate items to the full Board's agenda if appropriate.

## Board governance and activities

### Board evaluation

The Board evaluation for 2017 was an externally facilitated process led by Heidrick & Struggles JCA Group, which was selected following a review by the Nomination & Governance Committee of various providers and consideration of the potential scope of the evaluation. In addition to facilitating the Board evaluation, Heidrick & Struggles JCA Group was also engaged by Pearson in relation to Non-Executive Director and Senior Executive search activity during the year.

In reporting back to the Board, the evaluator reported that conversations with Board members were positive, with unanimous agreement that the Board operates effectively. The evaluator noted that the Board had acknowledged the management team's commitment which has put the business in a much more positive position at the end of the year than it was at the beginning of the year. This was the first external evaluation since the appointment of Sidney Taurel as Chairman, and it was noted by the other Board members that he had created a different and positive dynamic, with his leadership style and experience. The evaluator reported that the relationship between the Executive and Non-Executive Directors remains positive, with the additions of Coram Williams and Lincoln Wallen to the Board further complementing that dynamic. The evaluator noted that the Board was particularly appreciative of Elizabeth Corley's commitment throughout 2017 in her engagement with investors in respect of remuneration matters.

More detail on the evaluation process and the priorities arising from it is given opposite, and the Nomination & Governance Committee will consider Heidrick & Struggles JCA Group's findings and recommendations in greater detail throughout 2018.

A number of actions were taken during 2017 in response to findings arising from the 2016 Board evaluation process. You can read more about progress on these in the table below.

### Individual evaluation

In addition to the evaluation of the Board as a whole, Executives are evaluated each year on their performance against personal objectives under the company's annual incentive plan. These objectives are linked to certain strategic metrics, including efficiency and cost savings initiatives, driving the digital agenda, and growing market share in US higher education courseware. Progress against each of these metrics is reviewed by the Board on a monthly basis, as part of the dashboard of KPIs which we believe to be central to Pearson's turnaround.

The Chairman meets with each Non-Executive Director individually on a regular basis and, in assessing the contribution of each, has confirmed that each Director continues to make a significant contribution to the business and deliberations of the Board. The Non-Executive Directors, led by the Senior Independent Director, also conduct an annual review of the Chairman's performance.

### Committee evaluation

All committees undertake an annual evaluation process to review their performance and effectiveness. For 2017, the process was facilitated externally by Heidrick & Struggles JCA Group as part of the Board evaluation. The Committees were considered to be working effectively, led well by their respective chairmen with appropriate agendas and a strong work ethic from each committee member. Read more on this in the pages that follow.

## Progress on findings of 2016 evaluation

Finding	Response/Action taken
Continue to focus on US higher education courseware at every meeting, and build additional measures into the monthly dashboard to monitor this business.	US higher education courseware is a standing item at each Board meeting, with the responsible Executives providing updates on progress and initiatives. The regular monthly dashboard has been refined and provides more detail on US higher education courseware. The dashboard is kept under review and evolves as necessary with business and Board requirements.
Drive to increase use of external expertise in digital technologies.	Building on a scoping session involving Directors and members of the Pearson Executive, we launched a digital advisory network in 2017 to bring together a diverse cross-section of people with experience and knowledge of digital disruption. Learn more about the digital advisory network on p88.
Experience identified as valuable in new Board members, including digital transformation and disruption.	An agreed candidate specification was drawn up for any potential new Non-Executive Director appointments, resulting in the appointment of Michael Lynton.
Agree most appropriate format and scheduling for Non-Executive and Chairman only sessions	These sessions are a standing item at each Board, Audit Committee and Remuneration Committee meeting, to enable open discussion of issues and ensure the Board or committee continues to work effectively as a group. The Chairman also held a number of Non-Executive Director dinners in 2017.
Desire to build a compelling narrative about the role for Pearson in the future of learning.	Building on research with teachers and learners, a set of insights-driven communications principles and practices has been developed about who we are, what we do, and what that means for our customers.
Creation of a strategic framework to guide disposals.	This was discussed and agreed by the Board at a strategy session in late 2016 and the framework implemented in 2017.
Increase visibility of ROIC-style metrics in each part of portfolio.	Additional ROIC-style measures were introduced into the Board's reporting during 2017, and both gross and net ROIC were reported publicly in our 2017 full year results.
Continued focus on retention of key talent, both at senior levels and throughout organisation.	Key talent and 'regretted leavers' report considered regularly by Remuneration Committee. A 'managers' toolkit' has also been developed to encourage and enable retention of key employees.

## Board governance and activities

### External Board evaluation process 2017

#### Preparation

Following discussions with the Chairman, Senior Independent Director and Chief Executive, Heidrick & Struggles JCA Group (the evaluator) prepared a framework for discussion, as set out below, which formed the basis for all one-on-one meetings.

#### One-on-one meetings

The evaluator met individually with each of the Directors and the Company Secretary for an open, confidential, unattributed conversation using the framework for discussion as a prompt on proposed topics. The discussion was not limited to these topics if participants wanted to raise additional subjects.

#### Feedback to the Chairman and Senior Independent Director

The evaluator submitted a draft report to the Chairman and Senior Independent Director. This was followed by a discussion of the findings and a number of recommendations arising therefrom.

#### Feedback to the Board

The evaluator facilitated an open discussion with the Board in December 2017 on the findings of the evaluation process.

#### Final review with another Independent Director

For the purposes of good governance, the evaluator spoke with another Independent Non-Executive Director following the Board meeting to confirm all information provided was a fair reflection of the feedback from each of the Directors, and was not influenced inappropriately by any Director.

#### Discussion framework

A framework for an open discussion with Directors



#### Key themes arising from the evaluation

- › The Board and Committees work effectively, led well by their respective chairs, with a clear and significant personal commitment to Pearson demonstrated by all Board members
- › The Non-Executive Directors recognised the inclusive and thoughtful approach of the Executive Directors in ensuring transparent communication between the Board and the Executive
- › Effective processes and monthly reporting have helped the Board ensure the company achieves and maintains operational control and stability
- › The Board members appreciate the sequencing of meetings, including overseas meetings, which afford them the opportunity to engage with the wider senior management team and to meet employees, customers and other stakeholders
- › Board succession planning should consider future committee chairs, and other desirable expertise in new Board members
- › Ensure ongoing strategic development aligned with business transformation activity. New Chief Strategy Officer to facilitate, enabling all Board members' strategic perspectives to be captured and considered
- › Ongoing Board education to continue to focus on competitive landscape and digital technologies
- › A desire for additional informal joint Board and Executive sessions to permit open dialogue and discussion in a less structured format
- › Ensure continued understanding by the Board of significant shareholders' views to encourage constructive dialogue and clear communication of strategy
- › New Chief Human Resources Officer to continue executive succession planning and complete a talent review aligned to the strategic needs of the business.



# Nomination & Governance Committee report

## Committee Chairman

Vivienne Cox

**Members** Elizabeth Corley,  
Vivienne Cox, Josh Lewis,  
Harish Manwani,  
Tim Score and Sidney Taurel



## Committee responsibilities include:

### Appointments

Identifying and nominating candidates for Board vacancies.

### Balance

Ensuring that the Board and its Committees have the appropriate balance of skills, experience, independence, diversity and knowledge to operate effectively.

### Succession

Reviewing the company's leadership needs with a view to ensuring the continued ability of the organisation to compete in the marketplace.

### Governance

Review and oversight of Pearson's corporate governance framework, Board evaluation and training plans, and Board diversity policy.

## Terms of reference

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

## Attendance

Attendance by Directors at Nomination & Governance Committee meetings throughout 2017:

	Meetings attended
Elizabeth Corley	3/3
Vivienne Cox	3/3
Josh Lewis	3/3
Harish Manwani	3/3
Tim Score	3/3
Sidney Taurel	3/3

## Board search

Pearson uses a number of leading firms in its Board search activities and ensures that we retain good relationships with them. During 2017, the services of Heidrick & Struggles JCA Group were availed for the appointment of Michael Lynton, Non-Executive Director, who joined the Board on 1 February 2018. During 2017, Heidrick & Struggles JCA Group also led the externally facilitated evaluation of the Board and its Committees, and was engaged in Senior Executive search activity. Heidrick & Struggles JCA Group is a signatory to the voluntary code of conduct for executive search firms.

## Role and business of the Committee

The Committee monitors the composition and balance of the Board and of its Committees, identifying and recommending to the Board the appointment of new Directors and/or Committee members. The Committee also oversees talent and succession plans for senior roles.

As the remit of the Committee expanded in 2017, the Committee now also oversees the company's compliance with, and approach to, all applicable regulation and guidance related to corporate governance matters, including Board diversity, oversight of the annual Board evaluation processes, the company's corporate governance policies and practices, compliance with the Code, and oversight of Director induction and training. In respect of its governance remit, the Committee primarily has the role of reviewing current practices on behalf of the Board, and recommending actions or changes for the Board's formal approval.

The Committee is comprised of five independent Non-Executive Directors and the Chairman of the Board. The Chief Executive and other senior management attend Committee meetings by invitation.

## Appointment of Michael Lynton

During the 2016 Board evaluation process, the Board considered the experience it would require in its next Non-Executive Director. Accordingly, the Committee met in early 2017 and agreed the specific skills and experience required in potential candidates, which included: a current or former CEO of a mid-to-large sized company; experience in an industry which has undergone digital disruption; and global experience, including of the US market. Other desired experience included marketing or branding and experience in the service sector. Pearson also expects all Non-Executives to demonstrate the highest level of integrity and credibility, independence of judgement, maturity, collegiality, a high interest in education and the commitment to devote the necessary time. Based on these criteria, candidates were then shortlisted for the proposed role at the Committee's next meeting and were interviewed by Heidrick & Struggles JCA Group and then the Committee. As a result of this process, the Committee was satisfied that Michael Lynton met the required skills and experience and also possessed the personal attributes that we would expect to see in any Pearson Non-Executive Director.

## Diversity

The Board embraces the Code's underlying principles with regard to Board balance and diversity, including in respect of ethnicity, gender and age. In May 2017, the Committee adopted the Board diversity and inclusion policy. The objectives set out in the policy and our progress towards these objectives are shown in the table opposite. The Committee ensures that the Directors of Pearson demonstrate a broad balance of skills, background and experience, and nationalities, to support Pearson's strategic development and reflect the global nature of our business. The Committee also ensures that appointments are made on merit and relevant experience, while taking into account the broadest definition of diversity.

As at 31 December 2017, the gender diversity of the Board, exceeded Lord Davies' 2015 target with 30% female representation on the Board. However, as noted in the Board diversity and inclusion policy, we are committed to work towards the recommendations



## Nomination & Governance Committee report

suggested by the Hampton-Alexander Review aimed at having at least 33% female representation on the Board by 2020.

Our Code of Conduct sets out our global standards and responsibilities with regard to diversity & inclusion (D&I) at all employee levels, including the Pearson Executive, and covers many aspects, including gender, age, disability and sexual orientation. This is underpinned by a global statement on D&I along with country and business specific policies. We are a founder member of the 30% Club and the Chief Executive has also signed a personal commitment to set an aspirational target of 30% women in Pearson's senior management team by 2020. The Chief Executive and the Chief Financial Officer are both members of the Board. Among the other ten members of the Executive team there are currently two women (20%) although for most of 2017 the percentage was 22% (two members out of nine). The senior leadership team, comprising the members of the Pearson Executive and their direct reports, has 30% female representation. We believe that we have a strong pipeline of women in leadership and senior management positions, and the Committee will monitor their development, and the development of all key talent, with care. The sustainability section provides more detail on how we implement our standards on D&I on p28.

Further, in the UK, the government has introduced new regulations designed to help address the gender pay gap. Pearson has published its gender pay gap report in Great Britain and has made a commitment to extend our reporting globally by 2020.

[View details of the Board's diversity and breadth of professional experience on p64 & 66](#) ➔

### Committee evaluation

The Committee undertook an annual evaluation to review its own performance and effectiveness. This evaluation was facilitated by Heidrick & Struggles JCA Group as part of the wider Board evaluation process. The Committee was considered to have operated effectively throughout 2017 with a clear agenda and effective leadership. In response to the findings of the 2017 evaluation, the Committee will consider succession planning as a priority in 2018, particularly for Committee chair roles.

### Nomination & Governance Committee meeting focus during 2017

Area of responsibility	Activity
Appointments	› Appointment of Michael Lynton as Non-Executive Director
Balance	› Agreement of desired skills and experience of new Non-Executive Director › Board diversity and inclusion policy
Succession	› Contingency succession planning for temporary absence of CEO › Succession planning for senior executives including CEO › Succession planning and updates on search for Non-Executive Director
Governance	› Approval of committee terms of reference › Compliance with UK Corporate Governance Code › Consideration of Board evaluation feedback

### Committee aims for 2018

We will have a full agenda for 2018, with a particular focus on Non-Executive Directors' succession planning activity, Board and senior management diversity and inclusion plan, findings of the Board evaluation and review of the corporate governance framework in light of changes to the Code expected to come into effect during 2018.



**Vivienne Cox**  
Chairman of Nomination & Governance Committee

## Board diversity & inclusion objectives

The Committee has agreed the following objectives to support the Board diversity & inclusion policy:

Objectives	Progress
We will strive to maintain a Board composition of: › At least 25% female Directors, with a target of at least 33% female Directors by 2020 › At least one Director of colour	› 25% female Directors achieved › Achieved
All Board appointments will be made on merit, in the context of the skills and relevant experience that are needed for the Board to oversee Pearson's strategic development and that reflect the global nature of our business.	Achieved. Rigorous process used during recent search for Michael Lynton who has relevant experience and skills.
The Board will prioritise use of search firms which adhere to the Voluntary Code of Conduct for Executive Search Firms when seeking to make Board-level appointments.	Achieved. Aailed services of Heidrick & Struggles JCA Group, which has signed the Voluntary Code.
The Board will continue to adopt best practice, as appropriate, in response to the Davies Review, the Hampton-Alexander Review and the Parker Review.	Suggestions noted by the Board.
Where appropriate, we will assist with the development and support of initiatives that promote all forms of diversity and inclusion in the Board, Pearson Executive and our senior management.	Adopted the Board diversity & inclusion policy. Board members personally sponsor Women in Learning & Leadership network.

# Audit Committee report

## Committee Chairman

Tim Score

**Members** Elizabeth Corley, Vivienne Cox, Linda Lorimer, Tim Score and Lincoln Wallen



## Committee responsibilities include oversight of:

<b>Reporting</b>	The quality and integrity of financial reporting and statements and related disclosure.
<b>Policy</b>	Group policies, including accounting policies and practices.
<b>External audit</b>	External audit, including the appointment, qualification, independence and the performance of the external auditor.
<b>Risk &amp; internal control</b>	Risk management systems and internal control environment, including the performance of the internal audit function.
<b>Compliance &amp; governance</b>	Compliance with legal and regulatory requirements in relation to financial reporting and accounting matters.

## Terms of reference

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

## Attendance

Attendance by Directors at Audit Committee meetings throughout 2017:

	Meetings attended
Elizabeth Corley <sup>1</sup>	3/4
Vivienne Cox	4/4
Linda Lorimer	4/4
Tim Score	4/4
Lincoln Wallen	4/4

1. Unable to attend one meeting due to existing commitment pre-dating her appointment to the Committee. Ahead of the meeting, Ms Corley communicated her comments on the business of the Committee to the Chairman.

## Audit Committee role

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

Pearson's SVP Internal Audit, Compliance and Risk has a dual reporting line to the Chief Financial Officer and to me, and external auditors have direct access to the Committee to raise any matters of concern and to report on the results of work directed by the Committee. As Audit Committee Chairman, I report to the full Board at every Board meeting immediately following a Committee meeting. I also work closely with the Chief Financial Officer and senior financial management outside the formal meeting schedule to ensure robust oversight and challenge in relation to financial control and risk management.

## Audit Committee composition

The Committee comprises five independent Non-Executive Directors. As a committee, we have a good balance of skills and knowledge with competence and experience covering all aspects of the sector in which Pearson operates – education, digital and services – and our key geographic markets.

## Fair, balanced and understandable reporting

We are mindful of the Code's provision C.1.1 relating to fair, balanced and understandable reporting and we build sufficient time into our annual report timetable to ensure that the full Board receives sufficient opportunity to review, consider and comment on the report as it progresses. Learn more about fair, balanced and understandable reporting on p109 →

## Risk assessment, assurance and integrity

A key role of the Committee is to provide oversight and reassurance to the Board with regard to the integrity of the company's financial reporting, internal control policies and procedures for the identification, assessment and reporting of risk. During 2017, we conducted a number of deep dives into selected principal risks, and the key risks on which the Committee focused throughout the year are set out below. Learn more about principal risks and uncertainties on p50–60 →

## Business transformation

Ongoing business transformation is one of Pearson's key risks and opportunities. The Enabling Programme (TEP) is an important operational simplification project covering Pearson's key enterprise resource planning technology and processes, including financial and HR systems and processes, and the Committee received an update at each meeting as TEP progressed during the year.

## Audit Committee report

The primary areas of focus for the Committee throughout 2017 were monitoring the stabilisation of finance and operations systems in the UK which were implemented in the second half of 2016, and oversight of the planned implementation of finance and operations systems throughout our North American business. In particular, the Committee considered the phasing of the North America implementation which has been aligned to the business cycle to minimise associated risk. The Committee also considered lessons learned from the previous year's UK implementation, including employee training and design adaptations, and how these lessons would be applied to the next phase.

The Committee heard from the project team leading the North American design and implementation, as well as the senior management team in charge of the transformation programme. Customer experience, data quality and readiness were key areas under regular consideration by the Committee, and updates were considered at every meeting on adherence to key project milestones and budget. In addition to the continued finance and operations system implementation, new global procurement, supply chain and contingent worker systems were also rolled out across Pearson.

The Global Learning Platform (GLP) is a key customer- and learner-facing element of the transformation programme, and is a mitigating factor in a number of risks facing the business, including data security and accessibility. Accordingly, the Committee has introduced GLP as a standing item for consideration at each meeting as the project progresses. The Committee will continue to monitor progress on TEP and GLP throughout 2018 with the assistance of senior management.

Leveraging the progress made through TEP, a review of general controls operating in the business commenced in 2017 with the aim of moving the control environment to best-in-class standard, alongside processes and systems. To this end, a formal control Steering Committee was established with representation from finance, HR, and technology, chaired by the Deputy CFO. The Steering Committee has oversight for controls globally, and centres of excellence have been created for both financial and IT general controls. The controls transformation is expected to be a progressive programme, over a multi-year period, building on TEP, with automated controls. The "first line of defence" will also be strengthened to reduce reliance on mitigating and audit controls. The Committee approved the proposed framework at its meeting in May 2017, and progress reports are now a standing item for the Committee's consideration. Learn more about GLP on p15 and TEP on p51 ➔

### Audit Committee meeting focus during 2017

Area of responsibility	Activity		
<b>Reporting</b>	<ul style="list-style-type: none"> <li>Accounting and technical updates</li> <li>Impact of legal claims and regulatory issues on financial reporting</li> <li>Fair, balanced and understandable, Going concern and viability statements</li> </ul>	<ul style="list-style-type: none"> <li>2016 annual report and accounts: preliminary announcement, financial statements and income statement</li> <li>Review of interim results and trading updates</li> </ul>	<ul style="list-style-type: none"> <li>Form 20-F and related disclosures, including annual Sarbanes-Oxley Act section 404 attestation of financial reporting internal controls</li> <li>Significant issues reporting</li> </ul>
<b>Policy</b>	<ul style="list-style-type: none"> <li>Accounting matters and Group accounting policies</li> </ul>	<ul style="list-style-type: none"> <li>Analysis supporting viability statement</li> <li>Annual review and approval of external auditor policy</li> </ul>	<ul style="list-style-type: none"> <li>Treasury policy and strategy</li> <li>Tax strategy</li> </ul>
<b>External audit</b>	<ul style="list-style-type: none"> <li>Provision of non-audit services by PwC</li> <li>Receipt of external auditors' report on Form 20-F and year-end audit</li> <li>Half year review</li> </ul>	<ul style="list-style-type: none"> <li>Reappointment of external auditors</li> <li>Confirmation of auditor independence</li> <li>2017 external audit plan</li> </ul>	<ul style="list-style-type: none"> <li>Remuneration and engagement letter of external auditors</li> <li>Review opinion on interim results</li> <li>Review of the effectiveness of external auditors</li> </ul>
<b>Risk &amp; internal control</b>	<ul style="list-style-type: none"> <li>Internal audit activity reports and review of key findings</li> <li>Enterprise risk management</li> <li>2018 internal audit plan</li> <li>Legacy product review</li> </ul>	<ul style="list-style-type: none"> <li>Assessment of the effectiveness of internal control environment and risk management systems</li> <li>Impact of transformation on contract royalties</li> <li>Health and safety</li> <li>Global Learning Platform</li> </ul>	<ul style="list-style-type: none"> <li>Risk deep dives: data security; data privacy including GDPR; anti-bribery and corruption; tax; treasury; business resilience</li> <li>Oversight of The Enabling Programme</li> <li>Controls transformation initiative and subsequent Committee updates</li> </ul>
<b>Compliance &amp; governance</b>	<ul style="list-style-type: none"> <li>Fraud, whistleblowing reports and Code of Conduct matters</li> <li>Schedule of authorities</li> </ul>	<ul style="list-style-type: none"> <li>Compliance with accounting and audit-related aspects of the UK Corporate Governance Code</li> <li>Internal audit terms of reference</li> </ul>	<ul style="list-style-type: none"> <li>Committee terms of reference</li> <li>Review of the effectiveness of the internal audit function</li> </ul>

## Audit Committee report

### Data security and data privacy

In a deep dive led by the Chief Information Security Officer, the Committee considered the progress being made in security across Pearson's technology estate, where multiple workstreams arising from the business transformation programme have contributed to an improved remediation position in relation to risk. The risk level remains high overall, however, due primarily to the nature and volume of data held within our systems, particularly legacy systems, although decommissioning of these has accelerated under the simplification programme. The maturity of the security programme has improved through 2017, and business continuity and disaster recovery capabilities are expected to also improve as data centres are closed.

The Committee considered the balance to be struck between ongoing improvements to security maturity and the actions required by the Group-wide simplification initiatives, as well as the appropriate mix of talent required to both protect and remediate legacy systems and continue development of leading edge solutions.

The Chief Privacy Officer led a separate deep dive into Pearson's data privacy framework. The Committee considered a report on Pearson's readiness for the implementation of the General Data Protection Regulation (GDPR) in May 2018, and the plan in place to remediate the gaps identified. Also noted were the actions that were being taken to replace or retire legacy systems, and it was agreed that good progress had been made during the year in terms of Group-wide data privacy governance.

### Tax and treasury

The Committee held two deep dives into Pearson's tax strategy, led by the SVP Tax, to keep abreast of developments at a time of uncertainty in the tax environment. External factors under consideration by the Committee included possible impacts of the proposed US tax reforms and activity at an EU level, including potential effects on Pearson and the sectors in which we operate. From an internal perspective, the Committee considered with management and PwC the appropriate level of provisioning in respect of historical tax issues, and how such provisioning might be applied going forward, taking into account the evolution of Pearson's size and structure in recent years.

Tax transparency is a particular topic of focus in the corporate sector as a whole, being a matter of public trust for companies and the taxation system. In September 2017, Pearson published a report on its tax strategy and financial information on a country-by-country basis for our 12 largest markets, the report being a matter of consideration for the Committee prior to publication.

The Committee also considered the direction of Pearson's treasury strategy, with input from the new SVP Treasury who joined the business in early 2017. Key findings were that the fundamentals of the Group's funding structure were sound and controls around dealing and cash payments were in good shape. Priorities moving forward were also considered, including the continued evolution of the treasury strategy aligned with the commercial direction of the business and the finance transformation programme, and ongoing integration of the insurance function within treasury to give a more holistic view of financial risk.

### Audit Committee meetings and activities

At every meeting, the Committee considered reports on the activities of the internal audit and compliance functions, including the results of internal audits, risk reviews, project assurance reviews and fraud and whistleblowing reports. The Committee also monitored the company's financial reporting and risk management procedures, reviewed the services provided by PwC and considered any significant legal claims and regulatory issues in the context of their impact on financial reporting, each on a regular basis.

At our August meeting, the Committee considered the findings of our review of the performance and effectiveness of Pearson's internal audit function, a process which is undertaken annually. This review was conducted by distributing a questionnaire to the key stakeholders of the internal function – including Committee members, the lead external audit partner, members of the Pearson Executive, and senior financial, legal and operational management – and the findings indicated an effective internal audit function.

The Committee also considered Pearson's anti-bribery and corruption programme, and the planned governance framework in respect of new anti-facilitation of tax evasion legislation, which came into effect in September 2017. In February 2018, the Committee considered the 2017 annual report and accounts, including the preliminary results announcement, financial statements, strategic report and Directors' report.

Learn more about the key activities of the Audit Committee on p77 →

### Members

All of the Audit Committee members are independent Non-Executive Directors and have financial and/or related business experience due to the senior positions they hold or have held in other listed or publicly traded companies and/or similar large organisations. Tim Score, Chairman of the Committee since April 2015, is the company's designated financial expert, having recent

and relevant financial experience, and is an Associate Chartered Accountant. He also serves as Audit Committee Chairman for The British Land Company plc. The qualifications and relevant experience of the other Committee members are detailed on p64–65 →

# Audit Committee report

## Additional meeting attendees

In addition to the Committee members, advisers and executives from across the business also attended meetings during the year, as outlined in the table below. This gives the Committee direct contact with key leadership. The Chairman and Chief Executive each attend at least one meeting per year, and the Chief Executive also attends for discussion of matters with an operational focus. The Committee also met regularly in private with the external auditors, SVP Internal Audit, Compliance and Risk, and VP Internal Audit.

Attendees	Meetings attended
Chief Financial Officer	4/4
Deputy CFO	4/4
Legal Counsel	4/4
SVP Internal Audit, Compliance and Risk	4/4
SVP Finance, Group Reporting	4/4
VP Internal Audit*	3/3
Committee Secretary	4/4

\* VP Internal Audit role created partway through 2017

## Audit Committee training

The Committee receives regular technical updates as well as specific or personal training as appropriate. In August 2017, PwC led a training session for the Committee and other Board members on the current regulatory framework and corporate reporting.

Committee members also meet with local management on a periodic basis, such as when travelling for overseas Board meetings, in order to gain a better understanding of how Pearson's policies are embedded in operations.

## Committee evaluation

In 2017, the Committee evaluation was undertaken by Heidrick & Struggles JCA Group as part of the wider Board evaluation process. The responses illustrated an effective Committee, which uses its time well and has an appropriate focus on the key issues. The key findings were:

- › The combination of the Committee Chairman and CFO, who attends Committee meetings by invitation, is very effective and creates a well-functioning Audit Committee
- › All Committee members contribute fully and the balance of challenge and support is felt to be appropriate
- › The meetings are well run to a disciplined timetable ensuring appropriate allocation of time for discussion and agreement
- › Risk management is given the right attention and review in the Committee's meetings, and there is appropriate escalation of matters to the full Board when necessary
- › Directors who do not serve on the Committee feel well informed of its proceedings
- › Succession for the role of Audit Committee Chairman should be borne in mind with future Non-Executive Director appointments, although this is not immediately pressing.

## External audit

### Oversight of external auditors

The Committee reviews and makes recommendations to the Board in respect of the appointment and compensation of the external auditors. This recommendation is made by the Committee after considering the external auditors' performance during the year, reviewing external auditor fees, conducting an effectiveness review and confirming the independence, objectivity, qualifications and experience of the external auditors.

The Committee reviewed the effectiveness and independence of the external auditors during 2017, as it does every year, and remains satisfied that the auditors provide effective independent challenge to management.

The external auditor review was conducted by distributing a questionnaire to key audit stakeholders, including members of the Audit Committee, the Chief Executive, Chief Financial Officer, Deputy CFO, Company Secretary, SVP Internal Audit, Compliance and Risk, SVP Finance for each business area and other heads of corporate functions. Overall, responses to the questionnaire were very positive, indicating an effective external audit process.

The Committee will continue to review the performance of the external auditors on an annual basis and will consider their independence and objectivity, taking account of all appropriate guidelines. There are no contractual obligations restricting the Committee's choice of external auditors. The external auditors are required to rotate the audit partner responsible for the Pearson audit every five years. A new lead audit partner, Giles Hannam, rotates onto the Pearson audit from 2018, with the outgoing partner, Stuart Newman, having led the audit for five years concluding at the end of the 2017 audit.

### Audit tendering and rotation

Pearson's last audit tender was in respect of the 1996 year end, and resulted in the appointment of Price Waterhouse as auditors. Developments at an EU level regarding mandatory audit rotation for listed companies have changed the UK landscape on audit tendering and rotation. The Committee has reviewed the timetable for tendering and has taken into account relevant regulation and guidance. EU regulations and the ruling by the Competition and Markets Authority (CMA) impose mandatory tendering and rotation requirements, with EU rules requiring a new auditor to be appointed no later than for the 2024 financial year end.

In considering the appropriate audit tender timetable for Pearson in light of these requirements, the Committee has also taken account of the significant business change being experienced by the Group and is monitoring the extent to which the Group is drawing upon the services of other accounting firms. As noted elsewhere within this report, a series of programmes is well underway throughout Pearson to implement major simplification and efficiency improvements across all our enabling functions – particularly technology, finance, HR – to continue to bring the general and administrative costs of running Pearson more in line with global best practice. These include a major transformation programme – The Enabling Programme (TEP) – which includes the



## Audit Committee report

implementation of new financial systems and changes to our transaction processing and control activities, which launched in the UK during 2016, and is expected to be rolled out throughout our businesses by 2020. Pearson is supported in these changes, such as in project assurance matters and, more broadly, by external advisers, including accounting firms.

Due to the status of TEP and the involvement of accounting firms advising on TEP and other change projects, the Committee is of the opinion that the level of disruption likely with a change of auditor, as well as the focus required by finance and management teams to conduct the tender process thoroughly and effectively, may unduly impact the Group and would not be in the best interests of shareholders. The rotation of lead audit partner at the start of 2018 gives us further confidence in the ongoing effectiveness, independence and challenge brought by the external auditor.

As noted last year, it is the current expectation of the Committee that an audit tender process would commence in 2022 in order for the auditor selected as a result of the tender to be appointed for the financial year ending 31 December 2023. It would be our intention to look to accelerate this timing if feasible and appropriate following the completion of TEP, and we would communicate any change in our plans to shareholders in advance of any decision. For the reasons outlined above, the Committee considers this timing to be in the best interests of Pearson's shareholders and will continue to monitor this annually in light of the effectiveness and independence of the current auditors, as well as considering whether the timing remains appropriate in light of business developments.

Once the next audit tender occurs, Pearson will adopt a policy of putting the audit contract out to tender at least every ten years, as required.

### Compliance with the CMA Order

Pearson confirms that it was in compliance with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 during the financial year ended 31 December 2017.

### Review of the external audit

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

At the August 2017 Audit Committee meeting, the Committee discussed and approved the external audit plan and reviewed the key risks of misstatement of Pearson's financial statements, which were updated at the December 2017 Committee meeting.

The table on p81–82 sets out the significant issues considered by the Audit Committee together with details of how these items have been addressed. The Committee discussed these issues with the auditors at the time of their review of the half-year interim financial statements in August 2017 and again at the conclusion of their audit of the financial statements for the full year in February 2018.

All the significant issues were also areas of focus for the auditors. Learn more in the Independent auditors' report on p112–117 →

In December 2017, the Committee discussed with the auditors the status of their work, focusing in particular on internal controls and Sarbanes-Oxley testing, and covering the significant issues outlined on the following pages.

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

- › The work they had conducted over revenue, including over more complex revenue contracts and judgements in relation to provisions for returns
- › Their work in evaluating management's goodwill impairment exercise, on a fair value less costs to sell basis, including assessing assumptions around sales and operating cash flow forecasts, longer-term growth rates and discount rates
- › The work performed over the nature and presentation of non-trading items focusing on subjective judgements and the transparency with which related adjusted measures are presented
- › The work they had done to determine the provisioning levels in respect of potential tax exposures and uncertain tax provisions and related disclosures
- › Their evaluation of the recoverability of investments in digital platforms and pre-publication assets
- › Their work over completed disposals and the assessment of certain businesses meeting the definition of held for sale
- › The results of their controls testing for Sarbanes-Oxley Act section 404 reporting purposes and in support of their financial statements audit
- › The results of their work over the company's going concern and viability statement reports
- › Their work in relation to other matters which aren't classified as key audit matters, but may give rise to additional disclosure requirements e.g. the impact of new accounting standards.

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



## Audit Committee report

### Significant issues considered by the Audit Committee

Area of focus	Issue	Action taken by Audit Committee	Outcome
<b>Impairment reviews</b>	Pearson carries significant goodwill intangible asset balances. There is judgement exercised in the identification of CGUs and the process of allocating goodwill to CGUs and aggregate CGUs and in the assumptions underlying the impairment review. In 2016, Pearson made significant impairments to goodwill in its North American business. There were no impairments recorded in 2017.	The Committee considered the results of the Group's annual goodwill impairment review and the key assumptions which are considered to be the cash flows derived from strategic and operating plans, long-term growth rates and the weighted average cost of capital. The Committee considered the sensitivities to changes in assumptions and the related disclosures required by IAS 36 'Impairment of Assets'. The Committee considered sensitivity to assumptions in relation to the Group's CGUs noting that after a number of impairments in recent years even a relatively small change in assumptions could crystallise impairments particularly in the Group's Core CGU.	Annual impairment review finalised with confirmation of sufficient headroom in each of the CGUs.
<b>Revenue recognition and IFRS 15</b>	Pearson has a number of revenue streams where revenue recognition practices are complex and management assumptions and estimates are necessary. The Group also finalised its work on the disclosure required in connection with the transition to IFRS 15 'Revenue from Contracts with Customers' which will be applicable in 2018.	The Committee regularly reviews revenue recognition practice and the underlying assumptions and estimates. In addition, the Committee has visibility of internal audit findings relating to revenue recognition controls and processes and routinely monitors the views of external auditors on revenue recognition issues. During the year, the Committee continued to monitor the project to transition to the new revenue recognition standard, IFRS 15 'Revenue from Contracts with Customers'. The Committee noted the changes to revenue streams and the quantification of the impact on the opening balance sheet.	Assumptions underlying revenue recognition were reviewed and challenged and considered to be appropriate. Progress on the project to convert to IFRS 15 and final quantification and disclosures were reviewed and also agreed as appropriate.
<b>Financial instruments</b>	Pearson will adopt IFRS 9 'Financial Instruments' in 2018.	The Committee reviewed the work on the transition to IFRS 9 and noted the Group's new approach to hedge accounting, investment valuation and impairment. The Committee reviewed the impact on the opening balance sheet and in particular the impact on bad debt provisions.	Adjustments relating to IFRS 9 were reviewed and disclosure of impact in 2018 was considered appropriate.
<b>Disposal transactions</b>	The Group sold a significant portion of its stake in Penguin Random House and the China test preparation business, 'GEDU'. The Group also announced its intention to sell its English Language teaching business in China, 'WSE', and its K-12 school courseware business in the US.	The Committee reviewed the accounting for the disposal transactions, including the rationale for held for sale treatments in respect of proposed disposals. The Committee also considered the status of the remaining 25% investment in Penguin Random House and in particular considered whether Pearson continued to exert significant influence over the venture.	The Committee determined that disposal accounting had been correctly recorded and that the criteria for held for sale treatment in respect of potential disposals was appropriate. The Committee also agreed that the remaining investment in Penguin Random House should continue to be accounted for as an associate.

## Audit Committee report

### Significant issues considered by the Audit Committee (continued)

Area of focus	Issue	Action taken by Audit Committee	Outcome
<b>Pension valuations</b>	Pearson's UK pension plan includes a large defined benefit section. The valuation of this plan under IAS 19 'Employee Benefits' requires significant judgement.	The Committee looked at changes in the assumptions used to value the UK pension plan and in particular noted updated assumptions for mortality, discount rates and member options on retirement. The Committee also reviewed the accounting for the Plan's purchase of insurance buy-in policies during the year and for significant additional pension contributions made in respect of prior year business disposals.	Pension assumptions were considered appropriate and the pension surplus under IAS 19 was agreed to be fairly stated.
<b>Comment letters received from regulators</b>	During the year Pearson received comment letters from the Financial Reporting Council (FRC) in the UK and the Securities Exchange Commission (SEC) in the US.	Letters from the FRC and SEC were circulated to the Committee and responses by the company were reviewed. Where relevant additional disclosure was requested by the regulators this was also reviewed prior to publication in this report. In particular, the Committee reviewed proposed changes to disclosures relating to our alternative performance measures included in the Our KPIs section, the Financial Review section and the Financial key performance indicators section of this report.	The Committee agreed that the company's responses to comment letters were appropriate and ensured that disclosures were reviewed and updated. Both comment letter processes have been closed.
<b>Restructuring</b>	Pearson announced a new restructuring programme in May 2017. There are a number of accounting judgements to be made regarding categorisation and timing of recognition of cost.	The Committee reviewed progress on the restructuring programme and considered the judgements required in accounting for the costs of redundancy, asset impairment and property rationalisation mainly in respect of the Group's North America operations and enabling functions. The Committee also considered the disclosure of restructuring in Pearson's adjusted measures.	The Committee confirmed that the accounting and disclosure for the restructuring programme were appropriate.
<b>Returns</b>	In light of significant product returns in 2016 in the US higher education courseware business, we continued to review returns data and our policy on reserving for returns.	The Committee considered return provisioning for the US higher education courseware business following a high level of returns from retailers in 2016 and a subsequent change in methodology for establishing provisions. This methodology was subsequently refined in 2017.	Assumptions underlying the returns reserve methodology were reviewed and agreed as still being appropriate in the light of actual returns in 2017.
<b>Tax</b>	The impact of US tax reform and the trend for increased tax transparency, and provision levels.	The Committee reviewed tax provision levels and was updated on expanded annual report disclosures concerning tax provisions. The Committee addressed this matter through the presentation of two management reports on Pearson's tax affairs by the SVP Tax and through a presentation of the external auditors' assessment of the company's tax provisioning. In addition, the Committee considered the report on tax strategy issued in September 2017 prior to publication. The Committee was briefed by management on the anticipated impact of US tax reform in December 2017. As more information on the detailed application becomes available, these estimates may change, and the Committee will be updated as necessary.	The Committee was satisfied with Pearson's approach to tax provisioning, taking account of the views of management and the assessment of the external auditors. The Committee agreed that expanded disclosure in this report would be beneficial to users.

## Audit Committee report

### Auditors' independence

In line with best practice, our relationship with PwC is governed by our policy on external auditors, 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. Our policy on the use of the external auditors for non-audit services reflects the restriction on the use of pre-approval in the 2016 FRC Guidance on Audit Committees and, accordingly all non-audit services, irrespective of value, are required to be approved by the Audit Committee. In particular, we expressly prohibit the provision of certain tax, HR and other services by our external auditor. We review non-audit services on a case-by-case basis, including reviewing the ongoing effectiveness and appropriateness of our policy.

The Audit Committee receives regular reports summarising the amount of fees paid to the auditors. During 2017, Pearson spent £0.8m less on non-audit fees with PwC compared with 2016, due to a reduction in billing on tax services and on the efficacy programme. For 2017, non-audit fees represented 23% of external audit fees (35% in 2016). The policy on provision of non-audit services by external auditors in use in 2016 was in line with previous FRC requirements.

For all non-audit work in 2017, PwC was selected only after consideration that it was best able to provide the services we required at a reasonable fee and within the terms of our policy on external auditors. Where PwC is selected to provide audit-related services, we take into account its existing knowledge and experience of Pearson. Where appropriate, services were tendered prior to a decision being made as to whether to award work to the auditors.

Significant non-audit work performed by PwC during 2017 included:

- › Audit-related work in relation to potential and actual corporate finance transactions
- › Audit of IT general controls mandated by contractual commitments.

A full statement of the fees for audit and non-audit services is provided in note 4 to the consolidated financial statements on p137.



**Tim Score**  
Chairman of Audit Committee

# Risk governance and control

## Control environment

The Board has overall responsibility for Pearson's systems of internal control and risk management, which are designed to manage, and where possible mitigate, the risks facing Pearson, safeguard assets and provide reasonable, but not absolute, assurance against material financial misstatement or loss. The Board confirms that it has conducted a review of the effectiveness of Pearson's systems of risk management and internal control in accordance with provision C.2.3 of the Code and the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (FRC Guidance). The Board confirms these systems operated satisfactorily throughout the year and to the date of this report, and no significant failings or weaknesses were identified in the review process.

The Board has delegated responsibility for monitoring the effectiveness of the company's risk management and internal control systems to the Audit Committee. The Audit Committee oversees a risk-based internal audit programme, including periodic audits of the risk processes across the organisation. It provides assurance on the management of risk, and receives reports on the efficiency and effectiveness of internal controls. Each business area, including the corporate centre, maintains internal controls and procedures appropriate to its structure, business environment and risk assessment, while complying with company-wide policies, standards and guidelines.

## Internal control and risk management

Our internal controls and risk oversight are monitored and continually improved to ensure their compliance with FRC Guidance. Our risk journey is described more thoroughly in the risk management section on p50–60.

The Board is ultimately accountable for effective risk management in Pearson and determines our strategic approach to risk. It confirms risk appetite targets and receives and reviews semi-annual reports on the enterprise risk management (ERM) process and the status of top enterprise-wide risks.

It is supported in the following ways:

- › The Audit Committee is responsible for overseeing internal controls within Pearson which includes determining the risk appetite (recommended by Pearson Executive management), reviewing and commenting upon key risks and ensuring that risk management is effective
- › Pearson's Executive and leadership teams are responsible for identifying and mitigating risks, supported by the ERM team
- › Leaders and managers at all levels in Pearson are responsible for managing risk in their area of responsibility, including the identification, assessment and treatment of risk
- › The ERM team owns the overall risk management framework for the company and facilitates consolidated reporting on risk

› The internal audit team provides independent assurance on the adequacy of the risk management arrangements in place. The internal audit plan is aligned to identified enterprise-wide risks reported by the ERM team and it presents issues and risks arising from internal audits at each Audit Committee meeting.

The involvement of the Board and Audit Committee in the design, implementation, identification, monitoring and review of risks (including setting risk appetite, determining which are principal to the company and how risk is being embedded in our culture) is outlined in more detail in the risk management section on p50–60.

## Financial management and reporting

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

We have an ongoing process to monitor the risks and effectiveness of controls in relation to the financial reporting and consolidation process, including the related information systems. This includes up-to-date Pearson financial policies, formal requirements for finance to certify that they have been in compliance with policies and that the control environment has been maintained throughout the year, consolidation reviews and analysis of material variances, finance technical reviews, and review and sign-off by senior finance managers. The Group finance function also monitors and assesses these processes and controls through finance and technology compliance functions and a Controls Steering Committee comprising cross-functional experts.

These controls include those over external financial reporting which are documented and tested in accordance with the requirements of section 404 of the Sarbanes-Oxley Act, which is relevant to our US listing. One key control in this area is the Verification Committee, which submits reports to the Audit Committee. This Committee is chaired by the SVP Internal Audit, Compliance and Risk, and members include the Chief Financial Officer and/or their deputy, General Counsel, SVP Investor Relations and the Company Secretary as well as senior members of financial management. The primary responsibility of this Committee is to review Pearson's public reporting and disclosures to ensure that information provided to shareholders is complete, accurate and compliant with all applicable legislation and listing regulations. The effectiveness of key financial controls is subject to management review and self-certification and independent evaluation by the external auditors.

## Risk governance and control

### Internal audit

Pearson has an in-house internal audit function, supported by co-source agreements to augment our in-house resources, in areas such as providing specific subject matter expertise or language skills. The internal audit function is responsible for providing independent assurance to management and the Audit Committee on the design and effectiveness of internal controls to mitigate strategic, financial, operational and compliance risks. The SVP Internal Audit, Compliance and Risk reports formally to the Chairman of the Audit Committee and the Chief Financial Officer, with a reporting line to the General Counsel on compliance matters.

The internal audit mandate and plan are approved annually by the Audit Committee. Completion and changes to the plan are also reviewed and approved by the Audit Committee throughout the year. The internal audit plan is aligned to our greatest areas of risk as identified by the ERM process, and the Audit Committee considers issues and risks arising from internal audits. Management action plans to improve internal controls and to mitigate risks, or both, are agreed with the business area after each audit. Formal management self-assessments allow internal audit to monitor business areas' progress in implementing management action plans agreed as part of internal audits to resolve any control deficiencies. Progress of management action plans is reported to the Audit Committee at each meeting. Internal audit has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. Regular reports on the findings and emerging themes identified through internal audits are provided to Executive management and, via the Audit Committee, to the Board.

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

### Treasury management

The treasury department operates within policies approved by the Audit Committee on behalf of the Board, and treasury transactions and procedures are subject to regular internal audit. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the Chief Financial Officer and regular reports are prepared for the Audit Committee and the Board. The treasury policy is described in more detail in note 19 to the consolidated financial statements.

### Insurance

Pearson reviews its risk financing options regularly to determine how the company's insurable risk exposures are managed and protected. Pearson purchases comprehensive insurance cover and annually reviews coverage, insurers and premium spend, ensuring the programme is fit for purpose and cost-effective.

Pearson's insurance subsidiary, Spear Insurance Company Limited, is used to leverage Pearson's risk retention capability and to achieve a balance between retaining insurance risk and transferring it to external insurers.

# Reputation & Responsibility Committee report

**Committee Chairman**  
Linda Lorimer

**Members** Vivienne Cox, Linda Lorimer,  
Harish Manwani and Lincoln Wallen



## Committee responsibilities include oversight of:

### Reputation

Pearson's reputation among major stakeholders, including governments, investors, employees, customers, learners and the education community.

### Risk

Oversight of Pearson's approach to reputational risk, including ensuring that clear roles have been assigned for management.

### Sustainability

Oversight of 2020 sustainability plan and performance against sustainability goals and commitments.

### Brand & culture

Management of the Pearson brand to ensure that its value and reputation are maintained and enhanced. Pearson's approach to monitoring and supporting the values and desired behaviours that form our corporate culture.

### Ethics

Ethical business standards, including Pearson's approach to issues relevant to its reputation as a responsible corporate citizen.

### Strategy

Strategies, policies and plans related to reputation and responsibility issues and the people, processes and policies that are in place to manage them.

## Terms of reference

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

## Attendance

Attendance by Directors at Reputation & Responsibility Committee meetings throughout 2017:

	Meetings attended
Vivienne Cox	4/4
Linda Lorimer	4/4
Harish Manwani	4/4
Lincoln Wallen	4/4

## Reputation & Responsibility Committee role

The Committee forms an important part of the Board's oversight of the broader governance environment, working to advance Pearson's reputation across a range of stakeholders and to maximise the company's positive impact on society and the communities in which we work.

The Committee's agenda includes discussion of reputation, critical issues and initiatives, including those identified as material to Pearson's stakeholders and long-term sustainability, and consideration of immediate risks or opportunities. We are committed to promoting Pearson's 2020 sustainability plan, and the Committee works in alignment with the company's Responsible Business Leadership Council which comprises senior leaders from across the business.

Read more about our 2020 sustainability plan on p24–33.

## Changes to the Committee

Lincoln Wallen joined the Committee with effect from 1 January 2017, in place of Josh Lewis who stepped down from the Committee at the end of 2016. I was pleased to take over the chairmanship of the Committee at the start of the year from Vivienne Cox, who remains a valuable member of the Committee.

## Areas of focus during 2017

As part of Pearson's 2020 sustainability plan, the company has identified a shortlist of issues that are most relevant to the sustainability of our business. The Committee has an integral role in the oversight and governance of these issues, and during 2017 held a number of deep dives to consider specific issues, in particular considering the public goals and targets the company is setting to address these issues, and examining their associated reputational impacts.

At our August meeting, we reviewed proposals for Pearson's new global editorial policy, designed to ensure we consistently publish high-quality content and prevent errors. The Committee considered appropriate positioning and communication of the policy and discussed plans for training to be rolled out to content creators and editorial staff. We also discussed ways in which Pearson could adapt and modify its content to reflect local and cultural norms, while still being true to our values and purpose. During the year we also considered access enabled by affordability, particularly in the US higher education courseware market, and discussed plans to ensure our products meet the needs of learners, educators and administrators in accessing learning and teaching materials from anywhere, at any time. In addition, the Committee considered reports on other material sustainability issues, namely greenhouse gas emissions and climate change, 21st century skills and lobbying and public policy.

Read more about our material sustainability issues and our global editorial policy on p25–26.

During the year we reviewed the progress made by Pearson's ongoing social impact initiatives and partnerships. We focused on developing the next phases of Project Literacy and for the Pearson Affordable Learning Fund as well as studied the plans for Tomorrow's Markets Incubator.



## Reputation & Responsibility Committee report

Brand strategy is an important part of the Committee's mandate, and we assessed the progress in rolling out the new Pearson brand and the recent market campaigns in North America. We have been attentive to how the communications are migrating more to digital dissemination to align with our customers' practices and preferences.

The US is our largest market, so it is important for the Committee to follow Pearson's reputation and brand in the US particularly. The likely impact of the US 2016 elections was outlined for us early in 2017, and we have received updates on issues and initiatives in our higher education business as they related to reputation. Pearson will be reporting publicly, starting in 2018, on the efficacy of our products and services to demonstrate their measurable impact. Throughout 2017, the Committee monitored the progress of our external reporting plans; we looked at how we are aligning our efficacy goals with our wider business strategy, and considered examples of product efficacy reports. We were joined for our efficacy sessions by PwC, which is providing external assurance for the efficacy reporting process.

In our report to shareholders last year, we noted that, as a Committee, we would continue to monitor the Pearson culture and employee engagement, particularly in light of the changes and rationalisations throughout the business in 2016. However, due to the importance of this topic, it was instead considered by the full Board in 2017. Culture and engagement continues to fall within the remit of the Committee, and we will consider the matter as appropriate during 2018.

### Committee evaluation

In 2017, the Committee evaluation was undertaken by Heidrick & Struggles JCA Group as part of the wider Board evaluation process. Overall, the responses illustrated a collaborative and engaged Committee, and that the work of the Committee is increasingly aligned with the strategic agenda. The assessment indicated that there may be opportunity to evolve the Committee further by clarifying its focus. In particular, some overlap with the Audit Committee was identified. As a result, oversight on efficacy, health and safety and safeguarding will be lodged with this Committee rather than shared with the Audit Committee.

### Committee aims for 2018

Over the next year we will continue to explore Pearson's material sustainability issues, including employability and 21st century skills as well as affordability, health and safety and safeguarding. We will hold a deep dive into sustainability considerations relating to our supply chain and review our 2018 efficacy reporting activity and plans for 2019. We will also review our Group-wide approach to reputational risk management and will consider culture and employee engagement, bearing in mind challenges and opportunities presented by the ongoing transformation and simplification across the business.



Linda Lorimer

Chairman of Reputation & Responsibility Committee

## Reputation & Responsibility Committee meeting focus during 2017

Area of responsibility	Activity
Reputation	<ul style="list-style-type: none"> <li>› Issue management – customer and media engagement in UK and US</li> <li>› Global editorial policy: meeting learner expectations</li> <li>› North American markets – new US administration and approach to government affairs and public policy</li> </ul>
Sustainability	<ul style="list-style-type: none"> <li>› Sustainability report</li> <li>› Tomorrow's Markets Incubator initiative</li> <li>› Efficacy reporting plans</li> <li>› Greenhouse gas emissions and climate change</li> </ul>
Brand & culture	<ul style="list-style-type: none"> <li>› Brand strategy</li> <li>› Marketing campaigns</li> <li>› Review of any incidents</li> </ul>
Strategy	<ul style="list-style-type: none"> <li>› Access and affordability of US higher education courseware</li> <li>› Community investment plan, including Project Literacy updates</li> <li>› One story and digital narrative</li> </ul>

# Stakeholder engagement

## Engaging with shareholders

Access to capital is key to the long-term performance of our business. We work to ensure that our investors, analysts and other investment professionals have a good understanding of our strategy, performance and purpose.

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

**Shareholder outreach** In 2017, we continued with our shareholder outreach programme, conducting over 300 meetings in the UK, US, Canada and Continental Europe with over 260 investment institutions.

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

**The investor relations team** Led by Joanne Russell, SVP Investor Relations, who joined in June 2017 after six years as Head of Investor Relations at Whitbread plc. The IR team met with investors throughout the year, including attending several investor conferences, and addressed regular investor and analyst enquiries.

**Chairman and Non-Executive Directors** The Chairman meets regularly with shareholders to understand any issues and concerns they may have. This is in accordance with the Code and consistent with the duties of investors under the UK Stewardship Code. The Non-Executive Directors meet informally with shareholders both before and after the AGM and respond to shareholder queries and requests as necessary. The Chairman ensures that the Board is kept informed of investors' and advisers' views on strategy and corporate governance. At each Board meeting, the Directors consider commentary from advisers on major shareholders' positions and Pearson's share price. In addition, the Nomination & Governance and Remuneration Committees consider shareholder views on corporate governance and remuneration matters, respectively, as required.

The 2017 financial year has been one of significant engagement with our shareholders. Sidney Taurel, Elizabeth Corley and our senior management team also consulted with our major shareholders and with shareholder representative bodies on our approach to Directors' remuneration following the vote against our Directors' remuneration report at our 2017 AGM.

Further details regarding Directors' remuneration can be found on p90–105 →

**Private investors** Institutional investors' holdings in Pearson account for around 90% of total shares outstanding, but private investors represent over 80% of the shareholders on our register and we make a concerted effort to engage with them regularly. Shareholders who cannot attend the AGM are

## Non-Executive Director engagement

### Save the Children, Jordan – Vivienne Cox

Last September, Vivienne Cox accompanied Kate James (Chief Corporate Affairs and Global Marketing Officer) and other Pearson colleagues to Amman, Jordan, on behalf of Pearson, to launch the next phase of Pearson's 'Every Child Learning' partnership with Save the Children. The team launched a new pilot education project in Jordan, in partnership with the Jordanian Ministry of Education, to help Syrian refugees, and local children living in host communities, to improve their learning outcomes, to build resilience and to help make their schools safer.

As part of the trip, the Pearson team:

- › Visited a community centre in East Amman which over the previous 12 months had given us access to learners with whom to develop the maths learning app. The team met some of the refugee children and ran a focus testing group on the latest version of the app
- › Took part in an official launch of our pilot education project at the Al Emama Al Shafe'e School with officials from the Jordanian Ministry of Education, British Ambassador and Save the Children. The team met children, parents, teachers and Save the Children Jordan Field Staff who were taking part in our pilot education project
- › Visited Za'atari refugee camp to see various aid programmes run by Save the Children.

### Digital Advisory Network – Lincoln Wallen

For Pearson, tackling a major social need – making education more accessible and effective – is why we exist and how we create value for our shareholders. In a world where work is increasingly disrupted by machine intelligence, the need to be always learning is greater now than ever. It is also a great challenge, as the legacy analogue businesses that still generate a lot of Pearson's profits are themselves being disrupted by technology.

At this pivotal time in the digital transformation of education, Pearson launched the Digital Advisory Network to bring together a diverse cross-section of people with experience and knowledge of disruption in other industries and to help us apply lessons learned and insights to shape Pearson's business strategy for the Board.

Lincoln Wallen has been an instrumental leader since the Network's inception and participated in the first Network Summit in October 2017. Lincoln continues to serve as a leader and adviser to both the Network and the Pearson Executive.

## Stakeholder engagement

invited to e-mail questions to the Chairman in advance at [chairman-agm@pearson.com](mailto:chairman-agm@pearson.com)

We encourage our private shareholders to become more informed investors and have provided a wealth of information on our website about managing Pearson shareholdings. We also encourage all shareholders, who have not already done so, to register their e-mail addresses through our website and with our registrar. This enables them to receive e-mail alerts when trading updates and other important announcements are added to our website. See Shareholder information on p196 or visit our website <https://www.pearson.com/corporate/investors/managing-your-shares.html>

### Annual General Meeting

Our AGM, on 4 May 2018, is an opportunity for all shareholders to meet the Board and to hear presentations about Pearson's businesses and results.

### Share dealing service

Due to its continued popularity, we intend to provide shareholders with smaller holdings the opportunity to use our registrar's low-cost share dealing service, giving them the chance to add to or reduce their stake in Pearson at significantly reduced dealing rates, or to donate shares to charity with ease. We believe it is important that our employees have a shared interest in the direction and achievements of Pearson and are pleased to say that a large number of our employees are shareholders in the company.



Vivienne Cox engaging with refugee children at a community centre in East Amman, Jordan during 'Every Child Learning' visit.

### Engaging with all stakeholders

We post all company announcements on our website, [www.pearson.com](http://www.pearson.com), as soon as they are released, and key shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes information about all of our businesses, links to their websites and details of our sustainability policies and activities. Learn more about our approach to Sustainability on p24–33 →

## Engagement in action

### Industry & marketplace

- › Non-Executive Directors Josh Lewis and Linda Lorimer were engaged and instrumental in redefining the go-to-market strategy for Pearson's Online Program Management business, working alongside senior management
- › The Board attended a discussion event on Future of Skills: Employment in 2030, at which they considered the future of work and implications for education. The Board was joined at the event by external business, policy and thought leaders from the Boston area
- › Read more about the Future of Skills: Employment in 2030 on p10

### Employees

- › The Board met with local staff and senior management during 2017 visits to São Paulo and Boston. Dinners with senior local management and breakfasts with key talent allowed the Non-Executive Directors to share their experience and expertise with employees as well as allowing the Directors to better understand employees' abilities and motivations, helping them to assess the company's prospects and plans for succession
- › Non-Executive Directors Elizabeth Corley and Vivienne Cox participated in Women in Leadership and Learning network (WILL) meetings, giving virtual talks to employees on professional development

### Franchisees

- › The Board had an opportunity to interact with an audience of 800 people from the Pearson franchisee sales team at the Wizard sales convention in São Paulo, Brazil
- › During this event, the Board learned about the Wizard strategy, marketing campaigns and training provided to the franchisee sales team. The event also included recognition for high-performing employees

### Customers

- › The Board heard from faculty and students about the challenges and opportunities they face with digital teaching and learning at the Digital Teaching & Learning Customer Panels in Boston
- › This session enabled the Board to understand the customer context to our higher education strategy

# Remuneration overview

## Committee Chairman

Elizabeth Corley

## Members

Elizabeth Corley, Josh Lewis,  
Tim Score and Sidney Taurel



“After a thorough review and extensive shareholder engagement, we believe that our approach to remuneration is simpler, transparent, and a balanced reflection of the performance of the business.”

### Key changes to how we implement our remuneration policy for 2018

- › Maintaining lower award size for 2018 LTIP awards
- › Reduction in pension contributions for new hires
- › Shareholding guidelines to extend post-retirement
- › Simplified and balanced performance measures

### In this remuneration section

- [Part 1: Remuneration overview](#) p90
- [Part 2: Executive remuneration framework and implementation in 2018](#) p94
- [Part 3: 2017 remuneration report](#) p96

### Terms of reference

The Committee's full charter and terms of reference are available on the Governance page of the company's website. A summary of the Committee's responsibilities is shown on p105.

### Board Committee attendance

The following table shows attendance by Directors at Committee meetings throughout 2017:

	Remuneration
Elizabeth Corley	5/5
Josh Lewis	5/5
Tim Score	5/5
Sidney Taurel	5/5

[www.pearson.com/governance](http://www.pearson.com/governance)

## Dear shareholders,

The vote on remuneration at last year's AGM gave us a clear message about how we managed executive pay for 2016. We made a commitment to respond in a constructive way and have taken a comprehensive look at the remuneration of our Executive Directors for 2017.

### We have engaged with our shareholders

We have held extensive dialogue with major shareholders and shareholder representative bodies. We began this process in May 2017 and will continue it through this year's AGM. I would like to thank all those who contributed to the process. We have listened and sought to respond to the concerns we have heard. It is clear that shareholders and other stakeholders would like our approach to remuneration to be simpler, more transparent and with lower maximum levels of reward as the business goes through this challenging phase. Our investors continue to hold a diverse range of views regarding appropriate performance measures. We have endeavoured to develop an approach that the majority of shareholders can support.

### Our approach to remuneration supports our strategy

Pearson is the world's learning company. We create educational tools, content, products and services that people need to help them make progress in their lives through learning. Our ambition is to be the leader in digital learning on a global basis. To deliver on this ambition we have a strong global management team, and we compete for talent in a demanding international business environment. The company's ability to attract and retain the high calibre executives needed to lead this complex and changing business is critical for our shareholders. As such, we have tried to take a balanced approach to these commercial pressures when determining executive pay.

### We have reduced the LTIP awards for 2017 and 2018

The Remuneration Committee has reduced the 2017 grant of long-term incentives to the Executive Directors in the year by approximately 30%. This substantial reduction demonstrates a responsible approach to the operation of remuneration arrangements for our Executive Directors as we go through the current business transformation. The Committee has decided that we will maintain the same reduced award size for the LTIP grant to be made in 2018. Therefore, the 2018 awards will be made with the same face value as a % of salary as those in 2017. We have also reduced the proportion of these awards that will vest for threshold performance to 18% of the award.

These share awards will only vest to the extent that performance is delivered against stretching performance tests over the next three years. Any awards vesting will be subject to a further two-year holding period. The eventual value of the awards will depend on our share price performance and dividends paid to shareholders over a five-year period.

## Remuneration overview

### How we reflected our progress and performance in the annual bonus for 2017

Pearson delivered adjusted operating profit of £576m in 2017, which was at the top end of our guidance range, and underlying earnings per share of 54.1p, helped by an exceptional change to the tax rate during the year. The company continued to invest in digital transformation and simplification. In 2017, Pearson announced plans to deliver another c.£300m in cost savings over a three-year period, in addition to the c.£650m of cost savings delivered in the years immediately prior.

Pearson had strong cash flow generation in the year. The portfolio was further simplified with the partial disposal of Penguin Random House. A £300m share buyback programme was announced and the overall Net Debt of the business was reduced to £432m at the end of 2017 from £1.1bn in 2016. The proposed overall dividend for the year will be 17p. Further details of these results can be found elsewhere in this Annual Report.

The Committee took this progress and performance into account when determining the outcome of the annual incentive plan for 2017.

- › During 2017, the board set a demanding plan for the business. The thresholds of the performance ranges for the Annual Incentive Plan for our Executive Directors were set above market consensus expectations at the time. As such, bonus was only payable to the Executive Directors for 2017 for performance delivered ahead of market expectations.
- › The company delivered results in line with the demanding plan set for the year on operating profit and earnings per share. Good progress was made in delivering on a number of aspects of the strategic plan. Cash flow generation exceeded plan in the year driven by strong cash conversion of 116%.
- › We announced a £300m share buyback beginning 18 October 2017 utilising part of the proceeds from the disposal of a 22% stake in Penguin Random House. We completed the programme on 16 February 2018. The share buy back programme did not benefit the outcome of incentives for the Executive Directors.
- › Sales revenues in the year did not reach the stretch targets in the annual incentive plan.
- › There is no benefit from foreign exchange movements in the year in determining the outcome of the annual bonus.

### A year of progress and performance

-  Remuneration simplified and balanced
-  LTIP awards reduced for 2017 & 2018 by approximately 30%
-  Discretionary reductions in annual bonus for 2017

Based on performance against targets, in 2017 the CEO achieved a bonus outcome of 61% of maximum and the CFO achieved a bonus outcome of 58% of maximum. The Remuneration Committee exercised its discretion and reduced these outcomes by 5% to account for the exceptional change in the tax rate during the year so that the Executive Directors did not benefit from this. This resulted in a bonus outcome of 56% of maximum for the CEO and 53% of maximum for the CFO.

The Remuneration Committee then moved to consider the bonus outcomes in the context of the shareholder experience in the year. Mindful of this experience, and the work still to be done, the Executive Directors, along with the Committee, have agreed it would not be appropriate to take the full bonus and that a further reduction in outcomes was appropriate. The Committee commends the Executive Directors for their approach in these matters and confirmed that we should further reduce the bonus outcome based on the following considerations:

- › The degree of stretch in the targets set relative to plan was considered and the Committee were satisfied that the targets were appropriately calibrated;
- › Outcomes against the targets were a reflection of the performance of the company in the year and were a fair and reasonable outcome;
- › Management is making tangible progress in executing the strategy but, at the time of the Committee's deliberations, this was not fully reflected in the share price;
- › A change in dividend policy resulted in a reduced payout of a proposed 17p;
- › 2017 performance provides a solid foundation from which to build and positions the company well for a return to growth in 2018.

As a result, the annual bonus payable to the CEO for 2017 is 44% of maximum and for the CFO is 47% of maximum.



## Remuneration overview

### Understanding total remuneration for the CEO for 2017

Given the level of performance achieved and the progress made towards executing our longer term strategic plan, the overall reported 'single figure' for the total remuneration of John Fallon for 2017 is £1.758m. This is a 16% increase compared with 2016. The 'single figure' has increased because we have paid an annual bonus of 44% of the maximum opportunity for 2017. This is higher than the annual bonus for 2016, which was 24% of the maximum opportunity.

John Fallon did not receive a salary increase in 2017 and none of the 2015 LTIP award for the performance cycle from 2015 to 2017 vested. This was the sixth year in which none of the long-term incentive awards have vested, demonstrating the Remuneration Committee's consistent application of a rigorous approach to setting performance targets.

Having completed 20 years of service with Pearson, from October 2017 John Fallon had no further service accrual under his defined benefit pension arrangements.

### Looking forward to 2018 – simpler, balanced performance measures

The base salary for the CEO and CFO will be increased by 2.5% in 2018 in line with the average increases for UK employees. This is the first increase in three years.

Working within our existing policy, to simplify the annual incentive plan (AIP) structure for 2018, and reflecting shareholder feedback, we have reduced the number of performance measures from five to four. We have replaced the two profit based measures previously included (Operating Profit and EPS) with a single Operating Profit measure, which will determine 40% of the outcome of the plan. This provides a greater focus on the metric used by management on a day-to-day basis to manage the business, whilst reducing the prominence of EPS in the overall remuneration framework. We have also made minor adjustments to the weightings of the other performance measures (Cashflow 20%, Revenue 20% and Strategic Measures 20%). We believe this creates an AIP that is appropriately balanced between key metrics and objectives for 2018. Each performance measure will operate independently. There will be no changes to the maximum annual incentive opportunities for 2018.

As noted above, the Remuneration Committee has decided to maintain the lower level of long-term incentive awards in 2018. In 2017, we reduced LTIP awards by approximately 30% from prior levels, whilst retaining stretching performance targets. We have also reduced the proportion of these awards that will vest for threshold performance from 25% to 18% of the award. We will adopt the same approach for the 2018 awards by maintaining the 2017 award levels. Therefore, the 2018 awards will be made with the same face value as a % of salary as those in 2017.

Responding to shareholder feedback we are rebalancing the performance measures for 2018 awards. One third of any award will vest based on each of Earnings Per Share (EPS), Gross Return On Invested Capital (ROIC) and Relative Total Shareholder Return (TSR) measured over three years. Awards will also be subject to a further two year holding period. The eventual value of the awards will depend on our share price performance and dividends paid to shareholders over a five year period.

### Other important changes for the future

We will limit the pension allowance for future new external Executive Director appointments. This will reduce the maximum cash allowance in lieu of participation in a pension scheme from 26% to 16% of salary.

We are extending our minimum shareholding guidelines post-retirement. Executive directors will be expected to maintain a shareholding of at least half their normal guideline for two years following retirement.



## Remuneration overview

### Our remuneration policy is aligned with our strategy

Our shareholders approved our remuneration policy in 2017. Nevertheless, the Remuneration Committee considered carefully whether we should seek shareholder approval for a new policy at the AGM in 2018. The primary principle of our remuneration policy remains to support the company's strategy, which is focused on delivering sustainable performance and the creation of value over the long term for our stakeholders. The remuneration of our Executive Directors is closely tied to the achievement of annual and longer-term objectives, while remaining sensitive to the shareholder experience.

We concluded that we are able to operate within our current policy, which we believe underpins the company's strategic objectives and maintains an appropriate relationship between pay and performance. The policy has worked well in 2017 to provide the right framework to reflect strategy and execution priorities, while also allowing us to address the concerns raised by our shareholders as expressed at last year's AGM and also on subsequent engagement.

### Conclusion

Pearson is undergoing substantial change as the business delivers on digital transformation and continuous improvements in efficiency, while addressing the needs of all our stakeholders. This demands a strong leadership, whom we need to reward appropriately in the context of the performance of the business, while remaining mindful of the investor context.

My conversations with shareholders have been invaluable in understanding a range of perspectives and I thank those shareholders who engaged with us. Your feedback has helped us to simplify and balance our remuneration approach and to increase the transparency you need. I look forward to receiving your support at our AGM in May 2018 and to continuing the dialogue.



**Elizabeth Corley**  
Chairman of Remuneration Committee

14 March 2018

## Summary of key Committee actions and decisions

### 2017 actions

- › Comprehensive and multi-phased investor engagement
- › 30% reduction in LTIP award levels
- › Reduction in LTIP threshold vesting level from 25% to 18% of maximum
- › LTIP subject to stretching targets set above market consensus expectations at the time
- › AIP based on challenging targets with no benefit from buyback or currency movement
- › Maximum payout would require maximum performance on each individual component and outperformance on any one element cannot compensate for others
- › Discretionary downward adjustment to remove benefit of tax rate reduction
- › Further reduction in outcomes

### 2018 decisions

- › LTIP awards maintained at same reduced level as 2017
- › AIP and LTIP measures simplified and adjusted in the light of investor feedback
- › Stretching LTIP targets, disclosed prospectively for first time at Pearson
- › Salary increases of 2.5%, in line with employees. First increases for three years
- › Shareholding guidelines now extended to post-retirement
- › Reduced pension policy for new hires

# Our Executive remuneration framework and how we will implement it in 2018

Our remuneration policy was approved by shareholders at the AGM held on 5 May 2017 (and can be found in the Governance section of our website [Pearson.com/governance](http://Pearson.com/governance)). The table below summarises the key elements of

the remuneration framework for Directors as set out in our Policy, including how we intend to implement it in 2018 and the changes being introduced as a result of our recent review (see remuneration overview for further context).

## Base salary

### Key features of each Policy element

- › **Fixed pay** which reflects the level, role, skills, experience, the competitive market and individual contribution
- › Under the Policy, **base salary** increases will not ordinarily exceed 10% per annum
- › **Salary review** takes into account a range of factors, including: the level of increases made across the company as a whole; particular circumstances such as changes in role, responsibilities or organisation; the remuneration and level of increases for Executives in similar positions in comparable companies; general economic and market conditions; and individual performance

### 2018 implementation/changes

#### Salaries effective 1 April 2018:

John Fallon: £799,800 (+2.5%)

Coram Williams: £527,900 (+2.5%)

When reviewing salaries, the committee took into account the level of increases made across the company (which were 2.5% across the UK) as a whole, business and individual performance, and general economic and market conditions.

## Allowances and benefits

### Key features of each Policy element

- › **Allowances and benefits** which reflect the local competitive market and can include travel and health-related benefits
- › The **total value of allowances and benefits** for Executive Directors will not ordinarily exceed 15% of base salary in any year

### 2018 implementation/changes

Unchanged for 2018.

## Retirement benefits

### Key features of each Policy element

- › **Current Executive Directors** are members of the Final Pay section of The Pearson Pension Plan, which is closed to new members. Additional cash allowances may apply in specific circumstances
- › **New appointments** are eligible to join the Money Purchase section of The Pearson Pension Plan and receive contributions of up to 16% of pensionable salary (up to the earnings limit of £154,200 for 2017/18) or may receive a cash allowance of up to 26% of salary

### 2018 implementation/changes

There will be no changes to the pension provision of the existing Executive Directors.

**With effect from 2018, the maximum cash allowance for any future Executive Director external appointments will be reduced from 26% to 16% of salary.**

## Annual incentive plan

### Key features of each Policy element

- › Motivate the **achievement of annual business goals** aligned to financial and strategic imperatives
- › **Performance measures, weightings and targets** are set annually by the Committee to ensure continued alignment with strategy
- › **Each AIP component is independent.** For the CEO to achieve the maximum overall payout (180%) would require maximum performance on each individual component and outperformance on any one element cannot compensate for others
- › **Performance metrics** linked to strategic imperatives are selected to support Pearson's transformation strategy. A payout will only be made if a minimum level of performance has been achieved under the financial metrics
- › **Stretching performance targets** are fully disclosed in the annual remuneration report for the relevant financial year
- › **Malus and clawback** provisions apply

### 2018 implementation/changes

#### Maximum opportunity unchanged for 2018:

- › 180% of base salary for the CEO
- › 170% of base salary for the CFO

#### Performance metrics and associated weightings:

For 2018, the following balanced mix of financial and strategic measures will be used

- Operating Profit (40%)

The two profit based measures previously included (Operating Profit

and EPS) will be replaced with a single Operating Profit measure which will determine 40% of the outcome of the plan

We have also made minor adjustments to the weightings of the other performance measures:

- Sales (20%)
- Operating Cash Flow (20%)
- Strategic Measures (20%)

Targets will be disclosed in the 2018 directors' remuneration report

## Our Executive framework and how we will implement it in 2018

### Long-term incentive plan

#### Key features of each Policy element

- › Drive long-term earnings, share price growth and value creation
- › Align the interests of Executives and shareholders
- › Awards are made annually, and vest based on performance against stretching targets measured over a three-year performance period
- › An additional **two-year holding period** applies following vesting
- › The Committee will determine the performance measures, weightings and targets governing an award prior to grant to ensure continuing alignment with strategy and to ensure that targets are sufficiently stretching
- › **Malus and clawback** provisions apply

#### 2018 implementation/changes

##### Awards will be made at the same reduced level as in 2017:

- › 275% of base salary for the CEO
- › 245% of base salary for the CFO

##### Performance metrics, weightings and targets:

###### EPS (one-third)

Vesting schedule (% max)	EPS for FY20
15%	65p
65%	68p
100%	80p

###### Relative TSR (one-third)

Vesting schedule (% max)	Ranked position versus FTSE 100
25%	Median
100%	Upper quartile

Note: Straight line vesting in between points shown, with no vesting for performance below threshold

###### ROIC (one-third)

Vesting schedule (% max)	ROIC for FY20
15%	5%
65%	6%
100%	8%

### Shareholding guidelines

#### Key features of each Policy element

- › Align the interests of Executives and shareholders and encourage long-term shareholding and commitment to the company
- › Executive Directors are expected to build up a substantial **shareholding in the company**. The target holding is 300% of salary for the Chief Executive and 200% of salary for other Executive Directors
- › Executive Directors have five years from the date of appointment to reach the guideline

#### 2018 implementation/changes

With effect from 2018, shareholding guidelines for Executive Directors will be extended post-retirement

**Executive Directors will be required to retain half of the current guideline for a period of two years post-retirement in respect of shares vested from company incentive plans.**

### Non-Executive fees

#### Key features of each Policy element

- › The **Chairman** is paid a single fee for all of his responsibilities
- › The **Non-Executive Directors** are paid a basic fee. The Chairmen and members of the main Board Committees and the Senior Independent Director are paid an additional fee to reflect their extra responsibilities
- › The **Chairman and Non-Executive Directors** receive no other pay or benefits, except for reimbursement of expenses, and do not participate in incentive plans
- › A minimum of 25% of the Chairman's and Non-Executive Directors' basic fee is paid in shares

#### 2018 implementation/changes

##### There will be no changes to fees for 2018:

Role	Fees for 2018	
Chairman of the Board	£500,000	
Base fee for Non-Executive Directors	£70,000	
Additional SID fee	£22,000	

Role	Chair	Member
Audit Committee	£27,500	£15,000
Remuneration Committee	£22,000	£10,000
Nomination & Governance Committee	£15,000	£8,000
Reputation & Responsibility Committee	£13,000	£6,000

# 2017 remuneration report

Certain parts of this report have been audited as required by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended. Those tables which have been subject to audit are marked with an asterisk.

## Single total figure of remuneration and prior year comparison\*

Total aggregate emoluments for executive and non-executive directors were £4,067m in 2017. These emoluments are included within the total employee benefit expense in note 5 to the financial statements (p138).

### Executive Directors

The remuneration received by Executive Directors in respect of the financial years ended 31 December 2017 and 31 December 2016 is set out below.

### Executive Director remuneration

Element of remuneration £000s	John Fallon		Coram Williams	
	2017	2016	2017	2016
Base salary	780	780	515	515
Allowances and benefits	45	85	39	53
Annual incentives	624	343	412	193
Long-term incentives	0	0	0	-
Retirement benefits	309	310	52	47
<b>Total remuneration</b>	<b>1,758</b>	<b>1,518</b>	<b>1,018</b>	<b>808</b>

### Notes to single figure table

#### Base salary

The base salary shown in the single figure table reflects salary paid in the financial year.

#### Allowances and benefits

Travel benefits comprise company car, car allowance, private use of a driver and reimbursements of a taxable nature resulting from business travel and engagements. Health benefits comprise healthcare, health assessment and gym subsidy. In addition to the above benefits and allowances, Executive Directors may also participate in company benefit or policy arrangements that have no taxable value. The allowances and benefits figure for 2016 reflects what was reported in the single figure table in the 2016 report. However, the figure includes an amount in respect of certain risk benefits which do not form part of John Fallon's taxable benefits and so that amount (being £35k in 2016) has not been included in the corresponding figure for 2017.

The breakdown is as follows for 2017:

	John Fallon	Coram Williams
Travel	43	37
Healthcare	2	2

#### Annual incentives

Annual incentives for the directors are funded by Pearson global annual financial and non-financial KPIs, and pay-outs take into account individual performance against personal objectives. For more detail, see below.

#### Long-term incentives

The single figure of remuneration for 2017 includes all long-term incentive awards that were subject to a performance condition where the performance period ended at 31 December 2017. In 2017, the performance conditions for the 2015 Long-Term Incentive Plan (LTIP) were not met and so this award will not vest in 2018.

#### Retirement benefits

Further detail on retirement benefits is presented later in this report.

## 2017 remuneration report

### Executive Directors' annual incentive payments for 2017

Based on performance against targets, in 2017 the CEO achieved a bonus outcome of 61% of maximum and the CFO achieved a bonus outcome of 58% of maximum. The Remuneration Committee exercised its discretion and reduced these outcomes by 5% to account for the exceptional change in the tax rate during the year so that the Executive Directors did not benefit from this. This resulted in a bonus outcome of 56% of maximum for the CEO and 53% of maximum for the CFO.

The Remuneration Committee then moved to consider the bonus outcomes in the context of the shareholder experience in the year. Mindful of this experience, and the work still to be done, the Executive Directors, along with the Committee, have agreed it would not be appropriate to take the full bonus and that a further reduction in outcomes was appropriate. The Committee commends the Executive Directors for their approach in these matters and confirmed that we should further reduce the bonus outcome based on the following considerations:

› The degree of stretch in the targets set relative to plan was considered and the Committee were satisfied that the targets were appropriately calibrated;

› Outcomes against the targets were a reflection of the performance of the company in the year and were a fair and reasonable outcome;

› Management is making tangible progress in executing the strategy but, at the time of the Committee's deliberations, this was not fully reflected in the share price;

› A change in dividend policy resulted in a reduced payout of a proposed 17p;

› 2017 performance provides a solid foundation from which to build and positions the company well for a return to growth in 2018.

As a result, the annual bonus payable to the CEO for 2017 is 44% of maximum and for the CFO is 47% of maximum.

### Overall outcome and discretionary adjustment

Performance measure	% of total	Performance range				CEO payout		CFO payout	
		Threshold	Target	Max	Actual results	% of max bonus opportunity	% of salary	% of max bonus opportunity	% of salary
Operating profit	22.5%	£535m	£579m	£661m	£576m	11.5%	21%	11%	18%
Group EPS	22.5%	45.6p	48.0p	55.7p	54.1p	20.5%	37%	20%	34%
Sales	15%	£4,572m	£4,635m	£4,728m	£4,513m	0%	0%	0%	0%
Operating cash flow	15%	£460m	£506m	£598m	£669m	15%	27%	15%	26%
Strategic measures	25%	See performance against strategic measures table over page				14%	25%	12%	21%
	100%				Performance outcome	<b>61%</b>	<b>110%</b>	<b>58%</b>	<b>99%</b>

#### Notes:

- Targets have been re-stated on a constant currency basis using the average 2017 exchange rate.
- Any share buybacks did not benefit Group EPS bonus outcomes for the year.
- At Threshold, the payout is 15% of maximum. At Target, the payout is 55% of maximum for the CEO (reflecting his on-target bonus of 100% of salary) and 50% of maximum for the CFO (reflecting his on-target bonus of 85% of salary).

	CEO payout		CFO payout	
	% of max bonus opportunity	% of salary	% of max bonus opportunity	% of salary
<b>Group EPS adjusted to remove benefit of tax rate reduction</b>				
Shareholders benefited from a significant reduction in the effective corporate tax rate in 2017 from 21% budgeted to 11%. However, for the purposes of the bonus calculation, the Committee used the budgeted rate. This resulted in a reduction in the total bonus outcome as shown:	56% (-5%)	101% (-9%)	53% (-5%)	90% (-9%)
<b>Further discretionary adjustment</b>				
Whilst the Committee were satisfied that the targets were appropriately calibrated and that the outcomes were reflective of the performance in the year, in light of the work still to be done, and the recent shareholder experience, the Executive Directors along with the Committee agreed it would not be appropriate to take the full bonus and that a further reduction in outcomes was appropriate.	44% (-12%)	80% (-21%)	47% (-6%)	80% (-10%)

## 2017 remuneration report

### Performance against strategic measures

The targets (and outcomes) for performance against each of the strategic measures are shown in the table and supporting narrative below, with the outcome for each Executive Director shown in the table on the previous page.

Strategic measure	% of total funding	Threshold	Target	Max	Outcome
<b>Delivery of efficiency and cost savings</b> Measured by cost savings budgeted in 2018 Operating Plan through restructuring delivered in 2017 and underpinned by progress on The Enabling Programme (TEP)	10%	95% of Plan cost savings budgeted for 2018	Plan cost savings budgeted for 2018	110% of Plan cost savings budgeted for 2018	Management made encouraging progress, exceeding expected cost savings budgeted for 2018, as well as realising £15m of cost savings earlier than expected in 2017.  Much of the savings will come from the simplification of the technology architecture under TEP, which allows the increased use of shared service centres enabling us to standardise processes and reduce headcount.
<b>Driving digital agenda</b> Delivery of key strategic milestones in support of accelerating digital transformation through the Global Learning Platform (GLP) and progress in US higher education courseware total net digital sales (NDS) in 2017	10%	Some key milestones on track and hold NDS	Key milestones on track and achieve Plan NDS	All milestones on track and improve on Plan NDS by 5%	Management are on track with digital transformation, delivering a strong performance on NDS, which grew by 9% in the year. There has been continued investment in the Global Learning Platform (GLP) and innovative product and future pipeline. A further 210 new institutions were signed to Inclusive Access (Direct Digital Access) in 2017, taking the total to over 500 institutions. During the year, over 1m course enrolments were delivered in this way.
<b>Grow market share in our primary market</b> US higher education courseware (25% of revenues) as measured by Management Practice Inc. (MPI)/American Association of Publishers (AAP) net sales for 2017	5%	40.0%	41.0%	41.5%	Achieved US higher education courseware 2017 market share of 41% as reported by MPI and in the upper half of the c40-41.5% range seen over the last five years.
<b>Overall</b>	25%				With management outperforming against some of the strategic targets set for 2017, and achievement against plan for others, the Committee felt overall that an on-target outcome was a fair result under the strategic measures for 2017. This translates to a pay-out of 25% of salary for the CEO and 21% of salary for the CFO as shown on the previous page.

**Note:** If an element of judgement was required to assess achievements that were not completely quantifiable, Internal Audit provided an independent assessment to the Committee.

### Long-term incentives awarded in 2017\*

One of the significant changes that we made in 2017 was to reduce the grant of long-term incentives made to the Executive Directors in the year by approximately 30%. This substantial reduction demonstrates a responsible approach to the operation of remuneration arrangements for our Executive Directors as the company goes through the current transformation of the business.

The Remuneration Committee has decided that we will maintain the same approach for LTIP awards to be made in 2018. Therefore, the 2018 awards will be made with the same face value as those in 2017. We have also reduced the proportion of these awards that will vest for threshold performance from 25% to 18% of the award.

Director	Date of award	Vesting date	Number of shares	Face value	Face value (% of base salary)	Value for threshold performance (% of maximum)	Performance Period
John Fallon	11 September 17	1 May 20	366,000	£2,144,760	275%	18%	1 Jan 17–31 Dec 19
Coram Williams	11 September 17	1 May 20	215,000	£1,259,900	245%	18%	1 Jan 17–31 Dec 19

Face value was determined using a share price of 586p (previous trading day closing price as at the date of grant).

The awards will vest on 1 May 2020 subject to the following performance conditions. Any shares which vest will be subject to an additional two-year holding period to 1 May 2022.



## 2017 remuneration report

Details of the performance targets for the 2017 long-term incentive awards are set out in the tables below.

Earnings per share (EPS) (40%)		Return on invested capital (ROIC) (30%)		Relative total shareholder return (TSR) (30%)	
Vesting schedule (% max)	Adjusted EPS for FY19	Vesting schedule (% max)	Adjusted ROIC for FY19	Vesting schedule (% max)	Ranked position vs FTSE 100
15%	55p	15%	4.5%	25%	Median
75%	62p	75%	5.5%	100%	Upper quartile
100%	75p or above	100%	7.5% or above		

**Note 1:** Straight-line vesting will occur in between the points shown, with no vesting for performance below threshold.

**Note 2:** Pearson's total shareholder return performance is measured relative to the constituents of the FTSE 100 Index over the performance period.

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

#### Shareholding guidelines

Executive Directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee share ownership and to align further the interests of Executive Directors and shareholders. The target holding is 300% of salary for the Chief Executive and 200% of salary for the other Executive Directors. Shares that count towards these guidelines include any shares held unencumbered by an Executive Director, their spouse and/or dependent children plus any shares vested but held pending release under a share plan. Executive Directors have five years from the date of appointment to reach the guideline. Once the guideline has been met, it is not retested, other than when shares are sold.

With effect from 2018, shareholding guidelines for Executive Directors have been extended post-retirement. Executive Directors are required to retain half of the current guideline for a period of two years post-retirement in respect of shares vested from company incentive plans.

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

#### Directors' interests\*

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

Director	Current shareholding (ordinary shares) at 31 Dec 17	Conditional shares at 31 Dec 17	Total number of ordinary and conditional shares at 31 Dec 17	Guideline (% salary)	Guideline met?
<b>Chairman</b>					
Sidney Taurel	78,677	–	–	–	–
<b>Executive Directors</b>					
John Fallon	326,784	749,000	1,075,784	300%	Yes
Coram Williams	15,010	437,000	452,010	200%	n/a (see note 4)
<b>Non-Executive Directors</b>					
Elizabeth Corley	8,066	–	–	–	–
Vivienne Cox	5,263	–	–	–	–
Josh Lewis	11,033	–	–	–	–
Linda Lorimer	6,977	–	–	–	–
Harish Manwani	14,151	–	–	–	–
Tim Score	17,285	–	–	–	–
Lincoln Wallen	4,423	–	–	–	–

**Note 1:** The current value of the Executive Directors' shareholdings is based on the closing market value of Pearson shares of 725p on 1 March 2018 against base salaries at 31 December 2017.

**Note 2:** 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 under the long-term incentive plan and any legacy share plans they might have participated in.

**Note 3:** Conditional shares means unvested shares which remain subject to performance conditions and continuing employment for a pre-defined period.

**Note 4:** Coram Williams has five years from the date of his appointment as an Executive Director to reach the shareholding guideline.

**Note 5:** There have been no changes in the interests of any director between 31 December 2017 and 12 March 2018, being the latest practicable date prior to the publication of this report.

## 2017 remuneration report

### Movements in Directors' interests in share awards during 2017\*

Plan	Date of award	Vesting date	Number of shares as at 1 Jan 2017	Awarded	Released	Lapsed	Number of shares as at 31 Dec 2017	Status
<b>John Fallon</b>								
	11 September 2017	1 May 2020	0	366,000			366,000	Outstanding subject to performance
	3 May 2016	3 May 2019	383,000				383,000	Outstanding subject to performance
	1 May 2015	1 May 2018	230,000			230,000		Lapses in 2018
<b>Total</b>			<b>613,000</b>	<b>366,000</b>	<b>0</b>	<b>230,000</b>	<b>749,000</b>	
<b>Coram Williams</b>								
	11 September 2017	1 May 2020	0	215,000			215,000	Outstanding subject to performance
	3 May 2016	3 May 2019	222,000				222,000	Outstanding subject to performance
	1 Aug 2015	1 Aug 2018	129,000			129,000		Lapses in 2018
<b>Total</b>			<b>351,000</b>	<b>215,000</b>	<b>0</b>	<b>129,000</b>	<b>437,000</b>	

**Note 1:** Released means where shares have been transferred to participants.

**Note 2:** TSR is measured relative to the constituents of the FTSE World Media Index for 2015 and 2016 LTIP awards. For the LTIP awards granted in 2017, TSR is measured relative to the constituents of the FTSE 100.

**Note 3:** The performance targets for the 2015 award were not met and therefore this award will lapse in 2018.

**Note 4:** Coram Williams' 2015 award was made on his appointment to the Board on 1 August 2015 and will vest three years from this date on 1 August 2018, subject to the same performance conditions and holding periods as for other Executives.

**Note 5:** The share price did not reach the 2014 worldwide save for shares option price of £8.112 during the maturity period so John Fallon's award exercisable in 2017 lapsed.

### Performance targets for outstanding awards under the Long-Term Incentive Plan (LTIP)

The status of outstanding awards under the Long-Term Incentive Plan (LTIP) as described in the table above is set out in the following table.

Date of award	Share price on date of award	Vesting date	Performance measures	Weighting	Performance period	Payout at threshold	Payout at maximum
11 September 2017	586.0p	1 May 2020	Relative TSR	30%	1 Jan 2017 to 31 Dec 2019	25% at median	100% at upper quartile
			ROIC	30%	2019	15% for ROIC of 4.5%	100% for ROIC of 7.5%
			EPS	40%	2019	15% for EPS 55p	100% for EPS 75p
3 May 2016	805.0p	3 May 2019	Relative TSR	1/6	1 Jan 2016 to 31 Dec 2018	25% at median	100% at upper quartile
			ROIC	1/3	2018	25% for ROIC of 5.5%	100% for ROIC of 6.7%
			EPS	1/2	2018	25% for EPS 61.4p	100% for EPS 78.3p

### Executive Directors' retirement benefits and entitlements

Details of the Directors' pension entitlements and pension-related benefits during the year are as follows:

Director	Value of defined benefit over the period £000s	Other allowances in lieu of pension £000s	Total annual value in 2017 £000s	Accrued pension at 31 Dec 17 £000s
John Fallon	106	203	309	103
Coram Williams	52		52	32

**Note 1:** The accrued pension at 31 December 2017 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2017. It relates to the pension payable from the UK plan. Normal retirement age is 62.

**Note 2:** The value of defined benefit over the period comprises the defined benefit input value, less inflation, less individual contribution.

**Note 3:** Other allowances in lieu of pension represent the cash allowances paid in lieu of the previous FURBS arrangements.

**Note 4:** Total annual value is the sum of the previous two columns and is disclosed in the single figure of remuneration table.

## 2017 remuneration report

### Plans

#### John Fallon – The Pearson Group Pension Plan

Accrual rate of 1/30th of pensionable salary per annum, restricted to the plan earnings cap (£154,200 per annum in 2017/18).

John attained the maximum service accrual for this benefit when he reached 20 years' service in October 2017. With effect from this date he had accrued a benefit of two-thirds of his final pensionable salary and no further service-related benefits can accrue under the Plan. Based on the 2017/2018 earnings cap of £154,200, he will have accrued a pension of £102,800 per annum at this time. When the earnings cap under the Plan rules is increased in the future in line with increases in the UK retail price index, his final salary pension benefit will increase accordingly.

In addition, he received a taxable and non-pensionable cash supplement (of 26% of salary) in lieu of the previous FURBS arrangement. There are no enhanced early retirement benefits.

#### Coram Williams – The Pearson Group Pension Plan

Accrual rate of 1/60th of pensionable salary per annum, restricted to the plan earnings cap (£154,200 per annum in 2017/18), with continuous service with a service gap. There are no enhanced early retirement benefits.

### Chairman and Non-Executive Director remuneration\*

The remuneration paid to the Chairman and Non-Executive Directors in respect of the financial years ended 31 December 2017 and 31 December 2016 are as follows:

Director £000s	2017						2016					
	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total
Sidney Taurel	500	–	–	–	12	512	500	–	–	–	16	516
Elizabeth Corley	70	22	20	–	0	112	70	22	–	–	0	92
Vivienne Cox	70	10	21	22	3	126	70	10	25	22	3	130
Josh Lewis	70	–	15	–	59	144	70	–	15	–	10	95
Linda Lorimer	70	12	15	–	5	102	70	–	20	–	4	94
Harish Manwani	70	–	11	–	4	85	70	–	5	–	3	78
Tim Score	70	28	15	–	0	113	70	28	10	–	3	111
Lincoln Wallen	70	–	21	–	6	97	70	–	13	–	3	86
<b>Total</b>	<b>990</b>	<b>72</b>	<b>118</b>	<b>22</b>	<b>89</b>	<b>1,291</b>	<b>990</b>	<b>60</b>	<b>88</b>	<b>22</b>	<b>42</b>	<b>1,202</b>

**Note 1:** A minimum of 25% of the Chairman's and Non-Executive Directors' basic fee is paid in shares, effective from the 2017 AGM policy approval.

**Note 2:** Taxable benefits refer to travel, accommodation and subsistence expenses incurred while attending Board meetings during 2017 that were paid or reimbursed by the company which are deemed by HMRC to be taxable in the UK. The amounts in the table above include the grossed-up cost of UK tax to be paid by the company on behalf of the Directors. Josh Lewis's tax position has changed now that he has been a non-executive director of Pearson for more than five years (as of March 2016) with a consequential increase in the taxable value of the expenses he incurs visiting the UK for board meetings. As such, the taxable benefits figure in the table above is materially higher than last year's figure and the figures for other non-executive directors.

### Payments to former Directors

There were no payments made to former Directors in 2017.

### Payments for loss of office

There were no payments for loss of office made to or agreed for Directors in 2017.

### Historical performance and remuneration

#### Total shareholder return performance

We set out on the next page Pearson's total shareholder return (TSR) performance relative to the FTSE All-Share index on an annual basis over the nine-year period 2008 to 2017. This comparison has been chosen because the FTSE All-Share represents the broad market index within which Pearson shares are traded. TSR is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends (source: Datastream).

### Executive Directors' Non-Executive directorships

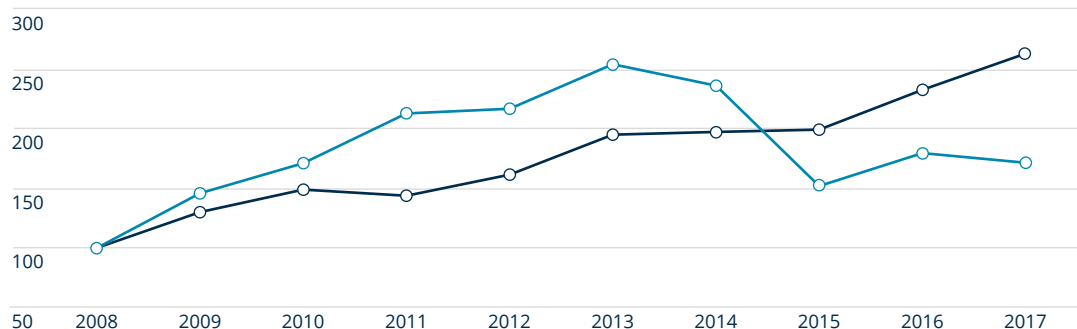
Coram Williams is engaged as a NED of Guardian Media Group plc. He received fees of £37,750 during 2017 in respect of this role. His current remuneration is at the rate of £39,000 p.a. since 1 April 2017 when became chair of the audit committee. In accordance with our policy, Coram is permitted to retain these fees.

In accordance with the reporting regulations, this section also presents Pearson's TSR performance alongside the single figure of total remuneration for the CEO over the last nine years and a summary of the variable pay outcomes relative to the prevailing maximum at the time.

## 2017 remuneration report

### Total shareholder return £

○ Pearson TSR  
○ FTSE All-share TSR



CEO remuneration	Marjorie Scardino				John Fallon				
Total remuneration (single figure, £000s)	6,370	8,466	8,340	5,330	1,727	1,895	1,263	1,518	<b>1,758</b>
Annual incentive (% of maximum)	91.3%	92.1%	75.7%	24.2%	34.3%	50.5%	Nil	24.4%	<b>44.4%</b>
Long-term incentive (% of maximum)	80.0%	97.5%	68.3%	36.7%	Nil	Nil	Nil	Nil	<b>Nil</b>

**Annual incentive** is the actual annual incentive received by the incumbent as a percentage of maximum opportunity.

**Long-term incentive** is the payout of performance-related restricted shares under the LTIP where the year shown is the final year of the performance period for the purposes of calculating the single total figure of remuneration.

**Total remuneration** is as reflected in the single total figure of remuneration table.

John Fallon's total remuneration opportunity is lower than that of the previous incumbent. Variable payouts under the annual and Long-Term Incentive Plans reflect performance for the relevant periods.

### Comparative information

The following information is intended to provide additional context regarding the total remuneration for Executive Directors.

#### Relative percentage change in remuneration for CEO

The following table sets out the change between 2016 and 2017 in three elements of remuneration for the CEO, in comparison with the average for all employees. While the Committee reviews base pay for the CEO relative to the broader employee population, benefits are driven by local practices and eligibility is determined by level and individual circumstances which do not lend themselves to comparison.

#### Change in CEO remuneration 2016/17

Base salary	Allowances and benefits	Annual incentives
⊞ no change	↓ 47% (see note 1)	↑ 82%

#### Change in employee remuneration 2016/17

Base salary	Allowances and benefits	Annual incentives
↑ 2%	↑ 5%	↑ 45% (see note 2)

**Note 1:** The above percentages relating to the CEO reflect the figures as shown in the single figure table on page 96. If the risk benefits are excluded from the allowances and benefits figure for 2016 (see the notes to the single figure table on page 96), the relevant percentage would be -10%.

**Note 2:** The figures for all employees reflect average salaries and average employee numbers each year at constant exchange rates. The change in annual incentives is an aggregate figure which includes all incentive arrangements across the company, including sales incentives. The equivalent year-on-year figure for the staff annual incentive plan for those eligible in 2017 was +127%.

## 2017 remuneration report

### Relative importance of pay spend

The Committee considers Directors' remuneration in the context of the company's allocation and disbursement of resources to different stakeholders. In particular, we chose operating profit because this is a measure of our ability to reinvest in the company. We include dividends because these constitute an important element of our return to shareholders.

All figures in £ millions	2017	2016	Change	
			£m	%
Adjusted operating profit	<b>576</b>	635	-59	<b>-9%</b>
Dividends	<b>318</b>	424	-106	<b>-25%</b>
Total wages and salaries	<b>1,567</b>	1,661	-94	<b>-6%</b>

**Note 1:** Adjusted operating profit is as set out in the financial statements.

**Note 2:** Wages and salaries include continuing operations only and include Directors. Average employee numbers for continuing operations for 2017 were 30,339 (2016: 32,719). Further details are set out in note 5 to the financial statements on p138.

### Dilution and use of equity

Pearson can use existing shares bought in the market, treasury shares or newly issued shares to satisfy awards under the company's various share plans. For restricted stock awards under the LTIP, the company would normally expect to use existing shares.

There are limits on the amount of new-issue equity we can use. In any rolling ten-year period, no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans, and no more than 5% of Pearson equity will be issued, or be capable of being issued, under Executive or discretionary plans. The headroom available for all Pearson plans, executive or discretionary, and shares held in trust is as follows:

Headroom	2017
All Pearson plans	<b>8.4%</b>
Executive or discretionary plans	<b>5%</b>
Shares held in trust	<b>4.3%</b>

### The Remuneration Committee in 2017

Role	Name	Title
Chairman	Elizabeth Corley	Independent
	Josh Lewis	Non-Executive Directors
	Tim Score	
	Sidney Taurel	Chairman of the Board
Internal attendees	John Fallon	Chief Executive
	Coram Williams	Chief Financial Officer
	Melinda Wolfe	Chief Human Resources Officer (to May 2017)
	Kate Bishop	Interim Chief Human Resources Officer (from June 2017)
	Stuart Nolan	SVP, Reward
	Stephen Jones	Company Secretary
External advisers	Willis Towers Watson (to June 2017)	
	Deloitte LLP (appointed in July 2017)	

Sidney Taurel was a member of the Committee throughout 2017 as permitted under the UK Corporate Governance Code.

### Advisers to the Remuneration Committee

During 2017, the Remuneration Committee undertook a formal tender process, the outcome of which resulted in Deloitte LLP being appointed as independent Remuneration Committee advisers in July 2017. Deloitte LLP supplied the Committee with advice on current market trends and developments, incentive plan design and target setting, investor engagement and other general executive remuneration matters. In respect of their services to the Committee, Deloitte LLP were paid fees, which were charged on a time spent basis, of £165,000. Deloitte LLP were founding members of the Remuneration Consultants' Group and adhere to its code of conduct.

During the year, Deloitte LLP also provided Pearson PLC with certain tax and other advisory and consultancy services.

The Committee also received advice from Willis Towers Watson, which supplied survey data and advice on market trends, long-term incentives and other general remuneration matters. During the year, Willis Towers Watson was paid fees for advice to the Committee, which were charged on a time spent basis, of £87,000. Willis Towers Watson also advised the company on health and welfare benefits in the US and provided consulting advice directly to certain Pearson operating companies.

The Committee remains satisfied that advice provided by both Deloitte LLP and Willis Towers Watson was objective and independent and that the provision of other services in no way compromised their independence.

## 2017 remuneration report

### Remuneration Committee meeting focus during 2017

Area of responsibility	Activities			
<b>Market</b>	Noted Willis Towers Watson's and subsequently Deloitte's overview of the current remuneration and governance environment.	Received a number of updates on changes to the corporate governance environment for executive compensation.		
<b>Performance</b>	Received input from the Audit Committee, Internal Audit and from management on the financial performance of the business and progress against strategic measures. Received input from Investor Relations on market consensus expectations.	Noted and reviewed the status of outstanding long-term incentive awards based on the current view of likely Pearson financial performance.	Reviewed the approach to the Annual Incentive Plan for Pearson executive management and the Management Incentive Plan for senior leaders.	Noted and reviewed the status of the 2016–2017 talent retention arrangements and impact on voluntary turnover.
<b>Implementation</b>	Reviewed and approved a pay freeze for 2017 for the Executive Directors and annual salary increases for Pearson executive management and senior leaders.	Reviewed and approved 2016 annual incentive plan payouts for the Executive Directors, Pearson executive management and senior leaders.  Reviewed and approved 2017 individual annual incentive opportunities for the Executive Directors and Pearson Executive management.  Reviewed and approved 2017 Pearson annual incentive plan targets including a detailed review of financial and non-financial targets.	Approved nil payout under 2014 long-term incentive plan awards.  Reviewed and approved 2017 long-term incentive awards for the Executive Directors and Pearson executive management, including the quantum of awards.  Noted 2017 long-term incentive awards for senior leaders and managers below Pearson executive management  Considered shareholder feedback and market consensus for setting 2017 long-term incentive performance conditions. Further consideration of investor feedback and experience prior to granting of awards.	Noted remuneration packages for new appointments to the Pearson executive management team and termination arrangements for leavers  Noted the deployment of 2016-17 retention arrangements and effectiveness of the arrangements in the retention of critical talent.
<b>Governance</b>	Noted the activity of the standing Committee of the Board in relation to the operation of the company's equity-based reward programmes.	Noted company's use of equity for employee share plans.	Conducted an evaluation of the Committee's performance.	Conducted a formal process to review the provision of external independent advice to the Committee.
<b>Policy</b>	Considered the Director's Remuneration Policy for approval by shareholders at the 2017 AGM.  Reviewed and reconfirmed the operation of the Policy for 2018.			
<b>Disclosure and engagement</b>	Considered feedback from Committee Chairman's meetings with key shareholders and proxy bodies during 2017.	Reviewed and approved 2016 Directors' remuneration report  Noted shareholder feedback on 2016 Directors' remuneration report.	Reviewed 2017 Annual General Meeting season, shareholder voting and engagement strategy.	Noted template and outline of 2017 Directors' remuneration report and shareholder engagement strategy.



## 2017 remuneration report

### Terms of reference

The Committee's full charter and terms of reference are available on the Governance page of the company's website. A summary of the Committee's responsibilities is set out below.

### Committee responsibilities:

#### Determine and review policy

Determine and regularly review the remuneration policies for the Executive Directors, the presidents and other members of the Pearson Executive management (who report directly to the CEO), and overview the approach for the senior leadership group. These policies include base salary, annual and long-term incentives, pension arrangements, any other benefits and termination of employment.

#### Shareholder engagement

Ensure the company maintains an appropriate level of engagement with its shareholders and shareholder representative bodies in relation to the remuneration policy and its implementation.

#### Review and approve implementation

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.

#### Approve performance related plans

Approve the design of, and determine targets for, any performance-related pay plans operated by the Group for Pearson Executive management and approve the total payments to be made under such plans.

#### Review long-term plans

Review the design of the company's long-term incentive and other share plans operated by the Group and where relevant recommend such plans for approval by the Board and shareholders.

#### Set termination arrangements

Advise and decide on general and specific arrangements in connection with the termination of employment of Executive Directors.

#### Review targets

Review and approve corporate goals and objectives relevant to Executive Directors' remuneration and evaluate the Executive Directors' performance in light of those goals and objectives.

#### Determine Chairman's remuneration

Delegated responsibility for determining the remuneration and benefits package of the Chairman of the Board.

#### Appoint remuneration consultants

Appoint and set the terms of engagement for any remuneration consultants who advise the Committee and monitor the cost of such advice.

### Committee evaluation

In 2017, the Committee evaluation was undertaken by Heidrick & Struggles JCA Group as part of the wider board evaluation process. The responses illustrated an effective Committee, which uses its time well and has an appropriate focus on the key issues. The key findings were:

- › The Committee is seen to be working effectively on the whole, led well by its Chair with an appropriate agenda and a strong work ethic from each member of the Committee.
- › Meetings are run well and in a disciplined manner.
- › Succession for the role of Committee chair should be borne in mind with future Non-Executive Director appointments, although this is not immediately pressing.
- › Some consideration might be given to ensuring there is minimal duplication with other Committees (e.g. gender pay could fall under both Reputation & Responsibility Committee and the Remuneration Committee depending on the outcomes of the UK Corporate Governance Code review), or how duplication will be handled so as not to create any unnecessary work.

### Voting at the 2017 AGM

The following table summarises the details of votes cast in respect of the remuneration resolutions at the 2017 AGM.

	% of votes cast for	% of votes cast against	Votes withheld
2017 Remuneration Policy vote	68.8% (404,615,934)	31.2% (183,100,737)	43,738,267
Annual remuneration votes	34.4% (202,512,759)	65.6% (385,996,157)	42,945,685

Following the 2017 AGM result, as part of our commitment to an ongoing dialogue, we have continued to engage actively with our investors to seek feedback on the reasons for the voting outcome. A number of our shareholders believed that there was a disconnect between pay and performance for 2016 and this was reflected in the voting outcome on the resolutions on remuneration. Since last year's AGM, Pearson has sought to address this in a number of ways that are explained in the remuneration overview section of this report. We appreciate and have acknowledged that feedback and are grateful to those shareholders who engaged with us.

The Directors' remuneration report has been approved by the Board on 14 March 2018 and signed on its behalf by:



**Elizabeth Corley**  
Chairman of Remuneration Committee

# Additional disclosures

Pages 62–109 of this document comprise the Directors' report for the year ended 31 December 2017.

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

## Going concern

The Directors have made an assessment of the Group's ability to continue as a going concern and consider it appropriate to adopt the going concern basis of accounting.

## Viability statement

As set out on p60, the Board has also reviewed the prospects of Pearson over the three-year period to December 2020 taking account of the company's strategic plans, a 'severe but plausible' downside case and further stress testing based on the principal risks set out on p50–60.

Based on the results of these procedures, and considering the company's strong balance sheet, the Directors have a reasonable expectation that Pearson will be able to continue in operation and meet its liabilities as they fall due over the three-year period ending December 2020. Further details of the Group's liquidity are shown in Financial review (see p34–40).

## Share capital

Details of share issues and cancellations are given in note 27 to the consolidated financial statements on p170. The company has a single class of shares which is divided into ordinary shares of 25p each. The ordinary shares are in registered form. As at 31 December 2017, 802,053,752 ordinary shares were in issue. At the AGM held on 5 May 2017, the company was authorised, subject to certain conditions, to acquire up to 82,258,685 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 4 May 2018.

## Share buyback

In July, we announced the sale of a 22% stake in Penguin Random House to Bertelsmann and recapitalisation of the business, generating total net proceeds of approximately \$1bn.

The partial divestment of our stake in Penguin Random House was in line with our strategy for simplification and allowed us to crystallise some of the significant shareholder value created through our successful partnership with Bertelsmann over the prior four years.

We have set out clear capital allocation priorities as follows:

1. Maintaining a strong balance sheet and solid investment grade credit ratings through an appropriate capital structure. Accordingly, we intend to maintain a year end net debt/EBITDA of less than 1.5x
2. Simplifying our portfolio and investing in the business to drive sustainable organic growth
3. Delivering shareholder returns through a sustainable and progressive dividend policy, returning surplus cash to shareholders where appropriate through buybacks or special dividends.

In line with those priorities, the Board decided that we would use the proceeds from the transaction to maintain a strong balance sheet and invest in our business in addition to returning £300m of surplus capital to shareholders following the closing of the transaction.

The Board considered investor views on preferred methods of cash return, the amount being returned and other factors and concluded a share buyback was the most appropriate methodology to return that capital to our shareholders at that time.

We launched a £300m share buyback, beginning on 18 October 2017 and completed the programme on 16 February 2018 repurchasing a total of 42,835,577 shares at an average price of 700p. The reduction in average shares outstanding as a result of the buyback increased 2017 adjusted earnings per share (EPS) by less than 1%, but will have a larger impact on 2018 adjusted EPS.

## Major shareholders

Information provided to the company pursuant to the Financial Conduct Authority's Disclosure and Transparency Rules (DTR) is published on a Regulatory Information Service and on the company's website.

As at 31 December 2017, the company had been notified under DTR 5 of the following holders of significant voting rights in its shares.

	Number of voting rights	Percentage as at date of notification
Schroders plc	108,691,682	13.63%
Silchester International Investors LLP	89,160,115	11.18%
Lindsell Train Limited	41,393,237	5.17%
Ameriprise Financial, Inc. and its group	41,236,375	5.02%
Libyan Investment Authority <sup>1</sup>	24,431,000	3.01%

1. Based on notification to the Company dated 7 June 2010. We have been notified of no change to this holding since that date. Assets belonging to, or owned, held or controlled on 16 September 2011 by the Libyan Investment Authority and located outside Libya on that date, are frozen in accordance with Article 5(4) of Regulation 2016/44 of the Council of the European Union.

Between 31 December 2017 and 14 March 2018, being the latest practicable date before the publication of this report, the company received further notifications under DTR 5, with the most recent positions being as follows:

- › Schroders plc disclosed a holding of 14.04%
- › Silchester International Investors LLP disclosed a holding of 11.14%.

## Annual General Meeting

The notice convening the AGM, to be held at 12 noon on Friday 4 May 2018 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 28 March 2018.

## Registered auditors

In accordance with section 489 of the Act, a resolution proposing the reappointment of PricewaterhouseCoopers LLP as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the Audit Committee.

## Additional disclosures

### Amendment to Articles of Association

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

### Rights attaching to shares

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

Subject to any restrictions below, shareholders may attend any general meeting of the company and, on a show of hands, every shareholder (or his/her representative) who is present at a general meeting has one vote on each resolution and, on a poll, every shareholder (whether an individual or a corporation) present in person or by proxy shall have one vote for every 25p of nominal share capital held. A resolution put to the vote at a general meeting is decided on a show of hands unless before, or on the declaration of the result of, a vote on a show of hands, a poll is demanded. A poll can be demanded by the Chairman of the meeting, or by at least three shareholders (or their representatives) present in person and having the right to vote, or by any shareholders (or their representatives) present in person having at least 10% of the total voting rights of all shareholders, or by any shareholders (or their representatives) present in person holding ordinary shares on which an aggregate sum has been paid up of at least 10% of the total sum paid up on all ordinary shares. At this year's AGM, voting will again be conducted on a poll, consistent with best practice.

Shareholders can declare a final dividend by passing an ordinary resolution but the amount of the dividend cannot exceed the amount recommended by the Board. The Board can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. In all cases the distributable profits of the company must be sufficient to justify the payment of the relevant dividend.

The Board may, if authorised by an ordinary resolution of the shareholders, offer any shareholder the right to elect to receive new ordinary shares, which will be credited as fully paid, instead of their cash dividend.

Any dividend which has not been claimed for 12 years after it became due for payment will be forfeited and will then belong to the company, unless the Directors decide otherwise.

If the company is wound up, the liquidator can, with the sanction of a special resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the company and he/she can value assets and determine how the division shall be carried out as between the shareholders or different classes of shareholders. The liquidator can also, with the same sanction, transfer the whole or any part of the assets to trustees upon such trusts for the benefit of the shareholders.

### Voting at general meetings

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

The Board may decide that a shareholder is not entitled to attend or vote either personally or by proxy at a general meeting or to exercise any other right conferred by being a shareholder if he/she or any person with an interest in shares has been sent a notice under section 793 of the Act (which confers upon public companies the power to require information with respect to interests in their voting shares) and he/she or any interested person failed to supply the company with the information requested within 14 days after delivery of that notice. The Board may also decide, where the relevant shareholding comprises at least 0.25% of the nominal value of the issued shares of that class, that no dividend is payable in respect of those default shares and that no transfer of any default shares shall be registered.

Pearson operates an employee benefit trust to hold shares, pending employees becoming entitled to them under the company's employee share plans. There were 5,993,536 shares held as at 31 December 2017. The trust has an independent trustee which has full discretion in relation to the voting of such shares. A dividend waiver operates on the shares held in the trust.

Pearson also operates two nominee shareholding arrangements which hold shares on behalf of employees. There were 2,561,000 shares held in the Sharestore account and 432,375 shares held in the Global Nominee account as at 31 December 2017. The beneficial owners of shares held in Sharestore are invited to submit voting instructions online at [www.shareview.co.uk](http://www.shareview.co.uk) and Global Nominee participants are invited to submit voting instructions by e-mail to [nominee@equiniti.com](mailto:nominee@equiniti.com). If no instructions are given by the beneficial owner by the date specified, the trustees holding these shares will not exercise the voting rights.

### Transfer of shares

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

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

## Additional disclosures

### Variation of rights

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

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

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

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

### Appointment and replacement of Directors

The Articles contain the following provisions in relation to Directors:

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

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

Notwithstanding the provisions of the Articles, the Board has resolved that all Directors should offer themselves for re-election annually, in accordance with the Code.

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

### Powers of the Directors

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

### Significant agreements

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

Under the \$1,750,000,000 revolving credit facility agreement dated August 2014 which matures in August 2021 between, among others, the company, Barclays Bank plc (Agent) and the banks and financial institutions named therein as lenders (the Facility), any such bank may, upon a change of control of the company, require its outstanding advances, together with accrued interest and any other amounts payable in respect of such Facility, and its commitments, to be cancelled, each within 60 days of notification to the banks by the Agent. For these purposes, a 'change of control' occurs if the company becomes a subsidiary of any other company, or one or more persons acting either individually or in concert obtains control (as defined in section 1124 of the Corporation Tax Act 2010) of the company.

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

## Additional disclosures

### Other statutory information

Other information that is required by the Companies Act 2006 (the Act) to be included in the Directors' report, and which is incorporated by reference, can be located as follows:

Summary disclosures index	See more
Dividend recommendation	p35
Financial instruments and financial risk management	p156–158
Important events since year end	p40
Future development of the business	p8–32
Research and development activities	p22–23
Employment of disabled persons	p28
Employee involvement	p25–28
Greenhouse gas emissions	p29

With the exception of the dividend waiver described on p107, there is no information to be disclosed in accordance with Listing Rule 9.8.4.

No political donations or contributions were made or expenditure incurred by the company or its subsidiaries during the year.

### Fair, balanced and understandable reporting and disclosure of information

As required by the Code, we have established arrangements to ensure that all information we report to investors and regulators is fair, balanced and understandable. A process and timetable for the production and approval of this year's report was agreed by the Board at its meeting in December 2017. The full Board then had opportunity to review and comment on the report as it progressed.

Representatives from financial reporting, corporate affairs, company secretarial, legal and internal audit, compliance and risk are involved in the preparation and review of the annual report to ensure a cohesive and balanced approach and, as with all of our financial reporting, our Verification Committee conducts a thorough verification of narrative and financial statements. We also have procedures in place to ensure the timely release of inside information, through our Market Disclosure Committee.

The Audit Committee is also available to advise the Board on certain aspects of the report, to enable the Directors to fulfil their responsibility in this regard. The Directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

The Directors also confirm that, for each Director in office at the date of this report:

- › So far as the Director is aware, there is no relevant audit information of which the Group and company's auditors are unaware
- › They have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Group and the company's auditors are aware of that information.

### Directors in office

The following Directors were in office during the year and up until signing of the financial statements:

E P L Corley	H Manwani
V Cox	T Score
J J Fallon	S Taurel
S J Lewis	L Wallen
L K Lorimer	C Williams
M M Lynton (appointed 1 February 2018)	

The Directors' report has been approved by the Board on 14 March 2018 and signed on its behalf by:



**Stephen Jones**  
Company Secretary

# Statement of Directors' responsibilities

## Statement of Directors' responsibilities

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and company and of the profit or loss of the Group and company for that period. In preparing the financial statements, the Directors are required to:

- › Select suitable accounting policies and then apply them consistently
- › State whether applicable IFRSs as adopted by the European Union have been followed for the Group and company financial statements, subject to any material departures disclosed and explained in the financial statements
- › Make judgements and accounting estimates that are reasonable and prudent
- › Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

The Directors are also responsible for safeguarding the assets of the Group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Each of the Directors, whose names and functions are listed on p64–65, confirms that, to the best of their knowledge:

- › The Group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group
- › The strategic report contained in the annual report includes a fair review of the development and performance of the business and the position of the Group and company, together with a description of the principal risks and uncertainties that it faces.

This responsibility statement has been approved by the Board on 14 March 2018 and signed on its behalf by:



**Coram Williams**  
Chief Financial Officer