PEARSON PLC
Form 20-F
March 25, 2011

Table of Contents

**AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON March 25, 2011**

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

**Form 20-F**

(Mark One)

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**or**

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**for the fiscal year ended December 31, 2010**

**or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**for the transition period from to**

**or**

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**Date of event requiring this shell company report**

**Commission file number 1-16055**
**PEARSON PLC**
*(Exact name of Registrant as specified in its charter)*

**England and Wales**
*(Jurisdiction of incorporation or organization)*

**80 Strand**
**London, England WC2R 0RL**
*(Address of principal executive offices)*

**Stephen Jones**
**Telephone: +44 20 7010 2000**
**Fax: +44 20 7010 6060**
**80 Strand**
**London, England WC2R 0RL**
*(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)*

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

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

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

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

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

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

Ordinary Shares, 25p par value 812,677,377

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

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

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

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

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

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

þ Large accelerated filer     o Accelerated filer     o Non-accelerated filer

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

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

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

Item 17 o     Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes **o**     No **þ**

# TABLE OF CONTENTS


| | | Page |
|---|---|---|
| | Introduction | 4 |
| | Forward-Looking Statements | 4 |
| | **PART I** | |
| **Item 1.** | **Identity of Directors, Senior Management and Advisers** | 6 |
| **Item 2.** | **Offer Statistics and Expected Timetable** | 6 |
| **Item 3.** | **Key Information** | 6 |
| | Selected Consolidated Financial Data | 6 |
| | Dividend Information | 7 |
| | Exchange Rate Information | 7 |
| | Risk Factors | 8 |
| **Item 4.** | **Information on the Company** | 12 |
| | Pearson plc | 12 |
| | Overview of Operating Divisions | 12 |
| | Our Strategy | 12 |
| | Operating Divisions | 13 |
| | Operating Cycles | 16 |
| | Competition | 16 |
| | Intellectual Property | 17 |
| | Raw Materials | 17 |
| | Government Regulation | 17 |
| | Licenses, Patents and Contracts | 17 |
| | Legal Proceedings | 17 |
| | Recent Developments | 17 |
| | Organizational Structure | 18 |
| | Property, Plant and Equipment | 18 |
| | Capital Expenditures | 19 |
| **Item 4A.** | **Unresolved Staff Comments** | 19 |
| **Item 5.** | **Operating and Financial Review and Prospects** | 19 |
| | General Overview | 19 |
| | Results of Operations | 22 |
| | Liquidity and Capital Resources | 37 |
| | Accounting Principles | 40 |
| **Item 6.** | **Directors, Senior Management and Employees** | 40 |
| | Directors and Senior Management | 40 |
| | Compensation of Senior Management | 41 |
| | Share Options of Senior Management | 48 |
| | Share Ownership of Senior Management | 49 |
| | Employee Share Ownership Plans | 49 |
| | Board Practices | 50 |
| | Employees | 50 |
| **Item 7.** | **Major Shareholders and Related Party Transactions** | 51 |
| **Item 8.** | **Financial Information** | 52 |

| **Item 9.** | **The Offer and Listing** | 52 |
|---|---|---|

Table of Contents


| | | Page |
|---|---|---|
| **Item 10.** | **Additional Information** | 53 |
| | Articles of Association | 53 |
| | Material Contracts | 57 |
| | Exchange Controls | 58 |
| | Tax Considerations | 58 |
| | Documents on Display | 60 |
| **Item 11.** | **Quantitative and Qualitative Disclosures about Market Risk** | 60 |
| | Introduction | 60 |
| | Interest Rates | 61 |
| | Currency Exchange Rates | 61 |
| | Forward Foreign Exchange Contracts | 62 |
| | Derivatives | 62 |
| | Quantitative Information about Market Risk | 63 |
| **Item 12.** | **Description of Securities Other Than Equity Securities** | 63 |
| **Item 12D.** | **American Depositary Shares** | 63 |
| | Fees paid by ADR holders | 63 |
| | Fees incurred in past annual period and fees to be paid in the future | 63 |
| | **PART II** | |
| **Item 13.** | **Defaults, Dividend Arrearages and Delinquencies** | 65 |
| **Item 14.** | **Material Modifications to the Rights of Security Holders and Use of Proceeds** | 65 |
| **Item 15.** | **Controls and Procedures** | 65 |
| | Disclosure Controls and Procedures | 65 |
| | Management s Annual Report on Internal Control over Financial Reporting | 65 |
| | Change in Internal Control over Financial Reporting | 65 |
| **Item 16A.** | **Audit Committee Financial Expert** | 65 |
| **Item 16B.** | **Code of Ethics** | 66 |
| **Item 16C.** | **Principal Accountant Fees and Services** | 66 |
| **Item 16D.** | **Exemptions from the Listing Standards for Audit Committees** | 66 |
| **Item 16E.** | **Purchases of Equity Securities by the Issuer and Affiliated Purchases** | 67 |
| **Item 16F.** | **Changes in Registrant s Certifying Auditor** | 67 |
| **Item 16G.** | **Corporate Governance** | 67 |
| | **PART III** | |
| **Item 17.** | **Financial Statements** | 67 |
| **Item 18.** | **Financial Statements** | 67 |
| **Item 19.** | **Exhibits** | 67 |

EX-1.1
EX-2.7
EX-8.1
EX-12.1
EX-12.2
EX-13.1
EX-13.2
EX-15

## INTRODUCTION

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

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

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

- references to sterling , pounds , pence or £ are to the lawful currency of the United Kingdom,

- references to euro or are to the euro, the lawful currency of the participating Member States in the Third Stage of the European Economic and Monetary Union of the Treaty Establishing the European Commission, and

- references to US dollars , dollars , cents or $ are to the lawful currency of the United States.

For convenience and except where we specify otherwise, we have translated some sterling figures into US dollars at the rate of £1.00 = $1.54, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2010, the last business day of 2010. We do not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On February 28, 2011 the noon buying rate for sterling was £1.00 = $1.62.

The Group consists of three major worldwide businesses, Pearson Education, The FT Group ( FT ) and the Penguin Group ( Penguin ). See Item 4. Information on the Company Overview of operating divisions .

## FORWARD-LOOKING STATEMENTS

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

- operations and prospects,

growth strategy,

funding needs and financing resources,

expected financial position,

market risk,

currency risk,

**Table of Contents**

US federal and state spending patterns,

debt levels, and

general market and economic conditions.

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

Table of Contents

## PART I

## ITEM 1. *IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS*

Not applicable.

## ITEM 2. *OFFER STATISTICS AND EXPECTED TIMETABLE*

Not applicable.

## ITEM 3. *KEY INFORMATION*

**Selected consolidated financial data**

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

The table below shows selected consolidated financial data under IFRS as issued by the IASB. The selected consolidated profit and loss account data for the years ended December 31, 2010, 2009 and 2008 and the selected consolidated balance sheet data as at December 31, 2010 and 2009 have been derived from our audited consolidated financial statements included in Item 18. Financial Statements in this Annual Report.

The results of the Interactive Data business (disposed in July 2010) have been included in discontinued operations for all the years to 2010. The results of the Data Management business (disposed in February 2008) have been included in discontinued operations for all years to 2008. The results of Government Solutions (disposed in February 2007) and Les Echos (disposed in December 2007) have been included in discontinued operations for all the years to 2007.

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

For convenience, we have translated the 2010 amounts into US dollars at the rate of £1.00 = $1.54, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2010.

| | Year Ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | **2010** | **2010** | **2009** | **2008** | **2007** | **2006** |
| | **$** | **£** | **£** | **£** | **£** | **£** |
| | (In millions, except for per share amounts) | | | | | |
| **Consolidated Income Statement data** | | | | | | |
| Total sales | 8,721 | 5,663 | 5,140 | 4,405 | 3,818 | 3,658 |
| Total operating profit | 1,144 | 743 | 619 | 564 | 484 | 440 |
| | 807 | 524 | 377 | 344 | 274 | 405 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Profit after taxation from continuing operations | | | | | | | |
| Profit for the financial year | | 2,002 | 1,300 | 462 | 323 | 310 | 469 |
| **Consolidated Earnings data per share** | | | | | | | |
| Basic earnings per equity share(1) | $ | 2.49 | 161.9p | 53.2p | 36.6p | 35.6p | 55.9p |
| Diluted earnings per equity share(2) | $ | 2.49 | 161.5p | 53.1p | 36.6p | 35.6p | 55.8p |
| Basic earnings from continuing operations per equity share(1) | $ | 1.02 | 66.0p | 47.0p | 42.9p | 34.1p | 50.6p |
| Diluted earnings from continuing operations per equity share(2) | $ | 1.01 | 65.9p | 47.0p | 42.9p | 34.1p | 50.5p |
| Dividends per ordinary share | $ | 0.60 | 38.7p | 35.5p | 33.8p | 31.6p | 29.3p |
| **Consolidated Balance Sheet data at period end** | | | | | | | |
| Total assets (non-current assets plus current assets) | | 16,429 | 10,668 | 9,412 | 9,896 | 7,292 | 7,213 |
| Net assets | | 8,632 | 5,605 | 4,636 | 5,024 | 3,874 | 3,644 |
| Long-term obligations(3) | | (4,344) | (2,821) | (3,051) | (2,902) | (1,681) | (1,853) |
| Capital stock | | 313 | 203 | 203 | 202 | 202 | 202 |
| Number of equity shares outstanding (millions of ordinary shares) | | 813 | 813 | 810 | 809 | 808 | 806 |

Notes:

(1) Basic earnings per equity share is based on profit for the financial period and the weighted average number of ordinary shares in issue during the period.

(2) Diluted earnings per equity share is based on diluted earnings for the financial period and the diluted weighted average number of ordinary shares in issue during the period. Diluted earnings comprise earnings adjusted for the tax benefit on the conversion of share options by employees and the weighted average number of ordinary shares adjusted for the dilutive effect of share options.

(3) Long-term obligations comprise any liabilities with a maturity of more than one year, including medium and long-term borrowings, derivative financial instruments, pension obligations and deferred income tax liabilities.

**Dividend information**

We pay dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. Our board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. Our board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders approval at our annual general meeting. At our annual general meeting on April 28, 2011 our shareholders will be asked to approve a final dividend of 25.7p per ordinary share for the year ended December 31, 2010.

The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in The City of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2010 fiscal year will be paid on May 6, 2011.

| Fiscal year | Interim | Final | Total | Interim | Final | Total |
|---|---|---|---|---|---|---|
| | (Pence per ordinary share) | | | (Cents per ordinary share) | | |
| **2010** | 13.0 | 25.7 | 38.7 | 20.3 | 39.6* | 59.9 |
| 2009 | 12.2 | 23.3 | 35.5 | 19.8 | 34.3 | 54.1 |
| 2008 | 11.8 | 22.0 | 33.8 | 21.6 | 33.2 | 54.8 |
| 2007 | 11.1 | 20.5 | 31.6 | 22.4 | 39.9 | 62.3 |
| 2006 | 10.5 | 18.8 | 29.3 | 20.0 | 31.4 | 51.4 |

* As the 2010 final dividend had not been paid by the filing date, the dividend has been translated into cents using the noon buying rate for sterling at December 31, 2010.

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

**Exchange rate information**

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in

The City of New York on each day during a monthly period and on the last day of each month during an annual period. On December 31, 2010 the noon buying rate for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes for sterling was £1.00 = $1.54. On February 28, 2011 the noon buying rate for sterling was £1.00 = $1.62.

| **Month** | **High** | **Low** |
|---|---|---|
| February 2011 | $ 1.62 | $ 1.60 |
| January 2011 | $ 1.60 | $ 1.55 |
| December 2010 | $ 1.59 | $ 1.54 |
| November 2010 | $ 1.63 | $ 1.56 |
| October 2010 | $ 1.60 | $ 1.57 |
| September 2010 | $ 1.59 | $ 1.53 |

Table of Contents

| Year Ended December 31 | Average rate |
|---|---|
| 2010 | $ 1.54 |
| 2009 | $ 1.57 |
| 2008 | $ 1.84 |
| 2007 | $ 2.01 |
| 2006 | $ 1.84 |

## Risk factors

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

***Our education, business information and book publishing businesses will be impacted by the rate of and state of technological change, including the digital evolution and other disruptive technologies.***

A common trend facing all our businesses is the digitization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration brings the need for change in product distribution, consumers perception of value and the publisher s position between retailers and authors, which affects managing stock levels. The trend to e-books has created contraction in the consumer books retail market which increases the risk of bankruptcy of a major retail customer; this could disrupt short-term product supply to the market as well as could result in a large debt write off.

We face competitive threats both from large media players and from smaller businesses, online and mobile portals and news redistributors operating in the digital arena and providing alternative sources of news and information. New distribution channels, e.g. digital format, the internet, online retailers, growing delivery platforms (e.g. e-readers), combined with the concentration of retailer power pose both threats and opportunities to our traditional consumer publishing models, potentially impacting both sales volumes and pricing.

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

***Investment returns outside our traditional core US and UK markets may be lower than anticipated.***

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

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

The results and growth of our US educational solutions and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. State, local and municipal finances have been adversely affected by the US recession and the unknown timing of economic recovery. Funding pressures remain, with competition from low price and disruptive new business models and promotion of open source to keep costs down. The current challenging environment could impact our ability to collect on education-related debt.

Federal and/or state legislative changes can also affect the funding available for educational expenditure, which include the impact of education reform, such as the reauthorization of the Elementary and Secondary Education Act, the introduction of the Common Core and Race to the Top funding. Similarly changes in the state

procurement process for textbooks, learning material and student tests, particularly in the adoptions market can also affect our markets. For example, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year.

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

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

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

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

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

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

***Our intellectual property and proprietary rights may not be adequately protected under current laws in some jurisdictions and that may adversely affect our results and our ability to grow.***

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

We cannot be sure that our proprietary rights will not be challenged, invalidated or circumvented. Our intellectual property rights in countries such as the US and the UK, jurisdictions covering the largest proportion of our operations, are well established. However, we also conduct business in other countries where the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. Moreover, despite trademark and copyright protection, third parties may copy, infringe or otherwise profit from our proprietary rights without our authorization.

These unauthorized activities may be more easily facilitated by the internet. The lack of internet-specific legislation relating to trademark and copyright protection creates an additional challenge for us in protecting our proprietary

rights relating to our online business processes and other digital technology rights. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance.

In that regard, Google reached a tentative settlement in 2008 with the Author s Guild and the Association of American Publishers over Google s plans to copy the full text of all books ever published without permission of the copyright owners, including Pearson. The agreement was revised in 2009 to narrow the definition of books covered under the settlement agreement to those registered with the US Copyright Office by January 2009 or published in Australia, UK, Canada or US. Subject to final court approvals, the settlement would allow copyright owners of

books covered by it to control the online display of those books by Google, with a sharing of revenues derived from that display. The amended settlement agreement has yet to be approved.

***A major data privacy breach may cause reputational damage to our brands and financial loss.***

Across our businesses we hold large volumes of personal data including that of employees, customers and, in our assessment businesses, students and citizens. Individuals may try to gain unauthorized access to our data in order to misappropriate such information for potentially fraudulent purposes. As the techniques used to gain unauthorized access change frequently, we may be unable to anticipate or protect against the threat of breaches. Failure to adequately protect personal data could lead to penalties, significant remediation costs, reputational damage, potential cancellation of some existing contracts and inability to compete for future business.

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

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

***Changes in students buying and distribution behaviour put downward pressure on price.***

Students are seeking cheaper sources of content, e.g. online discounters, file sharing, use of pirated copies, and rentals, along with open source. This change in behaviour, along with the move from professor-centric decision-making, puts downward pressure on textbook prices in our major markets.

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

These businesses are characterized by multi-million pound sterling contracts spread over several years. As in any contracting business, there are inherent risks associated with the bidding process, start-up, operational performance and contract compliance (including penalty clauses) which could adversely affect our financial performance and/or reputation. Failure to retain these contracts at the end of the contract term could adversely impact our future revenue growth. At Edexcel, our UK Examination board and testing business, any change in UK Government policy to examination marking (e.g. price capping) could have a significant impact on our present business model.

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

All our businesses, to a greater or lesser extent, are dependent on information technology. We either provide software and/or internet services to our customers or we use complex IT systems and products to support our business activities, particularly in business information publishing, back-office processing and infrastructure. We face several technological risks associated with software product development and service delivery in our educational businesses, information technology security (including virus and hacker attacks), e-commerce, enterprise resource planning

system implementations and upgrades. Although plans and procedures are in place to reduce such risks, our businesses could be adversely affected if our systems and infrastructure experience a significant failure or interruption.

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

We continually acquire and dispose of businesses to achieve our strategic objectives. In 2010 we acquired Melorio plc, Medley Global Advisors LLC, Sistema Educacional Brasileiro, Wall Street Institute Education Sarl, America s Choice Inc and several other small acquisitions, and we sold our interest in Interactive Data. Acquired goodwill and intangible assets could be impaired if we are unable to generate the anticipated revenue growth, synergies and/or cost savings associated with these or other acquisitions.

***Expected benefits from our finance transformation programme initiatives may not be realised.***

We have entered into a substantial finance transformation programme based around shared and common processes and services, including the outsourcing of financial transaction processing, which is expected to result in significant cost savings in future years. The programme may take longer than planned, cost more than planned, and may cause disruption to our business. There is no assurance that the full extent of the anticipated benefits will be realised in the timeline envisaged.

***Changes in our tax position can significantly affect our reported earnings and cash flows.***

Changes in corporate tax rates and/or other relevant tax laws in the UK and/or the US could have a material impact on our future reported tax rate and/or our future tax payments.

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

As with any international business our earnings can be materially affected by exchange rate movements. We are particularly exposed to movements in the US dollar to sterling exchange rate as approximately 60% of our revenue is generated in US dollars. Sales for 2010, translated at 2009 average rates, would have been £128m or 2% lower.

This is primarily a currency translation risk that only arises on consolidation and is the result of translating entities into sterling for reporting purposes (i.e. non-cash flow item), and not a trading risk (i.e. cash flow item) as our foreign currency trading cash flows in individual operating companies are relatively limited. See Item 5. Operating and Financial Review and Prospects General Overview, Exchange rate fluctuations .

Each 5¢ change in the average £:$ exchange rate for the full year (which in 2010 was £1:$1.54) has a translation impact of approximately 1.3p on reported earnings per share and affect shareholders funds by approximately £115m.

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

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

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

A prolonged and severe economic depression could significantly reduce the Group s revenues, profitability and cash flows as customers would be unable to purchase products and services in the expected quantities and/or pay for them within normal agreed terms. A liquidity shortfall may delay certain development initiatives or may expose the Group to a need to negotiate further funding. If there was a steep decline in operating profit the Group might breach its banking covenants, creating (or exacerbating) a need for further funding (or a renegotiation of the terms of the bank credit agreement) to maintain operations. The current fragile state of the credit markets could expose the Group to a risk that it could neither re-negotiate its existing banking facilities, nor raise enough new

funding, at a cost level that was sustainable for the business. Were this to occur, the inability to raise funding would likely lead to a curtailment in investment and growth plans, potential asset disposals (if possible), reduction or elimination in the dividend and in an extreme case a need to restructure the Group s debt, business model and terms of trade. In such event, the value of the Group s equity could not be assured.

***Social, environmental and ethical risk.***

We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. Our 2009 risk assessment did not identify any significant under-managed SEE risks, nor have any of our most important SEE risks, many concerned with reputational risks, changed year on year. These are: journalistic/author integrity, ethical business behaviour, intellectual copyright protection, compliance with UN Global Compact standards, environmental impact, people and data privacy.

## ITEM 4. *INFORMATION ON THE COMPANY*

### Pearson plc

Pearson plc, (Pearson) is an international media and education company with its principal operations in the education, business information and consumer publishing markets. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names, to inform, educate and entertain. We deliver our content in a variety of forms and through a variety of channels, including books, newspapers and online services. We increasingly offer services as well as content, from test creation, administration and processing to teacher development and school software. Though we operate in more than 70 countries around the world, today our largest markets are the US (59% of sales) and Europe (21% of sales) on a continuing basis.

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

### Overview of operating divisions

Pearson consists of three major worldwide businesses:

**Pearson Education** is a leading provider of educational materials and learning technologies. It provides test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. It publishes across the curriculum and provides a range of education services including teacher development, educational software and system-wide solutions. In 2010, Pearson Education operated through three worldwide segments, which we refer to as North American Education , International Education and Professional :

**The FT Group** provides business and financial news, data, comment and analysis, in print and online, to the international business community. The FT Group includes the *Financial Times* newspaper and FT.com website, a range of specialist financial magazines and online services, and Mergermarket, which provides proprietary forward-looking insights and intelligence to businesses and financial institutions. During the year Pearson sold its 61% interest in Interactive Data, previously part of the FT Group.

The FT Group also has a 50% ownership stake in both The Economist Group and FTSE International.

**The Penguin Group** is one of the world s leading consumer publishing businesses and an iconic global brand. We publish the works of many authors in an extensive portfolio of fiction, non-fiction and reference titles under imprints including Penguin, Hamish Hamilton, Putnam, Berkley, and Dorling Kindersley.

**Our strategy**

Our goal is to be the world s leading learning company, and to help people make progress in their lives through learning, wherever and whenever they are learning young or old; at home, school or at work; and through whatever medium and style of learning is most effective.

We aim to produce consistent growth on three key financial measures earnings per share, cash flow and return on invested capital which we believe are, together, good indicators that we are building long-term value of Pearson.

Table of Contents

To achieve this goal, our strategy has four parts, common to all our businesses:

Long-term organic investment in content: We invest steadily in content such as new education programmes, new and established authors for Penguin and the FT Group s journalism. We believe that this constant investment is critical to the quality and effectiveness of our products and services.

Digital products and services businesses: Our strategy centers on adding services to our content, usually enabled by technology, to make the content more useful, personal and valuable. These digital and services businesses give us access to new sources of revenues to sustain growth. We now receive close to one-third of our annual sales from digital products and services which is more than double the total five years ago.

International expansion: Pearson has market leading positions in major developed economies, particularly the US, UK and Western Europe. We are already present in more than 70 countries and we are investing to become a much larger global company, with particular emphasis on emerging markets, such as China, India, Africa and Latin America. Over the past 5 years our international (meaning outside North America ) education business has grown sales at an average annual rate of 18% through strong organic growth and acquisitions.

Efficiency: The businesses of Pearson have a lot in common, in costs, assets, and activities. Pooling those makes the company stronger and more efficient. It also allows our businesses to learn from each other and to collaborate to save money. On that basis we have invested for efficiency through savings in our individual businesses and through a strong centralized operations structure. We are integrated in many areas where our businesses share the same needs purchasing, warehousing, distribution, facilities and real estate, project management, people resources, finance and accounting, and transactions. Over the past five years, we have increased our adjusted operating profit margins from 12.7% to 15.1% and reduced average working capital as a percentage of sales from 26.3% to 20.1%. Adjusted operating profit is a key financial measure used by management to evaluate performance and allocate resources to our business segments. See Item 5. Operating and Financial Review and Prospects .

## Operating divisions

### *Pearson Education*

Pearson Education is one of the largest publishers of textbooks and online teaching materials, and provider of assessment services. It serves the growing demands of teachers, students, parents and professionals throughout the world for stimulating and effective education programs in print and online.

We report Pearson Education s performance in the three segments: North American Education, International Education, and Professional. In 2010, Pearson Education had sales of £4,207m or 74% (74% in 2009) of Pearson s total continuing sales. Pearson Education generated 78% of Pearson s continuing operating profit.

*North American Education*

Our North American Education business serves educators and students in the USA and Canada from early education through elementary, middle and high schools and into higher education with a wide range of products and services: curriculum textbooks and other learning materials; student assessments and testing services; and education technologies. Pearson has a leading position in each of these areas and a distinctive strategy of connecting those parts to support institutions and personalize learning. We have now integrated our North American School and Higher Education companies, which we believe will bring significant opportunities to develop growth businesses, to share investments and technologies and to gain further efficiencies.

Our North American School business contains a unique mix of publishing, testing and technology products for the elementary and secondary school markets, which are increasingly integrated. The major customers of this business are state education boards and local school districts. The business publishes high quality curriculum programmes for school students, at both elementary and secondary level, under a number of imprints including Pearson Scott Foresman and Pearson Prentice Hall. We also provide digital instructional solutions under Pearson Digital Learning, such as enVisionMATH and Miller-Levine Biology. The business also provides student information, assessment, reporting and business solutions (Pearson School Systems), which enables elementary and secondary schools and school districts to record and manage information about student attendance and performance.

**Table of Contents**

Our school testing business is the leading provider of test development, processing and scoring services to US states and the federal government. Its capabilities have been further enhanced through the integration of the Harcourt Assessment business.

Our North American Higher Education business is the largest publisher of textbooks and related course materials for colleges and universities in the US. We publish across all of the main fields of study with imprints such as Pearson Prentice Hall, Pearson Addison Wesley, Pearson Allyn & Bacon, Pearson Benjamin Cummings and Pearson Longman. Typically, professors or other instructors select or adopt the textbooks and online resources they recommend for their students, which students then purchase either in a bookstore or online. Today the majority of our textbooks are accompanied by online services which include homework and assessment tools, study guides and course management systems that enable professors to create online courses. We have also introduced new formats such as downloadable audio study guides and electronic textbooks which are sold on subscription. In addition, we have a fast-growing custom publishing business which works with professors to produce textbooks and online resources specifically adapted for their particular course.

See Item 5 Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2010 compared to year ended December 31, 2009 Sales and operating profit by division North American Education for a discussion of developments during 2010 with respect to this division.

*International Education*

Our International Education business covers all educational publishing and related services outside North America.

Our International schools business publishes educational materials in local languages in a number of countries. We are one of the world s leading providers of English Language Teaching (ELT) materials for children and adults, published under the well-known Longman imprint. In 2009 we strengthened our position further in international markets through the acquisition of Wall Street English, a chain of premium English language schools in China, and investment in vocational training and online learning in India, and in 2010 through the acquisition of Wall Street Institute, providing premium spoken English training for adults in 25 territories across Asia, Europe, the Middle East and Latin America, and Sistema Educacional Brasileiro s schools learning systems business.

Our International higher education business adapts our textbooks and technology services for individual markets, and we have a growing local publishing program, with our key markets including the UK, Benelux, Mexico, Germany, Hong Kong, Korea, Taiwan, Singapore, Japan and Malaysia.

We are also a leading provider of testing, assessment and qualification services in a number of key markets including, the UK under the brand name Edexcel, Australia, New Zealand, South Africa, Hong Kong and the Middle East.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2010 compared to year ended December 31, 2009 Sales and operating profit by division International Education for a discussion of developments during 2010 with respect to this division.

*Professional*

Our Professional education business is focused on publishing, training, testing and certification for professionals. Over the past five years we have significantly re-orientated our professional publishing business towards long-term growth markets and built professional testing into a profitable industry leader.

Our Professional education business publishes under the following imprints: Addison Wesley Professional, Prentice Hall and Cisco Press (for IT professionals); Peachpit Press and New Riders (for graphics and design professionals); Que and Sams (consumer and professional imprint); and Financial Times-Prentice Hall (for the business education market).

Our professional testing business, Pearson VUE, manages major long-term contracts to provide qualification and assessment services through its network of test centers around the world. Key customers include major technology companies, the Graduate Management Admissions Council, NCLEX, the Financial Industry Regulatory Authority and the UK s Driving Standards Agency.

Our professional training business has developed over the year with the acquisition of Melorio plc, a vocational training group.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2010 compared to year ended December 31, 2009 Sales and operating profit by division Professional for a discussion of developments during 2010 with respect to this division.

***The FT Group***

The FT Group provides a broad range of data, analysis and services to an audience of internationally-minded business people and financial institutions. In 2010, the FT Group had sales of £403m, or 7% of Pearson s total continuing sales (7% in 2009), and contributed 8% of Pearson s operating profit from continuing operations.

FT Group comprises the *Financial Times*, FT.com website, and a portfolio of financial magazines and online financial information companies. During the year Interactive Data, our 61%-owned financial information company was sold and has been reclassified as a discontinued operation.

The FT Group has significantly shifted its business towards digital, subscription and content revenues and has continued to invest in talent and in services in faster growing emerging markets.

The *Financial Times* is one of the world s leading international daily business newspapers, with five editions in the UK, Europe, Middle East and Africa, the US and Asia.

Its main sources of revenue are from sales of the newspaper, advertising and conferences. The *Financial Times* is complemented by FT.com which sells content and advertising online, and which charges subscribers for detailed industry news, comment and analysis, while providing general news and market data to a wider audience.

FT Business publishes specialist information on the retail, personal and institutional finance industries through titles including *Investors Chronicle*, *Money Management*, *Financial Adviser* and *The Banker*.

Mergermarket, our online financial data and intelligence provider, provides early stage proprietary intelligence to financial institutions and corporates. Its key products include *Mergermarket*, *Debtwire*, *dealReporter*, *Wealthmonitor* and *Pharmawire*.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2010 compared to year ended December 31, 2009 Sales and operating profit by division FT Group for a discussion of developments during 2010 with respect to this division.

*Joint Ventures and Associates*

The FT Group also has a number of associates and joint ventures, including:

- 50% interest in The Economist Group, publisher of one of the world s leading weekly business and current affairs magazines.

- 50% interest in FTSE International, a joint venture with the London Stock Exchange, which publishes a wide range of global indices, including the FTSE index.

50% interest in *Business Day* and *Financial Mail*, publishers of one of South Africa s leading financial newspapers and magazines.

33% interest in *Vedomosti,* a leading Russian business newspaper.

On March 27, 2008, Financial Times International Publishing Ltd sold its 50% partnership interest in Financial Times Deutschland GmbH & Co KG to Gruner & Jahr AG & Co KG.

***The Penguin Group***

Penguin is one of the most famous brands in book publishing. It publishes over 4,000 fiction and non-fiction books each year, on paper, screens and in audio formats for readers of all ages, and has an extensive range of backlist and frontlist titles including top literary prize winners, classics, reference volumes and children s titles.

Penguin operates around the world through a series of connected national publishing houses. It publishes under a number of well known imprints including Putnam, Viking, Allen Lane, Hamish Hamilton, Berkley, Dorling Kindersley, Puffin and Ladybird. Penguin combines a longstanding commitment to local publishing with a

determination to benefit from its worldwide scale, a globally recognized brand and growing demand for books in emerging markets. Its largest businesses are in the US, the UK, Australia, Canada, Ireland, India, South Africa and New Zealand.

In 2010, Penguin had sales of £1,053m, representing 19% of Pearson s total continuing sales (19% in 2009) and contributed 14% of Pearson s operating profit from continuing operations. Its largest market is the US, which generated around 59% of Penguin s sales in 2010. Penguin earns around 93% of its revenues from the sale of hard cover and paperback books. The balance comes from audio books and e-books.

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

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2010 compared to year ended December 31, 2009 Sales and operating profit by division The Penguin Group for a discussion of developments during 2010 with respect to this division.

### Operating cycles

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

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

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

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

The International Education markets operate in a similar way although often with less formal adoption processes.

The operating cycles in respect of Professional and the Penguin segment are more specialized in nature as they relate to educational or heavy reference products released into smaller markets (e.g. the financial training, IT and travel sectors). Nevertheless, in these markets, there is still a regular cycle of product renewal, in line with demand which

management monitor. Typically the life cycle is 5 years for Professional content and up to 4 years for Penguin content. Elsewhere in the Group operating cycles are typically less than one year.

**Competition**

All of Pearson s businesses operate in highly competitive environments.

Pearson Education competes with other publishers and creators of educational materials and services. These companies include large international companies, such as McGraw-Hill and Houghton Mifflin Harcourt, alongside smaller niche players that specialize in a particular academic discipline or focus on a learning technology.

Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the school boards, educators and government officials making purchasing decisions.

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

The Penguin Group competes with other publishers of fiction and non-fiction books. Principal competitors include Random House, HarperCollins, and Hachette Group. Publishers compete by developing a portfolio of books by established authors and by seeking out and promoting talented new writers.

**Intellectual property**

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

**Raw materials**

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

**Government regulation**

The manufacture of certain of our products in various markets is subject to governmental regulation relating to the discharge of materials into the environment. Our operations are also subject to the risks and uncertainties attendant to doing business in numerous countries. Some of the countries in which we conduct these operations maintain controls on the repatriation of earnings and capital and restrict the means available to us for hedging potential currency fluctuation risks. The operations that are affected by these controls, however, are not material to us. Accordingly, these controls have not significantly affected our international operations. Regulatory authorities may have enforcement powers that could have an impact on us. We believe, however, that in light of the nature of our business the risk of these sanctions does not represent a material threat to us.

**Licenses, patents and contracts**

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

**Legal Proceedings**

We and our subsidiaries are from time to time the subject of legal proceedings incidental to the nature of our and their operations. These may include private litigation or arbitrations, governmental proceedings and investigations by

regulatory bodies. We do not currently expect that the outcome of pending proceedings or investigations, either individually or in aggregate, will have a significant effect on our financial position or profitability nor have any such proceedings had such effect in the recent past. To our knowledge, there are no material proceedings in which any member of senior management or any of our affiliates is a party adverse to us or any of our subsidiaries or in respect of which any of those persons has a material interest adverse to us or any of our subsidiaries.

**Recent developments**

On November 22, 2010, the Group announced the proposed acquisition of a 75% stake in CTI Education Group, a leading South African education company for £31m. As at the end of December 2010 this acquisition had not been completed but is expected to complete in the first half of 2011.

Table of Contents

On January 18, 2011, the Group announced that it had agreed to increase it shareholding in Tutorvista, the Bangalore based tutoring services company, to a controlling 76% stake for a consideration of $127m.

On March 7, 2011, the Group and Education Development International plc (EDI) announced that they had reached agreement on the terms of a recommended cash offer to be made by Pearson for the entire issued share capital of EDI. The offer values EDI at approximately £112.7m. EDI is a leading provider of education and training qualifications and assessment services, with a strong reputation for the use of information technology to administer learning programmes and deliver on-screen assessments.

**Organizational structure**

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries as at December 31, 2010, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

| Name | Country of incorporation/residence | Percentage interest/voting power |
|---|---|---|
| **Pearson Education** | | |
| Pearson Education Inc. | United States (Delaware) | 100% |
| Pearson Education Ltd. | England and Wales | 100% |
| Edexcel Ltd. | England and Wales | 100% |
| NCS Pearson Inc. | United States (Minnesota) | 100% |
| **FT Group** | | |
| The Financial Times Limited | England and Wales | 100% |
| Mergermarket Ltd. | England and Wales | 100% |
| **The Penguin Group** | | |
| Penguin Group (USA) Inc. | United States (Delaware) | 100% |
| The Penguin Publishing Co Ltd. | England and Wales | 100% |
| Dorling Kindersley Holdings Ltd | England and Wales | 100% |

**Property, plant and equipment**

Our headquarters are located at leasehold premises in London, England. We own or lease approximately 1,000 properties, including approximately 550 testing/teaching centers in more than 70 countries worldwide, the majority of which are located in the United Kingdom and the United States.

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

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

We own the following principal properties at December 31, 2010:

| General use of property | Location | Area in square feet |
| --- | --- | --- |
| Warehouse/Office | Kirkwood, New York, USA | 524,000 |
| Warehouse/Office | Pittston, Pennsylvania, USA | 406,000 |
| Office | Iowa City, Iowa, USA | 310,000 |
| Warehouse/Office | Old Tappan, New Jersey, USA | 210,112 |
| Warehouse/Office | Cedar Rapids, Iowa, USA | 205,000 |
| Office | Southwark, London, UK | 155,000 |
| Office | Hadley, Massachusetts, USA | 137,070 |
| Printing | Owatonna, Minnesota, USA | 128,000 |

We lease the following principal properties at December 31, 2010:

| General use of property | Location | Area in square feet |
|---|---|---|
| Warehouse/Office | Lebanon, Indiana, USA | 1,091,435 |
| Warehouse/Office | Cranbury, New Jersey, USA | 886,747 |
| Warehouse/Office | Indianapolis, Indiana, USA | 737,850 |
| Warehouse/Office | San Antonio, Texas, USA | 559,258 |
| Office | Upper Saddle River, New Jersey, USA | 474,801 |
| Warehouse/Office | Rugby, UK | 446,077 |
| Office | New York City, New York, USA | 443,229 |
| Office | London, UK | 282,923 |
| Warehouse/Office | Newmarket, Ontario, Canada | 278,912 |
| Warehouse/Office | Austin, Texas, USA | 226,076 |
| Office | Boston, Massachusetts, USA | 225,299 |
| Warehouse | Scoresby, Victoria, Australia | 197,255 |
| Office | Glenview, Illinois, USA | 187,500 |
| Warehouse/Office | Bedfordshire, UK | 186,570 |
| Office | Bloomington, Minnesota, USA | 153,240 |
| Office | Boston, Massachusetts, USA | 138,112 |
| Office | Harlow, UK | 137,857 |
| Office | Chandler, Arizona, USA | 135,460 |
| Warehouse/Office | Cedar Rapids, Iowa, USA | 119,682 |
| Office | New York City, New York, USA | 117,478 |
| Warehouse | San Antonio Zomeyucan, Mexico | 113,638 |
| Office | London, UK | 112,000 |
| Call Center | Lawrence, Kansas, USA | 105,000 |

**Capital Expenditures**

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

**ITEM 4A.** ***UNRESOLVED STAFF COMMENTS***

The Company has not received, 180 days or more before the end of the 2010 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

**ITEM 5.** ***OPERATING AND FINANCIAL REVIEW AND PROSPECTS***

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

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

as changes due solely to changes in exchange rates are eliminated.

## General overview

### *Introduction*

Sales from continuing operations increased from £5,140m in 2009 to £5,663m in 2010, an increase of 10%. The year on year growth was impacted by exchange rates, in particular the US dollar. The average US dollar exchange rate in 2010 strengthened in comparison to sterling in 2009, which had the effect of increasing reported sales in 2010 by £128m when compared to the equivalent figure at constant 2009 rates. When measured at constant 2009 exchange rates, all our businesses contributed to the growth. The International Education business in particular, benefited from acquisitions made in 2009 and 2010.

Table of Contents

Reported operating profit increased by 20% from £619m in 2009 to £743m in 2010. The relative strength of the US dollar contributed to this increase and operating profit would have been approximately £37m lower if translated at constant 2009 exchange rates. Again, when measured at constant rates, we saw contributions to the growth in operating profit from all our businesses as we benefited from the improved sales performance and cost efficiencies.

Profit before taxation in 2010 of £670m compares to a profit before taxation of £523m in 2009. The increase of £147m reflects the improved operating performance and a reduction in net finance costs. Net finance costs reduced from £96m in 2009 to £73m in 2010. The Group s net interest payable decreased by £13m in 2010 as we benefited from a fall in average interest rates on our floating-rate US dollar debt and a decrease in our overall level of average net debt following the receipt of proceeds from the sale of Interactive Data. Exchange losses of £7m in 2009 compare to a net exchange gain of £9m in 2010. The gain in 2010 mainly relates to exchange on new US borrowing raised in the year. In 2009, the charge mainly related to losses on cross currency swaps. The finance charge relating to post-retirement plans of £12m in 2010 was the same as that in 2009.

On 29 July 2010, Pearson s 61% share in Interactive Data Corporation was sold to Silver Lake Technology Management LLC (Silver Lake) and Warburg Pincus LLC (Warburg Pincus) for $2bn. The results of Interactive Data have been included as discontinued operations for the period to 29 July 2010 and in prior periods. Included in discontinued operations in 2010 is the gain on sale of Interactive Data of £1,037m and the attributable tax charge of £306m. On February 22, 2008 the Group completed the sale of its Data Management business and this business has been included in discontinued operations for the period to February 22 in 2008, and in prior periods.

Net cash generated from operations increased to £1,169m in 2010 from £1,012m in 2009. The improved cash generation in 2010 was due to strong cash collections, particularly in our education businesses and was helped by our transition to a more digital and service based business. This transition is also helping to reduce our working capital and on an average basis, the ratio of working capital to sales improved from 25.1% to 20.1%, also reflecting tight working capital management and the favourable working capital profile of 2009 and 2010 acquisitions. Average working capital comprises the average of the monthly carrying values over the relevant 12 month period for inventory, pre-publication costs, debtors and creditors. Net interest paid at £68m in 2010 was £19m below the previous year, as a result of the fall in overall net interest and to the timing of interest payments on the bond portfolio. Tax paid excluding the amounts paid on the Interactive Data disposal in 2010 decreased to £85m compared to £103m in 2009 as Interactive Data itself had been a significant tax payer. Net capital expenditure on property, plant and equipment after proceeds from sales increased to £76m in 2010 from £61m in 2009. The net cash outflow in respect of businesses acquired increased from £208m in 2009 to £535m in 2010 whilst the Interactive Data sale in 2010 raised proceeds of £734m net of tax paid. There were no disposals in 2009. Dividends from joint ventures and associates were broadly flat year on year at £23m in 2010 against £22m in 2009. Dividends paid of £293m in 2009 (including £20m paid to non-controlling interests) compares to £298m in 2010 (including £6m paid to non-controlling interests). Overall net borrowings decreased by £662m from £1,092m at the end of 2009 to £430m at the end of 2010 largely due to the proceeds from the Interactive Data sale and the strong cash collections.

***Outlook***

Over the past five years Pearson has produced growth in earnings and cash flow. We sustained our growth even in the face of very tough economic and market conditions in recent years. We are planning for some of our markets to remain weak in 2011, particularly those that depend on government spending and traditional print publishing business models. In addition, we face tough comparatives (especially in the first half of the year) after our particularly strong competitive and financial performance in 2010.

Even so, we have built a series of competitive advantages which should help us deliver another good year in 2011. These advantages include our sustained investment, digital leadership, educational effectiveness, positions in

fast-growing economies and operating efficiency.

*Pearson Education*

In education, we expect to achieve continued growth in 2011. In North America, we see growth in higher education (despite slower enrolment rates) and assessment more than offsetting a slower year for the school publishing industry (the result of the lower new adoption opportunity and pressure on state budgets). Our International Education business will benefit from its rapidly-growing position in services, technology and developing economies, enabling it to grow again despite the weak public spending environment in some markets.

Table of Contents

*FT Group*

At the FT Group, we are rapidly shifting our business model towards digital and subscription revenues. Advertising revenues remain unpredictable, but we see healthy demand for the FT s premium content, especially in digital formats, and a recovery in business conditions for Mergermarket.

*The Penguin Group*

Penguin will face another year of fast-changing industry conditions, driven by the rapid growth of both digital sales channels and digital books, and by the resulting pressures on physical bookstores. After a particularly strong competitive performance and financial results in 2010, we expect Penguin to perform in line with the overall consumer publishing industry this year, while we continue to adapt the business to these industry changes.

***Sales information by operating division***

The following table shows sales information for each of the past three years by operating division:

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| | £m | £m | £m |
| Education: | | | |
| North American | 2,640 | 2,470 | 2,002 |
| International | 1,234 | 1,035 | 866 |
| Professional | 333 | 275 | 244 |
| FT Group | 403 | 358 | 390 |
| Penguin | 1,053 | 1,002 | 903 |
| Total | 5,663 | 5,140 | 4,405 |

***Sales information by geographic market supplied***

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

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| | £m | £m | £m |
| European countries | 1,205 | 1,081 | 1,092 |
| North America | 3,589 | 3,344 | 2,761 |
| Asia Pacific | 577 | 497 | 403 |
| Other countries | 292 | 218 | 149 |
| Total | 5,663 | 5,140 | 4,405 |

***Exchange rate fluctuations***

We earn a significant proportion of our sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was £1:$1.54 in 2010, £1:$1.57 in 2009 and £1:$1.85 in 2008. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. In 2010, Pearson generated 59% of its sales in the US (2009: 61%; 2008: 59%). In 2010 we estimate that a five cent change in the average exchange rate between the US dollar and sterling would have had an impact on our reported earnings per share of 1.3p and a five cent change in the closing exchange rate between the US dollar and sterling would have had an impact on shareholders funds of approximately £115m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for more information. The year-end US dollar rate for 2010 was £1:$1.57 compared to £1:$1.61 for 2009. In terms of the year end rate, the weakening of sterling in comparison to the US dollar in 2010 was less significant than the strengthening of sterling compared to the US dollar in the previous year when the relatively weak value of the US dollar had the effect of reducing shareholders funds. The net effect of movement in all currencies in 2010 was an increase in our shareholders funds of £173m. The year-end rate for the US dollar in 2009 was £1:$1.61 compared to £1:$1.44 for

2008. The comparative weakness of the US dollar, contributed to an overall reduction in shareholders funds due to exchange movements of £388m in 2009.

***Critical accounting policies***

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

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

## Results of operations

***Year ended December 31, 2010 compared to year ended December 31, 2009***

*Consolidated results of operations*

***Sales***

Our total sales from continuing operations increased by £523m, or 10%, to £5,663m in 2010, from £5,140m in 2009. The increase reflected growth, on a constant exchange rate basis, at all of our businesses together with additional contributions from acquisitions made in both 2009 and 2010. The year on year growth was impacted by movements in exchange rates, particularly in the US dollar. 2010 sales, translated at 2009 average exchange rates, would have been £5,535m.

Pearson Education increased sales by £427m or 11% from £3,780m to £4,207m. The North American, International and Professional businesses all contributed to the increase although the International Education business was helped by acquisitions made in 2009 and 2010 and the Professional business benefited from the acquisition of Melorio in 2010. A high proportion of the increase was also due to exchange. We estimate that after excluding acquisitions, Pearson Education saw sales growth of 5% at constant last year exchange rates. The North American business saw strong growth in Higher Education which again out-performed the market which grew at 7.3% in 2010, according to the Association of American Publishers after benefiting from healthy enrolment growth and good demand for instructional materials. The North American publishing business also gained share in the US school curriculum market as this market returned to growth, benefiting from the stronger new adoption opportunity and in spite of the fact that state budgets remained under pressure. The US school publishing market grew 3.2% according to the Association of American Publishers. Revenues at the US Assessment and Information division were broadly level against 2009. State funding issues produced tough market conditions for our state assessment and teacher licensure testing businesses. This was offset by good growth in clinical and diagnostic assessments. International Education sales also benefited from exchange and a contribution from the acquisitions of Sistema Educacional Brasileiro and Wall Street Institute in 2010 and a full year contribution from the 2009 acquisitions of Wall Street English and Fronter and the increased shareholdings in Longman Nigeria and Maskew Miller Longman. After excluding the effect of acquisitions we estimate that there was growth of 6% at constant last year exchange rates in the International Education business. Professional sales increased in 2010 by 21% although much of this increase was due to the contribution from Melorio, the UK vocational training business acquired in June 2010. In terms of constant last year exchange rates and after taking out the acquisition of Melorio there was still good growth in professional testing and modest growth in the professional publishing business.

FT Group sales were 13% ahead of last year driven by strong growth at the *Financial Times* with growth in digital readership and subscriptions, helped by good advertising growth in 2010. Mergermarket continued to benefit from an improvement in market conditions and its flexibility in adapting to new client investment strategies which supported a recovery in renewal rates and growth in new business revenues. An increase in global merger and acquisition activity benefited Mergermarket and dealReporter and continued volatility in debt markets helped sustain the strong performance of DebtWire.

Penguin s sales were up 5% in 2010 and it gained share in its three largest markets, the US, UK and Australia. Growth was also due to the very strong growth in ebooks which now account for 6% of Penguin revenues worldwide.

**Table of Contents**

Pearson Education, our largest business sector, accounted for 74% of our continuing business sales in 2010 and 2009. North America continued to be the most significant source of our sales and as a proportion of total continuing sales contributed 63% in 2010 and 65% in 2009.

***Cost of goods sold and operating expenses***

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

| | **Year Ended December 31** | |
|---|---|---|
| | **2010** | **2009** |
| | **£m** | **£m** |
| Cost of goods sold | 2,588 | 2,382 |
| Distribution costs | 298 | 275 |
| Administration and other expenses | 2,190 | 2,014 |
| Other operating income | (115) | (120) |
| Total | 2,373 | 2,169 |

*Cost of goods sold.* Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges and the cost of service provision in the assessment and testing business. Our cost of sales increased by £206m, or 9%, to £2,588m in 2010, from £2,382m in 2009. The increase corresponds to the increase in sales with cost of sales at 45.7% of sales in 2010 compared to 46.3% in 2009.

*Distribution costs.* Distribution costs consist primarily of shipping costs, postage and packing and remain a fairly constant percentage of sales.

*Administration and other expenses.* Our administration and other expenses increased by £176m, or 9%, to £2,190m in 2010, from £2,014m in 2009. As a percentage of sales they remained consistent at 39% in 2010 and 2009.

*Other operating income.* Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions together with income from the sale of assets. Other operating income decreased slightly to £115m in 2010 compared to £120m in 2009.

***Share of results of joint ventures and associates***

The contribution from our joint ventures and associates increased from £30m in 2009 to £41m in 2010. The 2010 result included a one off profit relating to a stepped acquisition at FTSE of £12m. The majority of the remainder of the profit comes from our 50% interest in the Economist.

***Operating profit***

The total operating profit increased by £124m, or 20%, to £743m in 2010 from £619m in 2009. 2010 operating profit, translated at 2009 average exchange rates, would have been £37m lower.

Operating profit attributable to Pearson Education increased by £71m, or 14%, to £576m in 2010, from £505m in 2009. The increase was attributable to a strong performance in the US Higher Education business and in the International businesses and due to the positive impact of exchange and a contribution from acquisitions. Operating profit attributable to the FT Group increased by £31m, or 100%, to £62m in 2010, from £31m in 2009. The increase reflects the improved profitability from digital businesses and the pick up in advertising together with the one off profit recorded by FTSE referred to above. Operating profit attributable to Penguin increased by £22m, or 27%, to £105m in 2010, from £83m in 2009. This increase was due to the improved sales performance and improved margins partly due to charges relating to the reorganisation of the business in the UK in 2009.

***Net finance costs***

Net finance costs decreased from £96m in 2009 to £73m in 2010. Net interest payable in 2010 was £73m, down from £86m in 2009. The Group s net interest payable decreased by £13m in 2010, mainly due to a reduction in average interest rates on our floating US dollar debt and the effect of lower average levels of net debt following the receipt of proceeds from the sale of Interactive Data. Year on year, average three month LIBOR (weighted for the

Table of Contents

Group s net borrowings in US dollars and sterling at each year end) fell by 0.3% to 0.4%. This reduction in floating market interest rates drove the Group s lower interest charge. However the low rates on deposited funds coupled with the impact on the calculation of significantly lower net debt, created an increase in the Group s average net interest payable of 5.3% to 7.9%. The Group s average net debt fell by £681m, reflecting the impact of the Interactive Data disposal. Finance charges relating to post-retirement plans were £12m in both 2010 and 2009.

Other net finance costs relating to foreign exchange and short-term fluctuations in the market value of financial instruments included a net foreign exchange loss of £7m in 2009 compared to a gain of £9 in 2010. In 2009 the loss mainly relates to losses on cross currency swaps and in 2010 the gain relates to exchange on new US dollar borrowing raised in the year. For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

***Taxation***

The total tax charge in 2010 of £146m represents 22% of pre-tax profits compared to a charge of £146m or 28% of pre-tax profits in 2009. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than the UK corporation tax rate (which had an effective statutory rate of 28% in 2010 and in 2009). Higher tax rates were partly offset by the recognition of tax losses and credits in the year including pre-acquisition and capital losses that were utilised in connection with the Interactive Data sale. The tax charge relating to that sale in July 2010 is included in the profit on discontinued businesses.

***Non-controlling interest***

The non-controlling interest in the income statement comprises mainly the publicly-held share of Interactive Data for the period to disposal in July 2010. There are also non-controlling interests in the Group s businesses in South Africa, Nigeria, China and India although none of these are material to the Group numbers. The non-controlling interest in the Group s newly acquired Brazilian business, Sistema Educacional Brasileiro, is expected to be bought out in the first half of 2011.

***Discontinued operations***

On 29 July 2010, Pearson s 61% share in Interactive Data Corporation was sold to Silver Lake and Warburg Pincus for $2bn. The results of Interactive Data have been included as discontinued operations up to the date of sale on 29 July 2010. Included in discontinued operations in 2010 is Interactive Data s results for the seven months to the date of sale, the gain on sale of £1,037m and the attributable tax charge of £306m. The total profit from discontinued operations, after taking account of the above items, was £776m in 2010 compared to £85m in 2009.

***Profit for the year***

The profit for the financial year in 2010 was £1,300m compared to a profit in 2009 of £462m. The overall increase of £838m was mainly due to the gain on sale of Interactive Data but also due to the improved operating performance and decrease in net finance costs.

***Earnings per ordinary share***

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 161.9p in 2010 compared to 53.2p in 2009 based on a weighted average number of shares in issue of 801.2m in 2010 and 799.3m in 2009. The increase in earnings per share was due to the

increase in profit for 2010 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 161.5p in 2010 and 53.1p in 2009 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

***Exchange rate fluctuations***

The strengthening of the US dollar and other currencies against sterling on an average basis had a positive impact on reported sales and profits in 2010 compared to 2009. 2010 sales, translated at 2009 average exchange rates, would have been lower by £128m and operating profit, translated at 2009 average exchange rates, would have

Table of Contents

been lower by £37m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding our management of exchange rate risks.

***Sales and operating profit by division***

The following tables summarize our sales and operating profit for each of Pearson s business segments. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. See also note 2 of Item 18. Financial Statements .

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

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

| | Year Ended December 31, 2010 | | | | | | |
|---|---|---|---|---|---|---|---|
| **£m** | **North American Education** | **International Education** | **Professional** | **FT Group** | **Interactive Data** | **Penguin** | **Total** |
| Sales | 2,640 | 1,234 | 333 | 403 | | 1,053 | 5,663 |
| | *47%* | *22%* | *6%* | *7%* | | *18%* | *100%* |
| Total operating profit | 415 | 119 | 42 | 62 | | 105 | 743 |
| | *56%* | *16%* | *6%* | *8%* | | *14%* | *100%* |
| Add back: | | | | | | | |
| Other net gains and losses | | 10 | | (12) | | | (2) |
| Acquisition costs | 1 | 7 | 2 | 1 | | | 11 |
| Amortization of acquired intangibles | 53 | 35 | 7 | 9 | | 1 | 105 |
| Adjusted operating profit: continuing operations | 469 | 171 | 51 | 60 | | 106 | 857 |
| Adjusted operating profit: discontinued operations | | | | | 81 | | 81 |
| Total adjusted operating profit | 469 | 171 | 51 | 60 | 81 | 106 | 938 |
| | *50%* | *18%* | *5%* | *6%* | *9%* | *12%* | *100%* |

Table of Contents

| | Year Ended December 31, 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| £m | North American Education | International Education | Professional | FT Group | Interactive Data | Penguin | Total |
| Sales | 2,470 | 1,035 | 275 | 358 | | 1,002 | 5,140 |
| | *48%* | *20%* | *6%* | *7%* | | *19%* | *100%* |
| Total operating profit | 354 | 109 | 42 | 31 | | 83 | 619 |
| | *57%* | *18%* | *7%* | *5%* | | *13%* | *100%* |
| Add back: | | | | | | | |
| Amortization of acquired intangibles | 49 | 32 | 1 | 8 | | 1 | 91 |
| Adjusted operating profit: continuing operations | 403 | 141 | 43 | 39 | | 84 | 710 |
| Adjusted operating profit: discontinued operations | | | | | 148 | | 148 |
| Total adjusted operating profit | 403 | 141 | 43 | 39 | 148 | 84 | 858 |
| | *47%* | *16%* | *5%* | *5%* | *17%* | 10% | *100%* |

*North American Education*

North American Education sales increased by £170m, or 7%, to £2,640m in 2010, from £2,470m in 2009 and adjusted operating profit increased by £66m, or 16%, to £469m in 2010 from £403m in 2009. The results were affected by the relative strength of the US dollar, which we estimate increased sales by £53m and adjusted operating profit by £10m when compared to the equivalent figures at constant 2009 exchange rates. At constant exchange and after taking account of the contribution from acquisitions there was underlying growth in sales of 4% and profits of 12%. Growth was driven by the US Higher Education business.

The US School publishing market grew 3.2% in 2010, according to the Association of American Publishers. State budgets continue to be under pressure but the industry returned to growth, benefiting from the stronger new adoption opportunity this year (total opportunity of $800m in 2010 against $500m in 2009). The US School curriculum business gained share with a strong performance from enVisionMATH, our digital math curriculum. Successnet, our online learning platform for teachers and students which supports Pearson s digital instruction, assessment and remediation programs, grew strongly, achieving almost 6 million registrations in 2010, up 33% on 2009, with the number of assessments taken through the system rising 53% to more than 8m. We continue to develop digital programs, platforms and mobile apps to boost achievement and to increase access and affordability. We successfully launched three major new school programs: digits (http://bit.ly/i9NcId), our digital middle school math program, which provides services for teachers including embedded assessment, differentiation of students and automation of administrative tasks; Writing Coach (http://www.phwritingcoach.com/) which is a blended print and online program that helps middle and high school students in writing and grammar with personalized assignments and grading; and Online Learning Exchange (www.onlinelearningexchange.com) which is an open education resource that allows teachers to create personalized digital learning programs using standards-based Pearson content as well as teacher-generated material. Poptropica (www.poptropica.com) is the largest virtual world for young children in the US with average monthly unique visitors growing by 40% to 8.1m from more than 100 countries and speaking more than

70 languages. Poptropica launched seven new islands and was the fifth most searched-for video game on Google.com in 2010. In September 2010 we acquired America s Choice to boost Pearson s services in school reform, a major focus of the US education department. America s Choice brings together instruction, assessment, leadership development, professional development, coaching and ongoing consulting services.

Revenues at our US Assessment & Information division were broadly level against 2009. State funding pressures produced tough market conditions for our state assessment and teacher licensure testing businesses. This was offset by good growth in clinical and diagnostic assessments. We saw good profit growth at Assessment and Information as we benefited from a shift to premium products and further efficiencies generated from the integration of the Harcourt Assessment business. We renewed two important contracts, extending our long-standing relationships with the College Board to administer the SATs and with the Texas Education Agency to

administer state-wide student assessments. We continue to achieve strong growth in secure online testing, delivering 13.3 million secure online tests in 2010, up 41% over 2009. Our market leading student information systems business in the US continued to achieve rapid organic growth further boosted by the acquisition of Administrative Assistants Limited in 2010. We now support almost 16 million US students, an increase of 49% over 2009. We achieved strong growth with AIMSWEB, our progress monitoring service which enables early intervention and remediation for struggling students. AIMSWEB now supports almost four million students, an increase of more than 20%.

The US Higher Education publishing market grew 7.3% in 2010, according to the Association of American Publishers with the industry benefiting from healthy enrolment growth and good demand for instructional materials. Pearson gained share from its lead in technology and customisation. Our US Higher Education business has now grown faster than its industry for 12 consecutive years. The pioneering MyLab digital learning, homework and assessment programs again grew strongly with student registrations up 32% to more than 7.3m in North America. We launched LearningStudio which provides a broad suite of learning management technologies including eCollege and Fronter. LearningStudio increased fully online enrolments by 54% to 8.3m in North America. Renewal rates remained high at approximately 90% by value.

Overall adjusted operating margins in the North American Education business were higher at 17.8% in 2010 compared to 16.3% in 2009 with the majority of the increase attributable to cost efficiencies and the relative success of higher margin digital products.

*International Education*

International Education sales increased by £199m, or 19%, to £1,234m in 2010, from £1,035m in 2009 and adjusted operating profit increased by £30m, or 21%, to £171m in 2010 from £141m in 2009. The sales results benefit from exchange gains and a full year contribution from acquisitions made in 2009.

The International Education business is active in more than 70 countries. More than 670,000 students outside America used our MyLab digital learning, homework and assessment programs, an increase of more than 40%. They included 150,000 users of our online English-language products MyEnglishLabs and MyNorthStarLab, a 170% increase. Our eCollege learning management system won new contracts in Malaysia and Colombia. Our Fronter learning management system continued to grow strongly with unique registration rising more than 20% to 1.1 million students in more than 8,700 schools, colleges and universities around the world. Pearson Learning Solutions, which combines products and services from across Pearson to deliver a systematic approach to improving student performance, won new contracts in South Africa, Malta, Vietnam and the UK. During the year, the International Education business acquired Wall Street Institute (WSI), which provides premium spoken English training for adults, for $101m in cash. WSI has about 340 franchised learning centers in 25 territories in Asia, Europe, the Middle East and Africa. The acquisition reunites Wall Street Institute with Wall Street English, the Chinese arm of the company acquired by Pearson in 2009.

In the UK, BTEC, our flagship vocational qualification, attracted more than 1.4 million student registrations, up 28% on 2009. Registrations for our NVQ work-based learning qualification grew 45% to more than 165,000, and we introduced the BTEC Apprenticeship to serve the work-based learning market. We marked more than 5.4 million A/AS Level and GCSE and Diploma scripts in the 2009-2010 academic year, with 90% now marked onscreen. Pearson marked and delivered 3.4 million tests in six weeks for the National Curriculum Tests at Key Stage 2. We established a new school improvement business in the UK, which will work with schools to help them train teachers, improve strategic planning and structure teaching methods.

In Italy, adoption of our Linx digital secondary science program increased three-fold, helping Pearson to grow strongly and become joint market leader for combined lower and upper secondary education. Linx is built around

content from our North American science programs customized for the Italian market. We began to develop a broader range and depth of digital products and services, including teacher training, to personalize learning and increase educational effectiveness. In the Netherlands, we launched iPockets, the first fully digital Early English course for 4-8 year-olds in Primary Education. The course is 100% digital and subscription based and customized for the Dutch market.

In South Africa s Western Cape province, we won a three-year contract to prepare, administer and report all Grade 9 student assessments. The tests focus on both individual student results and the systemic performance of

schools and districts. Pearson won new national contracts in Ethiopia, to supply 2.9 million Biology, Physics and English learning materials for Senior Secondary Grades 9 to 12. In Zimbabwe, we were awarded a contract by UNICEF to deliver 13.5 million textbooks to children in Grades 1 to 7 in Mathematics, Environmental Science, English, Shona and Ndebele.

We generated strong growth in the Gulf region in higher education with integrated technology products in Business & Economics and Science. Student enrolments at our Wall Street English schools in China increased by 27% and we announced plans to open 50 new English language centers in China over the next three to five years, adding to the 66 centers and schools already operating under the Wall Street English and Longman English brands

Pearson announced a strategic partnership with Sistema Educacional Brasileiro (SEB) in Brazil to provide services to its educational institutions and to acquire its school learning systems ( sistema ) business for $517m. A sistema is an integrated learning system incorporating curriculum design, teacher support and training, print and digital content, technology platforms, assessment and other services. SEB s sistemas serve more than 450,000 students across both private and public schools. Our School Curriculum business grew strongly, particularly in Mexico, Colombia, Chile and Peru, as we continued to build our locally developed materials as well as Spanish language adaptations of US school programmes. There was strong growth of English Language Teaching materials across Latin America underpinned by performance in Brazil, Colombia, Argentina, Chile, Dominican Republic and Peru.

International Education adjusted operating margins improved slightly from 13.6% in 2009 to 13.9% in 2010.

*Professional*

Professional sales increased by £58m, or 21%, to £333m in 2010 from £275m in 2009. Adjusted operating profit increased by £8m or 19% to £51m in 2010, from £43m in 2009. Sales growth in the assessment and training businesses was strong and benefited from the acquisition of Melorio in June 2010.

In professional testing we continued to see good growth at Pearson VUE which administered more than 8 million tests in 2010, up 3% on 2009. Average revenues per test are increasing as we develop a broader range of services and enhance our systems and assessments to meet our customer s needs. Pearson VUE renewed a number of major contracts including the Driving Standards Agency (DSA) of Great Britain and the Driver & Vehicle Agency (DVA) of Northern Ireland; Cisco; and Colorado Department of Regulatory Agencies. We also won a number of new contracts to deliver computer-based tests in the US, UK, UAE, Saudi Arabia, Egypt and Bahrain, covering the real estate, accountancy, legal, healthcare, skills and finance sectors.

In professional training, we acquired Melorio plc, one of the UK s leading vocational training groups, for £98m, supporting our vocational education strategy by combining Melorio s training delivery skills with our existing complementary strengths in educational publishing, technology and assessments. Melorio traded well in the second half of the year securing a number of large key contracts for training delivery, and successfully graduating and placing the largest IT graduate cohort in the history of the business. Our investment in systems, streamlining the course offering and training centres and back office integration are all on track.

Our Professional publishing business was level in 2010 with steady margins as strong growth in digital products and services offset continued challenging trading conditions in the retail market and a planned reduction in the number of print titles published. We launched online learning products with customisable content, assessment and personalised study paths and also delivered 450 hours of technical training through online subscriptions for the IT certification market. We developed applications for social networks and mobile devices to extend the reach and accessibility of our content and videos available within our Safari Books Online platform.

Overall adjusted operating margins in the Professional business were slightly lower at 15.3% in 2010 compared to 15.6% in 2009 as margins were impacted by the acquisition of Melorio.

*FT Group*

Sales at FT Group increased by £45m or 13%, from £358m in 2009 to £403m in 2010. Adjusted operating profit increased by £21m, from £39m in 2009 to £60m in 2010. The sales and profit increase is mainly from the *Financial Times* which saw increased demand for digital products and a pick up in advertising in the year. The Economist and other joint ventures and associates also contributed to the profit growth.

The *Financial Times* saw strong and accelerating growth in digital readership with digital subscriptions up over 50% to 207,000, more than 1,000 direct corporate customers and registered users up 79% to more than 3 million. It generated over 900,000 downloads of FT apps on mobile phones and tablet devices and won a prestigious Apple Design Award for its iPad app. The FT s combined paid print and digital circulation reached 597,000 in the fourth quarter of 2010. After weak advertising markets in 2009, we saw good advertising growth in 2010 although the visibility for advertising revenues is poor. We extended the breadth and depth of FT s premium subscription services through the launch of FT Tilt, focused on emerging markets; the launch of MandateWire US, extending the reach of this successful European brand into new markets; and the acquisition of Medley Global Advisors, a premier provider of macro policy intelligence.

Mergermarket benefited from improving market conditions and its flexibility in adapting to new client investment strategies, which supported stronger renewal rates and new business revenues. An increase in global merger and acquisition activity benefited Mergermarket and dealReporter; while continued volatility in debt markets helped sustain the strong performance of DebtWire. We saw strong growth in developing markets supported by new product launches including our first local language version of Mergermarket in China. In March 2010 we acquired Xtract research, which provides bond covenant data to allow investors to understand how covenants might impact on valuation.

*The Economist,* in which Pearson owns a 50% stake, increased global weekly circulation by 3.7% to 1.47 million (for the July-December 2010 ABC period) and total annual online visits increased to 118 million, up 21% on 2009. FTSE, our 50% owned joint venture with the London Stock Exchange, increased revenues by 20% and acquired the remaining 50% of FXI, FTSE s joint venture with Xinhua Finance in China. Business Day and Financial Mail (BDFM), our 50% owned joint-venture in South Africa with Avusa, returned to profitability with revenue increasing by 5%. The business benefited from a recovery in advertising and the closure of non-profitable operations.

Overall adjusted operating margins at FT Publishing increased from 10.9% in 2009 to 14.9% in 2010 as advertising revenue fell through to the bottom line.

*The Penguin Group*

Penguin sales increased by £51m or 5%, to £1,053m in 2010 from £1,002m in 2009 and adjusted operating profit was up 26% to £106m in 2010 from £84m in 2009. Both sales and adjusted operating profit were affected by the stronger US dollar which we estimate increased sales by £32m and adjusted operating profit by £13m when compared to the equivalent figures at constant 2009 exchange rates. In 2010, Penguin benefited from a series of organisational changes in the UK made in 2009. These were designed to strengthen its publishing, reduce costs and accelerate the transition to digital production, sales channels and formats and to lower cost markets for design and production. Penguin s 2009 results include approximately £9m of charges relating to these organisational changes.

Penguin saw a strong and consistent publishing performance across imprints and territories producing market share gains in the US, UK and Australia, our three largest markets. Strong growth in developing markets was boosted by the launch of new imprints and the increasing breadth and depth of our local publishing programs in India, China and South Africa. There was continued investment in global publishing with the launch of Penguin s Classics in Portuguese and Arabic, joining existing Mandarin and Korean editions, the launch in India of a new imprint in partnership with bestselling author Shobhaa De, and the continued international roll-out of our non-fiction imprint Allen Lane in Canada.

eBook sales were up 182% on the previous year and now account for 6% of Penguin revenues worldwide. We accelerated our investment in digital products and innovation with new app releases in the children s market including Spot, Peppa Pig, The Little Engine That Could, Ladybird s Babytouch and the Mad Libs app, which was named one of

the best apps at the 2010 E-Book Summit. For adults, we launched the groundbreaking myFry app; published the amplified ebook of Ken Follett s international bestselling novel *The Pillars of the Earth*, featuring video, art and music from the original TV series; and we introduced ten DK Eyewitness Top Ten Travel Guides apps with more to follow in 2011. Penguin continued to invest to transform its internal publishing processes onto Pearson-wide digital platforms enabling faster product development and more efficient creation and re-use of content.

Penguin performed strongly in the US with a broad range of number one bestsellers from repeat authors such as Charlaine Harris, Nora Roberts, Tom Clancy, Ken Follett and Patricia Cornwell. Kathryn Stockett s *The Help* stayed on the *New York Times* bestseller list for the whole of 2010 and has sold more than three million copies to date. Our outstanding performance in the UK, resulting in our market share rising two percentage points to 10%, was led by Jamie Oliver s *30 Minute Meals*. It sold 1.2 million copies to become the UK s biggest selling non-fiction title of the last decade. Major bestsellers included Stephen Fry s *The Fry Chronicles*, Kathryn Stockett s *The Help*, and *The History of the World in 100 Objects* (published in partnership with the BBC and the British Museum), as well as the *Percy Jackson* and *Diary of a Wimpy Kid* series. DK produced a very good year thanks in part to its top-performing franchise LEGO (*Lego Star Wars Visual Dictionary* was on the *New York Times* bestseller list for the whole of 2010 with 18 weeks at number one). Other bestselling titles included *The Masterchef Cookbook*, *Complete Human Body* and *Natural History*. DK continues to benefit from the organisation changes made in 2009 as well as the ongoing development of its publishing centre in India. Penguin Children s had an excellent year in both the US, with Penguin Young Readers Group achieving a record 39 *New York Times* bestsellers, and in the UK, where we reclaimed our position as the number one children s publisher with significant market share gains.

Penguin adjusted operating margins improved in 2010 to 10.1% from 8.4% in 2009.

***Year ended December 31, 2009 compared to year ended December 31, 2008***

*Consolidated results of operations*

***Sales***

Our total sales from continuing operations increased by 735m, or 17%, to £5,140m in 2009, from £4,405m in 2008. The increase reflected growth, on a constant exchange rate basis, at our North American Education and International Education businesses together with additional contributions from acquisitions made in both 2008 and 2009. The year on year growth was impacted by movements in exchange rates, particularly in the US dollar. 2009 sales, translated at 2008 average exchange rates, would have been £4,558m.

Pearson Education increased sales by £668m or 21% from £3,112m to £3,780m. The North American business was the major contributor to the increase although a high proportion of that increase was due to exchange. We estimate that after excluding acquisitions, Pearson Education saw sales growth of 4% at constant last year exchange rates. The North American Education business grew ahead of the market in its US Curriculum and Higher Education businesses which together grew at 5% compared to the industry which remained flat according to the Association of American Publishers. There was also a strong performance in the US Assessment and Information division which benefited from the successful integration of the Harcourt Assessment business acquired at the start of 2008. In International Education sales also benefited from exchange and a contribution from the acquisitions of Wall Street English and Fronter (a European online learning company based in Oslo) and the increased shares of Longman Nigeria and Maskew Miller Longman (MML), our publishing businesses in West Africa and South Africa respectively, which were all acquired in 2009. After excluding the effect of acquisitions we estimate that there was growth of 4% at constant last year exchange rates in the International Education business. Professional sales increased in 2009 by 13% although all of this increase was due to exchange and in terms of constant last year exchange rates there was a small decline in sales of 1%. This decline was entirely due to weakness in the professional publishing market which has offset growth in the professional testing and certification businesses.

FT Group sales were 8% behind last year or 12% after excluding the effect of exchange rates with adverse variances at the *Financial Times*. FT Group s sales decline mainly reflects tough market conditions for financial and corporate advertising. The impact of advertising revenue declines was partially mitigated by growth in content revenues, the resilience of our subscription businesses and an increase in paying online subscribers at FT.com.

Penguin s sales were up 11% in 2009 but this represents a 2% decline at constant last year exchange rates and before the effect of portfolio changes. Much of the underlying decline was due to a fall in sales of illustrated reference books which offset good performances in other categories.

Pearson Education, our largest business sector, accounted for 74% of our continuing business sales in 2009 compared to 71% in 2008. North America continued to be the most significant source of our sales and as a proportion of total continuing sales contributed 65% in 2009 and 63% in 2008.



---

Table of Contents

***Cost of goods sold and operating expenses***

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

| | Year Ended December 31 | |
|---|---|---|
| | 2009 £m | 2008 £m |
| Cost of goods sold | 2,382 | 2,046 |
| Distribution costs | 275 | 235 |
| Administration and other expenses | 2,014 | 1,687 |
| Other operating income | (120) | (102) |
| Total | 2,169 | 1,820 |

*Cost of goods sold.* Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges and the cost of service provision in our assessment and testing businesses. Our cost of sales increased by £336m, or 16%, to £2,382m in 2009, from £2,046m in 2008. The increase corresponds to the increase in sales with cost of sales at 46.3% of sales in 2009 compared to 46.4% in 2008.

*Distribution costs.* Distribution costs consist primarily of shipping costs, postage and packing and remain a fairly constant percentage of sales.

*Administration and other expenses.* Our administration and other expenses increased by £327m, or 19%, to £2,014m in 2009, from £1,687m in 2008. As a percentage of sales they remained consistent at 38% in 2008 and 39% in 2009.

*Other operating income.* Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions together with income from the sale of assets. Other operating income increased to £120m in 2009 compared to £102m in 2008 although much of this increase can be ascribed to exchange.

***Share of results of joint ventures and associates***

The contribution from our joint ventures and associates increased from £25m in 2008 to £30m in 2009. The majority of the profit comes from our 50% interest in the Economist.

***Operating profit***

The total operating profit increased by £55m, or 10%, to £619m in 2009 from £564m in 2008. 2009 operating profit, translated at 2008 average exchange rates, would have been £40m lower.

Operating profit attributable to Pearson Education increased by £99m, or 24%, to £505m in 2009, from £406m in 2008. The increase was attributable to strong performances in the US Higher Education business and both the US and International Assessments businesses and due to the positive impact of exchange. Operating profit attributable to the FT Group decreased by £36m to £31m in 2009, from £67m in 2008. The decrease reflects the decline in profitability at the *Financial Times*, as they faced tough conditions in the advertising market. Operating profit attributable to the

Penguin Group decreased by £8m, or 9%, to £83m in 2009, from £91m in 2008. This decrease was principally due to charges relating to reorganisation of the business in the UK.

***Net finance costs***

Net finance costs increased from £95m in 2008 to £96m in 2009. Net interest payable in 2009 was £86m, down from £93m in 2008. The Group s net interest payable decreased by £7m in 2009 as we benefited from a fall in average interest rates on our floating US dollar debt and a decrease in our overall level of average net debt. Year on year, average three month LIBOR (weighted for the Group s net borrowings in US dollars and sterling at each year end) fell by 2.4% to 0.7%. This reduction in floating market interest rates was partially offset by higher fixed bond coupons prevailing at the time of our 2009 bond issue. The overall result was a decrease in the Group s average net interest rate payable by 0.6% to 5.3%. In 2009 the net finance income relating to post-retirement plans was a charge of £12m compared to an income of £8m in the previous year reflecting lower returns on plan assets.

Table of Contents

Other net finance costs relating to foreign exchange and short-term fluctuations in the market value of financial instruments included a net foreign exchange loss of £7m in 2009 compared to a loss of £11m in 2008. The losses in 2008 mainly relate to the retranslation of foreign currency bank accounts together with other net losses on inter-company items. In 2009 the loss mainly relates to losses on cross currency swaps. For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

***Taxation***

The total tax charge in 2009 of £146m represents 28% of pre-tax profits compared to a charge of £125m or 27% of pre-tax profits in 2008. Our overseas profits, which arise mainly in the US are largely subject to tax at higher rates than the UK corporation tax rate (28% in 2009 compared to 28.5% in 2008). Higher tax rates were partly offset by releases from provisions reflecting continuing progress in agreeing our tax affairs with the authorities.

***Non-controlling interest***

This comprises mainly the non-controlling interest in Interactive Data. Our share of Interactive Data was 61% in 2009, compared to 62% in 2008.

***Discontinued operations***

On 29 July 2010, Pearson s 61% share in Interactive Data Corporation was sold to Silver Lake and Warburg Pincus for $2bn. The results of Interactive Data have been included as discontinued operations in both 2009 and 2008. Discontinued operations in 2008 also relate to the disposal of the Data Management business (in February 2008). The results of the Data Management business were included in discontinued operations to the date of disposal in 2008. The loss before tax on disposal in 2008 was £53m, mainly relating to the cumulative translation adjustment. There was a tax charge of £37m on the sale.

***Profit for the year***

The profit for the financial year in 2009 was £462m compared to a profit in 2008 of £323m. The overall increase of £139m was mainly due to the absence of the loss on discontinued operations in 2009 but also benefited from the improved operating performance offset by a small increase in net finance costs.

***Earnings per ordinary share***

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 53.2p in 2009 compared to 36.6p in 2008 based on a weighted average number of shares in issue of 799.3m in 2009 and 797.0m in 2008. The increase in earnings per share was due to the increase in profit for 2009 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 53.1p in 2009 and 36.6p in 2008 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

***Exchange rate fluctuations***

The strengthening of the US dollar and other currencies against sterling on an average basis had a positive impact on reported sales and profits in 2009 compared to 2008. 2009 sales, translated at 2008 average exchange rates, would

have been lower by £582m and operating profit, translated at 2008 average exchange rates, would have been lower by £40m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding our management of exchange rate risks.

***Sales and operating profit by division***

The following tables summarize our sales and operating profit for each of Pearson s divisions. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by

**Table of Contents**

management to evaluate performance and allocate resources to business segments. See also note 2 of Item 18. Financial Statements .

In our adjusted operating profit we have excluded amortization of acquired intangibles. The amortization of acquired intangibles is the amortization of intangible assets acquired through business combinations. The charge is not considered to be fully reflective of the underlying performance of the Group.

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

| | Year Ended December 31, 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| **£m** | **North American Education** | **International Education** | **Professional** | **FT Group** | **Interactive Data** | **Penguin** | **Total** |
| Sales | 2,470 | 1,035 | 275 | 358 | | 1,002 | 5,140 |
| | *48%* | *20%* | *6%* | *7%* | | *19%* | *100%* |
| Total operating profit | 354 | 109 | 42 | 31 | | 83 | 619 |
| | *57%* | *18%* | *7%* | *5%* | | *13%* | *100%* |
| Add back: | | | | | | | |
| Amortization of acquired intangibles | 49 | 32 | 1 | 8 | | 1 | 91 |
| Adjusted operating profit: continuing operations | 403 | 141 | 43 | 39 | | 84 | 710 |
| Adjusted operating profit: discontinued operations | | | | | 148 | | 148 |
| Total adjusted operating profit | 403 | 141 | 43 | 39 | 148 | 84 | 858 |
| | *47%* | *16%* | *5%* | *5%* | *17%* | 10% | *100%* |

| | Year Ended December 31, 2008 | | | | | | |
|---|---|---|---|---|---|---|---|
| **£m** | **North American Education** | **International Education** | **Professional** | **FT Group** | **Interactive Data** | **Penguin** | **Total** |
| Sales | 2,002 | 866 | 244 | 390 | | 903 | 4,405 |
| | *45%* | *20%* | *6%* | *9%* | | *20%* | *100%* |
| Total operating profit | 258 | 113 | 35 | 67 | | 91 | 564 |
| | *46%* | *20%* | *6%* | *12%* | | *16%* | *100%* |
| Add back: | | | | | | | |
| | 45 | 22 | 1 | 7 | | 2 | 77 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Amortization of acquired intangibles | | | | | | | |
| Adjusted operating profit: continuing operations | 303 | 135 | 36 | 74 | | 93 | 641 |
| Adjusted operating profit: discontinued operations | | | | | 121 | | 121 |
| Total adjusted operating profit | 303 | 135 | 36 | 74 | 121 | 93 | 762 |
| | *40%* | *17%* | *5%* | *10%* | *16%* | *12%* | *100%* |

**Table of Contents**

*North American Education*

North American Education sales increased by £468m, or 23%, to £2,470m in 2009, from £2,002m in 2008 and adjusted operating profit increased by £100m, or 33%, to £403m in 2009 from £303m in 2008. The results were significantly affected by the relative strength of the US dollar, which we estimate increased sales by £365m and adjusted operating profit by £60m when compared to the equivalent figures at constant 2008 exchange rates. At constant exchange and after taking account of the contribution from acquisitions there was underlying growth in sales of 5% and profits of 13%. Although the contribution from the US school curriculum business declined due to State budget pressures and a fall in the adoption market there were strong contributions from the US Higher Education, US Assessment and Information and Canadian businesses.

In the US school market, the Association of American Publishers estimated that there was an overall decrease for the industry in 2009 of 13.8% as state budget pressures and a slower new adoption year caused particular weakness in the basal publishing market. Though Pearson s US School publishing sales declined we attained an estimated 37% of new adoptions we competed for (our highest market share for a decade) and 32% of the total new adoption market. Pearson s enVisionMATH (www.envisionmath.com), an integrated print-and-digital program, was the top-selling basal program in the United States in 2009. It helped the School Curriculum business to an estimated 46% share of all math adoptions and sold strongly across the open territories. Successnet, the online learning platform for teachers and students which supports all Pearson s digital instruction, assessment and remedial programs, also grew strongly achieving more than 4 million registrations in 2009.

The US Assessment and Information business saw significant profit improvement in 2009, benefiting from the successful integration of the Harcourt Assessment business acquired in 2008. Our National Services assessment business renewed its contract with the College Board, worth $210m over 10 years, to process and score the SAT and contracts to support the College Board s new Readi-Step and ACCUPLACER diagnostics programs. Our State Services business won a number of significant new contracts including new programs in Florida and Arizona. We continued to gain share, winning 60% of the contracts bid for by value, and to be a leader in online testing, delivering 9 million secure online assessments in 2009, up more than 100% on 2008. Our Evaluation Systems teacher certification business secured contract extensions in California, Illinois, Arizona and Washington; won re-bids in Michigan and New York, each for five years; and added new contracts in California and Minnesota. In Clinical Assessments, our AIMSWeb response-to-intervention data management and progress monitoring service for children who are having difficulty learning, continued to grow and had more than 3 million students on the system at the end of 2009. Our Edustructures business, which provides interoperable systems to support data collection and reporting between school districts and state governments, doubled the number of students served to 8 million. Our Student Information Systems (SIS) business grew strongly, benefiting from strong demand for its services that help teachers automate and manage student attendance records, gradebooks, timetables and the like. It supported more than 12 million students 8 million of them through its flagship PowerSchool product which was available in more than 50 countries. In 2009 it won contracts for new school districts including Nova Scotia Department of Education (133,000 students), Newark, NJ (45,000 students), and the Hamilton County DOE, TN (40,000 students).

The US Higher Education publishing market grew 11.5% in 2009, according to the Association of American Publishers, benefiting from strong enrolment growth and federal government action to support student funding. Our US Higher Education business grew faster than the industry and outperformed the market for the eleventh straight year, continuing to see strong demand for instructional materials enhanced by technology and customization. Our sustained investment in content and technology continues to grow existing franchises and build new ones. In Engineering Mechanics, our market leading textbook, Hibbeler s Statistics and Dynamics 12th Edition, gained an additional four percentage points of market share with the addition of our newly launched MasteringEngineering digital learning and assessment platform. Pearson became market leader in psychology supported by the recently launched textbook Psychology 2nd Edition by Cicarelli with MyPsychLab. The MyLab digital learning, homework

and assessment programs again grew strongly. Our MyLab products saw more than 6 million student registrations globally, 39% higher than in 2008. In North America, student registrations grew 37% to more than 5.6 million. Custom Solutions grew strongly across both bespoke books and customized services including content creation, technology, curriculum, assessments and courseware. We partnered with the Kentucky Virtual Learning Initiative, for example, to deliver personalized mathematics instruction mapped to state college entry standards and have begun to extend this program into transitional English and Reading. eCollege, our platform for fully-online

Table of Contents

distance learning in higher education, increased online enrolments by 36% to 3.5 million and benefited from continued strong renewal rates of 95% by value, new contract wins and strong growth in the usage of the platform, particularly by US for-profit colleges. Thirteen Pearson higher education and school products in ten categories were nominated as America s best educational software products in the Software & Information Industry Association s 25th Annual CODiE Awards. They include MyMathLab, Miller & Levine Biology, PowerSchool, Prentice Hall Literature, myWorld Geography, MyWritingLab, CourseConnect and eCollege.

Overall adjusted operating margins in the North American Education business were higher at 16.3% in 2009 compared to 15.1% in 2008 with the majority of the increase attributable to the Harcourt Assessment integration costs that were charged in 2008.

*International Education*

International Education sales increased by £169m, or 20%, to £1,035m in 2009, from £866m in 2008 and adjusted operating profit increased by £6m, or 4%, to £141m in 2009 from £135m in 2008. The sales results benefit from exchange gains and a full year contribution from acquisitions made in 2009. At the adjusted operating profit level the 2008 results benefited from transactional exchange gains that were not repeated in 2009.

In the UK, we received over 3.7 million registrations for vocational assessment and general qualifications. We marked 4.5 million A -level and GCSE scripts on-screen and successfully delivered the 2009 National Curriculum test series and were awarded the contract to administer the 2010 National Curriculum Tests at Key Stage 2. We made significant investments in supporting the new Diploma qualification for 14-19 year-olds; the IGCSE qualifications to meet the needs of International schools and colleges; and BTEC, our flagship vocational qualification. BTEC registrations totalled more than 1 million for the first time and were up almost 30% on 2008. Our UK Higher Education business grew strongly, helped by the success of new first editions, the rapid take up of MyLabs adapted to meet local requirements, and the growing popularity of custom publishing. Sales of UK primary resources fell, on the back of minimal curriculum change and some signs of schools managing their budgets more tightly.

In Continental Europe, the launch of our digi libre (Content Plus) products helped us to gain share in the lower and upper secondary markets in Italy and positioned us well for major curriculum reforms in 2010. In Spain, our sales were down sharply with pressures on central and regional government spending and a worsening retail environment. Our ELT sales continued to grow in Poland, and across central and Eastern Europe we saw good demand for our publishing and digital resources and our fledgling Language Learning Solutions activities. The Fronter learning management system continued to grow very strongly with more than 6 million students in more than 8,000 schools, colleges and Universities around the world at the end of 2009.

In the Middle East we successfully implemented the Abu Dhabi Education Council s (ADEC) External Measurement of Student Achievement (EMSA) program covering English, Arabic, Math and Science in April 2009. In South Africa, we launched Platinum, the first blended print and online course developed for the South African National Curriculum. In addition 7,000 students registered for MyMathLab+ at the University of Witwatersrand in 2009.

In China, we acquired Wall Street English, the leading provider of premium English language training to adults, for £101m. The combination of Longman Schools and Wall Street English gives Pearson a leading position in the English language teaching market in China, serving students from elementary school to professional levels. We stepped up our presence in the Indian education market with two investments totalling $30m: a 50:50 joint-venture with Educomp, called IndiaCan, to offer vocational and skills training through 120 training centres across the country; and a 17.2% stake in TutorVista, which provides online tutoring for K-12 and college students.

New editions of the proven bestsellers, BackPack and Pockets, along with the successful launch of two new courses, CornerStone and KeyStone, helped to deliver strong growth in the sales of ELT materials across Latin America. In Brazil, which has one of Latin America s largest and fastest-growing university populations, our virtual library supported 30 post-secondary institutions. And, in Panama, 75,000 high school students were learning Biology and Chemistry, using Prentice Hall Virtual Labs.

On a global basis our MyLab digital learning, homework and assessment programmes were used by more than 470,000 students, up almost 60% on 2008, and are now sold in more than 200 countries. In 2009, we launched the Pearson Test of English, our new test of Academic English which will be delivered in up to 200 Pearson VUE testing centers in 37 countries. Approximately 1,000 academic programs worldwide now recognise, or are in the

process of recognising, the Pearson Test of English. Our eCollege learning management system is growing rapidly in international markets, winning new contracts in Australia, Brazil, Mexico, Colombia, Puerto Rico and Saudi Arabia in 2009. Our new Pearson Learning Solutions business won its first contracts in the UK, the Gulf and Africa. It combines a broad range of products and services from across Pearson to deliver a systematic approach to improving student performance.

International Education adjusted operating margins declined from 15.6% in 2008 to 13.6% in 2009 as the benefit from transactional exchange gains at the profit level in 2008 weren t repeated in 2009.

*Professional*

Professional sales increased by £31m, or 13%, to £275m in 2009 from £244m in 2008. Adjusted operating profit increased by £7m or 19% to £43m in 2009, from £36m in 2008. The sales growth was entirely due to exchange rates which increased sales by £33m when compared to the equivalent figures at constant 2008 exchange rates.

In Professional testing and certification in the UK, we extended our contract with the Driving Standards Agency to deliver the UK drivers theory test until 2014. More than seven million secure online tests were delivered in more than 4,000 test centers worldwide in 2009, an increase of 9% over 2008. Registration volumes for the Graduate Management Admissions Council test rose 8% worldwide in 2009, including a 16% increase outside the US. In the US, Pearson VUE won a number of new contracts with organizations including Oracle, Citrix, Novell, VMWare, and Adobe, the National Registry of Food Safety Professionals and the National Institute for Certification in Engineering Technologies. Pearson VUE extended its international reach, signing an agreement with the Dubai Road and Transport Authority to deliver a new, high-tech Driver Testing System and launching the Law School Admission Test in India.

Our Professional education business experienced tough trading conditions in the retail market but benefited from the increased breadth of its publishing and range of revenue streams, from online retail through digital subscriptions. A best-selling product in 2009 was CCNA Network Simulator, which are digital networking labs designed, developed and published by Pearson, to help candidates successfully pass the Cisco CCNA certification exam. Pearson launched new learning solutions for IT Professionals preparing for certification accreditation. Cert Flash Card applications were launched for students studying for Cisco CCNA, CompTIA and Microsoft certification exams and are accessible through web browsers and iPhone and iPod Touch devices. FT Press launched a new e-publishing imprint, FT Press Delivers, providing essential insights from some of its leading business authors including Jim Champy, Brian Solis, Mark Zandi, Jon M. Huntsman, John Kao, Michael Abrashoff, and Seth Goldman.

Overall adjusted operating margins in the Professional business continued to improve and were higher at 15.6% in 2009 compared to 14.8% in 2008 as margins improved again in both the testing and professional publishing businesses.

*FT Group*

Sales at FT Group decreased by £32m or 8%, from £390m in 2008 to £358m in 2009. Adjusted operating profit decreased by £35m, from £74m in 2008 to £39m in 2009. The sales and profit decrease is mainly from the FT Newspaper business which faced tough market conditions for financial and corporate advertising. The impact of advertising revenue declines was partially mitigated by growth in content revenues, the resilience of our subscription businesses and early actions to manage our cost base tightly.

We continued to see good demand in 2009 for high-quality analysis of global business, finance, politics and economics which resulted in a 15% increase in paying online subscribers to more than 126,000 with registered users

on FT.com up 85% to 1.8 million and users up 12% to 1.4 million on FTChinese.com. *Financial Times* worldwide newspaper circulation was 7% lower at 402,799 (for the July-December 2009 ABC period) although subscription circulation grew modestly. We continued to invest in fast-growing digital formats. We launched a new luxury lifestyle website, to complement our existing *How To Spend It* magazine; a new iPhone application which has received more than 200,000 downloads; and, in association with Longman, Lexicon, an online glossary of economic, financial and business terms.

Mergermarket faced challenging conditions in some of its markets with reduced Mergers and Acquisition activity impacting the merger arbitrage sector serviced by dealReporter whilst Debtwire benefited from an

increased focus on distressed debt. Mergermarket continued to launch new products and expand globally. MergerID was launched in September 2009, providing a secure online environment for principals and professionals to post and view merger and acquisition opportunities globally and by the end of 2009 had secured over 1,500 active users in more than 450 companies across the globe.

*The Economist*, in which Pearson owns a 50% stake, increased global weekly circulation by 2.2% to 1.42 million (for the July December 2009 ABC period). FTSE, our 50% owned joint-venture with the London Stock Exchange, increased revenues 17% and made a strong improvement in profits.

Overall adjusted operating margins at FT Group decreased from 19.0% in 2008 to 10.9% in 2009 as lost advertising revenue fell through to the bottom line.

*The Penguin Group*

Penguin sales increased by £99m or 11%, to £1,002m in 2009 from £903m in 2008 but adjusted operating profit was down 10% to £84m in 2009 from £93m in 2008. Both sales and adjusted operating profit were affected by the stronger US dollar which we estimate increased sales by £109m and adjusted operating profit by £7m when compared to the equivalent figures at constant 2008 exchange rates. In 2009, Penguin implemented a series of organisational changes in the UK designed to strengthen its publishing, reduce costs and accelerate the transition to digital production, sales channels and formats and to lower cost markets for design and production. Penguin s 2009 results include approximately £9m of charges relating to these organisational changes.

In the US, Penguin had 30 number 1 *New York Times* bestsellers, Penguin s most ever, and placed 243 bestsellers on *New York Times* lists. Bestsellers included works from debut novels such as Kathryn Stockett s *The Help* and Janice Y.K. Lee s *The Piano Teacher*, along with books by established authors such as Charlaine Harris and Nora Roberts.

In the UK, top-selling titles included Marian Keyes *This Charming Man*, Malcolm Gladwell s *Outliers*, Ant and Dec s *Ooh! What a Lovely Pair* and Antony Beevor s *D-Day*. Penguin Children s list had a very strong year with standout performances from brands such as *The Very Hungry Caterpillar* (which celebrated its 40th anniversary) and *Peppa Pig*. Through an iPhone app, consumers were offered a try-before-you buy model of Paul Hoffman s *The Left Hand of God*, providing free downloads of the first three chapters.

In Australia, Penguin was named Publisher of the Year for the second year running at the Australian Book Industry Awards. Number 1 bestselling authors included Bryce Courtenay, Tom Winton, Clive Cussler and Richelle Mead. In Canada, top-selling local authors included Joseph Boyden and Alice Munro, who was awarded the International Man Booker prize, and our international authors Greg Mortenson and Elizabeth Gilbert led the paperback non-fiction category. In India, Penguin is the largest English language trade publisher, with bestselling authors in 2009 including Narayana Murthy and Nandan Nilekani. In South Africa, top-selling Penguin authors included John van de Ruit and Justin Bonello.

eBook sales grew fourfold on the previous year. 14,000 eBook titles were available at the end of 2009, benefiting from the popularity of e-readers such as Amazon s Kindle, the Sony Reader and Barnes and Noble s nook as well as new devices such as Apple s iPad.

Penguin s adjusted operating margins deteriorated in 2009, dropping to 8.4% from 10.3% in 2008. The main reason for the decline was the charges in 2009 relating to the reorganisation of the UK business.

**Liquidity and capital resources**

***Cash flows and financing***

Net cash generated from operations increased by £157m (or 16%), to £1,169m in 2010 from £1,012m in 2009. This increase reflected strong cash contributions, particularly from our education businesses. The exchange rate for translation of dollar cash flows was $1.57 in 2010, $1.61 in 2009 and $1.44 in 2008. In 2010, the average working capital to sales ratio for our book publishing businesses improved to 20.1% from 25.1% in 2009, reflecting tight working capital management and the financial impact of the shift to more digital and service-orientated products and businesses. Average working capital is the average month end balance in the year of inventory (including pre-publication), receivables and payables. Net cash generated from operations increased by £118m (or 13%), to £1,012m in 2009 from £894m in 2008. This increase reflected strong cash contributions from all businesses,

Table of Contents

together with the significant strengthening of the US dollar against sterling. In 2009, the headline average working capital to sales ratio for our book publishing businesses improved to 25.1% from 26.1% in 2008, reflecting tight working capital management and the favourable working capital profile of 2009 acquisitions.

Net interest paid decreased to £68m in 2010 from £87m in 2009. The decrease reflects the repayment of a US Dollar bond in 2009 and lower variable interest rates. Net interest paid increased to £87m in 2009 from £76m in 2008. The increase is due to the timing of payments on bonds issued in 2008 and 2009.

Capital expenditure on property, plant and equipment was £76m in 2010, £62m in 2009 and £75m in 2008. The increase in 2010 reflects a return to a more normal level of expenditure given the improved economic environment and exchange rate movements. The reduction in spend in 2009 reflects a more cautious approach to capital investment, given the uncertain economic environment, particularly in the first half of the year.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £557m in 2010 against £222m in 2009 and £400m in 2008. The principal acquisitions in 2010 were of Sistema Educacional Brasileiro for £228m, Melorio for £98m, Wall Street Institute for £65m and America s Choice for £65m. The principal acquisitions in 2009 were of Wall Street English for £101m and a controlling interest in Maskew Miller Longman for £54m, comprising £49m in cash and £5m in other consideration.

The sale of subsidiaries and associates produced a net cash inflow of £734m in 2010 against £nil in 2009 and £99m in 2008. The proceeds in 2010 relate to the sale of Interactive Data, with proceeds received being £984 and tax paid relating to this disposal of £250m. Proceeds of £99m in 2008 relate to the sale of the Data Management business.

The cash outflow from financing of £92m in 2010 reflects a further increase in the group dividend and the purchase of treasury shares, with some offset from a $350m US Dollar Note issued in the year. The cash outflow from financing of £366m in 2009 reflects the repayment of one $350m bond, the repayment of borrowings under the Group s committed borrowing facility and an increase of the dividend in line with earnings. Offsetting this, the Group issued £300m of sterling bonds in the year. The cash outflow from financing of £137m in 2008 reflects the repayment at maturity of one £100m bond, the repayment of borrowings against a short-term bridge financing facility and a further increase in the dividend. Offsetting this, the Group issued $900m of US Dollar bonds.

***Capital resources***

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

At December 31, 2010, our net debt was £430m compared to net debt of £1,092m at December 31, 2009. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash, cash equivalents and liquid resources. Cash equivalents comprise short-term deposits with a maturity of up to 90 days, while liquid resources comprise short-term deposits with maturities of more than 90 days and other marketable instruments which are readily realizable and held on a short-term basis. Short-term, medium-term and long-term

borrowing amounted to £2,312m at December 31, 2010, compared to £2,008m at December 31, 2009 reflecting the $350m US Dollar Note issued in the year and the strengthening of sterling relative to the US Dollar. At December 31, 2010, cash and liquid resources were £1,736m, compared to £750m at December 31, 2009. This increase in cash is due to receipt of the proceeds from the sale of Interactive Data, only partially re-invested in acquisitions, and strong cash generation in our education businesses.

Table of Contents

### *Contractual obligations*

The following table summarizes the maturity of our borrowings, our obligations under non-cancelable leases, and pension funding obligations, exclusive of anticipated interest payments.

| | At December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | **Total £m** | **Less than one year £m** | **One to two years £m** | **Two to five years £m** | **After five years £m** |
| Gross borrowings: | | | | | |
| Bank loans, overdrafts and commercial paper | 73 | 73 | | | |
| Bonds | 2,226 | 325 | | 1,077 | 824 |
| Finance lease obligations | 13 | 6 | 4 | 3 | |
| Operating lease obligations | 1,437 | 164 | 151 | 337 | 785 |
| UK Pension funding obligations | 410 | 41 | 41 | 123 | 205 |
| **Total** | **4,159** | **609** | **196** | **1,540** | **1,814** |

At December 31, 2010 the Group had capital commitments for fixed assets, including finance leases already under contract, of £13m (2009: £15m). There are contingent liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities in respect of legal and royalty claims. None of these claims or guarantees is expected to result in a material gain or loss.

In 2010, the Group negotiated a new $1,750m committed revolving credit facility which matures in November 2015. The Group is committed to an annual fee of 0.2625% payable quarterly, on the unused amount of this facility.

### *Off-Balance sheet arrangements*

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

### *Borrowings*

The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets.

We have in place a committed revolving credit facility of $1.75bn, which matures in November 2015. At December 31, 2010, the full $1.75bn was available under this facility. This credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

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

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

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

***Treasury policy***

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

***Related parties***

There were no significant or unusual related party transactions in 2010, 2009 or 2008. Refer to note 34 in Item 18. Financial Statements .

### Accounting principles

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

## ITEM 6. *DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES*

### Directors and senior management

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

The following table sets forth information concerning senior management, as of March 2011*.

| Name | Age | Position |
|---|---|---|
| Glen Moreno | 67 | Chairman |
| Marjorie Scardino | 64 | Chief Executive |
| David Arculus | 64 | Non-executive Director |
| Patrick Cescau | 62 | Non-executive Director |
| Will Ethridge | 59 | Chief Executive, Pearson North American Education |
| Rona Fairhead | 49 | Chairman and Chief Executive, The Financial Times Group |
| Robin Freestone | 52 | Chief Financial Officer |
| Susan Fuhrman | 66 | Non-executive Director |
| Ken Hydon | 66 | Non-executive Director |
| Joshua Lewis | 48 | Non-executive Director |
| John Makinson | 56 | Chairman and Chief Executive, The Penguin Group |

**Glen Moreno** was appointed chairman of Pearson on October 1, 2005 and is chairman of the nomination committee. He was appointed deputy chairman of The Financial Reporting Council Limited in November 2010. He is also the senior independent director of Lloyds Banking Group plc as well as a non-executive director of Fidelity International Limited. He was previously the senior independent director of Man Group plc and acting chairman of UK Financial Investments Limited, the company set up by HM Treasury to manage the government s shareholdings in UK banks.

**Marjorie Scardino** joined the Pearson board in January 1997. She trained and practised as a lawyer, and was chief executive of The Economist Group from 1993 until joining Pearson. She is also vice chairman of Nokia Corporation and on the boards of several charitable organisations. In 2010 she was named a fellow of the American Academy of Arts and Sciences.

**David Arculus** is a non-executive director of Telefónica S.A. He is also chairman of Numis Corporation plc and in October 2010 was appointed chairman of Aldermore Bank plc. His previous roles include chairman of O2 plc, Severn Trent plc and IPC Group, chief operating officer of United Business Media plc and group managing director of EMAP plc. He became a non-executive director of Pearson in February 2006 and is chairman of the remuneration committee.

**Patrick Cescau** is the senior independent director of Tesco plc and a director of INSEAD, the Business School for the World. In September 2010, he joined the board of IAG, the International Consolidated Airlines Group, S.A. He was

previously group chief executive of Unilever. He became a non-executive director of Pearson in April 2002 and senior independent director in April 2010.

**Will Ethridge** joined the Pearson board in May 2008, having held a number of senior positions within Pearson Education, including CEO of the International and Higher Education divisions. He is chairman of CourseSmart, a publishers digital retail consortium and chairman of the Association of American Publishers.

**Rona Fairhead** joined the Pearson board in June 2002 as chief financial officer. She was appointed chief executive of The Financial Times Group in June 2006 and became responsible for Pearson VUE in March 2008.

* Terry Burns retired from the Pearson plc board on April 30, 2010. CK Prahalad passed away on April 16, 2010. Joshua Lewis was appointed to the Pearson plc board effective March 1, 2011.

From 1996 until 2001, she served as executive vice president, group control and strategy at ICI. She is also a non-executive director of HSBC Holdings plc and chairs the HSBC audit and risk committees. In December 2010 she was appointed as a non-executive director of The Cabinet Office.

**Robin Freestone** joined Pearson in 2004 as deputy chief financial officer and became chief financial officer in June 2006, when he also joined the Pearson board. He was previously group financial controller of Amersham plc (now part of GE). He qualified as a chartered accountant with Touche Ross (now Deloitte). He is also a non-executive director and founder shareholder of eChem Limited.

**Susan Fuhrman** is president of Teachers College at Columbia University, America s oldest and largest graduate school of education and president of the National Academy of Education. She was previously dean of the Graduate School of Education at the University of Pennsylvania and on the board of trustees of the Carnegie Foundation for the Advancement of Teaching. She became a non-executive director of Pearson in July 2004.

**Ken Hydon** is a non-executive director of Reckitt Benckiser Group plc, Royal Berkshire NHS Foundation Trust and Tesco plc. He was previously financial director of Vodafone Group plc and of subsidiaries of Racal Electronics. He became a non-executive director of Pearson in February 2006 and is chairman of the audit committee.

**Joshua Lewis** is managing principal of Salmon River Capital LLC, a private equity/venture capital investment firm, and is also an advisor to the Bill & Melinda Gates Foundation s Next Generation Learning Challenges programme. He was previously a general partner of both Warburg Pincus and Forstmann Little, and served on the board of the Capella Education Company, a pioneering provider of web-based post-secondary education. He was also chair of New Leaders for New Schools, a social enterprise training the next generation of US urban principals, and remains involved with that organisation.

**John Makinson** joined the Pearson board in March 1996 and was finance director until June 2002. He was appointed chairman of The Penguin Group in May 2001. He is also chairman of The Royal National Theatre and trustee of the Institute for Public Policy Research.

**Compensation of senior management**

It is the role of the remuneration committee (the committee) to approve the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee. The committee also takes note of the remuneration for those executives with base pay over a certain level, representing approximately the top 50 executives of the company.

***Remuneration policy***

Our goal as a company is to make an impact on people s lives and on society through education and information. Our strategy to achieve that goal is pursued by all Pearson s businesses in some shape or form and has four parts: investment in quality content; adding services to this content; working in markets around the world, particularly in the developing world; and efficiency.

An important measure of our strategy is financial performance. Our goal is to achieve sustainable growth in three key financial measures earnings, cash and return on invested capital and reliable cash returns to our investors through healthy and growing dividends. Therefore those measures, or others that contribute to them such as operating margins and working capital, form the basis of our annual budgets and plans, and the basis for bonuses and long-term incentives.

Our starting point continues to be that total remuneration (base compensation plus annual and long-term incentives) should reward both short and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional company performance. The performance conditions that we select for the company s various performance related annual or long-term incentive plans are linked to the company s strategic objectives set out above and aligned with the interests of shareholders.

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives. Base salary reflects competitive market level, role and individual contribution. Annual incentives motivate the achievement of annual strategic goals. Bonus share matching encourages executive directors and other senior executives to acquire and hold Pearson shares and aligns executives and shareholders

interests. Long-term incentives drive long-term earnings and share price growth and value creation and align executives and shareholders interests.

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

We want our executive directors remuneration to be competitive with those of directors and executives in similar positions in comparable companies. For benchmarking purposes we review remuneration by reference to the UK and US market depending on the relevant market or markets for particular jobs. We look separately at three comparator groups:

First, we use a select peer group of FTSE 100 companies with very substantial overseas operations. These companies are of a range of sizes around Pearson, but the method our independent advisers use to make comparisons on remuneration takes this variation in size into account; secondly, for the US, we use a broad media industry group; and thirdly, we look at the FTSE 20-50, excluding financial services. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

***Base salary***

Our normal policy is to review salaries annually, consistent with the way we benchmark pay and taking into account the approach to pay across the company as a whole.

***Allowances and benefits***

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

***Annual incentives***

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

The committee will continue to review the annual incentive plans each year and to revise the performance measures, targets and individual incentive opportunities in light of current conditions.

Annual incentive payments do not form part of pensionable earnings.

***Performance Measures***

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

A proportion (which for 2011 may be up to 30%) of the total annual incentive opportunity for the executive directors and other members of the Pearson Management Committee is based on performance against personal objectives as agreed with the chief executive (or in this case the chief executive or chairman). These comprise functional, operational, strategic and non-financial objectives relevant to the executives specific areas of responsibility and *inter alia* may include objectives relating to environmental, social and governance issues.

For 2011 the principle financial performance measures for Pearson plc are sales, operating profit (for the operating companies) and growth in underlying earnings per share for continuing operations at constant exchange rates (for Pearson plc), average working capital as a ratio to sales and operating cash flow. The selection and weighting of the performance measures takes into account the strategic objectives and the business priorities relevant to each operating company and to Pearson overall each year.

Table of Contents

The individual annual incentive opportunities for the executive directors other than the chief executive are expressed as % of base salary. The committee with the advice of the chief executive determines the aggregate level of annual incentives and individual incentive opportunities taking into account all relevant factors. These factors may include the profitability of the company, individual roles and responsibilities, market annual incentive levels, and the level of stretch in the performance targets.

For 2011, there are no changes to the target and maximum annual incentive opportunities for the chief executive which remain at 100% and 180% respectively, of base salary (as in 2010).

For the other members of the Pearson Management Committee, individual incentive opportunities take into account their membership of that committee and the contribution of their respective businesses or role to Pearson s overall financial goals. In the case of the executive directors, the target individual incentive opportunity for 2011 is in a range from 80% to 87.5% of base salary (as in 2010). The maximum opportunity remains at twice target (as in 2010).

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

| Name | Pearson plc | Operating company | Personal objectives |
|---|---|---|---|
| Marjorie Scardino | 90% | | 10% |
| Will Ethridge | 30% | 60% | 10% |
| Rona Fairhead | 30% | 60% | 10% |
| Robin Freestone | 80% | | 20% |
| John Makinson | 30% | 60% | 10% |

For Pearson plc, the performance measures were sales, earnings per share growth, average working capital to sales ratio and operating cash flow. Underlying growth in adjusted earnings per share at constant exchange rates, average working capital as a ratio to sales and operating cash flow were all above maximum. Sales were above target but below maximum.

For North American Education, the performance measures were sales, operating profit, and average working capital as a ratio to sales and operating cash flow. Average working capital as a ratio to sales and operating cash flow were above maximum. Sales and operating profit were above target but below maximum.

For FT Publishing, the performance measures were sales, operating profit and operating cash flow. All performance measures were above maximum.

For Pearson VUE, the performance measures were sales, operating profit, average working capital as a ratio to sales and operating cash flow. Sales were above target but below maximum. Performance across all other measures was above maximum.

For Penguin Group, the performance measures were sales, operating profit, operating margin, average working capital as a ratio to sales and operating cash flow. Operating profit, operating margin and average working capital as a ration to sales were all above maximum. Sales and operating cash flow were above target but below maximum.

***Bonus share matching***

In 2008, shareholders approved the renewal of the annual bonus share matching plan, which permits executive directors and senior executives around the company to invest up to 50% of any after-tax annual bonus in Pearson shares.

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

One matching share for every two invested shares held i.e. 50% of the maximum matching award, will be released if the company s adjusted earnings per share increase in real terms by 3% per annum compound over the three-year performance period. One matching share for every one invested share held i.e. 100% of the maximum matching award, will be released if the company s adjusted earnings per share increase in real terms by 5% per annum compound over the same period.

For real growth in adjusted earnings per share of between 3% and 5% per annum compound, the rate at which the participant s invested shares will be matched will be calculated according to a straight-line sliding scale.

Real growth is calculated by reference to the UK Government s Index of Retail Prices (All Items). We choose to test our earnings per share growth against UK inflation over three years to measure the company s financial progress over the period to which the entitlement to matching shares relates.

Where matching shares vest in accordance with the plan, a participant will also receive additional shares representing the gross value of dividends that would have been paid on the matching shares during the performance period and re-invested.

***Long-term incentives***

By separate resolution, shareholders are being asked to approve the renewal of the long-term incentive plan first introduced in 2001 and renewed again in 2006. The committee has reviewed the operation of this plan in light of the company s strategic goals. The committee has concluded that the plan is achieving its objectives and, looking forward, will continue to enable the company to recruit and retain the most able managers worldwide and to ensure their long-term incentives encourage outstanding performance and are competitive in the markets in which we operate. We are therefore seeking approval of its renewal on broadly its existing terms.

Subject to shareholders approval, executive directors, senior executives and other managers can participate in this plan which can deliver restricted stock and/or stock options. Approximately 6% of the company s employees currently hold awards under this plan. The aim is to give the committee a range of tools with which to link corporate performance to management s long-term reward in a flexible way. It is not the committee s intention to grant stock options in 2011.

Restricted stock granted to executive directors vests only if stretching corporate performance targets over a specified period have been met. Awards vest on a sliding scale based on performance over the period. There is no retesting. The committee determines the performance measures and targets governing an award of restricted stock prior to grant.

The performance measures that will apply for the executive directors for awards in 2011 and subsequent years will continue to be focused on delivering and improving returns to shareholders. These measures, which have applied since 2004, are relative total shareholder return (TSR), return on invested capital (ROIC) and earnings per share (EPS) growth.

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

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

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

Pearson wishes to encourage executives and managers to build up a long-term holding of shares so as to demonstrate their commitment to the company. To achieve this, for awards of restricted stock that are subject to performance

conditions over a three-year period, a percentage of the award (normally 75%) vests at the end of the three-year period. The remainder of the award (normally 25%) only vests if the participant retains the after-tax number of shares that vest at year three for a further two years.

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. In addition, for existing shares no more than 5% of Pearson equity may be held in trust at any time.

Table of Contents

*Shareholding policy*

The committee expects executive directors to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership. To complement the operation of the company s long-term incentive arrangements, we will in future, operate formal shareholding guidelines for executive directors. The target holding will be 200% of the salary for the chief executive and 125% of salary for the other executive directors consistent with median practice in FTSE 100 companies that operate such arrangements.

*Service agreements*

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

The committee reviewed the policy on executive service agreements in 2008 and again in 2010. Future executive director service agreements should provide that the company may terminate these agreements by giving no more than 12 months notice. As an alternative, the company may at its discretion pay in lieu of that notice. Payment in lieu of notice may be made in instalments and may be subject to mitigation. In the case of the longer serving directors with legacy employment agreements, the compensation payable in circumstances where the company terminates the agreements without notice or cause takes the form of liquidated damages.

There are no special provisions for notice, pay in lieu of notice or liquidated damages in the event of termination of employment in the event of a change of control of Pearson. On termination of employment, executive directors entitlements to any vested or unvested awards under Pearson s discretionary share plans are treated in accordance with the terms of the relevant plan.

*Retirement benefits*

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

The differences in the arrangements for the current executive directors reflect the different arrangements in the UK and the US and the changes in pension arrangements generally over the periods of their employment. Executive directors are entitled to life insurance cover while in employment, and to a pension in the event of ill-health or disability. A pension for their spouse and/or dependants is also available on death.

In the US, the defined benefit arrangement is the Pearson Inc. Pension Plan. This plan provides a lump sum convertible to an annuity on retirement. The lump sum accrued at 6% of capped compensation until December 31, 2001 when further benefit accruals ceased. Normal retirement age is 65 although early retirement is possible subject to a reduction for early payment. No increases are guaranteed for pensions in payment. There is a spouse s pension on death in service and the option to provide a death in retirement pension by reducing the member s pension.

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

In the UK, the pension plan is the Pearson Group Pension Plan and executive directors participate in either the Final Pay or the Money Purchase 2003 section. Normal retirement age is 62, but, subject to company consent, retirement is

currently possible from age 55. In the Final Pay section, the accrued pension is reduced on retirement prior to age 60. Pensions in payment are guaranteed to increase each year at 5% or the rise in inflation each year, if lower. Pensions for a member s spouse, dependant children and/or nominated financial dependant are payable in the event of death. In the Money Purchase 2003 section the account balances are used to provide benefits at retirement. In the event of death before retirement pensions for a member s spouse, dependant children and/or nominated financial dependant are payable.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at April 6, 2006, was abolished by the Finance Act 2004. However the Pearson Group Pension Plan has retained its own cap , which

will increase annually in line with the UK Government s Index of Retail Prices (All Items). The cap was £123,600 as at April 6, 2010.

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

***Marjorie Scardino***

Marjorie Scardino participates in the Pearson Inc. Pension Plan and the approved 401(k) plan.

Since 2010, additional pension benefits are provided through: a taxable and non-pensionable cash supplement in place of the unfunded plan; a funded defined contribution plan approved by HM Revenue and Customs (HMRC) as a corresponding plan; and amounts in the legacy unfunded plan. In aggregate, the cash supplement and contributions to the funded plan are based on a percentage of salary and a fixed cash amount index-linked to inflation. The notional cash balance of the legacy unfunded plan increases annually by a specified notional interest rate. The unfunded plan also provides the opportunity to convert a proportion of this notional cash account into a notional share account reflecting the value of a number of Pearson ordinary shares. The number of shares in the notional share account is determined by reference to the market value of Pearson shares at the date of conversion.

***Will Ethridge***

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

***Rona Fairhead***

Rona Fairhead is a member of the Pearson Group Pension Plan. Her pension accrual rate is 1/30th of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on her behalf. Since April 2006, she has received a taxable and non-pensionable cash supplement in replacement of the FURBS.

***Robin Freestone***

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

***John Makinson***

John Makinson is a member of the Pearson Group Pension Plan under which his pensionable salary is restricted to the plan earnings cap. The company ceased contributions on December 31, 2001 to his FURBS arrangement. During 2002 it set up an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for him. The UURBS tops up the pension payable from the Pearson Group Pension Plan and the closed FURBS to target a pension of two-thirds of a revalued base salary on retirement at age 62. The revalued base salary is defined as £450,000 effective at June 1, 2002,

increased at January 1, each year by reference to the increase in the UK Government s Index of Retail Prices (All Items). In the event of his death a pension from the Pearson Group Pension Plan, the FURBS and the UURBS will be paid to his spouse or nominated financial dependant. Early retirement is currently possible from age 55, with company consent.

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

***Executive directors non-executive directorships***

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

Table of Contents

The following executive directors served as non-executive directors elsewhere and received fees or other benefits for the period covered by this report as follows: Marjorie Scardino (Nokia Corporation and MacArthur Foundation); Rona Fairhead (HSBC Holdings plc and Spencer Stuart Advisory Board).

***Chairman s remuneration***

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

There were no changes in the chairman s remuneration in 2010. With effect from 1 January 2007, his remuneration was £450,000 per year. We reviewed the chairman s remuneration at the end of 2010 and agreed that this would be increased to £500,000 per year with effect from April 1, 2011. The next review will take place in three years time.

***Non-executive directors***

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

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

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

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

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

***Remuneration of senior management***

Excluding contributions to pension funds and related benefits, senior management remuneration for 2010 was as follows:

| | **Salaries/ Fees £000** | **Annual Incentive £000** | **Allowances(1) £000** | **Benefits(2+3) £000** | **Total £000** |
|---|---|---|---|---|---|

| | | | | | |
|---|---|---|---|---|---|
| **Non-executive Chairman** | | | | | |
| Glen Moreno | 450 | | | | 450 |
| **Executive directors** | | | | | |
| Marjorie Scardino | 969 | 1,606 | 70 | 17 | 2,662 |
| Will Ethridge | 661 | 1,010 | | | 1,671 |
| Rona Fairhead | 516 | 826 | 12 | 19 | 1,373 |
| Robin Freestone | 460 | 685 | 7 | 6 | 1,158 |
| John Makinson | 536 | 801 | 232 | 6 | 1,575 |
| **Senior management as a group** | **3,592** | **4,928** | **321** | **48** | **8,889** |

Table of Contents

Notes:

(1) Allowances for Marjorie Scardino include £45,005 in respect of housing costs and a US payroll supplement of £11,754. John Makinson is entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US and received £218,653 for 2010.

(2) Benefits include company car, car allowance and UK health care premiums. US health and welfare benefits for Marjorie Scardino and Will Ethridge are self-insured and the company cost, after employee contributions, is tax free to employees. For Marjorie Scardino, benefits include £15,450 for pension planning and financial advice. Marjorie Scardino, Rona Fairhead and John Makinson have the use of a chauffeur.

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

**Share options of senior management**

This table sets forth for each director the number of share options held as of December 31, 2010 as well as the exercise price, rounded to the nearest whole pence/cent, and the range of expiration dates of these options.

| Director | Number of Options | (2) | Exercise Price | Earliest Exercise Date | Expiry Date |
|---|---|---|---|---|---|
| Marjorie Scardino | 1,672 | a | 547.2p | 08/01/12 | 02/01/13 |
| | 41,550 | b* | 1421.0p | 05/09/02 | 05/09/11 |
| | 41,550 | b* | 1421.0p | 05/09/03 | 05/09/11 |
| | 41,550 | b* | 1421.0p | 05/09/04 | 05/09/11 |
| | 41,550 | b* | 1421.0p | 05/09/05 | 05/09/11 |
| **Total** | **167,872** | | | | |
| Will Ethridge | 11,010 | b* | $21.00 | 05/09/02 | 05/09/11 |
| | 11,010 | b* | $21.00 | 05/09/03 | 05/09/11 |
| | 11,010 | b* | $21.00 | 05/09/04 | 05/09/11 |
| | 11,010 | b* | $21.00 | 05/09/05 | 05/09/11 |
| **Total** | **44,040** | | | | |
| Rona Fairhead | 2,371 | a | 690.4p | 08/01/12 | 02/01/13 |
| | 20,000 | b* | 822.0p | 11/01/02 | 11/01/11 |
| | 20,000 | b* | 822.0p | 11/01/03 | 11/01/11 |
| | 20,000 | b* | 822.0p | 11/01/04 | 11/01/11 |
| **Total** | **62,371** | | | | |
| Robin Freestone | 1,757 | a | 534.8p | 08/01/11 | 02/01/12 |
| **Total** | **1,757** | | | | |

| | | | | | |
|---|---|---|---|---|---|
| John Makinson | 19,785 | b* | 1421.0p | 05/09/02 | 05/09/11 |
| | 19,785 | b* | 1421.0p | 05/09/03 | 05/09/11 |
| | 19,785 | b* | 1421.0p | 05/09/04 | 05/09/11 |
| | 19,785 | b* | 1421.0p | 05/09/05 | 05/09/11 |
| **Total** | **79,140** | | | | |

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

(2) Each plan is described below.

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

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

* Where options are exercisable.

(3) Marjorie Scardino contributes US$1,000 per month (the maximum allowed) to the US employee stock purchase plan. The terms of this plan allow participants to make monthly contributions for 6 month periods

and to acquire shares twice annually at the end of these periods at a price that is the lower of the market price at the beginning or the end of each period, both less 15%.

(4) The market price on December 31, 2010 was 1,008.0p per share and the range during the year was 855.0p to 1,051.0p.

**Share ownership of senior management**

The table below sets forth the number of ordinary shares and restricted shares held by each of our directors as at February 28, 2011. Additional information with respect to share options held by, and bonus awards for, these persons is set out above in Remuneration of Senior Management and Share Options of Senior Management . The total number of ordinary shares held by senior management as of February 28, 2011 was 2,735,220 representing less than 1% of the issued share capital on February 28, 2011.

| As at February 28, 2011 | Ordinary shares(1) | Restricted shares(2) |
|---|---|---|
| Glen Moreno | 150,000 | |
| Marjorie Scardino | 1,107,118 | 1,641,511 |
| David Arculus | 14,053 | |
| Terry Burns (stepped down on April 30, 2010 ) | 12,222 | |
| Patrick Cescau | 6,282 | |
| Will Ethridge | 333,395 | 665,820 |
| Rona Fairhead | 342,669 | 467,143 |
| Robin Freestone | 193,954 | 560,526 |
| Susan Fuhrman | 11,363 | |
| Ken Hydon | 10,715 | |
| John Makinson | 551,039 | 446,042 |
| CK Prahalad (deceased April 16, 2010) | 2,410 | |

Notes:

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

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

(3) The register of directors interests (which is open to inspection during normal office hours) contains full details of directors shareholdings and options to subscribe for shares. The market price on December 31, 2010 was 1,008.0p per share and the range during the year was 855.0p to 1,051.0p.

(4) At December 31, 2010, Patrick Cescau held 168,000 Pearson bonds.

(5) Ordinary shares do not include any shares vested but held pending release under a restricted share plan.

**Employee share ownership plans**

***Worldwide save for shares and US employee share purchase plans***

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

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

option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

## Board practices

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

However since 2008, in accordance with good corporate governance, the board has resolved that all directors should offer themselves for re-election on an annual basis at the company s annual general meeting. Accordingly, all of the directors will offer themselves for re-election, (or re-appointment in the case of directors who were appointed since the last meeting), at the forthcoming annual general meeting on 28 April 2011.

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

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

### *Audit committee*

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

### *Remuneration committee*

This committee meets regularly to decide the remuneration and benefits of the executive directors and the chief executives of our three operating divisions. The committee also recommends the chairman s remuneration to the board of directors for its decision and reviews management development and succession plans. David Arculus chairs this committee and its other members are Patrick Cescau, Glen Moreno and Ken Hydon.

### *Nomination committee*

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

**Employees**

The average number of persons employed by us in continuing operations during each of the three fiscal years ended 2010 were as follows:

36,317 in fiscal 2010,

34,705 in fiscal 2009, and

31,171 in fiscal 2008.

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

The table set forth below shows for 2010, 2009 and 2008 the average number of persons employed in each of our operating divisions.

| **Average number employed** | **2010** | **2009** | **2008** |
|---|---|---|---|
| North American Education | 14,828 | 15,606 | 15,412 |
| International Education | 10,713 | 8,899 | 5,718 |
| Professional | 3,721 | 2,662 | 2,641 |
| FT Group | 2,557 | 2,328 | 2,379 |
| Penguin | 3,470 | 4,163 | 4,112 |
| Other | 1,028 | 1,047 | 909 |
| Continuing operations | **36,317** | **34,705** | **31,171** |

The average number employed in discontinued operations was 2,459 in 2009 and 2,509 in 2008.

## ITEM 7. *MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS*

To our knowledge, as of February 28, 2011, the beneficial owners of 3% or more of our issued and outstanding ordinary share capital were as follows:

| **Name of shareholder** | **Number of ordinary shares held** | **% of outstanding ordinary shares represented by number of shares held** |
|---|---|---|
| Legal & General Group plc | 32,300,784 | 3.98% |
| Libyan Investment Authority | 24,431,000 | 3.01% |

On February 28, 2011, record holders with registered addresses in the United States held 48,543,471 ADRs, which represented 5.97% of our outstanding ordinary shares. Some of these ADRs are held by nominees and so these numbers may not accurately represent the number of beneficial owners in the United States.

Loans and equity advanced to joint ventures and associates during the year and as at December 31, 2010 are shown in note 12 in Item 18. Financial Statements. Dividends receivable from joint ventures and associates are set out in note 12 in Item 18. Financial Statements . There were no other related party transactions in 2010.

## ITEM 8. *FINANCIAL INFORMATION*

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

Other than those events described in note 35 in Item 18. Financial Statements of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to our financial condition or results of operations since December 31, 2010. Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements of the educational book business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December.

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

## ITEM 9. *THE OFFER AND LISTING*

The principal trading market for our ordinary shares is the London Stock Exchange. Our ordinary shares also trade in the United States in the form of ADSs evidenced by ADRs under a sponsored ADR facility with The Bank of New York Mellon, as depositary. We established this facility in March 1995 and amended it in August 2000 in connection with our New York Stock Exchange listing. Each ADS represents one ordinary share.

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

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

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

| **Reference period** | **Ordinary shares High** | **Low** | **Average daily trading volume** |
|---|---|---|---|
| | **(In pence)** | | **(Ordinary shares)** |
| *Five most recent fiscal years* | | | |
| 2010 | 1051 | 855 | 2,424,600 |
| 2009 | 893 | 578 | 4,030,500 |
| 2008 | 733 | 519 | 4,758,300 |
| 2007 | 915 | 695 | 6,405,600 |
| 2006 | 811 | 671 | 5,004,500 |
| *Most recent quarter and two most recent fiscal years* | | | |
| 2010 Fourth quarter | 1034 | 926 | 2,126,500 |
| Third quarter | 1029 | 864 | 2,167,800 |
| Second quarter | 1051 | 888 | 2,967,400 |
| First quarter | 1037 | 855 | 2,466,700 |

| | | | |
|---|---|---|---|
| 2009 Fourth quarter | 893 | 755 | 2,777,200 |
| Third quarter | 777 | 578 | 3,158,500 |
| Second quarter | 733 | 600 | 4,554,700 |
| First quarter | 714 | 584 | 5,695,700 |
| *Most recent six months* | | | |
| February 2011 | 1064 | 1013 | 1,524,200 |
| January 2011 | 1066 | 983 | 2,075,800 |
| December 2010 | 1034 | 961 | 1,673,100 |
| November 2010 | 974 | 926 | 1,909,900 |
| October 2010 | 1009 | 948 | 2,806,800 |
| September 2010 | 1022 | 985 | 1,877,000 |

## ITEM 10. *ADDITIONAL INFORMATION*

### Articles of association

We summarize below the material provisions of our articles of association, as amended, which have been filed as an exhibit to our annual report on Form 20-F for the year ended December 31, 2010. The summary below is qualified entirely by reference to the Articles of Association. We have multiple business objectives and purposes and are authorized to do such things as the board may consider fit to further our interests or incidental or conducive to the attainment of our objectives and purposes.

***Directors powers***

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

***Interested directors***

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

(a) any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and

(b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

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

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

(a) may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise (directly or indirectly) interested;

(b) may act by himself or his firm in a professional capacity for the Company (otherwise than as auditor) and he or his firm shall be entitled to remuneration for professional services as if he were not a Director;

(c) may be a director or other officer of, or employed by, or a party to a transaction or arrangement with, or otherwise interested in, any body corporate in which the Company is otherwise (directly or indirectly) interested.

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

(a) the acceptance, entry into or existence of which has been approved by the board (subject, in any such case, to any limits or conditions to which such approval was subject); or

(b) which he is permitted to hold or enter into by virtue of paragraph (a), (b) or (c) above;

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

A Director shall be under no duty to the Company with respect to any information which he obtains or has obtained otherwise than as a director of the Company and in respect of which he owes a duty of confidentiality to another person. However, to the extent that his relationship with that other person gives rise to a conflict of interest

Table of Contents

or possible conflict of interest, which has been approved by the board: the director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he fails:

(a) to disclose any such information to the board or to any Director or other officer or employee of the Company; and/or

(b) to use or apply any such information in performing his duties as a Director of the Company.

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

(a) absents himself from meetings of the board at which any matter relating to the conflict of interest or possible conflict of interest will or may be discussed or from the discussion of any such matter at a meeting or otherwise; and/or

(b) makes arrangements not to receive documents and information relating to any matter which gives rise to the conflict of interest or possible conflict of interest sent or supplied by the Company and/or for such documents and information to be received and read by a professional adviser,

for so long as he reasonably believes such conflict of interest or possible conflict of interest subsists.

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

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

the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of or for the benefit of the Company or any of its subsidiaries;

the giving of any guarantee, security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which he himself has assumed responsibility in whole or in part and whether alone or jointly with others under a guarantee or indemnity or by the giving of security;

any proposal relating to the Company or any of its subsidiary undertakings where it is offering securities in which offer a Director is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which a Director is to participate;

any proposal relating to another company in which he and any persons connected with him do not to his knowledge hold an interest in shares (as that term is used in sections 820 to 825 of the Act) representing one per cent or more of either any class of the equity share capital, or the voting rights, in such company;

any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; and

any proposal concerning insurance that we propose to maintain or purchase for the benefit of directors or for the benefit of persons, including directors.

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

Table of Contents

***Borrowing powers***

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

***Other provisions relating to directors***

Under the articles of association, directors are paid out of our funds for their services as we may from time to time determine by ordinary resolution and, in the case of non-executive directors, up to an aggregate of £750,000 or such other amounts as resolved by the shareholders at a general meeting. Directors currently are not required to hold any share qualification.

***Annual general meetings***

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

- approving final dividends;
- consideration of the accounts and balance sheet;
- ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;
- the re-appointment or re-election of directors;
- appointment or reappointment of, and authorizing the directors to determine the remuneration of, the auditors; and
- the renewal, limitation, extension, variation or grant of any authority to the board in relation to the allotment of securities.

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

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

If a quorum for a meeting convened at the request of shareholders is not present within fifteen minutes of the appointed time, the meeting will be dissolved. In any other case, the general meeting will be adjourned to the same day in the next week, at the same time and place, or to a time and place that the chairman fixes. If at that rescheduled meeting a quorum is not present within fifteen minutes from the time appointed for holding the meeting, the

shareholders present in person or by proxy will be a quorum. The chairman or, in his absence, the deputy chairman or any other director nominated by the board, will preside as chairman at every general meeting. If no director is present at the general meeting or no director consents to act as chairman, the shareholders present shall elect one of their number to be chairman of the meeting.

***Share certificates***

Every person whose name is entered as a member in the Company s Register of Members shall be entitled to one certificate in respect of each class of shares held. (The law regarding this does not apply to stock exchange

nominees). Subject to the terms of issue of the shares, certificates are issued following allotment or receipt of the form of transfer bearing the appropriate stamp duty by our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom, telephone number +44 (0) 121 415 7062.

***Share capital***

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

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

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

***Voting rights***

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

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

***Dividends***

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

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

dividend.

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

***Liquidation rights***

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

***Other provisions of the articles of association***

Whenever our capital is divided into different classes of shares, the special rights attached to any class may, unless otherwise provided by the terms of the issue of the shares of that class, be varied or abrogated, either with the written consent of the holders of three-fourths of the issued shares of the class or with the sanction of a special resolution passed at a separate meeting of these holders.

In the event that a shareholder or other person appearing to the board of directors to be interested in ordinary shares fails to comply with a notice requiring him or her to provide information with respect to their interest in voting shares pursuant to section 820 of the Act, we may serve that shareholder with a notice of default. After service of a default notice, that shareholder shall not be entitled to attend or vote at any general meeting or at a separate meeting of holders of a class of shares or on a poll until he or she has complied in full with our information request.

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

- we will not pay dividends (or issue shares in lieu of dividends); and

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

No provision of our articles of association expressly governs the ordinary share ownership threshold above which shareholder ownership must be disclosed. Under UK regulations, any person who acquires, either alone or, in specified circumstances, with others an interest in our voting share capital equal to or in excess of 3% (and each percentage point above it) comes under an obligation to disclose prescribed particulars to us in respect of those ordinary shares. A disclosure obligation also arises where a person s notifiable interests fall below the notifiable percentage, or where, above that level, the percentage of our voting share capital in which a person has a notifiable interest increases or decreases.

***Limitations affecting holders of ordinary shares or American Depositary Shares (ADSs)***

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

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

**Material contracts**

Pearson has not entered into any contracts outside the ordinary course of business during the two year period immediately preceding the date of this annual report.

***Executive employment contracts***

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

may be terminated by us on 12 months notice or by the executive director on six months notice. In the event we terminate any executive director, excluding the current chief financial officer, without giving the full 12 months advance notice, the executive director is entitled to receive liquidated damages equal to 12 months base salary and benefits together with a proportion of potential bonus. The chief financial officer has no contractual provisions for compensation on termination by the company without notice or cause.

**Exchange controls**

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

**Tax considerations**

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

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

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

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

For US federal income tax purposes, holders of ADSs will be treated as the owners of the ordinary shares represented by those ADSs.

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

**Because US and UK tax consequences may differ from one holder to the next, the discussion set out below does not purport to describe all of the tax considerations that may be relevant to you and your particular situation. Accordingly, you are advised to consult your own tax advisor as to the US federal, state and local, UK and other, including foreign, tax consequences of investing in the ordinary shares or ADSs. The statements of US and UK tax law set out below are based on the laws and interpretations in force as of the date of this Annual Report, and are subject to any changes occurring after that date.**

***UK income taxation of distributions***

The UK does not impose dividend withholding tax on dividends paid to US holders.

***US income taxation of distributions***

Distributions that we make with respect to the ordinary shares or ADSs, other than distributions in liquidation and distributions in redemption of stock that are treated as exchanges, will be taxed to US holders as ordinary

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

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

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

A distribution by the Company to noncorporate shareholders before 2013 will be taxed as net capital gain at a maximum rate of 15%, provided certain holding periods are met, to the extent such distribution is treated as a dividend under US federal income tax principles.

***UK income taxation of capital gains***

Under the Income Tax Treaty, each country generally may tax capital gains in accordance with the provisions of its domestic law. Under present UK law, a US holder that is not a resident, and, in the case of an individual, not ordinarily resident, in the UK for UK tax purposes and who (in the case of an individual) does not carry on a trade, profession or vocation in the UK through a branch or agency, or (in the case of a company) does not carry on a trade in the UK through a UK permanent establishment, to which ordinary shares or ADSs are attributable will not be liable for UK taxation on capital gains or eligible for relief for allowable losses, realized on the sale or other disposal (including redemption) of these ordinary shares or ADSs.

A US holder who is an individual and who has ceased to be resident or ordinarily resident for tax purposes in the UK on or after 17 March 1988 or who falls to be regarded as resident outside the UK for the purposes of any double tax treaty ( Treaty Non-resident ) on or after 16 March 2005 and continues to not be resident or ordinarily resident in the UK, or continues to be Treaty Non-resident, for a period of less than five years of assessment and who disposes of his ordinary shares or ADSs during that period may also be liable on his return to the UK to UK tax on capital gains, subject to any available exemption or relief, even though he is not resident or ordinarily resident in the UK, or is Treaty Non-resident, at the time of the disposal.

***US income taxation of capital gains***

Upon a sale or exchange of ordinary shares or ADSs to a person other than Pearson, a US holder will recognize gain or loss in an amount equal to the difference between the amount realized on the sale or exchange and the US holder s adjusted tax basis in the ordinary shares or ADSs. Any gain or loss recognized will be capital gain or loss and will be long-term capital gain or loss if the US holder has held the ordinary shares or ADSs for more than one year. Long-term capital gain of a noncorporate US holder is generally taxed at a maximum rate of 15%. This long-term capital gain rate is scheduled to expire in 2013.

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

***Estate and gift tax***

The current Estate and Gift Tax Convention, or the Convention, between the US and the UK generally relieves from UK Inheritance Tax (the equivalent of US Estate and Gift Tax) the transfer of ordinary shares or of ADSs

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

***Stamp duty***

The statements below reflect what is understood to be HMRC s currency practice under existing law.

No stamp duty or stamp duty reserve tax (SDRT) will be payable in the UK on the purchase or transfer of an ADS, provided that the ADS, and any separate instrument or written agreement of transfer, remain at all times outside the UK and that the instrument or written agreement of transfer is not executed in the UK. Subject to the following paragraph, stamp duty or SDRT is, however, generally payable at the rate of 1.5% of the amount or value of the consideration or, in some circumstances, the value of the ordinary shares, where ordinary shares are issued or transferred to a person whose business is or includes issuing depositary receipts, or to a nominee or agent for such a person, or issued or transferred to a person whose business is or includes the provision of clearance services or a nominee or agent for such a person.

Following a decision of the European Court of Justice in 2009, HMRC has announced that it will not seek to apply the 1.5% SDRT charge when new shares are issued an EU clearance service or EU depositary receipt system. It seems that HMRC s view is that the 1.5% SDRT charge will continue to apply to transfer of shares into a clearance service or depositary receipt system, and also in respect of issues of shares into non-EU clearance services and non-EU depositary receipt systems. Arguably the 1.5% SDRT charge in such situations is not consistent with the 2009 decision of the European Court of Justice, although HMRC is likely to impose such charges until further case law or legislation resolves the issue.

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

***Close company status***

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

**Documents on display**

A copy of Articles of Association is filed as an exhibit to this Annual Report and certain other documents referred to in this Annual Report are available for inspection at our registered office at 80 Strand, London WC2R 0RL (c/o the Company Secretary), or, in the US, at the registered office of Pearson Inc. at 1330 Avenue of the Americas, 7th Floor, New York, New York, during usual business hours upon reasonable prior request.

**ITEM 11.** ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

**Introduction**

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

Table of Contents

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

We have formulated policies for hedging exposures to interest rate and foreign exchange risk, and have used derivatives to ensure compliance with these policies. Although a proportion of our derivative contracts were transacted without regard to existing IFRS requirements on hedge accounting, during 2010 and 2009 we qualified for hedge accounting under IFRS on a number of our key derivative contracts.

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

### Interest rates

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

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

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

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

The Group s accounting objective in its use of interest rate derivatives is to minimize the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces significantly the income statement impact of changes in the market value of a derivative). The Group then divides the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimized.

### Currency exchange rates

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

The Group s policy is to align approximately the currency composition of its core net borrowings with its forecast operating profit before depreciation and amortization. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. This policy applies only to currencies that account for more than 15% of group operating profit, which currently are the US dollar and sterling. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. In addition, the Group s policy does not require existing currency debt to be terminated to match declines in that currency s share of

Table of Contents

Group operating profit. Also, the chief financial officer may request the inclusion of currencies that account for less than 15% of Group operating profit before depreciation and amortization in the above hedging process. Only one hedging transaction, denominated in South African rand, has been undertaken under that authority.

At December 31, 2010 the Group s net borrowings in our main currencies (taking into account the effect of cross currency rate swaps) were: US dollar £683m, sterling £179m, and South African rand £9m.

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of reporting under IFRS.

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

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

**Forward foreign exchange contracts**

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

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

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

**Derivatives**

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

In 2010 and 2009 the Group met the prescribed designation requirements and hedge effectiveness tests under IFRS for some of its derivative contracts. As a result, the movements in the fair value of the effective portion of fair value hedges and net investment hedges have been offset in earnings and reserves respectively by the corresponding

movement in the fair value of the underlying hedged item.

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

### Quantitative information about market risk

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

## ITEM 12. *DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES*

## ITEM 12D. *AMERICAN DEPOSITARY SHARES*

### Fees paid by ADR holders

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

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

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

| **Person depositing or withdrawing shares must pay to the depositary:** | **For:** |
|---|---|
| $5.00 (or less) per 100 ADSs (or portion of 100 ADSs) | Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property |
| | Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates |
| $.02 (or less) per ADS | Any cash distribution to ADS registered holders |
| A fee equivalent to the fee that would be payable if securities distributed had been shares and the shares had been deposited for issuance of ADSs | Distribution of securities by the depositary to ADS registered holders of deposited securities |
| $.02 (or less) per ADS per calendar year | Depositary services |
| Registration of transfer fees | Transfer and registration of shares on the share register to or from the name of the depositary or its agent when shares are deposited or withdrawn |
| Expenses of the depositary | Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement) |
| | Converting foreign currency to U.S. dollars |
| Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying | As necessary |

| | |
|---|---|
| an ADS, for example, stock transfer taxes, stamp duty or withholding taxes | |
| Any charges incurred by the depositary or its agents for servicing the deposited securities | As necessary |

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

From January 1, 2010 to February 28, 2011 the Company received payments from the depositary of $350,000 and $38,000 for continuing annual stock exchange listing fees, standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing the annual and interim financial reports, printing and distributing dividend cheques, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees.

Table of Contents

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

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

## PART II

### ITEM 13. *DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES*

None.

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

None.

### ITEM 15. *CONTROLS AND PROCEDURES*

**Disclosure controls and procedures**

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2010 was carried out by us under the supervision and with the participation of our management, including the chief executive officer and chief financial officer. Based on that evaluation the chief executive officer and chief financial officer concluded that Pearson s disclosure controls and procedures have been designed to provide, and are effective in providing, reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate to allow such timely decision regarding required disclosures. A controls system, no matter how well designed and operated cannot provide absolute assurance to achieve its objectives.

**Management s annual report on internal control over financial reporting**

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management has assessed the effectiveness of internal control over financial reporting, as at December 31, 2010, and has concluded that such internal control over financial reporting was effective.

PricewaterhouseCoopers LLP, which has audited the consolidated financial statements of the Company for the year ended December 31, 2010, has also audited the effectiveness of the Company s internal control over financial reporting under Auditing Standard No. 5 of the Public Company Accounting Oversight Board (United States). Their audit report may be found on page F-2.

**Change in internal control over financial reporting**

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

**ITEM 16A.** ***AUDIT COMMITTEE FINANCIAL EXPERT***

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

Table of Contents

## ITEM 16B. *CODE OF ETHICS*

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

## ITEM 16C. *PRINCIPAL ACCOUNTANT FEES AND SERVICES*

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

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

Pre-approved non-audit services can be authorized by the chief financial officer up to £100,000 per project, subject to a cumulative limit of £500,000 per annum;

Acquisition due diligence services up to £100,000 per transaction;

Tax compliance and related activities up to the greater of £1,000,000 per annum or 50% of the external audit fee; and

For forward-looking tax planning services we use the most appropriate advisor, usually after a tender process. Where we decide to use our independent auditor, authority, up to £100,000 per project subject to a cumulative limit of £500,000 per annum, has been delegated by the audit committee to management.

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

The following table sets forth remuneration paid to PwC for 2009 and 2010:

| **Auditors Remuneration** | **2010 £m** | **2009 £m** |
|---|---|---|
| Audit fees | 6 | 6 |
| Tax fees | 2 | 2 |
| All other fees | 2 | 1 |

Audit fees include £35,000 (2009: £35,000) of audit fees relating to the audit of the parent company.

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

Tax services include services related to tax planning and various other tax advisory services.

Other services relates mainly to due diligence on acquisitions, notably our Brazilian acquisition, Sistema Educacional Brasileiro where we assessed that our auditors were best qualified and cost effective in taking on this role.

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

Not applicable.

Table of Contents

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

| Period | Total number of shares purchased | Average price paid per share | Total number of units purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|---|---|---|---|---|
| June 1, 2009 - June 30, 2009 | 2,000,000 | £6.14 | N/A | N/A |
| May 1, 2010 - May 31, 2010 | 3,000,000 | £9.94 | N/A | N/A |
| June 1, 2010 - June 30, 2010 | 2,000,000 | £9.17 | N/A | N/A |
| October 1, 2010 - October 31, 2010 | 1,000,000 | £9.83 | N/A | N/A |
| November 1, 2010 - November 31, 2010 | 2,000,000 | £9.46 | N/A | N/A |

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

**ITEM 16F.** ***CHANGE IN REGISTRANT S CERTIFYING AUDITOR***

Not applicable.

**ITEM 16G.** ***CORPORATE GOVERNANCE***

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

**PART III**

**ITEM 17.** ***FINANCIAL STATEMENTS***

Not applicable.

**ITEM 18.** ***FINANCIAL STATEMENTS***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-70 hereof.

**ITEM 19.** ***EXHIBITS***

1.1 Articles of Association of Pearson plc.
2.1 Indenture dated June 23, 2003 between Pearson plc and The Bank of New York, as trustee *
2.2 Indenture dated May 25, 2004 among Pearson Dollar Finance plc, as Issuer, Pearson plc, Guarantor, and the Bank of New York, as trustee, Paying Agent and Calculation Agent. #
2.3 Indenture dated June 21, 2001 between Pearson plc and The Bank of New York, as trustee.
2.4 Indenture dated March 26, 2009 among Pearson Funding One plc, as the Issuer, Pearson plc, Guarantor, and The Law Debenture Trust Corporation P.L.C., as trustee. ¥
2.5 Indenture dated May 6, 2008 among Pearson Dollar Finance Two plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York, as trustee, Paying Agent and Calculation Agent. ¥

| | |
|---|---|
| 2.6 | Indenture dated October 27, 1999 between Pearson plc, as the Issuer and The Law Debenture Trust Corporation P.L.C., as trustee. ¥ |
| 2.7 | Indenture dated May 17, 2010 between Pearson Funding Two plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. |
| 8.1 | List of Significant Subsidiaries. |
| 12.1 | Certification of Chief Executive Officer. |
| 12.2 | Certification of Chief Financial Officer. |
| 13.1 | Certification of Chief Executive Officer. |
| 13.2 | Certification of Chief Financial Officer. |
| 15 | Consent of PricewaterhouseCoopers LLP. |

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

# Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2004 and filed June 27, 2005.

Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2001 and filed June 10, 2002.

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

**FINANCIAL STATEMENTS: CONTENTS**


| | |
|---|---|
| Report of Independent Registered Public Accounting Firm | F-2 |
| Consolidated Income Statement for the year ended December 31, 2010, 2009 and 2008 | F-3 |
| Consolidated Statement of Comprehensive Income for the year ended December 31, 2010, 2009 and 2008 | F-4 |
| Consolidated Balance Sheet as at December 31, 2010 and 2009 | F-5 |
| Consolidated Statement of Changes in Equity for the year ended December 31, 2010, 2009 and 2008 | F-7 |
| Consolidated Cash Flow Statement for the year ended December 31, 2010, 2009 and 2008 | F-9 |
| Notes to the Consolidated Financial Statements | F-10 |

Table of Contents

## Report of Independent Registered Public Accounting Firm

**To the Board of Directors and Shareholders of Pearson plc**

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, equity and cash flows present fairly, in all material respects, the financial position of Pearson plc and its subsidiaries (the Group ) at December 31, 2010 and December 31, 2009 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. Also in our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Group s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Annual Report on Internal Control Over Financial Reporting appearing under Item 15 of this Form 20-F. Our responsibility is to express opinions on these financial statements and on the Group s internal control over financial reporting based on our integrated audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

**PricewaterhouseCoopers LLP**

**London**
**United Kingdom**
**March 25, 2011**

Table of Contents

**Consolidated Income Statement**
**Year ended 31 December 2010**
**All figures in £ millions**

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| Sales | 2 | **5,663** | 5,140 | 4,405 |
| Cost of goods sold | 4 | **(2,588)** | (2,382) | (2,046) |
| **Gross profit** | | **3,075** | 2,758 | 2,359 |
| Operating expenses | 4 | **(2,373)** | (2,169) | (1,820) |
| Share of results of joint ventures and associates | 12 | **41** | 30 | 25 |
| **Operating profit** | 2 | **743** | 619 | 564 |
| Finance costs | 6 | **(109)** | (122) | (136) |
| Finance income | 6 | **36** | 26 | 41 |
| **Profit before tax** | | **670** | 523 | 469 |
| Income tax | 7 | **(146)** | (146) | (125) |
| **Profit for the year from continuing operations** | | **524** | 377 | 344 |
| Profit/(loss) for the year from discontinued operations | 3 | **776** | 85 | (21) |
| **Profit for the year** | | **1,300** | 462 | 323 |
| **Attributable to:** | | | | |
| Equity holders of the company | | **1,297** | 425 | 292 |
| Non-controlling interest | | **3** | 37 | 31 |
| **Earnings per share for profit from continuing and discontinued operations attributable to equity holders of the company during the year** (expressed in pence per share) | | | | |
| basic | 8 | **161.9p** | 53.2p | 36.6p |
| diluted | 8 | **161.5p** | 53.1p | 36.6p |
| **Earnings per share for profit from continuing operations attributable to equity holders of the company during the year** (expressed in pence per share) | | | | |
| basic | 8 | **66.0p** | 47.0p | 42.9p |
| diluted | 8 | **65.9p** | 47.0p | 42.9P |

Table of Contents

**Consolidated Statement of Comprehensive Income**
**Year ended 31 December 2010**
**All figures in £ millions**

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| Profit for the year | | **1,300** | 462 | 323 |
| Net exchange differences on translation of foreign operations | | **173** | (388) | 1,125 |
| Currency translation adjustment disposed subsidiaries | | **13** | | 49 |
| Currency translation adjustment disposed joint venture | | | | 1 |
| Actuarial gains/(losses) on retirement benefit obligations Group | 25 | **70** | (299) | (71) |
| Actuarial gains/(losses) on retirement benefit obligations associate | 12 | **1** | (3) | (3) |
| Net increase in fair values of proportionate holding arising on stepped acquisition | | | 18 | |
| Tax on items recognised in other comprehensive income | 7 | **(41)** | 91 | 9 |
| **Other comprehensive income/(expense) for the year** | | **216** | (581) | 1,110 |
| **Total comprehensive income/(expense) for the year** | | **1,516** | (119) | 1,433 |
| **Attributable to:** | | | | |
| Equity holders of the company | | **1,502** | (127) | 1,327 |
| Non-controlling interest | | **14** | 8 | 106 |

Table of Contents

**Consolidated Balance Sheet**
**As at 31 December 2010**
**All figures in £ millions**

| | Notes | 2010 | 2009 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | **366** | 388 |
| Intangible assets | 11 | **5,467** | 5,129 |
| Investments in joint ventures and associates | 12 | **71** | 30 |
| Deferred income tax assets | 13 | **276** | 387 |
| Financial assets Derivative financial instruments | 16 | **134** | 112 |
| Other financial assets | 15 | **58** | 62 |
| Trade and other receivables | 22 | **129** | 112 |
| | | **6,501** | 6,220 |
| **Current assets** | | | |
| Intangible assets Pre-publication | 20 | **647** | 650 |
| Inventories | 21 | **429** | 445 |
| Trade and other receivables | 22 | **1,337** | 1,284 |
| Financial assets Derivative financial instruments | 16 | **6** | |
| Financial assets Marketable securities | 14 | **12** | 63 |
| Cash and cash equivalents (excluding overdrafts) | 17 | **1,736** | 750 |
| | | **4,167** | 3,192 |
| **Total assets** | | **10,668** | 9,412 |

F-5

**Consolidated Balance Sheet (Continued)**
**As at 31 December 2010**
**All figures in £ millions**

| | Notes | 2010 | 2009 |
|---|---|---|---|
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Financial liabilities Borrowings | 18 | **(1,908)** | (1,934) |
| Financial liabilities Derivative financial instruments | 16 | **(6)** | (2) |
| Deferred income tax liabilities | 13 | **(471)** | (473) |
| Retirement benefit obligations | 25 | **(148)** | (339) |
| Provisions for other liabilities and charges | 23 | **(42)** | (50) |
| Other liabilities | 24 | **(246)** | (253) |
| | | **(2,821)** | (3,051) |
| **Current liabilities** | | | |
| Trade and other liabilities | 24 | **(1,605)** | (1,467) |
| Financial liabilities Borrowings | 18 | **(404)** | (74) |
| Financial liabilities Derivative financial instruments | 16 | | (7) |
| Current income tax liabilities | | **(215)** | (159) |
| Provisions for other liabilities and charges | 23 | **(18)** | (18) |
| | | **(2,242)** | (1,725) |
| **Total liabilities** | | **(5,063)** | (4,776) |
| **Net assets** | | **5,605** | 4,636 |
| **Equity** | | | |
| Share capital | 27 | **203** | 203 |
| Share premium | 27 | **2,524** | 2,512 |
| Treasury shares | 28 | **(137)** | (226) |
| Translation reserve | | **402** | 227 |
| Retained earnings | | **2,546** | 1,629 |
| **Total equity attributable to equity holders of the company** | | **5,538** | 4,345 |
| Non-controlling interest | | **67** | 291 |
| **Total equity** | | **5,605** | 4,636 |

These financial statements have been approved for issue by the board of directors on 7 March 2011 and signed on its behalf by

Robin Freestone *Chief financial officer*

**Consolidated Statement of Changes in Equity**
**Year ended 31 December 2010**
**All figures in £ millions**

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

| | Equity attributable to equity holders of the company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Share capital** | **Share premium** | **Treasury shares** | **Translation reserve** | **Retained earnings** | **Total** | **Non-controlling interest** | **Total equity** |
| At 1 January 2009 | 202 | 2,505 | (222) | 586 | 1,679 | 4,750 | 274 | 5,024 |
| Profit for the year | | | | | 425 | 425 | 37 | 462 |
| Other comprehensive expense | | | | (359) | (193) | (552) | (29) | (581) |
| Equity-settled transactions | | | | | 37 | 37 | | 37 |
| Tax on equity-settled transactions | | | | | 6 | 6 | | 6 |
| Issue of ordinary shares under share option schemes | 1 | 7 | | | | 8 | | 8 |
| Purchase of treasury shares | | | (33) | | | (33) | | (33) |
| Release of treasury shares | | | 29 | | (29) | | | |
| Put option over non-controlling interest | | | | | (23) | (23) | | (23) |
| | | | | | | | 24 | 24 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Changes in non-controlling shareholding | | | | | | | | |
| Dividends | | | | | (273) | (273) | (15) | (288) |
| At 31 December 2009 | 203 | 2,512 | (226) | 227 | 1,629 | 4,345 | 291 | 4,636 |

Table of Contents

| | Equity attributable to equity holders of the company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Treasury shares | Translation reserve | Retained earnings | Total | Non-controlling interest | Total equity |
| At 1 January 2008 | 202 | 2,499 | (216) | (514) | 1,724 | 3,695 | 179 | 3,874 |
| Profit for the year | | | | | 292 | 292 | 31 | 323 |
| Other comprehensive income/(expense) | | | | 1,100 | (65) | 1,035 | 75 | 1,110 |
| Equity-settled transactions | | | | | 33 | 33 | | 33 |
| Tax on equity-settled transactions | | | | | (7) | (7) | | (7) |
| Issue of ordinary shares under share option schemes | | 6 | | | | 6 | | 6 |
| Purchase of treasury shares | | | (47) | | | (47) | | (47) |
| Release of treasury shares | | | 41 | | (41) | | | |
| Changes in non-controlling shareholding | | | | | | | 6 | 6 |
| Dividends | | | | | (257) | (257) | (17) | (274) |
| At 31 December 2008 | 202 | 2,505 | (222) | 586 | 1,679 | 4,750 | 274 | 5,024 |

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

**Consolidated Cash Flow Statement**
**Year ended 31 December 2010**
**All figures in £ millions**

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Net cash generated from operations | 31 | **1,169** | 1,012 | 894 |
| Interest paid | | **(78)** | (90) | (87) |
| Tax paid | | **(85)** | (103) | (89) |
| Net cash generated from operating activities | | **1,006** | 819 | 718 |
| **Cash flows from investing activities** | | | | |
| Acquisition of subsidiaries, net of cash acquired | 29 | **(535)** | (208) | (395) |
| Acquisition of joint ventures and associates | | **(22)** | (14) | (5) |
| Purchase of investments | | **(7)** | (10) | (1) |
| Purchase of property, plant and equipment | | **(76)** | (62) | (75) |
| Proceeds from the sale of investments | | | | 5 |
| Proceeds from sale of property, plant and equipment | 31 | | 1 | 2 |
| Purchase of intangible assets | | **(56)** | (58) | (45) |
| Disposal of subsidiaries, net of cash disposed | 30 | **984** | | 99 |
| Tax paid on disposal of subsidiaries | | **(250)** | | |
| Interest received | | **10** | 3 | 11 |
| Dividends received from joint ventures and associates | | **23** | 22 | 23 |
| Net cash received from/(used in) investing activities | | **71** | (326) | (381) |
| **Cash flows from financing activities** | | | | |
| Proceeds from issue of ordinary shares | | **12** | 8 | 6 |
| Purchase of treasury shares | | **(77)** | (33) | (47) |
| Proceeds from borrowings | | **241** | 296 | 455 |
| Liquid resources acquired | | | (13) | |
| Liquid resources sold | | **53** | | |
| Repayment of borrowings | | **(13)** | (343) | (275) |
| Finance lease principal payments | | **(3)** | (2) | (3) |
| Dividends paid to company s shareholders | 9 | **(292)** | (273) | (257) |
| Dividends paid to non-controlling interest | | **(6)** | (20) | (28) |
| Transactions with non-controlling interest | | **(7)** | 14 | 12 |
| Net cash used in financing activities | | **(92)** | (366) | (137) |
| Effects of exchange rate changes on cash and cash equivalents | | **(1)** | (36) | (103) |
| **Net increase in cash and cash equivalents** | | **984** | 91 | 97 |
| Cash and cash equivalents at beginning of year | | **680** | 589 | 492 |
| **Cash and cash equivalents at end of year** | 17 | **1,664** | 680 | 589 |

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

## Notes to the Consolidated Financial Statements

### General information

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 7 March 2011.

### 1. Accounting policies

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

### a. Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. These consolidated financial statements are also prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB). In respect of the accounting standards applicable to the Group there is no difference between EU-adopted and IASB-adopted IFRS. The Group transitioned from UK GAAP to IFRS on 1 January 2003.

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

***1. Interpretations and amendments to published standards effective in 2010***

IFRS 3 (Revised) Business Combinations and amendments to IAS 27 Consolidated and Separate Financial Statements , effective for annual reporting periods beginning on or after 1 July 2009. The amendments affect the accounting for business combinations, including the requirement to re-measure the fair value of previously held interests in step acquisitions with any gain or loss arising being recognised in the income statement, the requirement to expense acquisition costs and the requirement to recognise adjustments to contingent consideration in the income statement.

Amendments to IAS 39 Financial Instruments: Recognition and Measurement , effective for annual reporting periods beginning on or after 1 July 2009. The amendments clarify that inflation may only be hedged where changes in inflation are a specified portion of cash flows of a financial instrument, and also clarify hedging with options. Management have assessed that the amendments have no impact on the Group s financial statements.

Amendments to IFRS 2 Share-based Payment : Group cash-settled share-based payment transactions, effective for annual reporting periods beginning on or after 1 January 2010. The amendments clarify the scope and accounting for group cash-settled share-based payment transactions. Management have assessed that the amendments have no impact on the Group s financial statements.

IFRIC 17 Distributions of Non-cash Assets to Owners , effective for annual reporting periods beginning on or after 1 July 2009. IFRIC 17 provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends, including recognition upon authorisation and measurement at fair value of assets distributed, with any difference between fair value and carrying value of these assets being recognised in the income statement when an entity settles the dividend payable. This does not apply to distributions of non-cash assets under common control. Management have assessed that this interpretation has no impact on the Group s financial statements as the Group does not currently distribute non-cash assets.



---

**Notes to the Consolidated Financial Statements (Continued)**

IFRIC 18 Transfers of Assets from Customers , effective for transfers of assets from customers received on or after 1 July 2009. IFRIC 18 states that when an item of property, plant and equipment is received from a customer and it meets the definition of an asset from the perspective of the recipient, the recipient should recognise the asset at its fair value at the date of transfer and recognise the credit in accordance with IAS 18 Revenue . Management have assessed that this interpretation has no impact on the Group s financial statements as the Group has not received such assets from customers.

Improvements to IFRSs 2009 , effective dates vary upon the amendment. This is the second set of amendments published under the IASB s annual improvements process and incorporates minor amendments to 12 standards and interpretations. Management have assessed that these amendments have no impact on the Group s financial statements.

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

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

Amendments to IAS 24 Related Parties , effective for annual reporting periods beginning on or after 1 January 2011. The amendments simplify disclosure for government related entities and clarify the definition of a related party.

Amendments to IAS 32 Financial Instruments: Presentation - Classification of Rights, effective for annual reporting periods beginning on or after 1 February 2010. The amendments clarify that rights, options or warrants issued to acquire a fixed number of an entity s own non-derivative equity instruments for a fixed amount in any currency are classified as equity instruments provided the offer is made pro-rata to all existing owners of the same class of the entity s own non-derivative equity instruments.

IFRS 9 Financial Instruments , effective for annual reporting periods beginning on or after 1 January 2013. The new standard details the requirements for the classification and measurement of financial assets and liabilities.

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments , effective for annual reporting periods beginning on or after 1 July 2010. IFRIC 19 clarifies accounting required by entities issuing equity instruments to extinguish all or part of a financial liability.

Amendments to IFRIC 14 Prepayments of a Minimum Funding Requirement , effective for annual reporting periods beginning on or after 1 January 2011. The amendments remedy a consequence of IFRIC 14 where, in certain circumstances, an entity was not permitted to recognise prepayments of a minimum funding requirement as an asset.

Amendments to IFRS 7 Financial Instruments: Disclosures Transfers of Financial Assets, effective for annual reporting periods beginning on or after 1 July 2011. The amendments require enhanced disclosure where an asset is transferred but not derecognised, and new disclosure for assets that are derecognised but to which the entity continues to have an exposure.

Amendments to IAS 12 Deferred Tax Recoverability of Underlying Assets, effective for annual reporting periods beginning on or after 1 January 2012. The amendments provide, for certain investment properties, an exception to the principle that the measurement of deferred tax assets and liabilities should reflect the tax

consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset.

Improvements to IFRSs 2010 , effective dates vary upon the amendment. This is the third set of amendments published under IASB s annual improvements process and incorporates minor amendments to seven standards and interpretations.

Management are currently assessing the impact of these new standards, interpretations and amendments on the Group s financial statements.

F-11

---

**Notes to the Consolidated Financial Statements (Continued)**

***3. Critical accounting assumptions and judgements***

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

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

**b. Consolidation**

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

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

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

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

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

***4. Joint ventures and associates*** Joint ventures are entities in which the Group holds an interest on a long-term basis and which are jointly controlled, with one or more other venturers, under a contractual arrangement. Associates are

entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at cost.

The Group s share of its joint ventures and associates post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves. The Group s share of its joint ventures and associates results is recognised as a component of operating profit as these

**Notes to the Consolidated Financial Statements (Continued)**

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

### c. Foreign currency translation

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

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

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

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

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

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

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

At the date of transition to IFRS the cumulative translation differences in respect of foreign operations have been deemed to be zero.

Any gains and losses on disposals of foreign operations will exclude translation differences that arose prior to the transition date.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.54 (2009: $1.57) and the year end rate was $1.57 (2009: $1.61).

### d. Property, plant and equipment

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

estimated useful lives as follows:

Buildings (freehold): 20-50 years

Buildings (leasehold): over the period of the lease

Plant and equipment: 3-10 years

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

**Notes to the Consolidated Financial Statements (Continued)**

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

### e. Intangible assets

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

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

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

IFRS 3 Business Combinations has not been applied retrospectively to business combinations before the date of transition to IFRS. Subject to the transition adjustments to IFRS required by IFRS 1, the accounting for business combinations before the date of transition has been grandfathered.

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

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

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

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

**Notes to the Consolidated Financial Statements (Continued)**

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 31).

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

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

### f. Other financial assets

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

### g. Inventories

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

### h. Royalty advances

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

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

### i. Newspaper development costs

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

### j. Cash and cash equivalents

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

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

## Notes to the Consolidated Financial Statements (Continued)

### k. Share capital

Ordinary shares are classified as equity.

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

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

### l. Borrowings

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

### m. Derivative financial instruments

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

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

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

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

### n. Taxation

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

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

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

## Notes to the Consolidated Financial Statements (Continued)

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

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

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

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

### o. Employee benefits

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

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

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

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

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

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

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

**Notes to the Consolidated Financial Statements (Continued)**

exercised. The Group has applied IFRS 2 Share-based Payment retrospectively to all options granted but not fully vested at the date of transition to IFRS.

### p. Provisions

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

The Group recognises a provision for deferred consideration when the payment of the deferred consideration is probable.

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

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

### q. Revenue recognition

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

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

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

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

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

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

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

**r. Leases**

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease

**Notes to the Consolidated Financial Statements (Continued)**

payment is allocated between the liability and finance charges to achieve a constant rate on the finance balance outstanding.

The corresponding rental obligations, net of finance charges, are included in financial liabilities -borrowings. The interest element of the finance cost is charged to the income statement over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

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

**s. Dividends**

Dividends are recorded in the Group s financial statements in the period in which they are approved by the company s shareholders. Interim dividends are recorded in the period in which they are approved and paid.

**t. Non-current assets and liabilities held for sale**

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

**u. Trade receivables**

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

**2. Segment information**

The Group is organised into five business segments:

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

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

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

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

***Penguin*** Publisher with brand imprints such as Penguin, Putnam, Berkley, Viking and Dorling Kindersley.

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

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

The results of the Interactive Data segment are shown as discontinued.

| | | | | | 2010 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Notes | North American Education | International Education | Professional | FT Group | Penguin | Corporate | Discontinued operations | Group |
| | | | | | All figures in £ millions | | | | |
| **Continuing operations** | | | | | | | | | |
| Sales (external) | | **2,640** | **1,234** | **333** | **403** | **1,053** | | | **5,663** |
| Sales (inter-segment) | | | | **5** | | **3** | | | **8** |
| Adjusted operating profit | | **469** | **171** | **51** | **60** | **106** | | | **857** |
| Amortisation of acquired intangibles | | **(53)** | **(35)** | **(7)** | **(9)** | **(1)** | | | **(105)** |
| Acquisition costs | | **(1)** | **(7)** | **(2)** | **(1)** | | | | **(11)** |
| Other net gains and losses | | | **(10)** | | **12** | | | | **2** |
| **Operating profit** | | **415** | **119** | **42** | **62** | **105** | | | **743** |
| Finance costs | 6 | | | | | | | | **(109)** |
| Finance income | 6 | | | | | | | | **36** |
| **Profit before tax** | | | | | | | | | **670** |
| Income tax | 7 | | | | | | | | **(146)** |
| **Profit for the year from continuing operations** | | | | | | | | | **524** |
| Segment assets | | **4,401** | **2,122** | **601** | **447** | **1,138** | **1,888** | | **10,597** |
| Joint ventures | 12 | **15** | | **1** | **1** | **1** | | | **18** |
| Associates | 12 | **24** | **6** | | **23** | | | | **53** |
| **Total assets** | | **4,440** | **2,128** | **602** | **471** | **1,139** | **1,888** | | **10,668** |
| **Other segment items** | | | | | | | | | |
| Share of results of joint ventures and associates | 12 | **(3)** | **1** | **1** | **42** | | | | **41** |
| Capital expenditure | 10,11 | **45** | **27** | **16** | **17** | **18** | | **21** | **144** |
| Pre-publication investment | 20 | **215** | **61** | **7** | | **36** | | | **319** |
| Depreciation | 10 | **23** | **19** | **9** | **5** | **13** | | **13** | **82** |
| Amortisation | 11,20 | **307** | **111** | **18** | **23** | **43** | | **12** | **514** |

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

| | | 2009 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Notes | North American Education | International Education | Professional | FT Group | Penguin | Corporate | Discontinued operations | Group |
| | | All figures in £ millions | | | | | | | |
| **Continuing operations** | | | | | | | | | |
| Sales (external) | | 2,470 | 1,035 | 275 | 358 | 1,002 | | | 5,140 |
| Sales (inter-segment) | | | | 7 | | 24 | | | 31 |
| Adjusted operating profit | | 403 | 141 | 43 | 39 | 84 | | | 710 |
| Amortisation of acquired intangibles | | (49) | (32) | (1) | (8) | (1) | | | (91) |
| **Operating profit** | | 354 | 109 | 42 | 31 | 83 | | | 619 |
| Finance costs | 6 | | | | | | | | (122) |
| Finance income | 6 | | | | | | | | 26 |
| **Profit before tax** | | | | | | | | | 523 |
| Income tax | 7 | | | | | | | | (146) |
| **Profit for the year from continuing operations** | | | | | | | | | 377 |
| Segment assets | | 4,382 | 1,635 | 377 | 420 | 1,173 | 924 | 471 | 9,382 |
| Joint ventures | 12 | 13 | | 1 | 1 | 3 | | | 18 |
| Associates | 12 | | 5 | | 7 | | | | 12 |
| **Total assets** | | 4,395 | 1,640 | 378 | 428 | 1,176 | 924 | 471 | 9,412 |
| **Other segment items** | | | | | | | | | |
| Share of results of joint ventures and associates | 12 | (2) | 6 | 1 | 25 | | | | 30 |
| Capital expenditure | 10,11 | 38 | 22 | 12 | 15 | 10 | | 29 | 126 |
| Pre-publication investments | 20 | 220 | 58 | 8 | | 36 | | | 322 |
| Depreciation | 10 | 24 | 16 | 10 | 5 | 9 | | 21 | 85 |
| Amortisation | 11,20 | 274 | 89 | 13 | 20 | 42 | | 16 | 454 |

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

| | 2008 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | North American | International | | | | | Discontinued | |
| | Notes | Education | Education | Professional | FT Group | Penguin | Corporate | operations | Group |
| | All figures in £ millions | | | | | | | | |
| **Continuing operations** | | | | | | | | | |
| Sales (external) | | 2,002 | 866 | 244 | 390 | 903 | | | 4,405 |
| Sales (inter-segment) | | | | 4 | | 22 | | | 26 |
| Adjusted operating profit | | 303 | 135 | 36 | 74 | 93 | | | 641 |
| Amortisation of acquired intangibles | | (45) | (22) | (1) | (7) | (2) | | | (77) |
| **Operating profit** | | 258 | 113 | 35 | 67 | 91 | | | 564 |
| Finance costs | 6 | | | | | | | | (136) |
| Finance income | 6 | | | | | | | | 41 |
| **Profit before tax** | | | | | | | | | 469 |
| Income tax | 7 | | | | | | | | (125) |
| **Profit for the year from continuing operations** | | | | | | | | | 344 |
| Segment assets | | 4,952 | 1,358 | 423 | 482 | 1,211 | 923 | 524 | 9,873 |
| Joint ventures | 12 | | 8 | | 2 | 3 | | | 13 |
| Associates | 12 | | 4 | | 6 | | | | 10 |
| **Total assets** | | 4,952 | 1,370 | 423 | 490 | 1,214 | 923 | 524 | 9,896 |
| **Other segment items** | | | | | | | | | |
| Share of results of joint ventures and associates | 12 | | 5 | | 19 | 1 | | | 25 |
| Capital expenditure | 10, 11 | 22 | 30 | 15 | 17 | 15 | | 25 | 124 |
| Pre-publication investments | 20 | 202 | 52 | 7 | | 36 | | | 297 |
| Depreciation | 10 | 25 | 12 | 8 | 13 | 9 | | 13 | 80 |
| Amortisation | 11, 20 | 219 | 69 | 12 | 12 | 36 | | 12 | 360 |

In 2010, sales from the provision of goods were £4,200m (2009: £3,838m; 2008: £3,374m) and sales from the provision of services were £1,463m (2009: £1,302m; 2008: £1,031m). Sales from the Group s educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing and other service businesses are classified as being from the provision of services.

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

Property, plant and equipment and intangible assets acquired through business combination were £311m (2009: £153m) (see note 29). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations.

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

The Group operates in the following main geographic areas:

| | Sales | | | Non-current assets | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | 2008 | 2010 | 2009 | 2008 |
| | All figures in £ millions | | | | | |
| **Continuing operations** | | | | | | |
| UK | **790** | 694 | 700 | **1,031** | 904 | 660 |
| Other European countries | **415** | 387 | 392 | **237** | 179 | 154 |
| USA | **3,361** | 3,146 | 2,596 | **3,790** | 3,607 | 4,396 |
| Canada | **228** | 198 | 165 | **235** | 204 | 209 |
| Asia Pacific | **577** | 497 | 403 | **364** | 319 | 155 |
| Other countries | **292** | 218 | 149 | **376** | 121 | 14 |
| **Total continuing** | **5,663** | 5,140 | 4,405 | **6,033** | 5,334 | 5,588 |
| **Discontinued operations** | | | | | | |
| UK | **31** | 54 | 55 | | 37 | 41 |
| Other European countries | **48** | 86 | 71 | | 63 | 70 |
| USA | **196** | 317 | 272 | | 204 | 228 |
| Canada | **2** | 2 | 2 | | | |
| Asia Pacific | **18** | 23 | 12 | | 21 | 24 |
| Other countries | **1** | 2 | 2 | | | |
| **Total discontinued** | **296** | 484 | 414 | | 325 | 363 |
| **Total** | **5,959** | 5,624 | 4,819 | **6,033** | 5,659 | 5,951 |

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. Non-current assets are based on the subsidiary s country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

## Notes to the Consolidated Financial Statements (Continued)

### 3. Discontinued operations

Discontinued operations in 2009 and 2010 relate to the Group s interest in Interactive Data (sold on 29 July 2010). Discontinued operations in 2008 relate to interactive Data and the Data Management business (sold on 22 February 2008).

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

| | 2010 Interactive Data | 2009 Interactive Data | 2008 Interactive Data | 2008 Data Management | 2008 Total |
|---|---|---|---|---|---|
| | All figures in £ millions | | | | |
| Sales | **296** | 484 | 406 | 8 | 414 |
| Operating profit | **73** | 136 | 112 | | 112 |
| Finance income | | 1 | 4 | | 4 |
| **Profit before tax** | **73** | 137 | 116 | | 116 |
| Attributable tax expense | **(28)** | (52) | (47) | | (47) |
| **Profit after tax** | **45** | 85 | 69 | | 69 |
| Profit/(loss) on disposal of discontinued operations before tax | **1,037** | | | (53) | (53) |
| Attributable tax expense | **(306)** | | | (37) | (37) |
| **Profit/(loss) for the year from discontinued operations** | **776** | 85 | 69 | (90) | (21) |
| Operating cash flows | **85** | 132 | 127 | | 127 |
| Investing cash flows | **(35)** | (23) | (50) | | (50) |
| Financing cash flows | **49** | (80) | (29) | | (29) |
| **Total cash flows** | **99** | 29 | 48 | | 48 |

### 4. Operating expenses

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| **By function:** | | | |
| **Cost of goods sold** | **2,588** | 2,382 | 2,046 |

**Operating expenses**

| | | | |
|---|---|---|---|
| Distribution costs | **298** | 275 | 235 |
| Administrative and other expenses | **2,190** | 2,014 | 1,687 |
| Other income | **(115)** | (120) | (102) |
| **Total operating expenses** | **2,373** | 2,169 | 1,820 |
| **Total** | **4,961** | 4,551 | 3,866 |

**Notes to the Consolidated Financial Statements (Continued)**

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| **By nature:** | | | | |
| Utilisation of inventory | 21 | **836** | 843 | 832 |
| Depreciation of property, plant and equipment | 10 | **69** | 64 | 67 |
| Amortisation of intangible assets Pre-publication | 20 | **350** | 307 | 244 |
| Amortisation of intangible assets Other | 11 | **152** | 131 | 104 |
| Employee benefit expense | 5 | **1,849** | 1,725 | 1,392 |
| Operating lease rentals | | **166** | 157 | 156 |
| Other property costs | | **64** | 70 | 102 |
| Royalties expensed | | **524** | 479 | 400 |
| Advertising, promotion and marketing | | **250** | 219 | 238 |
| Information technology costs | | **78** | 72 | 60 |
| Other costs | | **738** | 604 | 373 |
| Other income | | **(115)** | (120) | (102) |
| **Total** | | **4,961** | 4,551 | 3,866 |

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| Fees payable to the company s auditors for the audit of parent company and consolidated financial statements | **4** | 4 | 3 |
| The audit of the company s subsidiaries pursuant to legislation | **2** | 2 | 2 |
| Tax services | **2** | 2 | 2 |
| Other services | **2** | 1 | 1 |
| **Total** | **10** | 9 | 8 |

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act | **6** | 6 | 5 |
| Non-audit fees | **4** | 3 | 3 |
| **Total** | **10** | 9 | 8 |

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Tax services include services related to tax planning and various other tax advisory matters. Other services is mainly due diligence on acquisitions, notably our Brazilian acquisition, Sistema Educational Brasileiro (SEB), where we assessed that our auditors were best qualified and cost effective in taking on this role.

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

### 5. Employee information

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| **Employee benefit expense** | | | | |
| Wages and salaries (including termination benefits and restructuring costs) | | **1,588** | 1,496 | 1,184 |
| Social security costs | | **136** | 124 | 103 |
| Share-based payment costs | 26 | **35** | 27 | 25 |
| Retirement benefits defined contribution plans | 25 | **66** | 60 | 39 |
| Retirement benefits defined benefit plans | 25 | **22** | 16 | 35 |
| Other post-retirement benefits | 25 | **2** | 2 | 6 |
| | | **1,849** | 1,725 | 1,392 |

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | Average number employed | | |
| **Employee numbers** | | | |
| North American Education | **14,828** | 15,606 | 15,412 |
| International Education | **10,713** | 8,899 | 5,718 |
| Professional | **3,721** | 2,662 | 2,641 |
| FT Group | **2,557** | 2,328 | 2,379 |
| Penguin | **3,470** | 4,163 | 4,112 |
| Other | **1,028** | 1,047 | 909 |
| **Continuing operations** | **36,317** | 34,705 | 31,171 |

The average number employed in discontinued operations in 2009 was 2,459, and in 2008 was 2,509.

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

### 6. Net finance costs

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| Interest payable | | **(82)** | (92) | (106) |
| Finance costs in respect of retirement benefits | 25 | **(12)** | (12) | |
| Net foreign exchange losses | | **(9)** | (7) | (11) |
| Other losses on financial instruments in a hedging relationship: | | | | |
| fair value hedges | | | (1) | (7) |
| Other losses on financial instruments not in a hedging relationship: | | | | |
| derivatives | | **(6)** | (10) | (12) |
| **Finance costs** | | **(109)** | (122) | (136) |
| Interest receivable | | **9** | 6 | 13 |
| Finance income in respect of retirement benefits | 25 | | | 8 |
| Net foreign exchange gains | | **18** | | |
| Other gains on financial instruments in a hedging relationship: | | | | |
| fair value hedges | | | 4 | 2 |
| net investment hedges | | | | 1 |
| Other gains on financial instruments not in a hedging relationship: | | | | |
| amortisation of transitional adjustment on bonds | | **2** | 3 | 1 |
| derivatives | | **7** | 13 | 16 |
| **Finance income** | | **36** | 26 | 41 |
| **Net finance costs** | | **(73)** | (96) | (95) |

The £nil net gain (2009: £3m net gain; 2008: £5m net loss) on fair value hedges comprises a £40m loss (2009: £96m gain; 2008: £156m loss) on the underlying bonds offset by a £40m gain (2009: £93m loss; 2008: £151m gain) on the related derivative financial instruments.

### 7. Income tax

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| **Current tax** | | | | |
| Charge in respect of current year | | **(82)** | (106) | (48) |
| Other adjustments in respect of prior years | | **13** | 7 | 12 |
| **Total current tax charge** | | **(69)** | (99) | (36) |

| | | | | |
|---|---|---|---|---|
| **Deferred tax** | | | | |
| In respect of temporary differences | | **(77)** | (51) | (93) |
| Other adjustments in respect of prior years | | | 4 | 4 |
| **Total deferred tax charge** | 13 | **(77)** | (47) | (89) |
| **Total tax charge** | | **(146)** | (146) | (125) |

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | **All figures in £ millions** | | |
| Profit before tax | **670** | 523 | 469 |
| Tax calculated at UK rate (2010: 28%, 2009: 28%, 2008: 28.5%) | **(188)** | (147) | (134) |
| Effect of overseas tax rates | **(40)** | (27) | (13) |
| Joint venture and associate income reported net of tax | **11** | 8 | 7 |
| Net income/(expense) not subject to tax | **8** | 8 | (5) |
| Utilisation of previously unrecognised tax losses and credits | **56** | 2 | 4 |
| Unutilised tax losses | **(6)** | (1) | |
| Prior year adjustments | **13** | 11 | 16 |
| **Total tax charge** | **(146)** | (146) | (125) |
| UK | **(28)** | (41) | (47) |
| Overseas | **(118)** | (105) | (78) |
| **Total tax charge** | **(146)** | (146) | (125) |
| Tax rate reflected in earnings | **21.8%** | 27.9% | 26.7% |

A number of changes to the UK Corporation tax system were announced in the June 2010 Budget Statement. The Finance (No. 2) Act 2010 was enacted in July 2010 and reduces the main rate of corporation tax from 28% to 27% from 1 April 2011. A reduction in the rate of corporation tax from 28% to 27% resulted in a reduction in the net deferred tax asset provided at 31 December 2010 of £3m, of which £1m was charged to the income statement and £2m to other comprehensive income.

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | **All figures in £ millions** | | |
| Pension contributions and actuarial gains and losses | **(42)** | 79 | 10 |
| Net investment hedges and other foreign exchange gains and losses | **1** | 12 | (1) |
| | **(41)** | 91 | 9 |

A tax benefit of £4m (2009: tax benefit £6m; 2008: tax charge £7m) relating to share-based payments has been recognised directly in equity.

## 8. Earnings per share

**Basic**

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

**Diluted**

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

## Notes to the Consolidated Financial Statements (Continued)

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| Profit for the year from continuing operations | | **524** | 377 | 344 |
| Non-controlling interest | | **5** | (1) | (2) |
| **Earnings from continuing operations** | | **529** | 376 | 342 |
| Profit/(loss) for the year from discontinued operations | 3 | **776** | 85 | (21) |
| Non-controlling interest | | **(8)** | (36) | (29) |
| **Earnings** | | **1,297** | 425 | 292 |
| Weighted average number of shares (millions) | | **801.2** | 799.3 | 797.0 |
| Effect of dilutive share options (millions) | | **1.8** | 0.8 | 0.5 |
| Weighted average number of shares (millions) for diluted earnings | | **803.0** | 800.1 | 797.5 |
| **Earnings per share from continuing and discontinued operations** | | | | |
| Basic | | **161.9p** | 53.2p | 36.6p |
| Diluted | | **161.5p** | 53.1p | 36.6p |
| **Earnings per share from continuing operations** | | | | |
| Basic | | **66.0p** | 47.0p | 42.9p |
| Diluted | | **65.9p** | 47.0p | 42.9p |
| **Earnings per share from discontinued operations** | | | | |
| Basic | | **95.9p** | 6.2p | (6.3p) |

### 9. Dividends

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| Final paid in respect of prior year 23.3p (2009: 22.0p; 2008: 20.5p) | **187** | 176 | 163 |
| Interim paid in respect of current year 13.0p (2009: 12.2p; 2008: 11.8p) | **105** | 97 | 94 |
| | **292** | 273 | 257 |

The directors are proposing a final dividend in respect of the financial year ended 31 December 2010 of 25.7p per share which will absorb an estimated £206m of shareholders funds. It will be paid on 6 May 2011 to shareholders who are on the register of members on 8 April 2011. These financial statements do not reflect this dividend.

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

### 10. Property, plant and equipment

| | Land and buildings | Plant and equipment | Assets in course of construction | Total |
|---|---|---|---|---|
| | All figures in £ millions | | | |
| **Cost** | | | | |
| At 1 January 2009 | 355 | 839 | 7 | 1,201 |
| Exchange differences | (21) | (55) | (1) | (77) |
| Additions | 14 | 46 | 7 | 67 |
| Disposals | (2) | (41) | | (43) |
| Acquisition through business combination | 1 | 17 | | 18 |
| Reclassifications | 1 | 5 | (6) | |
| At 31 December 2009 | 348 | 811 | 7 | 1,166 |
| Exchange differences | **8** | **28** | | **36** |
| Additions | **21** | **55** | **12** | **88** |
| Disposals | **(4)** | **(58)** | | **(62)** |
| Acquisition through business combination | **8** | **25** | | **33** |
| Disposal through business disposal | **(48)** | **(201)** | | **(249)** |
| Reclassifications | **3** | **5** | **(8)** | |
| **At 31 December 2010** | **336** | **665** | **11** | **1,012** |

| | Land and buildings | Plant and equipment | Assets in course of construction | Total |
|---|---|---|---|---|
| | All figures in £ millions | | | |
| **Depreciation** | | | | |
| At 1 January 2009 | (170) | (608) | | (778) |
| Exchange differences | 11 | 42 | | 53 |
| Charge for the year | (17) | (68) | | (85) |
| Disposals | 2 | 39 | | 41 |
| Acquisition through business combination | | (9) | | (9) |
| At 31 December 2009 | (174) | (604) | | (778) |
| Exchange differences | **(4)** | **(19)** | | **(23)** |
| Charge for the year | **(16)** | **(66)** | | **(82)** |

| | | | | |
|---|---|---|---|---|
| Disposals | **3** | **58** | | **61** |
| Acquisition through business combination | **(3)** | **(13)** | | **(16)** |
| Disposal through business disposal | **28** | **164** | | **192** |
| **At 31 December 2010** | **(166)** | **(480)** | | **(646)** |
| **Carrying amounts** | | | | |
| At 1 January 2009 | 185 | 231 | 7 | 423 |
| At 31 December 2009 | 174 | 207 | 7 | 388 |
| **At 31 December 2010** | **170** | **185** | **11** | **366** |

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

Depreciation expense of £10m (2009: £12m) has been included in the income statement in cost of goods sold, £7m (2009: £7m) in distribution expenses and £52m (2009: £45m) in administrative and other expenses. In 2010 £13m (2009: £21m) relates to discontinued operations.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £12m (2009: £15m).

## 11. Intangible assets

| | Goodwill | Software | Acquired customer lists and relationships | Acquired trademarks and brands | Acquired publishing rights | Other intangibles acquired | Total |
|---|---|---|---|---|---|---|---|
| | All figures in £ millions | | | | | | |
| **Cost** | | | | | | | |
| At 1 January 2009 | 4,570 | 310 | 341 | 128 | 165 | 258 | 5,772 |
| Exchange differences | (420) | (25) | (32) | (9) | (5) | (22) | (513) |
| Additions internal development | | 35 | | | | | 35 |
| Additions purchased | | 24 | | | | | 24 |
| Disposals | (9) | (5) | | | | | (14) |
| Acquisition through business combination | 205 | | 38 | 24 | 55 | 25 | 347 |
| At 31 December 2009 | 4,346 | 339 | 347 | 143 | 215 | 261 | 5,651 |
| Exchange differences | **140** | **9** | **10** | **4** | **9** | **10** | **182** |
| Additions internal development | | **41** | | | | | **41** |
| Additions purchased | | **15** | | | | | **15** |
| Disposals | **(11)** | **(18)** | | | | | **(29)** |
| Acquisition through business combination | **288** | **9** | **159** | **40** | **6** | **76** | **578** |
| Disposal through business disposal | **(195)** | **(43)** | **(85)** | **(1)** | | **(41)** | **(365)** |
| **At 31 December 2010** | **4,568** | **352** | **431** | **186** | **230** | **306** | **6,073** |

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

| | Goodwill | Software | Acquired customer lists and relationships | Acquired trademarks and brands | Acquired publishing rights | Other intangibles acquired | Total |
|---|---|---|---|---|---|---|---|
| | All figures in £ millions | | | | | | |
| **Amortisation** | | | | | | | |
| At 1 January 2009 | | (203) | (67) | (17) | (69) | (63) | (419) |
| Exchange differences | | 19 | 6 | 1 | 6 | 8 | 40 |
| Charge for the year | | (44) | (35) | (11) | (22) | (35) | (147) |
| Disposals | | 4 | | | | | 4 |
| At 31 December 2009 | | (224) | (96) | (27) | (85) | (90) | (522) |
| Exchange differences | | **(5)** | **(3)** | **(2)** | **(2)** | **(1)** | **(13)** |
| Charge for the year | | **(51)** | **(39)** | **(12)** | **(24)** | **(38)** | **(164)** |
| Disposals | | **16** | | | | | **16** |
| Acquisition through business combination | | **(5)** | | | | | **(5)** |
| Disposal through business disposal | | **19** | **35** | | | **28** | **82** |
| **At 31 December 2010** | | **(250)** | **(103)** | **(41)** | **(111)** | **(101)** | **(606)** |
| **Carrying amounts** | | | | | | | |
| At 1 January 2009 | 4,570 | 107 | 274 | 111 | 96 | 195 | 5,353 |
| At 31 December 2009 | 4,346 | 115 | 251 | 116 | 130 | 171 | 5,129 |
| **At 31 December 2010** | **4,568** | **102** | **328** | **145** | **119** | **205** | **5,467** |

**Goodwill**

The goodwill carrying value of £4,568m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. £3,090m of the carrying value relates to acquisitions completed between 1 January 1998 and 31 December 2002 and £1,478m relates to acquisitions completed after 1 January 2003 (the date of transition to IFRS).

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

**Other intangible assets**

Other intangibles acquired include content, technology, contracts and software rights. Amortisation of £3m (2009: £5m) is included in the income statement in cost of goods sold and £149m (2009: £126m) in administrative and other expenses. In 2010 £12m (2009: £16m) of amortisation relates to discontinued operations.

**Impairment tests for cash-generating units containing goodwill**

Impairment tests have been carried out where appropriate as described below. The recoverable amount for each unit tested exceeds its carrying value.

**Table of Contents**

**Notes to the Consolidated Financial Statements (Continued)**

Goodwill in respect of continuing operations is allocated to 12 cash-generating units (CGUs) within the business segments as follows:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| US Education Publishing | **1,976** | 1,876 |
| US School Assessment and Information | **683** | 652 |
| Canada | **197** | 181 |
| International Education Publishing | **686** | 468 |
| International Education Assessment and Testing | **227** | 222 |
| Professional Publishing | **13** | 13 |
| Professional Assessment and Training | **287** | 226 |
| **Pearson Education total** | **4,069** | 3,638 |
| Financial Times | **48** | 43 |
| Mergermarket | **136** | 125 |
| **FT Group total** | **184** | 168 |
| Penguin US | **196** | 190 |
| Penguin UK | **103** | 103 |
| Penguin Asia Pacific & International | **16** | 63 |
| **Penguin total** | **315** | 356 |
| **Continuing operations** | **4,568** | 4,162 |
| Interactive Data | | 184 |
| **Total goodwill** | **4,568** | 4,346 |

As highlighted in the 2008 business review, integration of the US School and Higher Education businesses began in 2008. This integration continued throughout 2009 and advanced to a point where, from 1 January 2010, these companies have been combined into one CGU for impairment review purposes.

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

**Key assumptions**

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

***Discount rate*** The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates used are in the range of 11.2% to 12.1% for the Pearson Education businesses (2009: 10.9% to 11.8%), 12.9% to 20.0% for the FT Group businesses (2009: 12.7% to 18.1%) and 10.5% to 13.0% for the Penguin businesses (2009: 9.5% to 11.4%).

***Perpetuity growth rates*** A perpetuity growth rate of 2.0% was used for cash flows subsequent to the approved budget period for all CGUs in 2010 (2009: 2.0%). This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates.

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

***Cash flow growth rates*** The cash flow growth rates are derived from management s latest forecast of sales taking into consideration experience of operating margins achieved in the CGU. Historically, such forecasts have been reasonably accurate.

**Sensitivities**

The Group s impairment review is sensitive to a change in assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group s sensitivity analysis, a reasonably possible change in any of these assumptions is unlikely to cause an impairment in any of the CGUs.

## 12. Investments in joint ventures and associates

### Joint ventures

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| At beginning of year | **18** | 13 |
| Share of (loss)/profit after tax | **(1)** | 4 |
| Dividends | **(3)** | (3) |
| Loan repayment | | (3) |
| Additions and further investment | **4** | 13 |
| Transfer to subsidiary | | (6) |
| **At end of year** | **18** | 18 |

Investments in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost. The total goodwill recorded on acquisition of joint ventures at 31 December 2010 was £12m (2009: £11m).

The aggregate of the Group s share of its joint ventures assets (including goodwill) and liabilities, none of which are individually significant, are as follows:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| **Assets** | | |
| Non-current assets | **15** | 15 |
| Current assets | **14** | 11 |
| **Liabilities** | | |
| Current liabilities | **(11)** | (8) |

| | | |
|---|---|---|
| **Net assets** | **18** | 18 |
| Income | **17** | 12 |
| Expenses | **(18)** | (8) |
| **(Loss)/profit after tax** | **(1)** | 4 |

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

**Associates**

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| At beginning of year | **12** | 10 |
| Exchange differences | **(1)** | 4 |
| Share of profit after tax | **42** | 26 |
| Dividends | **(20)** | (19) |
| Additions | **17** | 1 |
| Reversal of distribution from associate in excess of carrying value | **(7)** | (7) |
| Actuarial gains/(losses) on retirement benefit obligations | **1** | (3) |
| Transfer from other financial assets | **9** | |
| **At end of year** | **53** | 12 |

Included in the share of profit after tax is a gain in fair values of £12m (2009: £nil) arising on a stepped acquisition by FTSE International Ltd.

In addition to the amounts disclosed above, FTSE paid royalties of £11m (2009: £10m) to the FT Group during the year.

Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The total goodwill recorded on acquisition of associates at 31 December 2010 was £21m (2009: £nil).

The Group s interests in its principal associates, all of which are unlisted, are as follows:

| 2010 | Country of incorporation | % interest held | Assets | Liabilities | Revenues | Profit |
|---|---|---|---|---|---|---|
| | | All figures in £ millions | | | | |
| The Economist Newspaper Ltd | **England** | **50** | **129** | **(129)** | **169** | **25** |
| FTSE International Ltd | **England** | **50** | **62** | **(44)** | **45** | **17** |
| Other | | | **41** | **(6)** | **9** | |
| **Total** | | | **232** | **(179)** | **223** | **42** |

| 2009 | Country of incorporation | % interest held | Assets | Liabilities | Revenues | Profit |
|---|---|---|---|---|---|---|

| | | All figures in £ millions | | | | |
|---|---|---|---|---|---|---|
| The Economist Newspaper Ltd | England | 50 | 116 | (116) | 161 | 22 |
| FTSE International Ltd | England | 50 | 28 | (24) | 38 | 4 |
| Other | | | 14 | (6) | 12 | |
| **Total** | | | 158 | (146) | 211 | 26 |

The interests held in associates are equivalent to voting rights.

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

## 13. Deferred income tax

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| **Deferred income tax assets** | | |
| Deferred income tax assets to be recovered after more than 12 months | **276** | 374 |
| Deferred income tax assets to be recovered within 12 months | | 13 |
| | **276** | 387 |
| **Deferred income tax liabilities** | | |
| Deferred income tax liabilities to be settled after more than 12 months | **(471)** | (473) |
| Deferred income tax liabilities to be settled within 12 months | | |
| | **(471)** | (473) |
| **Net deferred income tax** | **(195)** | (86) |

Deferred income tax assets to be recovered within 12 months relate to the utilisation of losses in the US.

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The Group has unrecognised deferred income tax assets of £14m at 31 December 2010 in respect of UK losses, and approximately £16m in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them.

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

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

| | Notes | 2010 | 2009 |
|---|---|---|---|
| | | All figures in £ millions | |
| At beginning of year | | **(86)** | (75) |
| Exchange differences | | **(4)** | 10 |
| Income statement charge | 7 | **(72)** | (51) |
| Acquisition through business combination | 29 | **(37)** | (45) |
| Disposal through business disposal | 30 | **47** | |
| Tax (charge)/benefit to other comprehensive income or equity | | **(43)** | 75 |

| | | |
|---|---|---|
| **At end of year** | **(195)** | (86) |

Included in the income statement charge above is a £5m credit relating to discontinued operations (2009: £4m charge).

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

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

| | Trading losses | Goodwill and intangibles | Returns provisions | Retirement benefit obligations | Other | Total |
|---|---|---|---|---|---|---|
| | All figures in £ millions | | | | | |
| **Deferred income tax assets** | | | | | | |
| At 1 January 2009 | 73 | 20 | 106 | 7 | 166 | 372 |
| Exchange differences | (5) | (2) | (10) | (1) | (17) | (35) |
| Acquisition through business combination | | | | | | |
| Income statement (charge)/benefit | (46) | (7) | (4) | (6) | 42 | (21) |
| Tax benefit to other comprehensive income or equity | | | | 68 | 3 | 71 |
| **At 31 December 2009** | 22 | 11 | 92 | 68 | 194 | 387 |
| Exchange differences | **1** | | **3** | | **5** | **9** |
| Acquisition through business combination | | | | | **4** | **4** |
| Disposal through business disposal | | | | | **(7)** | **(7)** |
| Income statement (charge)/benefit | **(18)** | **(7)** | **1** | **(9)** | **(35)** | **(68)** |
| Tax (charge)/benefit to other comprehensive income or equity | | | | **(53)** | **4** | **(49)** |
| **At 31 December 2010** | **5** | **4** | **96** | **6** | **165** | **276** |

Other deferred income tax assets include temporary differences on share-based payments, inventory and other provisions.

| | Goodwill and intangibles | Other | Total |
|---|---|---|---|
| | All figures in £ millions | | |
| **Deferred income tax liabilities** | | | |
| At 1 January 2009 | (318) | (129) | (447) |
| Exchange differences | 30 | 15 | 45 |
| Acquisition through business combination | (41) | (4) | (45) |
| Income statement benefit/(charge) | 10 | (40) | (30) |
| Tax benefit to other comprehensive income or equity | | 4 | 4 |
| **At 31 December 2009** | (319) | (154) | (473) |

| | | | |
|---|---|---|---|
| Exchange differences | **(9)** | **(4)** | **(13)** |
| Acquisition through business combination | **(41)** | | **(41)** |
| Disposal through business disposal | **25** | **29** | **54** |
| Income statement benefit/(charge) | **10** | **(14)** | **(4)** |
| Tax benefit to other comprehensive income or equity | | **6** | **6** |
| **At 31 December 2010** | **(334)** | **(137)** | **(471)** |

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

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

## 14. Classification of financial instruments

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

| | | 2010 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Fair value | | | | Amortised cost | | | |
| | Notes | Available for sale | Derivatives deemed held for trading | Derivatives in hedging relationships | Other liabilities | Loans and receivables | Other liabilities | Total carrying value | Total market value |
| | | All figures in £ millions | | | | | | | |
| Investments in unlisted securities | 15 | **58** | | | | | | **58** | **58** |
| Cash and cash equivalents | 17 | | | | | **1,736** | | **1,736** | **1,736** |
| Marketable securities | | **12** | | | | | | **12** | **12** |
| Derivative financial instruments | 16 | | **28** | **112** | | | | **140** | **140** |
| Trade receivables | 22 | | | | | **1,031** | | **1,031** | **1,031** |
| **Total financial assets** | | **70** | **28** | **112** | | **2,767** | | **2,977** | **2,977** |
| Derivative financial instruments | 16 | | **(6)** | | | | | **(6)** | **(6)** |
| Trade payables | 24 | | | | | | **(470)** | **(470)** | **(470)** |
| Other financial liabilities put option over non-controlling interest | 24 | | | | **(25)** | | | **(25)** | **(25)** |
| Bank loans and overdrafts | 18 | | | | | | **(73)** | **(73)** | **(73)** |
| Borrowings due within one year | 18 | | | | | | **(331)** | **(331)** | **(333)** |
| Borrowings due after more than one year | 18 | | | | | | **(1,908)** | **(1,908)** | **(1,939)** |
| **Total financial liabilities** | | | **(6)** | | **(25)** | | **(2,782)** | **(2,813)** | **(2,846)** |

**Notes to the Consolidated Financial Statements (Continued)**

| | | 2009 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Fair value | | | | Amortised cost | | | |
| | Notes | Available for sale | Derivatives deemed held for trading | Derivatives in hedging relationships | Other liabilities | Loans and receivables | Other liabilities | Total carrying value | Total market value |
| | | All figures in £ millions | | | | | | | |
| Investments in unlisted securities | 15 | 62 | | | | | | 62 | 62 |
| Cash and cash equivalents | 17 | | | | | 750 | | 750 | 750 |
| Marketable securities | | 63 | | | | | | 63 | 63 |
| Derivative financial instruments | 16 | | 42 | 70 | | | | 112 | 112 |
| Trade receivables | 22 | | | | | 989 | | 989 | 989 |
| **Total financial assets** | | 125 | 42 | 70 | | 1,739 | | 1,976 | 1,976 |
| Derivative financial instruments | 16 | | (9) | | | | | (9) | (9) |
| Trade payables | 24 | | | | | | (461) | (461) | (461) |
| Other financial liabilities put option over non controlling interest | 24 | | | | (23) | | | (23) | (23) |
| Bank loans and overdrafts | 18 | | | | | | (70) | (70) | (70) |
| Borrowings due within one year | 18 | | | | | | (4) | (4) | (4) |
| Borrowings due after more than one year | 18 | | | | | | (1,934) | (1,934) | (1,969) |
| **Total financial liabilities** | | | (9) | | (23) | | (2,469) | (2,501) | (2,536) |

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

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

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

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

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

## Notes to the Consolidated Financial Statements (Continued)

### 15. Other financial assets

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| At beginning of year | **62** | 63 |
| Exchange differences | **1** | (6) |
| Acquisition of investments | **7** | 10 |
| Transfers to associates | **(9)** | |
| Disposal of investments | **(3)** | (5) |
| **At end of year** | **58** | 62 |

Other financial assets comprise non-current unlisted securities.

### 16. Derivative financial instruments

The Group s approach to the management of financial risks is set out in note 19. The Group s outstanding derivative financial instruments are as follows:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | Gross notional amounts | Assets | Liabilities | Gross notional amounts | Assets | Liabilities |
| | All figures in £ millions | | | | | |
| Interest rate derivatives in a fair value hedge relationship | **1,327** | **112** | | 1,103 | 70 | |
| Interest rate derivatives not in a hedge relationship | **256** | **8** | | 486 | 13 | (7) |
| Cross currency rate derivatives in a net investment hedge relationship | **220** | **20** | **(6)** | 220 | 29 | (2) |
| **Total** | **1,803** | **140** | **(6)** | 1,809 | 112 | (9) |
| **Analysed as expiring:** | | | | | | |
| In less than one year | **319** | **6** | | 238 | | (7) |
| Later than one year and not later than five years | **749** | **74** | **(6)** | 844 | 60 | (2) |
| Later than five years | **735** | **60** | | 727 | 52 | |
| **Total** | **1,803** | **140** | **(6)** | 1,809 | 112 | (9) |

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

At the end of 2010, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross currency rate derivatives, was US dollar £(97)m, sterling £259m and South African rand £(28)m (2009: US dollar £(127)m, sterling £252m and South African rand £(22)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2010 range from 3.65% to 9.28% (2009: 3.65% to 9.28%) and the floating rates are based on LIBOR in US dollar and sterling.

The Group s portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

## Notes to the Consolidated Financial Statements (Continued)

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

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

### 17. Cash and cash equivalents (excluding overdrafts)

| | **2010** | **2009** |
|---|---|---|
| | **All figures in £ millions** | |
| Cash at bank and in hand | **763** | 580 |
| Short-term bank deposits | **973** | 170 |
| | **1,736** | 750 |

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

At the end of 2010 the currency split of cash and cash equivalents was US dollar 73% (2009: 35%), sterling 9% (2009: 22%), euro 6% (2009: 18%) and other 12% (2009: 25%).

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

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

| | **2010** | **2009** |
|---|---|---|
| | **All figures in £ millions** | |
| Cash and cash equivalents | **1,736** | 750 |
| Bank overdrafts | **(72)** | (70) |
| | **1,664** | 680 |

## Notes to the Consolidated Financial Statements (Continued)

### 18. Financial liabilities Borrowings

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

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| **Non-current** | | |
| 7.0% Global Dollar Bonds 2011 (nominal amount $500m) | | 322 |
| 5.5% Global Dollar Bonds 2013 (nominal amount $350m) | **236** | 226 |
| 5.7% US Dollar Bonds 2014 (nominal amount $400m) | **288** | 274 |
| 7.0% Sterling Bonds 2014 (nominal amount £250m) | **256** | 254 |
| 6.0% Sterling Bonds 2015 (nominal amount £300m) | **297** | 297 |
| 4.0% US Dollar Notes 2016 (nominal amount $350m) | **227** | |
| 6.25% Global Dollar Bonds 2018 (nominal amount $550m) | **389** | 359 |
| 4.625% US Dollar Notes 2018 (nominal amount $300m) | **208** | 191 |
| Finance lease liabilities | **7** | 11 |
| | **1,908** | 1,934 |
| **Current** | | |
| **Due within one year or on demand:** | | |
| Bank loans and overdrafts | **73** | 70 |
| 7.0% Global Dollar Bonds 2011 (nominal amount $500m) | **325** | |
| Finance lease liabilities | **6** | 4 |
| | **404** | 74 |
| **Total borrowings** | **2,312** | 2,008 |

Included in the non-current borrowings above is £12m of accrued interest (2009: £12m). Included in the current borrowings above is £1m of accrued interest (2009: £nil).

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

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Between one and two years | **4** | 327 |
| Between two and five years | **1,080** | 760 |
| Over five years | **824** | 847 |

| | | |
|---|---|---|
| | **1,908** | 1,934 |

**Table of Contents**

**Notes to the Consolidated Financial Statements (Continued)**

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

| | Effective interest rate | 2010 Carrying value | Market value | 2009 Carrying value | Market value |
|---|---|---|---|---|---|
| | | All figures in £ millions | | | |
| Bank loans and overdrafts | **n/a** | **73** | **73** | 70 | 70 |
| 7.0% Global Dollar Bonds 2011 | **7.16%** | **325** | **327** | 322 | 331 |
| 5.5% Global Dollar Bonds 2013 | **5.76%** | **236** | **241** | 226 | 232 |
| 5.7% US Dollar Bonds 2014 | **5.88%** | **288** | **277** | 274 | 266 |
| 7.0% Sterling Bonds 2014 | **7.20%** | **256** | **282** | 254 | 276 |
| 6.0% Sterling Bonds 2015 | **6.27%** | **297** | **329** | 297 | 317 |
| 4.0% US Dollar Notes 2016 | **4.26%** | **227** | **226** | | |
| 6.25% Global Dollar Bonds 2018 | **6.46%** | **389** | **385** | 359 | 360 |
| 4.625% US Dollar Notes 2018 | **4.69%** | **208** | **192** | 191 | 176 |
| Finance lease liabilities | **n/a** | **13** | **13** | 15 | 15 |
| | | **2,312** | **2,345** | 2,008 | 2,043 |

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group s borrowings are denominated in the following currencies:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| US dollar | **1,759** | 1,457 |
| Sterling | **553** | 551 |
| Euro | | |
| | **2,312** | 2,008 |

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

| 2010 | 2009 |
|---|---|
| All figures in £ millions | |

| | | |
|---|---|---|
| Floating rate | | |
| expiring within one year | | |
| expiring beyond one year | **1,118** | 1,084 |
| | **1,118** | 1,084 |

In addition to the above facilities, there are a number of short-term facilities that are utilised in the normal course of business.

All of the Group s borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

The maturity of the Group s finance lease obligations is as follows:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| **Finance lease liabilities minimum lease payments** | | |
| Not later than one year | **6** | 4 |
| Later than one year and not later than two years | **4** | 5 |
| Later than two years and not later than three years | **3** | 3 |
| Later than three years and not later than four years | | 3 |
| Later than four years and not later than five years | | |
| Later than five years | | |
| Future finance charges on finance leases | | |
| **Present value of finance lease liabilities** | **13** | 15 |

The Present value of finance lease liabilities is as follows:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Not later than one year | **6** | 4 |
| Later than one year and not later than five years | **7** | 11 |
| Later than five years | | |
| | **13** | 15 |

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

## 19. Financial risk management

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

***Treasury policy***

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. The Group borrows principally in US dollars and sterling, at both floating and fixed rates of interest, using derivative financial instruments ( derivatives ), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate

swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group s financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised below. All the treasury policies remained unchanged throughout 2010, except for a revision to the Group s bank counterparty limits.

The audit committee receives reports on the Group s treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.

***Interest rate risk management***

The Group s exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group s policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against

**Notes to the Consolidated Financial Statements (Continued)**

floating rate debt and before certain adjustments for IAS 39 Financial Instruments: Recognition and Measurement ) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2010 the fixed to floating hedging ratio, on the above basis, was approximately 136%. This above-policy level reflects the receipt of the proceeds from the divestment of Interactive Data in 2010, combined with strong cash collections, resulting in lower than typical net debt and hence a higher hedging ratio. Our policy does not require us to cancel derivative contracts and we expect to return to compliance with this policy during 2011. A simultaneous 1% change on 1 January 2011 in the Group s variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £2m effect on profit before tax.

***Use of interest rate derivatives***

The policy described in the section above creates a group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a second group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates. The Group s accounting objective in its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces sharply the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

***Liquidity and refinancing risk management***

The Group s objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group s policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2010 the average maturity of gross borrowings was 4.4 years (2009: 5.1 years) of which bonds represented 96% (2009: 96%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of the Group s credit ratings remained unchanged during the year. The long-term ratings are Baal from Moody s and BBB+ from Standard & Poor s, and the short-term ratings are P2 and A2 respectively. The Group s policy is to strive to maintain a rating of Baal/BBB+ over the long term. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2010 the committed facilities amounted to £1,118m and their weighted average maturity was 4.9 years.

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

***Analysis of Group debt, including the impact of derivatives***

The following tables analyse the Group s sources of funding and the impact of derivatives on the Group s debt instruments.

The Group s net debt position is set out below:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Cash and cash equivalents | **1,736** | 750 |
| Marketable securities | **12** | 63 |
| Derivative financial instruments | **134** | 103 |
| Bank loans, overdrafts and loan notes | **(73)** | (70) |
| Bonds | **(2,226)** | (1,923) |
| Finance lease liabilities | **(13)** | (15) |
| **Net debt** | **(430)** | (1,092) |

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

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Fixed rate | **577** | 772 |
| Floating rate | **(147)** | 320 |
| **Total** | **430** | 1,092 |

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

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| US dollar | **1,954** | 1,656 |
| Sterling | **333** | 330 |
| Other | **25** | 22 |
| **Total** | **2,312** | 2,008 |

As at 31 December 2010 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows:

| | Less than one year | One to five years | More than five years | Total |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| Re-pricing profile of borrowings | **403** | **1,084** | **825** | **2,312** |
| Effect of rate derivatives | **1,264** | **(529)** | **(735)** | |
| **Total** | **1,667** | **555** | **90** | **2,312** |

**Notes to the Consolidated Financial Statements (Continued)**

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

| | 2010 | | | |
|---|---|---|---|---|
| | USD | GBP | Other | Total |
| | All figures in £ millions | | | |
| Not later than one year | **571** | **117** | **160** | **848** |
| Later than one year and not later than five years | **767** | **399** | **32** | **1,198** |
| Later than five years | **792** | | | **792** |
| **Total** | **2,130** | **516** | **192** | **2,838** |
| **Analysed as:** | | | | |
| Bonds | **1,938** | **710** | | **2,648** |
| Rate derivatives inflows | **(364)** | **(297)** | | **(661)** |
| Rate derivatives outflows | **340** | **7** | **34** | **381** |
| Trade creditors | **216** | **96** | **158** | **470** |
| **Total** | **2,130** | **516** | **192** | **2,838** |

| | 2009 | | | |
|---|---|---|---|---|
| | USD | GBP | Other | Total |
| | All figures in £ millions | | | |
| Not later than one year | 265 | 110 | 151 | 526 |
| Later than one year and not later than five years | 878 | 313 | 30 | 1,221 |
| Later than five years | 739 | 106 | | 845 |
| **Total** | 1,882 | 529 | 181 | 2,592 |
| **Analysed as:** | | | | |
| Bonds | 1,692 | 745 | | 2,437 |
| Rate derivatives inflows | (386) | (313) | | (699) |
| Rate derivatives outflows | 353 | 8 | 32 | 393 |
| Trade creditors | 223 | 89 | 149 | 461 |
| **Total** | 1,882 | 529 | 181 | 2,592 |

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the Group net settles these amounts wherever possible.

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

***Financial counterparty risk management***

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover our total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

## Notes to the Consolidated Financial Statements (Continued)

***Foreign currency risk management***

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group s policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group s operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. Our policy does not require existing currency debt to be terminated to match declines in that currency s share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross currency swaps) were: US dollar £683m, sterling £179m and South African rand £9m.

***Use of currency debt and currency derivatives***

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

***Financial instruments fair value measurement***

The following table provides an analysis of those financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

**Notes to the Consolidated Financial Statements (Continued)**

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| | All figures in £ millions | | | | | | | |
| **Financial assets at fair value** | | | | | | | | |
| Derivative financial assets | | **140** | | **140** | | 112 | | 112 |
| Marketable securities | | **12** | | **12** | | 63 | | 63 |
| **Available for sale financial assets** | | | | | | | | |
| Investments in unlisted securities | | | **58** | **58** | | | 62 | 62 |
| **Financial liabilities at fair value** | | | | | | | | |
| Derivative financial liabilities | | **(6)** | | **(6)** | | (9) | | (9) |
| Other financial liabilities put option over non-controlling interest | | | **(25)** | **(25)** | | | (23) | (23) |
| **Total** | | **146** | **33** | **179** | | 166 | 39 | 205 |

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

| | 2010 | |
|---|---|---|
| | Investments in unlisted securities | Other financial liabilities |
| | All figures in £ millions | |
| At beginning of year | **62** | **(23)** |
| Exchange differences | **1** | |
| Additions | **7** | **(2)** |
| Disposals | **(12)** | |
| **At end of year** | **58** | **(25)** |

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets. The fair value of other financial liabilities represents the present value of the estimated future liability.

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

***Financial instruments sensitivity analysis***

As at 31 December 2010 the sensitivity of the carrying value of the Group s financial instruments to fluctuations in interest rates and exchange rates is as follows:

| | Carrying value | Impact of 1% increase in interest rates | Impact of 1% decrease in interest rates | Impact of 10% strengthening in sterling | Impact of 10% weakening in sterling |
|---|---|---|---|---|---|
| | All figures in £ millions | | | | |
| Investments in unlisted securities | **58** | | | **(2)** | **3** |
| Cash and cash equivalents | **1,736** | | | **(140)** | **171** |
| Marketable securities | **12** | | | | |
| Derivative financial instruments | **134** | **(62)** | **67** | **11** | **(14)** |
| Bonds | **(2,226)** | **59** | **(64)** | **142** | **(174)** |
| Other borrowings | **(86)** | | | **8** | **(9)** |
| Put option over non-controlling interest | **(25)** | | | **2** | **(3)** |
| Other net financial assets | **556** | | | **(42)** | **51** |
| **Total financial instruments** | **159** | **(3)** | **3** | **(21)** | **25** |

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

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

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

### 20. Intangible assets Pre-publication

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| **Cost** | | |
| At beginning of year | **1,727** | 1,800 |
| Exchange differences | **52** | (160) |
| Additions | **319** | 322 |
| Disposals | **(248)** | (230) |
| Acquisition through business combination | **13** | (1) |
| Transfer to inventories | | (4) |
| **At end of year** | **1,863** | 1,727 |
| **Amortisation** | | |
| At beginning of year | **(1,077)** | (1,105) |
| Exchange differences | **(33)** | 102 |
| Charge for the year | **(350)** | (307) |
| Disposals | **248** | 230 |
| Acquisition through business combination | **(4)** | 3 |
| **At end of year** | **(1,216)** | (1,077) |
| Carrying amounts | | |
| **At end of year** | **647** | 650 |

Included in the above are pre-publication assets amounting to £399m (2009: £398m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold.

### 21. Inventories

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Raw materials | **34** | 32 |
| Work in progress | **19** | 23 |
| Finished goods | **376** | 390 |
| | **429** | 445 |

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £836m (2009: £843m). In 2010 £87m (2009: £75m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

**Notes to the Consolidated Financial Statements (Continued)**

## 22. Trade and other receivables

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| **Current** | | |
| Trade receivables | **1,028** | 989 |
| Royalty advances | **111** | 99 |
| Prepayments and accrued income | **77** | 75 |
| Other receivables | **121** | 121 |
| | **1,337** | 1,284 |
| **Non-current** | | |
| Trade receivables | **3** | |
| Royalty advances | **89** | 86 |
| Prepayments and accrued income | **28** | 24 |
| Other receivables | **9** | 2 |
| | **129** | 112 |

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns. The movements on the provision for bad and doubtful debts are as follows:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| At beginning of year | **(76)** | (72) |
| Exchange differences | **(2)** | 5 |
| Income statement movements | **(33)** | (26) |
| Utilised | **26** | 20 |
| Acquisition through business combination | **(3)** | (3) |
| Disposal through business disposal | **5** | |
| **At end of year** | **(83)** | (76) |

Concentrations of credit risk with respect to trade receivables are limited due to the Group s large number of customers, who are internationally dispersed.

Table of Contents

## Notes to the Consolidated Financial Statements (Continued)

The ageing of the Group s trade receivables is as follows:

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Within due date | **1,180** | 1,096 |
| Up to three months past due date | **234** | 228 |
| Three to six months past due date | **39** | 51 |
| Six to nine months past due date | **6** | 20 |
| Nine to 12 months past due date | **13** | 4 |
| More than 12 months past due date | **21** | 20 |
| **Total trade receivables** | **1,493** | 1,419 |
| Less: provision for bad and doubtful debts | **(83)** | (76) |
| Less: provision for sales returns | **(379)** | (354) |
| **Net trade receivables** | **1,031** | 989 |

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

### 23. Provisions for other liabilities and charges

| | Deferred consideration | Leases | Other | Total |
|---|---|---|---|---|
| | All figures in £ millions | | | |
| At 1 January 2010 | 38 | 9 | 21 | 68 |
| Exchange differences | **1** | **1** | | **2** |
| Charged to income statement | **2** | | **5** | **7** |
| Deferred consideration on acquisition current year | **8** | | | **8** |
| Deferred consideration on acquisition prior year adjustments | **(10)** | | | **(10)** |
| Acquisition through business combination current year | **10** | | | **10** |
| Utilised | **(20)** | | **(5)** | **(25)** |
| **At 31 December 2010** | **29** | **10** | **21** | **60** |

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |

| **Analysis of provisions** | | |
|---|---|---|
| Non-current | **42** | 50 |
| Current | **18** | 18 |
| | **60** | 68 |

Deferred consideration primarily relates to the acquisition of Fronter in 2009.

## Notes to the Consolidated Financial Statements (Continued)

### 24. Trade and other liabilities

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Trade payables | **470** | 461 |
| Social security and other taxes | **22** | 30 |
| Accruals | **559** | 504 |
| Deferred income | **559** | 487 |
| Interest payable | **12** | 10 |
| Put option over non-controlling interest | **25** | 23 |
| Other liabilities | **204** | 205 |
| | **1,851** | 1,720 |
| **Less: non-current portion** | | |
| Accruals | **26** | 23 |
| Deferred income | **120** | 116 |
| Put option over non-controlling interest | **25** | 23 |
| Other liabilities | **75** | 91 |
| | **246** | 253 |
| **Current portion** | **1,605** | 1,467 |

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

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

The put option over non-controlling interest is the fair value of an option held by the non-controlling interest in the Group s South African business. The option enables the non-controlling interest to sell their 15% share of Pearson South Africa to Pearson from 1 January 2012 at a price determined by the future performance of that business.

### 25. Retirement benefit and other post-retirement obligations

*Background*

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world. For the defined benefit plans, benefits are based on employees length of service and final pensionable pay. Defined contribution benefits are based on the amount of contributions paid in respect of an individual member, the investment returns earned and the amount of pension this money will buy when a member retires.

The largest plan is the Pearson Group Pension Plan (  UK Group plan  ) with both defined benefit and defined contribution sections. From 1 November 2006, all sections of the UK Group plan were closed to new members with the exception of a defined contribution section that was opened in 2003. This section is available to all new employees of participating companies. The other major defined benefit plans are based in the US.

Other defined contribution plans are operated principally overseas with the largest plan being in the US. The specific features of these plans vary in accordance with the regulations of the country in which employees are located.

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

**Notes to the Consolidated Financial Statements (Continued)**

***Assumptions***

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

| | **2010** | | | **2009** | | | **2008** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **UK Group plan** | **Other plans** | **PRMB** | **UK Group plan** | **Other plans** | **PRMB** | **UK Group plan** | **Other plans** | **PRMB** |
| % | | | | | | | | | |
| Inflation | **3.50** | **2.50** | **2.50** | 3.50 | 2.50 | 2.50 | 2.80 | 2.80 | 2.80 |
| Rate used to discount plan liabilities | **5.50** | **5.10** | **5.10** | 5.70 | 5.30 | 5.50 | 6.40 | 6.30 | 6.30 |
| Expected return on assets | **6.00** | **6.60** | | 6.00 | 6.80 | | 6.30 | 7.60 | |
| Expected rate of increase in salaries | **4.70** | **4.00** | | 5.00 | 4.00 | | 4.30 | 4.50 | |
| Expected rate of increase for pensions in payment and deferred pensions | **2.60 to 4.40** | | | 2.60 to 4.40 | | | 2.30 to 4.20 | | |
| Initial rate of increase in healthcare rate | | | **8.00** | | | 8.50 | | | 9.00 |
| Ultimate rate of increase in healthcare rate | | | **5.00** | | | 5.00 | | | 5.00 |

The UK discount rate is based on the annualised yield on the iBoxx over 15-year AA-rated corporate bond index, adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching

model. The expected return on assets is based on market expectations of long-term asset returns for the defined portfolio at the end of the year.

The inflation rate of 3.5% reflects the RPI rate. In line with changes to legislation certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.8% has been used. The change from RPI to CPI for deferred revaluation and Post 88 GMP pension increases in payment has been included in these results, resulting in a gain of £23m, taken as an actuarial gain on the obligation.

The expected rates of return on categories of plan assets are determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan s investment portfolio, plus a diversification premium.

The expected rate of increase in salaries has been set at 4.7% for 2010 with a short-term assumption of 3.3% for two years.

In 2008 the UK mortality assumptions were derived by adjusting standard mortality tables (PMFA 92 tables projected forward with medium cohort improvement factors). In 2009 the Group changed its mortality assumptions in the UK. The mortality base table assumptions have been derived from the SAPS all pensioners tables for males and the SAPS normal health pensioners tables for females, adjusted to reflect the observed experience of the plan,

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

with medium cohort improvement factors. In 2008 a 1% improvement floor on the medium cohort was applied. In 2009 this was changed to 1.5% for males and 1.25% for females, with tapering.

For the US plans, the assumptions used were based on standard US mortality tables. In 2008 a switch from GAM94 to RP2000 was made, to reflect the mortality assumption now more prevalent in the US, and in 2010 a 10 year projection was added.

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

| | UK | | US | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Male | **22.8** | 22.7 | **18.4** | 17.6 |
| Female | **23.6** | 23.5 | **20.6** | 20.2 |

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

| | UK | | US | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Male | **25.4** | 25.3 | **18.4** | 17.6 |
| Female | **25.7** | 25.6 | **20.6** | 20.2 |

***Financial statement information***

The amounts recognised in the income statement are as follows:

| | 2010 | | | | | |
|---|---|---|---|---|---|---|
| | **UK Group plan** | **Defined benefit other** | **Sub-total** | **Defined contribution** | **PRMB** | **Total** |
| | All figures in £ millions | | | | | |
| Current service cost | **21** | **2** | **23** | **68** | **2** | **93** |
| Curtailments | **(5)** | | **(5)** | | | **(5)** |
| **Total operating expense** | **16** | **2** | **18** | **68** | **2** | **88** |
| Expected return on plan assets | **(93)** | **(7)** | **(100)** | | | **(100)** |
| Interest on plan liabilities | **100** | **9** | **109** | | **3** | **112** |
| **Net finance expense** | **7** | **2** | **9** | | **3** | **12** |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Net income statement charge** | **23** | **4** | **27** | **68** | **5** | **100** |
| **Actual return on plan assets** | **177** | **13** | **190** | | | **190** |

**Notes to the Consolidated Financial Statements (Continued)**

| | 2009 | | | | | |
|---|---|---|---|---|---|---|
| | UK Group plan | Defined benefit other | Sub-total | Defined contribution | PRMB | Total |
| | All figures in £ millions | | | | | |
| Current service cost | 14 | 3 | 17 | 62 | 2 | 81 |
| Past service cost | | 1 | 1 | | | 1 |
| **Total operating expense** | 14 | 4 | 18 | 62 | 2 | 82 |
| Expected return on plan assets | (83) | (5) | (88) | | | (88) |
| Interest on plan liabilities | 89 | 8 | 97 | | 3 | 100 |
| **Net finance expense** | 6 | 3 | 9 | | 3 | 12 |
| **Net income statement charge** | 20 | 7 | 27 | 62 | 5 | 94 |
| **Actual return on plan assets** | 136 | 8 | 144 | | | 144 |

| | 2008 | | | | | |
|---|---|---|---|---|---|---|
| | UK Group plan | Defined benefit other | Sub-total | Defined contribution | PRMB | Total |
| | All figures in £ millions | | | | | |
| Current service cost | 33 | 3 | 36 | 41 | 1 | 78 |
| Past service cost | | 1 | 1 | | 5 | 6 |
| **Total operating expense** | 33 | 4 | 37 | 41 | 6 | 84 |
| Expected return on plan assets | (104) | (7) | (111) | | | (111) |
| Interest on plan liabilities | 93 | 7 | 100 | | 3 | 103 |
| **Net finance (income)/expense** | (11) | | (11) | | 3 | (8) |
| **Net income statement charge** | 22 | 4 | 26 | 41 | 9 | 76 |
| **Actual loss on plan assets** | (130) | (27) | (157) | | | (157) |

Included within the 2010 results are discontinued operations of £5m relating to the curtailment credit, a £1m charge relating to defined benefit schemes and a £2m charge relating to defined contribution schemes (2009: £2m charge relating to defined benefit schemes and £2m charge relating to defined contribution schemes; 2008: £2m charge

relating to defined benefit schemes and £2m charge relating to defined contribution schemes).

In 2008 the UK Group plan current service cost included £14m relating to defined contribution sections. In 2009 and 2010 the defined contribution section of the UK Group plan is recorded within the defined contribution expense.

**Table of Contents**

**Notes to the Consolidated Financial Statements (Continued)**

The amounts recognised in the balance sheet are as follows:

| | **2010** | | | | **2009** | | | |
|---|---|---|---|---|---|---|---|---|
| | **UK Group plan** | **Other funded plans** | **Other unfunded plans** | **Total** | **UK Group plan** | **Other funded plans** | **Other unfunded plans** | **Total** |
| | **All figures in £ millions** | | | | | | | |
| Fair value of plan assets | **1,847** | **135** | | **1,982** | 1,609 | 118 | | 1,727 |
| Present value of defined benefit obligation | **(1,852)** | **(158)** | **(20)** | **(2,030)** | (1,798) | (151) | (18) | (1,967) |
| **Net pension liability** | **(5)** | **(23)** | **(20)** | **(48)** | (189) | (33) | (18) | (240) |
| Other post-retirement medical benefit obligation | | | | **(72)** | | | | (65) |
| Other pension accruals | | | | **(28)** | | | | (34) |
| **Net retirement benefit obligations** | | | | **(148)** | | | | (339) |
| **Analysed as:** | | | | | | | | |
| Retirement benefit assets | | | | | | | | |
| Retirement benefit obligations | | | | **(148)** | | | | (339) |

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

| | **2010** | **2009** | **2008** |
|---|---|---|---|
| | **All figures in £ millions** | | |
| Amounts recognised for defined benefit plans | **75** | (295) | (74) |
| Amounts recognised for post-retirement medical benefit plans | **(5)** | (4) | 3 |
| **Total recognised in year** | **70** | (299) | (71) |
| **Cumulative amounts recognised** | **(176)** | (246) | 53 |

The fair value of plan assets comprises the following:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | UK Group plan | Other funded plans | Total | UK Group plan | Other funded plans | Total |
| | % | | | | | |
| Equities | **27.0** | **3.3** | **30.3** | 27.4 | 2.4 | 29.8 |
| Bonds | **49.3** | **2.7** | **52.0** | 47.2 | 2.1 | 49.3 |
| Properties | **11.2** | **0.1** | **11.3** | 9.4 | 0.0 | 9.4 |
| Other | **5.6** | **0.8** | **6.4** | 10.4 | 1.1 | 11.5 |

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

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

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

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | UK Group plan | Other plans | Total | UK Group plan | Other plans | Total |
| | All figures in £ millions | | | | | |
| **Fair value of plan assets** | | | | | | |
| Opening fair value of plan assets | **1,609** | **118** | **1,727** | 1,478 | 100 | 1,578 |
| Exchange differences | | **4** | **4** | | (6) | (6) |
| Expected return on plan assets | **93** | **7** | **100** | 83 | 5 | 88 |
| Actuarial gains | **84** | **6** | **90** | 53 | 3 | 56 |
| Contributions by employer | **132** | **13** | **145** | 64 | 26 | 90 |
| Contributions by employee | **3** | | **3** | 3 | | 3 |
| Benefits paid | **(74)** | **(13)** | **(87)** | (72) | (10) | (82) |
| **Closing fair value of plan assets** | **1,847** | **135** | **1,982** | 1,609 | 118 | 1,727 |
| **Present value of defined benefit obligation** | | | | | | |
| Opening defined benefit obligation | **(1,798)** | **(169)** | **(1,967)** | (1,429) | (165) | (1,594) |
| Exchange differences | | **(5)** | **(5)** | | 14 | 14 |
| Current service cost | **(21)** | **(2)** | **(23)** | (14) | (3) | (17) |
| Past service cost | | | | | (1) | (1) |
| Curtailment | **5** | | **5** | | | |
| Interest cost | **(100)** | **(9)** | **(109)** | (89) | (8) | (97) |
| Actuarial losses | **(9)** | **(6)** | **(15)** | (335) | (16) | (351) |
| Contributions by employee | **(3)** | | **(3)** | (3) | | (3) |
| Benefits paid | **74** | **13** | **87** | 72 | 10 | 82 |
| **Closing defined benefit obligation** | **(1,852)** | **(178)** | **(2,030)** | (1,798) | (169) | (1,967) |

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

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Opening defined benefit obligation | **(65)** | (68) |
| Exchange differences | **(2)** | 8 |
| Current service cost | **(2)** | (2) |
| Interest cost | **(3)** | (3) |
| Actuarial losses | **(5)** | (4) |

| | | |
|---|---|---|
| Benefits paid | **5** | 4 |
| **Closing defined benefit obligation** | **(72)** | (65) |

F-59

**Notes to the Consolidated Financial Statements (Continued)**

The history of the defined benefit plans is as follows:

| | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| | All figures in £ millions | | | | |
| Fair value of plan assets | **1,982** | 1,727 | 1,578 | 1,853 | 1,633 |
| Present value of defined benefit obligation | **(2,030)** | (1,967) | (1,594) | (1,811) | (1,810) |
| **Net pension (liability)/asset** | **(48)** | (240) | (16) | 42 | (177) |
| Experience adjustments on plan assets | **90** | 56 | (268) | 29 | 74 |
| Experience adjustments on plan liabilities | **(15)** | (351) | 194 | 50 | 28 |

***Funding***

The UK Group plan is self-administered with the plan s assets being held independently of the Group. The trustees of the plan are required to act in the best interest of the plan s beneficiaries. The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2009 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by 31 December 2020. In 2010 the Group contributed £41m (2009: £42m) towards the funding shortfall and has agreed to contribute a similar amount per annum until 2020 in excess of regular contributions. Regular contributions to the plan are estimated to be £22m for 2011.

Under UK law (section 75 debt) a company that participates in a multi-employer defined benefit plan is liable, on withdrawal from that pension plan, for its share of the total deficit in the plan calculated on a solvency or buy out basis. The Interactive Data sale and the termination of Interactive Data Corporation (Europe) Ltd s participation in the UK Group plan triggered this section 75 liability. £68m was contributed to the plan in respect of this liability.

The Group expects to contribute $94m in 2011 and $97m in 2012 to its US pension plans.

***Sensitivities***

The net retirement benefit obligations are calculated using a number of assumptions, the most significant being the discount rate used to calculate the defined benefit obligation. The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows:

| | 2010 | |
|---|---|---|
| | 1% increase | 1% decrease |
| | All figures in £ millions | |
| **Effect on:** | | |
| (Decrease)/increase in defined benefit obligation UK Group plan | **(262.0)** | **324.0** |
| (Decrease)/increase of aggregate of service cost and interest cost UK Group plan | **(13.7)** | **16.3** |
| (Decrease)/increase in defined benefit obligation US plan | **(2.5)** | **1.3** |

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

| | | 2010 | |
|---|---|---|---|
| | | **1 year increase** | **1 year decrease** |
| | | **All figures in £ millions** | |
| **Effect on:** | | | |
| lncrease/(decrease) in defined benefit obligation | UK Group plan | **52.7** | **(50.5)** |
| lncrease/(decrease) in defined benefit obligation | US plan | **1.6** | **(1.7)** |

**Table of Contents**

**Notes to the Consolidated Financial Statements (Continued)**

The effect of a one percentage point increase and decrease in the assumed medical cost trend rates is as follows:

| | 2010 | |
|---|---|---|
| | 1% increase | 1% decrease |
| | All figures in £ millions | |
| **Effect on:** | | |
| lncrease/(decrease) in post-retirement medical benefit obligation | **3.1** | **(2.8)** |
| lncrease/(decrease) of aggregate of service cost and interest cost | **0.1** | **(0.1)** |

**26. Share-based payments**

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| Pearson plans | **35** | 27 | 25 |

Share-based payments included in discontinued operations amounted to £4m (2009: £10m; 2008: £8m).

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

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

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

***Long-Term Incentive Plan*** This plan was introduced in 2001 and renewed in 2006 and consists of two parts: share options and/or restricted shares.

Options were last granted under this plan in 2001 based on a pre-grant earnings per share growth test and are not subject to further performance conditions on exercise. The options became exercisable in tranches and lapse if they remain unexercised at the tenth anniversary of the date of grant.

The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in March 2009 and March 2010 vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2009 and 2010 vest depending on continuing service over a three-year period.

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

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

In addition to the above, share options remain outstanding under Executive Share Option, Reward and Special Share Option Plans. These are legacy plans which were replaced with the introduction of the Long-Term Incentive Plan in 2001.

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

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Number of share options 000s | Weighted average exercise price £ | Number of share options 000s | Weighted average exercise price £ |
| Outstanding at beginning of year | **12,487** | **12.78** | 14,379 | 13.14 |
| Granted during the year | **628** | **8.06** | 1,320 | 5.47 |
| Exercised during the year | **(1,154)** | **7.12** | (656) | 5.91 |
| Forfeited during the year | **(457)** | **9.08** | (2,488) | 13.02 |
| Expired during the year | **(2,626)** | **23.47** | (68) | 5.20 |
| **Outstanding at end of year** | **8,878** | **10.20** | 12,487 | 12.78 |
| **Options exercisable at end of year** | **5,825** | **12.40** | 9,264 | 15.28 |

Options were exercised regularly throughout the year. The weighted average share price during the year was £9.63 (2009: £7.15). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

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

| | 2010 | | 2009 | |
|---|---|---|---|---|
| **Range of exercise prices £** | Number of share options 000s | Weighted average contractual life Years | Number of share options 000s | Weighted average contractual life Years |
| 0 5 | **38** | **0.65** | 172 | 1.07 |
| 5 10 | **4,757** | **1.86** | 5,523 | 2.37 |
| 10 15 | **4,083** | **0.36** | 4,225 | 1.36 |
| 15 20 | | | 270 | 0.75 |

| | | | | |
|---|---|---|---|---|
| 20 25 | | | 344 | 0.19 |
| >25 | | | 1,953 | 0.19 |
| | **8,878** | **1.17** | 12,487 | 1.57 |

In 2010 and 2009 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

**Notes to the Consolidated Financial Statements (Continued)**

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

| | **2010 Weighted average** | **2009 Weighted average** |
|---|---|---|
| Fair value | **£2.14** | £1.69 |
| Weighted average share price | **£9.48** | £7.13 |
| Weighted average exercise price | **£8.06** | £5.47 |
| Expected volatility | **28.28%** | 27.32% |
| Expected life | **4.0 years** | 4.0 years |
| Risk free rate | **2.24%** | 2.45% |
| Expected dividend yield | **3.75%** | 4.74% |
| Forfeiture rate | **3.5%** | 3.5% |

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

The following shares were granted under restricted share arrangements:

| | **2010** | | **2009** | |
|---|---|---|---|---|
| | **Number of shares 000s** | **Weighted average fair value £** | **Number of shares 000s** | **Weighted average fair value £** |
| Long-Term Incentive Plan | **4,742** | **9.45** | 4,519 | 5.77 |
| Annual Bonus Share Matching Plan | **266** | **10.25** | 271 | 6.70 |

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. Participants of the Long-Term Incentive Plan are entitled to dividends during the vesting period. The number of shares to vest has been adjusted, based on historical experience, to account for any potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Shares granted include the entitlement to dividends during the vesting period and therefore the share price is not discounted.

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

**27. Share capital and share premium**

| | Number of shares 000s | Ordinary shares £m | Share premium £m |
|---|---|---|---|
| At 1 January 2009 | 809,276 | 202 | 2,505 |
| Issue of ordinary shares share option schemes | 1,523 | 1 | 7 |
| At 31 December 2009 | 810,799 | 203 | 2,512 |
| Issue of ordinary shares share option schemes | **1,878** | | **12** |
| **At 31 December 2010** | **812,677** | **203** | **2,524** |

The ordinary shares have a par value of 25p per share (2009: 25p per share). All issued shares are fully paid. All shares have the same rights.

**Notes to the Consolidated Financial Statements (Continued)**

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

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

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

### 28. Treasury shares

| | Pearson plc | | Interactive Data | | Total |
|---|---|---|---|---|---|
| | Number of shares 000s | £m | Number of shares 000s | £m | £m |
| At 1 January 2009 | 10,448 | 112 | 9,205 | 110 | 222 |
| Purchase of treasury shares | 2,200 | 13 | 1,280 | 20 | 33 |
| Release of treasury shares | (2,983) | (29) | | | (29) |
| At 31 December 2009 | 9,665 | 96 | 10,485 | 130 | 226 |
| Purchase of treasury shares | **8,000** | **77** | | | **77** |
| Release/cancellation of treasury shares | **(3,656)** | **(36)** | **(10,485)** | **(130)** | **(166)** |
| **At 31 December 2010** | **14,009** | **137** | | | **137** |

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.7% (2009: 1.2%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £3.5m (2009: £2.4m).

At 31 December 2010 the market value of Pearson plc treasury shares was £141.2m (2009: £86.1m).

### 29. Business combinations

On 17 June 2010 the Group acquired 100% of the shares of Melorio plc, a vocational training provider. On 19 August 2010 the Group acquired 100% of the shares of Wall Street Institute Education S.a.r.l (WSI), a group providing spoken English training for adults. On 1 September 2010 the Group acquired 69% of the voting equity of Sistema Educacional Brasileiro s (SEB) school learning systems division. On 7 September 2010 the Group acquired 100% of the shares of America s Choice Inc, a provider of school improvement services.

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

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

| | | 2010 | | | | | | 2009 |
|---|---|---|---|---|---|---|---|---|
| | | | | | America s | | | |
| | | Melorio | SEB | WSI | Choice | Other | Total | Total |
| | | fair | fair | fair | fair | fair | fair | fair |
| | Notes | value | value | value | value | value | value | value |
| | | All figures in £ millions | | | | | | |
| Property, plant and equipment | 10 | **4** | **7** | **3** | | **3** | **17** | 9 |
| Intangible assets | 11 | **89** | **103** | **32** | **24** | **37** | **285** | 142 |
| Intangible assets Pre-publication | 20 | | **3** | | | **6** | **9** | 2 |
| Inventories | | | **5** | **1** | **1** | **(5)** | **2** | 14 |
| Trade and other receivables | | **8** | **13** | **8** | **7** | **5** | **41** | 23 |
| Cash and cash equivalents | | **3** | **5** | **2** | **12** | **4** | **26** | 29 |
| Financial liabilities Borrowings | | **(13)** | | | | | **(13)** | |
| Net deferred income tax liabilities | 13 | **(24)** | | **(3)** | **(4)** | **(6)** | **(37)** | (45) |
| Retirement benefit obligations | | | | | | **(1)** | **(1)** | (1) |
| Provisions for other liabilities and charges | 23 | **(10)** | | | | | **(10)** | |
| Trade and other liabilities | | **(9)** | **(10)** | **(14)** | **(5)** | **1** | **(37)** | (91) |
| Current income tax liabilities | | | | **(3)** | | | **(3)** | (4) |
| Non-controlling interest | | | **(39)** | | | | **(39)** | (16) |
| **Net assets acquired at fair value** | | **48** | **87** | **26** | **35** | **44** | **240** | 62 |
| Goodwill | 11 | **50** | **141** | **39** | **30** | **28** | **288** | 205 |
| Increase in fair values of proportionate holding arising on stepped acquisition | | | | | | | | (23) |
| **Total** | | **98** | **228** | **65** | **65** | **72** | **528** | 244 |
| Satisfied by: | | | | | | | | |
| Cash | | **(98)** | **(228)** | **(65)** | **(65)** | **(74)** | **(530)** | (201) |
| Other consideration | | | | | | | | (5) |
| Deferred consideration | | | | | | **(8)** | **(8)** | (27) |
| Net prior year adjustments | | | | | | **10** | **10** | (11) |
| **Total consideration** | | **(98)** | **(228)** | **(65)** | **(65)** | **(72)** | **(528)** | (244) |

The goodwill arising on these acquisitions results from substantial cost and revenue synergies and from benefits that cannot be separately recognised, such as the assembled workforce.

The fair value of trade and other receivables is £41m and includes trade receivables with a fair value of £34m. The gross contractual amount for trade receivables due is £37m of which £3m is expected to be uncollectable.

A provisional value of £12m of goodwill arising on 2010 acquisitions is expected to be deductible for tax purposes.

The non-controlling interest in SEB was measured using the non-controlling interest s proportionate share of the acquiree s net assets.

**Notes to the Consolidated Financial Statements (Continued)**

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| **Cash flow on acquisitions** | | | |
| Cash Current year acquisitions | **(530)** | (201) | (394) |
| Cash Acquisitions yet to complete | | (4) | (12) |
| Deferred payments for prior year acquisitions and other items | **(20)** | (32) | (5) |
| Cash and cash equivalents acquired | **26** | 29 | 16 |
| Acquisition costs paid | **(11)** | | |
| **Net cash outflow** | **(535)** | (208) | (395) |

In 2010, acquisitions contributed £84m to sales and £6m to operating profit before acquisition costs and amortisation of acquired intangibles from the date of acquisition to the balance sheet date. Of these amounts, Melorio contributed £38m of sales and £5m of profit, SEB contributed £11m of sales and a loss of £2m, WSI contributed £13m of sales and £1m of profit and America s Choice contributed £9m of sales and £nil of profit.

If the acquisitions had completed on 1 January 2010, the Group estimates that sales for the period would have been £5,799m and profit before tax would have been £676m.

## 30. Disposals

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| **Disposal of subsidiaries** | | | | |
| Property, plant and equipment | 10 | **(57)** | | (7) |
| Intangible assets | 11 | **(88)** | | (3) |
| Inventories | | | | (7) |
| Other financial assets | | **(3)** | | |
| Trade and other receivables | | **(103)** | | (8) |
| Cash and cash equivalents | | **(165)** | | |
| Net deferred income tax liabilities | 13 | **47** | | |
| Retirement benefit obligations | | **8** | | |
| Trade and other liabilities | | **132** | | 9 |
| Current income tax liabilities | | **12** | | |
| Non-controlling interest | | **271** | | |
| Attributable goodwill | 11 | **(195)** | | (99) |
| Cumulative translation adjustment | | **(13)** | | (49) |
| **Net assets disposed** | | **(154)** | | (164) |
| Cash received | | **1,234** | | 114 |
| Deferred receipts | | | | 2 |

| | | |
|---|---|---|
| Costs | **(43)** | (5) |
| **Profit/(Loss) on sale** | **1,037** | (53) |

Table of Contents

**Notes to the Consolidated Financial Statements (Continued)**

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| **Cash flow from disposals** | | | |
| Cash Current year disposals | **1,234** | | 114 |
| Cash and cash equivalents disposed | **(165)** | | |
| Costs paid | **(32)** | | (15) |
| Pension contribution paid on disposal | **(53)** | | |
| **Net cash inflow** | **984** | | 99 |

The disposal in 2010 relates to Interactive Data and the disposal in 2008 relates to the Data Management business. Further details are shown in note 3.

## 31. Cash generated from operations

| | Notes | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| | | All figures in £ millions | | |
| Profit | | **1,300** | 462 | 323 |
| **Adjustments for:** | | | | |
| Income tax | | **480** | 198 | 209 |
| Depreciation | 10 | **82** | 85 | 80 |
| Amortisation of acquired intangible assets | 11 | **113** | 103 | 86 |
| Amortisation of other intangible assets | 11 | **51** | 44 | 30 |
| Loss on sale of property, plant and equipment | | **3** | 2 | 1 |
| Net finance costs | 3,6 | **73** | 95 | 91 |
| Share of results of joint ventures and associates | 12 | **(41)** | (30) | (25) |
| (Profit)/loss on disposal of discontinued operations | 3 | **(1,037)** | | 53 |
| Loss on disposal | | **10** | | |
| Acquisition costs | | **11** | | |
| Net foreign exchange adjustment from transactions | | **(3)** | (14) | 105 |
| Share-based payment costs | 26 | **39** | 37 | 33 |
| Pre-publication | | **29** | (16) | (58) |
| Inventories | | **37** | 32 | (12) |
| Trade and other receivables | | **(82)** | (14) | (81) |
| Trade and other liabilities | | **165** | 103 | 82 |
| Retirement benefit obligations | | **(64)** | (72) | (14) |
| Provisions for other liabilities and charges | | **3** | (3) | (9) |
| **Net cash generated from operations** | | **1,169** | 1,012 | 894 |

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

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



---

## Notes to the Consolidated Financial Statements (Continued)

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | All figures in £ millions | | |
| Net book amount | **3** | 3 | 3 |
| Loss on sale of property, plant and equipment | **(3)** | (2) | (1) |
| **Proceeds from sale of property, plant and equipment** | | 1 | 2 |

The principal other non-cash transactions are movements in finance lease obligations of £2m (2009: £8m; 2008: £2m).

### 32. Contingencies

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

### 33. Commitments

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

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. The lease expenditure charged to the income statement during the year is disclosed in note 4.

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

| | 2010 | 2009 |
|---|---|---|
| | All figures in £ millions | |
| Not later than one year | **164** | 153 |
| Later than one year and not later than two years | **151** | 144 |
| Later than two years and not later than three years | **130** | 129 |
| Later than three years and not later than four years | **112** | 114 |
| Later than four years and not later than five years | **95** | 99 |
| Later than five years | **785** | 848 |
| | **1,437** | 1,487 |

**34. Related party transactions**

***Joint ventures and associates*** Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. There are no material amounts falling due from joint ventures and associates.

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

There were no other material related party transactions.

No guarantees have been provided to related parties.

## Notes to the Consolidated Financial Statements (Continued)

### 35. Events after the balance sheet date

On 22 November 2010, the Group announced the proposed acquisition of a 75% stake in CTI Education Group, a leading South African education company for £31m. As at the end of December 2010, this acquisition had not been completed but is expected to complete in the first half of 2011.

On 18 January 2011, the Group announced that it had agreed to increase its shareholding in TutorVista, the Bangalore based tutoring services company, to a controlling 76% stake for a consideration of $127m.

On 7 March 2011, the Group and Education Development International plc (EDI) announced that they had reached agreement on the terms of a recommended cash offer to be made by Pearson for the entire issued share capital of EDI. The offer values EDI at approximately £112.7m. EDI is a leading provider of education and training qualifications and assessment services, with a strong reputation for the use of information technology to administer learning programmes and deliver on-screen assessments.

## SIGNATURES

The registrant hereby certifies that it meets the requirements for filing on Form 20-F and that it has caused and authorized the undersigned to sign this annual report on its behalf

Pearson plc

/s/ Robin Freestone
Robin Freestone
Chief Financial Officer

Date: March 25, 2011