

PEARSON PLC  
Form 20-F  
March 27, 2014  
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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON March 27, 2014

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

**Form 20-F**

(Mark One)

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

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
for the fiscal year ended December 31, 2013

or

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

or

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

# 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

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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.

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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

818,580,354

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

US GAAP

International financial Reporting Standards as Issued

Other

by the International Accounting Standards Board

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

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



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**INTRODUCTION**

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

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

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

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

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

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

For convenience and except where we specify otherwise, we have translated some sterling figures into US dollars at the rate of £1.00 = \$1.66, 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, 2013. 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, 2014 the noon buying rate for sterling was £1.00 = \$1.68.

The Group currently consists of two major worldwide businesses, Pearson Education and the FT Group, plus a 47% interest in the consumer publishing business Penguin Random House. See Item 4. Information on the Company Overview of operating divisions.

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**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 could , or other comparable terminology. Examples of these forward-looking statements include, but are not limited to, statements regarding the following:

operations and prospects,

growth strategy,

funding needs and financing resources,

expected financial position,

market risk,

currency risk,

US federal and state spending patterns,

debt levels, and

general market and economic conditions.

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



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**PART I**

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

Not applicable.

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

Not applicable.

**ITEM 3. KEY INFORMATION**

**Selected consolidated financial data**

The table below shows selected consolidated financial data under IFRS as issued by the IASB. The selected consolidated income statement data for the years ended December 31, 2013, 2012 and 2011 and the selected consolidated balance sheet data as at December 31, 2013 and 2012 have been derived from our audited consolidated financial statements included in Item 18. Financial Statements in this Annual Report.

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

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

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

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

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

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For convenience, we have translated the 2013 amounts into US dollars at the rate of £1.00 = \$1.66, 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, 2013.

	Year Ended December 31(4)					
	2013 \$	2013 £	2012 £	2011 £	2010 £	2009 £
<b>Consolidated Income Statement data</b>						
Sales operating	8,415	5,069	4,959	4,728	4,532	4,068
Profit	760	458	487	1,099	625	522
Profit after taxation from continuing operations	490	295	253	864	447	310
Profit for the financial year	895	539	314	945	1,300	462
<b>Consolidated Earnings data per share</b>						
Basic earnings per equity share(1)	1.11	66.6p	38.7p	118.2p	161.9p	53.2p
Diluted earnings per equity share(2)	1.10	66.5p	38.6p	118.0p	161.5p	53.1p
Basic earnings from continuing operations per equity share(1)	0.60	36.4p	31.1p	108.1p	56.4p	38.7p
Diluted earnings from continuing operations per equity share(2)	0.60	36.3p	31.0p	107.9p	56.3p	38.6p
Dividends per ordinary share	0.80	48.0p	45.0p	42.0p	38.7p	35.5p
<b>Consolidated Balance Sheet data at period end</b>						
Total assets (non-current assets plus current assets)	18,145	10,931	11,348	11,244	10,668	9,412
Net assets	9,472	5,706	5,710	5,962	5,605	4,636
Long-term obligations(3)	(4,696)	(2,829)	(3,175)	(3,192)	(2,821)	(3,051)
Capital stock	340	205	204	204	203	203
Number of equity shares outstanding (millions of ordinary shares)	819	819	817	816	813	810

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.
- (4) 2011 and 2012 have been restated to reflect the adoption of IAS 19 revised. Prior periods have not been restated.

**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 25, 2014 our shareholders will be asked to approve a final dividend of 32.0p per ordinary share for the year ended December 31, 2013.

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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 2013 fiscal year will be paid on May 2, 2014 (subject to shareholder approval),

<b>Fiscal year</b>	<b>Interim (Pence per ordinary share)</b>	<b>Final (Pence per ordinary share)</b>	<b>Total (Pence per ordinary share)</b>	<b>Interim (Cents per ordinary share)</b>	<b>Final (Cents per ordinary share)</b>	<b>Total (Cents per ordinary share)</b>
2013	16.0	32.0	48.0	25.4	53.1*	78.5
2012	15.0	30.0	45.0	24.3	46.7	71.0
2011	14.0	28.0	42.0	22.1	45.2	67.3
2010	13.0	25.7	38.7	20.3	42.2	62.5
2009	12.2	23.3	35.5	19.8	34.3	54.1

\* As the 2013 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, 2013.

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, 2013 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 = \$1.66. On February 28, 2014 the noon buying rate for sterling was £1.00 = \$1.68.

<b>Month</b>	<b>High</b>	<b>Low</b>
February 2014	\$ 1.68	\$ 1.63
January 2014	\$ 1.66	\$ 1.63
December 2013	\$ 1.66	\$ 1.63
November 2013	\$ 1.64	\$ 1.59
October 2013	\$ 1.62	\$ 1.59
September 2013	\$ 1.62	\$ 1.55

<b>Year Ended December 31</b>	<b>Average rate</b>
2013	\$ 1.57
2012	\$ 1.59
2011	\$ 1.61
2010	\$ 1.54
2009	\$ 1.57

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### **Risk factors**

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

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

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

***Global economic conditions may adversely impact our financial performance.***

With the continued pressure and uncertainty in the worldwide economies during 2013, there remains a continuing risk of a further weakening in trading conditions in 2014 which could adversely impact our financial performance. The effect of continued deterioration or lack of recovery in the global economy will vary across our different businesses and will depend on the depth, length and severity of any economic downturn. Specific economic risks by business are described more fully in the other risk factors below.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our services and assessment businesses are characterized by 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.

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

To take advantage of international growth opportunities and to reduce our reliance on our 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 and compliance risks (including fraud, bribery and corruption) as well as unmanaged expansion are all factors which could limit our returns on investments made in these markets.

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

We continually acquire and dispose of businesses to achieve our strategic objectives. In 2013 we announced the acquisition of Grupo Multi, acquired our partners' shareholdings in IndiaCan and TutorVista and made several other small acquisitions. Acquired goodwill and intangible assets could be impaired if we are unable to generate the anticipated revenue growth, synergies and/or cost savings associated with these or other acquisitions.

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

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

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

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

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

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

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

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

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

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

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

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

### ***Changes in 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 have been subject to audit by tax authorities. Although we believe our tax provision is reasonable, the final determination of our tax liability could be materially different from our historical income tax provisions, which could have a material effect on our financial position, results of operations or cash flows.

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

As with any international business our earnings can be materially affected by exchange rate movements. We are particularly exposed to movements in the US dollar to sterling exchange rate as approximately 60% of our total revenue is generated in US dollars. In addition, we are increasingly exposed to a range of international currencies. Sales for 2013, translated at 2012 average rates, would have been £18m or 2% higher.

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

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

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

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

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

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

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

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

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





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### **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 (57% of sales) and Europe (20% of sales) on a continuing basis.

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

#### **Overview of operating divisions**

Pearson consists of two major worldwide businesses, Pearson Education and the FT Group, plus a 47% interest in Penguin Random House.

**Pearson Education** is a leading provider of educational materials and learning technologies. It provides test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. It publishes across the curriculum and provides a range of education services including teacher development, educational software and system-wide solutions, and also owns and operates schools. In 2013, 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 2013 FT Group announced that it was to sell Mergermarket, which completed on February 4, 2014. The FT Group has a 50% ownership stake in The Economist Group. Also during 2013 the FT Group sold its 50% ownership stake in *Business Day* and *Financial Mail*. During 2011 the FT Group sold its 50% ownership stake in FTSE International.

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

#### **Our strategy**

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

Pearson's strategy centres on a significant long-term opportunity: the sustained and growing global demand for greater access, achievement and affordability in education. We can meet this demand by accelerating our shift from the mature to developing markets, from print to digital products and from education inputs to services with demonstrable learning outcomes. For much of the last decade, we have been implementing this strategy by reshaping the company portfolio through acquisitions and disposals and we continued this work last year. We completed the Penguin Random House merger, securing both Penguin's commercial and creative future and an opportunity for significant economies of scale. We sold Mergermarket in February 2014, which has flourished

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under Pearson's ownership, but was not part of our strategy in global education. The sale proceeds helped us to finance the acquisition of Grupo Multi, the leading adult English language training company in Brazil. It fits with our strategy of investing more in faster growing economies and in digital and related services that can have a greater and more measurable impact on education.

The strategy now demands that we run the company in a fundamentally different way. Early last year, we started the biggest restructuring in the company's recent history, to tilt us towards our biggest growth opportunities, and by measuring everything we do in terms of impact in improving learning outcomes. We are therefore undertaking the following:

Redirecting more of our operating expenses, and our organic investment, more quickly to our most promising opportunities. We need fewer people, and resources, deployed in the publishing, production and manufacturing of textbooks and their physical distribution, sales and marketing. We need less print-based testing capacity, as we consolidate our operations and move more towards online testing. By spending much less on these activities as demand falls (for example, US Higher Education textbook volumes have declined by more than 20% in four years), we can invest much more in our biggest growth opportunities (for example, MyLab digital registrations and our sales in emerging markets have both doubled over the same period).

Managing Pearson as one globally connected company. Our operations are now entirely focused on our global education strategy in which we include the FT Group, and we have appointed a new executive team to lead it. We were previously a collection of relatively stand-alone companies, and as such were duplicating investment and proliferating small-scale initiatives, limiting our ability to build global scale. We are now organizing around a smaller number of global products and platforms, built around a single, world-class infrastructure and common systems and processes. This will help us to grow more quickly, as it frees up resources to invest in our digital transformation, and the new, more service-orientated, products that are vital to future growth.

Publicly committing to efficacy and improving learning outcomes. We will judge ourselves not by the products we make, but by their impact on learners. It will change how we decide which companies to acquire, where and how we invest, which products we get behind and which we retire. It changes how we recruit, train and reward each person in the company. This change will take time, and is why we talk about a path to efficacy that we are on, and it is why we have committed to providing audited learning outcomes data for all our products and services by 2018.

We are putting the learner at the heart of everything we do. Our commitment to efficacy recognizes our belief that, whilst our customer is often a teacher, an institution, an education authority, a parent or a company; the real beneficiary of our work and our customers' work is always the learner.

The transformation of our company is fundamental to get ahead of the significant structural changes taking place in education, chiefly the digital shift. It means that we are now in a much more intensive phase of investment at the same time as we are financing the one-off costs of the restructuring. We are investing much more, both in building the technology and related infrastructure, and in the next generation of products and services, that are vital to making the most of that global education opportunity. We make this investment with confidence as we continue to grow strongly in emerging markets and with our digital and service-related products.

### **Operating divisions**

#### ***Pearson Education***

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

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For 2013 we reported Pearson Education's performance in the three segments: North American Education, International Education, and Professional. In 2013, Pearson Education had sales of £4,728m or 93% (93% in 2012) of Pearson's sales. Pearson Education generated 90% of Pearson's 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.

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 for elementary and Pearson Prentice Hall for secondary. 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, and instructional improvement systems that allow for data-driven personalized instruction and teacher support.

Our North American Higher Education business is the largest publisher of textbooks and related course materials for colleges and universities in the US. We also provide learning tools and technologies, and about three million US College students are currently pursuing their studies online using Pearson Higher Education's products. Our imprints include Pearson Prentice Hall, a leading higher education publisher across all disciplines; Pearson Addison Wesley and Pearson Benjamin Cummings, the premier publishers in computing, economics, finance, mathematics, science, and statistics; Pearson Longman, the highly regarded publisher of quality materials in English, history, philosophy, political science, and religion; and Pearson Allyn & Bacon, at the forefront of the social services, humanities and education disciplines. 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.

Our North American Assessment and Information business provides educational assessment services and solutions in the US, developing, scoring and processing a large volume of student tests each year, for US states and the federal government. We also develop clinical assessments for the professional practice areas of psychology, speech, language, hearing, occupational and physical therapy; global talent assessment and learning assessment.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2013 compared to year ended December 31, 2012 Sales and operating profit by division North American Education for a discussion of developments during 2013 with respect to this division.

### *International Education*

Our International Education business covers all educational publishing and related services outside North America. Our portfolio includes innovative text books, digital learning solutions, online testing and assessments and a suite of integrated services.

Our International schools business publishes educational materials in local languages in a number of countries, and is taking an active role in teaching. 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. We are also teaching the English language in our Wall Street English group of global language schools.

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Our International higher education business adapts our textbooks and technology services for individual markets including our MyLab and Mastering online learning products. 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.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2013 compared to year ended December 31, 2012 Sales and operating profit by division International Education for a discussion of developments during 2013 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 leading computer, information technology, and business titles. Our imprints include Addison-Wesley Professional; Financial Times-Prentice Hall; New Riders; Peachpit Press, Prentice Hall, Que and Sams, Wharton School Publishing and Cisco Press.

Our professional testing business, Pearson VUE is a global leader in electronic testing for regulatory and certification boards, providing a full suite of services from test development to test delivery and data management. Pearson VUE offers exams through an extensive network of test centres in 163 countries, delivering the NCLEX exam for the National Council of State Boards of Nursing, the GMAT for the Graduate Management Admissions Council and numerous IT exams such as Cisco and CompTIA. In the UK Pearson VUE works with the DSA to deliver the Driver Theory Test and the University Admissions exams for LNAT and UKCAT.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2013 compared to year ended December 31, 2012 Sales and operating profit by division Professional for a discussion of developments during 2013 with respect to this division.

### *The FT Group*

The FT Group provides a broad range of data, analysis and services through a growing number of print, digital and mobile channels, to an audience of internationally-minded business people and financial institutions. In 2013, the FT Group had continuing sales of £341m, or 7% of Pearson's sales (7% in 2012), and contributed 6% of Pearson's operating profit.

FT Group comprises the *Financial Times*, FT.com website, and a portfolio of financial magazines and online financial information companies. 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, Continental Europe, the US, Asia-Pacific and the Middle East. Its main sources of revenue are from sales of the newspaper, (both in print and online), 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*.

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See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2013 compared to year ended December 31, 2012 Sales and operating profit by division FT Group for a discussion of developments during 2013 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.

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

On April 15, 2013, the FT Group sold its 50% interest in *Business Day* and *Financial Mail*. On December 16, 2011, the FT Group sold its 50% interest in FTSE International to the London Stock Exchange, the owner of the remaining 50%.

### ***Penguin Random House***

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

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

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

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

In 2013, our share of Penguin Random House profit after tax for the six months to December 31, 2013 was £31m.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2013 compared to year ended December 31, 2012 Sales and operating profit by division Consumer Publishing for a discussion of developments during 2013 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.

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

## **Competition**

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

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

## **Intellectual property**

Our principal intellectual property assets consist of our trademarks and other rights in our brand names, particularly the *Financial Times* and the various imprints of 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.

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### **Raw materials**

Paper is the principal raw material used by Pearson Education and the FT 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.

The US Iran Threat Reduction and Syria Human Rights Act of 2012 requires US-listed companies to disclose information relating to certain transactions with Iran, even when such transactions were in accordance with applicable laws. In 2013, certain non-US Group companies in compliance with applicable law provided a subscription to the Financial Times to an Iranian individual and accepted advertising in an FT Group publication from several Iranian banks, and sold English language Penguin Group imprint books to Iranian wholesalers and retailers. The gross revenues to the Group from these activities were approximately £180,000, and we estimate the net profit was approximately £19,000. In addition, a non-US Group company in compliance with applicable law issued credits in the amount of £229,000 in respect of returns of educational materials from prior years. The Group may undertake similar activities in future periods in accordance with applicable law.

### **Licenses, patents and contracts**

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

### **Legal Proceedings**

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

### **Recent developments**

On November 29, 2013 Pearson announced the sale of Mergermarket to BC Partners. The Group completed the sale on February 4, 2014 for £382m. On February 11, 2014 the Group acquired 100% of Grupo Multi for approximately £435m in cash plus the assumption of £57m of debt.



**Table of Contents****Organizational structure**

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries and associates as at December 31, 2013, 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
<b>Pearson Education</b>		
Pearson Education Inc.	United States (Delaware)	100%
Pearson Education Ltd.	England and Wales	100%
NCS Pearson Inc.	United States (Minnesota)	100%
<b>FT Group</b>		
The Financial Times Ltd.	England and Wales	100%
Mergermarket Ltd.	England and Wales	100%
<b>Consumer Publishing</b>		
Penguin Random House LLC.	United States (Delaware)	47%
Penguin Random House Ltd.	England and Wales	47%
<b>Property, plant and equipment</b>		

Our headquarters are located at leasehold premises in London, England. We own or lease approximately 1,150 properties, including approximately 700 testing/teaching centers in over 60 countries worldwide, the majority of which are located in the United Kingdom 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, 2013:

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

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We lease the following principal properties at December 31, 2013:

<b>General use of property</b>	<b>Location</b>	<b>Area in square feet</b>
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
Office	New York City, New York, USA	313,285
Office	London, UK	282,923
Warehouse/Office	Newmarket, Ontario, Canada	278,912
Office	Boston, Massachusetts, USA	234,745
Warehouse/Office	Austin, Texas, USA	226,076
Office	Glenview, Illinois, USA	187,500
Warehouse/Office	Bedfordshire, UK	186,570
Office	Bloomington, Minnesota, USA	167,218
Warehouse/Office	Cape Town, South Africa	160,387
Warehouse/Office	Uttar Pradesh, India	145,041
Office	Manchester, UK	139,680
Office	Boston, Massachusetts, USA	138,112
Office	Harlow, UK	137,857
Office	Chandler, Arizona, USA	135,460
Warehouse	Sao Paulo, Brazil	132,331
Warehouse/Office	Cedar Rapids, Iowa, USA	119,682
Office	Centennial, Colorado, USA	117,554
Warehouse	Naucalpan, Mexico	113,638
Office	London, UK	112,000
Teaching Centre	Pretoria, South Africa	105,241
Call Center/Office	Lawrence, Kansas, USA	105,000
<b>Capital Expenditures</b>		

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 2013 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

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### **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***

In October 2012, Pearson and Bertelsmann entered into an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction completed on July 1, 2013 and, at that point, Pearson no longer controlled the Penguin Group of companies. It now holds a 47% equity interest in the combined Penguin Random House venture, which is accounted for under the equity method. The loss of control resulted in the Penguin business being classified as held for sale on the Pearson balance sheet at December 31, 2012 and Penguin's results for 2011, 2012 and the first 6 months of 2013 have been included in discontinued operations. The share of profit after tax from the associate interest in the Penguin Random House venture arising in the second half of the year has been included in operating profit in continuing operations.

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

Sales from continuing operations increased from £4,959m in 2012 to £5,069m in 2013, an increase of £110m or 2%. This year on year growth was helped by both currency movements and acquisitions. In 2013 currency movements increased sales by £18m when compared to the equivalent figures at constant 2012 rates (with a £49m benefit primarily from a stronger dollar partly offset by a £31m reduction from non-dollar currency depreciation relative to sterling largely in emerging markets). When measured at 2012 constant exchange rates, our sales grew 2%.

Reported operating profit (from continuing operations) decreased by £29m or 6% from £487m in 2012 to £458m in 2013. The decrease reflects a fall in profits owing to the expensing of £135m of net restructuring charges (£176m of restructuring costs with an estimated benefit of £41m) in 2013 which are partly offset by the absence of the loss on closure of the Pearson in Practice business which reduced 2012 operating profit by £113m. Currency movements adversely affected operating profit, and we estimate that operating profit would have been approximately £7m higher if translated at constant 2012 exchange rates.

Profit before taxation in 2013 of £382m compared to a profit before taxation of £391m in 2012. The decrease of £9m reflects the net restructuring charge of £135m in 2013 partially offset by the absence of the Pearson in Practice closure cost in 2013 and a decrease in net finance costs from £96m in 2012 to £76m in 2013. The Group's net interest payable increased from £65m in 2012 to £72m in 2013, mainly due to higher levels of average net debt in the period and some impact from exchange movements in the period. Also included in net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2013 the total of these items was a loss of £1m compared to a loss of £29m in 2012. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2013 losses relating to put options were largely offset by foreign exchange gains on a proportion of unhedged US dollar assets.

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Net cash generated from operating activities decreased to £684m in 2013 from £916m in 2012. The principal reasons for the reduced cash flow were a reduction in operating profit for the year together with restructuring, continuing investment in pre-publication and new education programmes, and reduced cashflow from the Penguin Random House venture. Our average working capital to sales ratio improved by a further 0.4 percentage points to 13.4% reflecting lower inventory levels and the absence of Penguin in the second half of the year. 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 £82m in 2013 was £7m more than the previous year, reflecting the overall increase in net interest. Tax paid in 2013 was £246m compared to £65m in 2012. Tax paid in 2012 was unusually low as a result of the permitted deferral of US tax payments following Hurricane Sandy. These payments were subsequently made in 2013 and were accompanied by additional payments arising from settlements with tax authorities including £55m relating to prior year disposals. Net capital expenditure on property, plant and equipment after proceeds from sales increased to £90m in 2013 from £77m in 2012. The net cash outflow in respect of businesses and investments acquired was £122m in 2013 and £765m in 2012. Dividends from joint ventures and associates increased from £27m in 2012 to £64m in 2013 due to dividends received in the second half of 2013 from the Penguin Random House venture. Dividends paid of £372m in 2013 (no amounts paid to non-controlling interests) compares to £348m in 2012 (including £2m paid to non-controlling interests). Overall the Group's net borrowings rose from £918m at the end of 2012 to £1,379m at the end of 2013. The increase in net debt was due to acquisition activity, cash costs relating to the formation of Penguin Random House and cash paid in respect of the closure of Pearson in Practice, together with the increase in tax and dividend payments and lower than expected cash generation for the year.

***Outlook***

In 2014, we will continue the major restructuring and product investment programme, initiated in 2013, designed to accelerate Pearson's shift towards significant growth opportunities in digital, services and fast-growing economies. We believe this will provide Pearson with a significantly larger market opportunity, a sharper focus on the fastest-growing markets and stronger financial returns. This restructuring coincides with continued structural, cyclical and policy-related pressures in some of our largest markets.

We will benefit from the absence of £176m of gross restructuring charges expensed in 2013, which we expect to generate £60m of incremental cost savings in 2014. These benefits will be partly offset by an additional net restructuring charge of approximately £50m in 2014, primarily in North America and weighted towards the first half of the year. Our goal is to complete our restructuring programme by the end of 2014, returning to more normal levels of restructuring expenditure from 2015.

As Pearson's structure has changed to better suit our marketplace, our financial reporting will change also. In this year's report we discuss results based on our existing financial reporting segments (North American Education, International Education, Professional and the Financial Times Group). We will report our 2014 revenues and operating profit against new segments that better reflect the shape of our business. These will be by Geography (North America, Core and Growth) and by Line of Business (School, Higher Education, and Professional).

We expect trading conditions to remain challenging in 2014. In North America, our largest market, we expect college enrolments to decline again and some states to defer assessment programmes as they transition to the Common Core State Standards. Though we expect the School publishing market to show some improvement, we expect the benefits to be largely offset by higher revenue deferrals and pre-publication amortization. We expect margins to be lower in 2014 when compared to 2013, reflecting the above organic outlook, revenue mix, launch costs for major multi-year service-based contracts, higher amortization and new product development expenditure.

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In our Core markets (which include the UK and Australia), we expect to see tough trading conditions in the UK as curriculum change affects school, vocational publishing and assessments, market stabilization in Australia, and a new adoption year in Italy.

In our Growth markets (which include Brazil, China, India and South Africa), we expect continued growth in China with Brazil benefitting from a better year in public sistemas and a part-year contribution from Grupo Multi. We expect a slower year in South Africa after strong gains in 2013.

Looking at our global Lines of Business, we expect School and Higher Education to remain challenging, especially in our two largest markets, North America and the UK. In Professional we expect continued good growth in Pearson VUE and English with the *Financial Times* continuing to benefit from its digital transformation.

*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		
	2013 £m	2012 £m	2011 £m
Education:			
North American	2,779	2,658	2,584
International	1,539	1,568	1,424
Professional	410	390	382
FT Group	341	343	338
Total continuing operations	5,069	4,959	4,728
Discontinued operations	621	1,153	1,134
Total	5,690	6,112	5,862

*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		
	2013 £m	2012 £m	2011 £m
Continuing operations			
European countries	1,015	1,055	1,071
North America	3,041	2,900	2,817
Asia Pacific	624	633	504
Other countries	389	371	336
Total continuing operations	5,069	4,959	4,728
Discontinued operations			
European countries	146	279	265
North America	393	704	705
Asia Pacific	74	153	142
Other countries	8	17	22
Total discontinued operations	621	1,153	1,134

Total	5,690	6,112	5,862
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***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:\$1.57 in 2013, £1:\$1.59 in 2012 and £1:\$1.60 in 2011. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. In 2013, Pearson generated 57% of its continuing sales in the US (2012: 56%; 2011: 56%). In 2013 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 1.2p 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 £134m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for more information. The year-end US dollar rate for 2013 was £1:\$1.66 compared to £1:\$1.63 for 2012 and £1:\$1.55 for 2011. The impact on shareholders' funds was a loss of £217m in 2013 compared to a loss of £238m in 2012. These net losses are principally due to movements in the US dollar as a significant portion of the Group's operations are in the US.

***Critical accounting policies***

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

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

**Results of operations*****Year ended December 31, 2013 compared to year ended December 31, 2012******Consolidated results of operations******Sales***

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

Pearson Education increased sales by £112m or 2% from £4,616m to £4,728m. The North American and Professional businesses both contributed to the increase. We estimate that after excluding acquisitions and the impact of exchange, Pearson Education sales growth was 1% in 2013 compared to 2012. Pearson Education, our largest business sector, accounted for 93% of our sales in both 2013 and 2012. North America continued to be the most significant source of our sales and as a proportion of sales contributed 60% in 2013 and 58% in 2012.

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

Our International education business achieved another strong underlying performance in emerging markets, particularly South Africa and China. This growth was offset by weak textbook sales in developed markets;

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currency weakness against sterling; the exit from certain publishing businesses primarily in Australia, Japan, Germany, France and the UK; increased customization resulting from the Kirtsaeng ruling in the US; and policy changes affecting qualifications and text book publishing in the UK. The Professional division performed well, with good sales growth in testing and training partly offset by declines in publishing.

FT Group sales were in line with last year. The FT Group experienced strong growth in digital and content businesses and improved print circulation margins which more than offset weak advertising. FT Group sales accounted for 7% of our continuing business sales in both 2013 and 2012.

**Cost of goods sold and operating expenses**

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

	Year Ended December 31	
	2013	2012
	£m	£m
Cost of goods sold	2,312	2,187
Operating expenses		
Distribution costs	90	82
Selling, marketing and product development costs	1,027	925
Administrative and other expenses	1,162	1,242
Restructuring costs	176	
Other net gains and losses	16	10
Other income	(118)	(78)
<b>Total operating expenses</b>	<b>2,353</b>	<b>2,181</b>

*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 £125m, or 6%, to £2,312m in 2013, from £2,187m in 2012. The increase corresponds primarily to the increase in sales, with cost of sales at 45.6% of sales in 2013 compared to 44.1% in 2012.

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

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

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

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

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



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

### ***Loss on closure of subsidiary***

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

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

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

### ***Operating profit***

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

Operating profit attributable to Pearson Education decreased by £60m, or 13%, to £412m in 2013, from £472m in 2012. The decrease was largely due to tough markets, restructuring charges, launch costs related to major multi-year service based contracts in higher education, and increased returns provisions. These factors were off-set by the absence in 2013 of the £113m closure charge relating to Pearson in Practice in 2012. Operating profit attributable to the FT Group was up by £11m or 73%, to £26m in 2013, from £15m in 2012.

### ***Net finance costs***

Net finance costs decreased from £96m in 2012 to £76m in 2013. Net interest payable increased from £65m in 2012 to £72m in 2013. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) fell by 0.2% to 0.3%. This decrease in floating market interest rates was offset by an increase in the Group's average net debt which was the main driver behind the Group's higher interest charge. These factors combined with lower levels of cash and deposits and the impact of new notes issued in 2013 created a decrease in the Group's average net interest payable from 7.0% to 4.8%. The Group's average net debt rose by £561m, largely reflecting acquisition activity, cash costs relating to the formation of the Penguin Random House venture and cash paid in respect of the closure of Pearson in Practice in 2012 together with an increase in tax and dividend payments which more than offset cash generated from operations.

Net finance costs relating to post-retirement plans have been restated to reflect the adoption of IAS 19 (revised) and under the new standard were £3m in 2013 compared to £2m in 2012. Also included in net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2013 the total of these items was a loss of £1m compared to a loss of £29m in 2012. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2013 losses relating to put options were largely offset by foreign exchange gains on a proportion of unhedged US dollar assets. For a more detailed discussion of our borrowings and interest expenses see [Liquidity and Capital Resources](#), [Capital Resources](#) and [Borrowings](#) below and [Item 11. Quantitative and Qualitative Disclosures about Market Risk](#).

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### ***Taxation***

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

### ***Non-controlling interest***

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

### ***Discontinued operations***

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

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

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

### ***Profit for the year***

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

### ***Earnings per ordinary share***

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

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

### ***Exchange rate fluctuations***

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

**Table of Contents****Sales and operating profit by division**

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

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

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

£m	Year Ended December 31, 2013							Total
	North American Education	International Education	Professional	FT Group	PRH	Continuing	Discontinued	
Sales	2,779	1,539	410	341		5,069	621	5,690
	55%	30%	8%	7%		100%		
Total operating profit	312	55	45	26	20	458	52	510
	68%	12%	10%	6%	4%	100%		
Add back:								
Other net gains and losses		16				16		16
Acquisition costs	2	9		1		12		12
Intangible charges	92	60	12	2	30	196	2	198
Adjusted operating profit:								
continuing operations	406	140	57	29	50	682		682
Adjusted operating profit:								
discontinued operations							54	54
Total adjusted operating profit	406	140	57	29	50	682	54	736
	55%	19%	8%	4%	7%	93%	7%	100%

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£m	Year Ended December 31, 2012						Total
	North American Education	International Education	Professional	FT Group	Continuing	Discontinued	
Sales	2,658	1,568	390	343	4,959	1,153	6,112
	53%	32%	8%	7%	100%		
Total operating profit	463	133	(124)	15	487	86	573
	95%	27%	(25)%	3%	100%		
Add back:							
Other net gains and losses			123		123	32	155
Acquisition costs	7	8	1	4	20	1	21
Intangible charges	66	73	37	3	179	4	183
Adjusted operating profit: continuing operations	536	214	37	22	809		809
Adjusted operating profit: discontinued operations						123	123
Total adjusted operating profit	536	214	37	22	809	123	932
	58%	23%	4%	2%	87%	13%	100%

*North American Education*

North American Education sales grew by £121m, or 5%, from £2,658m in 2012, to £2,779m in 2013 and adjusted operating profit decreased by £130m, or 24%, from £536m in 2012 to £406m in 2013. The average dollar rate strengthened slightly from 2012 to 2013 which we estimate increased sales by £37m and adjusted operating profit by £4m when compared to the equivalent figures at constant 2012 exchange rates. At constant exchange and after taking account of the contribution from acquisitions sales remained flat, and there was a decline in profits of 30%, largely due to the restructuring costs incurred in 2013.

Overall adjusted operating margins in the North American Education business were lower in 2013 at 14.6% compared to 20.2% in 2012 with the majority of the decrease attributable to the restructuring undertaken in 2013.

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

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

We introduced adaptive learning capabilities in over 200 MyLab and Mastering products across eleven subjects. Student registrations in North America grew 9% to almost 11 million. Usage continues to grow strongly with graded submissions up 15% to almost 370 million across the globe. Evaluation studies show that the use of MyLab programmes, as part of a broader course redesign, can significantly improve student test scores and

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institutional efficiency. We acquired Learning Catalytics, which allows faculty to obtain real-time responses to open-ended or critical thinking questions, to determine which areas require further explanation, and enables earlier intervention to help improve retention and outcomes.

Enterprise-wide partnerships with Arizona State University Online, Ocean Community College, Indiana Wesleyan University and Rutgers, where we run fully-online learning programmes and earn revenues based on the success of the students and the institution, gained more than 64,000 student registrations, up 45% on 2012. Embanet increased new student enrolments by 8% to almost 12,000 and total student enrolment by 6.5% to more than 27,000; adding sixteen new programmes, launching three new key academic partners with Adelphi University, Villanova University and University of Maryland; and expanding partnerships with existing customers such as Maryville and Northeastern. More than 200 colleges are working with Pearson to build online learning programmes that improve access to high quality undergraduate and graduate degree programmes.

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

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

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

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

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

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

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

Pearson Clinical Assessment launched Q-interactive, a portable digital tool that enables mental health professionals to automatically manage the administration of clinical assessments, digital stimuli, response recording through stylus notes and audio. It serves 1,500 users within hospitals, private practice, and schools in five countries (US, UK, Australia, Canada and Netherlands). Paid test administrations have increased ten-fold since launch.

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

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

### *International Education*

International Education sales decreased by £29m, or 2%, from £1,568m in 2012 to £1,539 in 2013 and adjusted operating profit decreased by £74m, or 35%, from £214m in 2012 to £140m in 2013. At constant exchange and after taking account of the contribution from acquisitions there was growth in sales of 1% but a decrease in profits of 30% mainly due to restructuring charges incurred in 2013.

Overall adjusted operating margins in the International Education business decreased from 13.6% in 2012 to 9.1% in 2013. This was due to the £69m net of restructuring charges expensed during the year, and margins before restructuring charges were similar to 2012.

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

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

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

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

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

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

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

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

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

In the UK, revenues declined due to a softer school curriculum and vocational qualifications (BTEC) market anticipating curriculum change. This was partly offset by a strong performance in the GCSE and A/AS level qualifications market. In higher education, we partnered with Leeds Metropolitan University to develop a suite of online learning business education courses. In assessment, we marked almost 6 million GCSE, A/AS Level and

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other examinations with more than 93% using onscreen technology. We marked 2.7 million test scripts for over half a million pupils taking National Curriculum Tests at Key Stage Two in 2013 and were selected to administer the test until 2016. 2013 also saw the first delivery of the Next generation BTEC qualifications to over 100,000 students, with a further 365,000 students to date enrolled for 2014/15 delivery.

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

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

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

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

### *Professional*

Professional sales increased by £20m, or 5%, to £410m in 2013 from £390m in 2012. Adjusted operating profit increased by £20m or 54% to £57m in 2013, from £37m in 2012.

Overall adjusted operating margins in the Professional business were significantly higher at 13.9% in 2013 compared to 9.5% in 2012. Restructuring charges in 2013 were more than offset by the poor performance at the Pearson in Practice business in 2012.

The Professional division performed well in 2013, with good revenue and profit growth in testing and training partly offset by declines in publishing. The UK training business Pearson in Practice had a significant negative impact on the 2012 performance.

Professional testing continued to see good revenue and profit with growth test volumes at Pearson VUE up 25% on 2012 to almost 12 million. Key contract renewals included tests for the American Board of Internal Medicine, the Association of Social Work Boards and the Pharmacy Technician Certification Board. We will continue to deliver our UK contract to administer the Driving Theory test for the DVSA until September 2016. We won a number of new contracts for computer-based testing including the Charter of Financial Analysts, Saudi Commission of Health Specialties and the Korean Productivity Centre.

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

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



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### *FT Group*

Sales at FT Group decreased by £2m or 1%, from £343m in 2012 to £341m in 2013. Adjusted operating profit from continuing operations increased by £7m, from £22m in 2012 to £29m in 2013.

The increase in adjusted operating profit was driven by strong growth in digital and content businesses and improved print circulation margins which more than offset weak advertising. Digital and services revenues accounted for 55% of FT Group revenues (31% in 2008). Content revenues comprised 63% of revenues (48% in 2008), while advertising accounted for 37% of FT Group revenues (52% in 2008). Overall adjusted operating margins at FT Group increased from 6.4% in 2012 to 8.5% in 2013.

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

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

Mobile is an increasingly important channel for the FT, driving 62% of subscriber consumption, 45% of total traffic and almost a quarter of new digital subscriptions. The FT's flagship web app now has more than 5 million users and new FT apps on Google Newsstand and Flipboard have strengthened our mobile offering. Other innovations, including launching 24-hour news service fastFT, redesigns to mobile apps and improvements to FT.com, have helped significantly increase overall digital engagement.

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

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

### *Penguin Random House*

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

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

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

In the US, on a full year basis, Penguin and Random House published 480 *New York Times* bestsellers, including three out of the top five Bookscan Adult Fiction bestsellers for the year: Dan Brown's *Inferno*,

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John Grisham's *Sycamore Row* and Khaled Hosseini's *And The Mountains Echoed*. Other *New York Times* bestsellers included, in Adult Nonfiction: Sheryl Sandberg's *Lean in*; Charles Krauthammer's *Things That Matter*; and in Children's Fiction: John Green's #1 bestselling *The Fault in Our Stars*.

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

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

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

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

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

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

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

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

## **Results of operations**

### ***Year ended December 31, 2012 compared to year ended December 31, 2011***

#### *Consolidated results of operations*

#### **Sales**

Our total sales from continuing operations increased by £231m, or 5%, to £4,959m in 2012, from £4,728m in 2011. The increase reflected growth, on a constant exchange rate basis of 4% together with additional

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contributions from acquisitions made in both 2011 and 2012. The year on year growth was not significantly impacted by movements in exchange rates and 2012 sales, translated at 2011 average exchange rates, would have been £4,989m.

Pearson Education increased sales by £226m or 5% from £4,390m to £4,616m. The North America, International and Professional businesses all contributed to the increase and were helped by acquisitions made in 2011 and 2012. We estimate that after excluding acquisitions and the negative impact of exchange, Pearson Education sales growth was flat in 2012 compared to 2011. Pearson Education, our largest business sector, accounted for 93% of our sales in 2012 and 93% in 2011. North American Education continued to be the most significant source of our sales and as a proportion of sales contributed 54% in 2012 and 55% in 2011.

The US higher education publishing market declined by 6% net in 2012, according to the Association of American Publishers. Total US College enrollments were lower in 2012 than 2011, affected by rising employment rates, state budget pressures and regulatory change affecting the for-profit sector. In a difficult trading environment Pearson gained share for the 14<sup>th</sup> consecutive year, again benefitting from our lead in technology and customization. The US school textbook publishing market declined 15% in 2012, according to the Association of American Publishers. There were several pressures on the industry including weakness in state budgets, a lower new adoption opportunity (total opportunity of \$380m in 2012 against \$650m in 2011) and delays in purchasing decisions during the transition to the new Common Core standards. Pearson gained share in tough market conditions, taking an estimated 31% of new adoptions where we competed. State funding pressures and the transition to Common Core assessments also made market conditions tough for our state assessment and teacher testing businesses; these were offset by good growth in secure online testing and in the clinical assessments business.

Our businesses in emerging markets continued to perform strongly, supported by good enrollment trends and sustained investment. Our UK business made solid progress during the year despite significant regulatory and policy changes across vocational and general qualifications, apprenticeships and higher education. In the rest of the world, a recovery in Japan following the 2011 tsunami and a strong competitive performance in Italy more than offset weak market conditions in Spain. After excluding the effect of acquisitions we estimate that there was growth of 13% at constant 2011 exchange rates in the International Education business. Professional sales increased in 2012 by 2%; the UK training business was weak but other parts of the professional division performed well.

FT Group continuing sales were 1% ahead of last year driven by good underlying growth at the Financial Times. Growth at the Financial Times was driven by increases in digital readership and subscriptions, although advertising remained weak and volatile. FT Group sales accounted for 7% of our continuing business sales in both 2012 and 2011.

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

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

	<b>Year Ended December 31</b>	
	<b>2012</b>	<b>2011</b>
	<b>£m</b>	<b>£m</b>
Cost of goods sold	2,187	2,039
Operating expenses		
Distribution costs	82	88
Selling, marketing and product development costs	925	863
Administrative and other expenses	1,242	1,201
Other net gains and losses	10	(23)
Other income	(78)	(94)
Total operating expenses	2,181	2,035

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*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 £148m, or 7%, to £2,187m in 2012, from £2,039m in 2011. The increase corresponds to the increase in sales, with cost of sales at 44.1% of sales in 2012 compares to 43.1% in 2011.

*Distribution costs.* Distribution costs consist primarily of shipping costs, postage and packing. A reduction in costs in 2012 reflects the change in product mix with digital and services businesses incurring less distribution expense.

*Selling, marketing and product development costs.* Our selling, marketing and product development costs increased by £62m, or 7%, to £925m in 2012, from £863m in 2011. As a percentage of sales they remained broadly consistent at 18.7% in 2012 and 18.3% in 2011.

*Administration and other expenses.* Our administration and other expenses increased by £41m, or 3%, to £1,242m in 2012, from £1,201m in 2011. As a percentage of sales they remained consistent at 25.0% in 2012 and 25.4% in 2011.

*Other net gains and losses.* Other net gains and losses in 2012 relate to an impairment loss on a joint venture. Included in 2011 are a £29m gain on the sale of an investment, a £8m gain on a stepped acquisition in the International Education business, and a loss of £14m on the sale of a business.

*Other income.* Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions. Other operating income decreased to £78m in 2012 compared to £94m in 2011, mainly due to a reduction in royalty income following the sale of FTSE in 2011 as disclosed below.

***Loss on closure of subsidiary***

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

***Profit on sale of associate***

On December 16, 2011 the FT Group completed the disposal of its 50% stake in FTSE International Limited (FTSE) realizing a profit on sale of £412m. This profit has been disclosed separately on the face of the income statement.

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

The contribution from our joint ventures and associates decreased from £33m in 2011 to £9m in 2012. Included in the 2011 figure were the results of the FTSE up to its disposal, which are not in the 2012 figures. In addition in 2012 there is a write down of £10m of goodwill relating to a joint venture in India.

***Operating profit***

The total operating profit decreased by £612m, or 56%, to £487m in 2012 from £1,099m in 2011. 2011 operating profit, includes the profit on sale of FTSE of £412m, and 2012 operating profit includes a charge of £113m relating to the loss on the closure of the Pearson in Practice business. After excluding these items, operating profit in 2012 decreased by £87m, or 13%.

Operating profit attributable to Pearson Education decreased by £165m, or 26%, to £472m in 2012, from £637m in 2011. The decrease was largely attributable to the £113m closure charge, together with intangible impairments and the weakness in trading of Pearson in Practice over the year. Operating profit attributable to the FT Group after taking out the profit on sale of FTSE decreased by £35m, or 70%, to £15m in 2012, from £50m in 2011. In 2011 the share of profit from the FTSE investment together with royalties received from FTSE was included within FT Group's operating profits, and this totaled £20m.

**Table of Contents*****Net finance costs***

Net finance costs increased from £81m in 2011 to £96m in 2012. Net interest payable increased from £55m in 2011 to £65m in 2012, reflecting an increase in floating market interest rates on US dollar borrowings combined with the effect of higher average levels of net debt resulting from the Group's acquisition activity during 2012. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) rose by 0.2% to 0.5%. This increase in floating market interest rates combined with an increase in the Group's average net debt helped drive the Group's higher interest charge. These factors combined with a decrease in interest income on deposits created an increase in the Group's average net interest payable from 6.5% to 7.0%. Overall net borrowings increased by £419m from £499m at the end of 2011 to £918m at the end of 2012. In 2012 we invested £759m in new acquisitions and that together with tax and dividend payments was enough to offset cash generated from operating activities.

Also included in net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2012 the total of these items was a loss of £29m compared to a loss of £19m in 2011. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2011 the loss relates mainly to foreign exchange differences on a proportion of the unhedged US dollar proceeds from the Interactive Data sale in 2010. 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 2012 of £138m represents 35% of pre-tax profits compared to a charge of £154m or 15% of pre-tax profits in 2011. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 24.5% in 2012 and 26.5% in 2011). The increase in the tax rate in 2012 is largely due to the lack of tax relief on the loss on closure of Pearson in Practice together with the effect of a low tax charge in 2011 on the gain on disposal of FTSE.

***Non-controlling interest***

In 2012 there are non-controlling interests in the Group's businesses in South Africa, China and India although none of these are material to the Group numbers. The non-controlling interest in the Group's Brazilian business, SEB, was bought out in the first half of 2011.

***Profit for the year***

The profit for the financial year in 2012 was £314m compared to a profit in 2011 of £945m. The 2011 profit included the contribution from the FTSE disposal of £412m, and 2012 included costs relating to business closures of £113m.

***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 38.7p in 2012 compared to 118.2p in 2011 based on a weighted average number of shares in issue of 804.3m in 2012 and 800.2m in 2011. The decrease in earnings per share was due to the decrease in profit for 2012 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 38.6p in 2012 and 118.0p in 2011 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

**Table of Contents*****Exchange rate fluctuations***

The weakening of non- US dollar currency against sterling on an average basis had an adverse impact on reported sales and profits in 2012 compared to 2011. 2012 sales, translated at 2011 average exchange rates, would have been higher by £30m and operating profit, translated at 2011 average exchange rates, would have been higher by £7m. 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 adjusted operating profit for each of Pearson's business segments. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments.

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

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

£m	Year Ended December 31, 2012						Total
	North American Education	International Education	Professional	FT Group	Continuing	Discontinued	
Sales	2,658	1,568	390	343	4,959	1,153	6,112
	53%	32%	8%	7%	100%		
Total operating profit	463	133	(124)	15	487	86	573
	95%	27%	(25)%	3%	100%		
Add back:							
Other net gains and losses			123		123	32	155
Acquisition costs	7	8	1	4	20	1	21
Intangible charges	66	73	37	3	179	4	183
Adjusted operating profit: continuing operations	536	214	37	22	809		809
Adjusted operating profit: discontinued operations						123	123
Total adjusted operating profit	536	214	37	22	809	123	932
	58%	23%	4%	2%	87%	13%	100%

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£m	Year Ended December 31, 2011						Total
	North American Education	International Education	Professional	FT Group	Continuing	Discontinued	
Sales	2,584	1,424	382	338	4,728	1,134	5,862
	55%	30%	8%	7%	100%		
Total operating profit	463	119	55	462	1,099	123	1,222
	42%	11%	5%	42%	100%		
Add back:							
Other net gains and losses	(29)	6		(412)	(435)		(435)
Acquisition costs	2	9		1	12		12
Intangible charges	57	60	11	2	130	9	139
Adjusted operating profit: continuing operations	493	194	66	53	806		806
Adjusted operating profit: discontinued operations						132	132
Total adjusted operating profit	493	194	66	53	806	132	938
	52%	21%	7%	6%	86%	14%	100%

*North American Education*

North American Education sales grew by £74m, or 3%, to £2,658m in 2012, from £2,584m in 2011 and adjusted operating profit increased by £43m, or 9%, to £536m in 2012 from £493m in 2011. The average dollar rate strengthened slightly from 2011 to 2012 which we estimate increased sales by £19m and adjusted operating profit by £5m when compared to the equivalent figures at constant 2011 exchange rates. At constant exchange and after taking account of the contribution from acquisitions there was a decline in sales of 4% and increase in profits of 3%.

Overall adjusted operating margins in the North American Education business were higher at 20.2% in 2012 compared to 19.1% in 2011 with the majority of the increase attributable to further cost efficiencies and the continued success of higher margin digital products.

In 2012, our strength in digital and services businesses and tight cost control enabled us to perform ahead of our more traditional print publishing markets, which declined by 10% for the industry as a whole and were adversely affected by state budget pressures and declines in college enrolments.

In US School, the textbook publishing market declined by 15% in 2012, according to the Association of American Publishers. There were several pressures on the industry including weakness in state budgets, a lower new adoption opportunity (total opportunity of \$380m in 2012 against \$650m in 2011) and delays in purchasing decisions during the transition to the new Common Core standards. Pearson gained share in very difficult market conditions, taking an estimated 31% of new adoptions where we competed. enVision Math continued to perform strongly, with a recent *What Works Clearing House* study showing that students using the programme out-performed peers by between six and eight percentiles in math across a broad range of student populations. iLit, our new digital reading intervention programme, was successfully implemented in 20 districts with early results showing strong reading gains. Connections Education, which operates online K-12 schools in 22 states and a nationwide charter programme, served more than 43,000 students in 2012, up 31% from 2011 and broadened its product offering to include virtual classrooms for public school campuses. Connections Academy Schools have consistently high performance ratings, particularly in states focused on measuring growth in student learning.

At our Assessment and Information business, revenues were flat in 2012. State funding pressures and the transition to Common Core assessments continued to make market conditions tough for our state assessment and teacher testing businesses. We continued to produce strong growth in secure online testing and we increased

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online testing volumes by more than 10m, delivering 6.5 million state accountability tests, 4.5 million constructed response items and 21 million spoken tests. We now assess oral proficiency in English, Spanish, French, Dutch, Arabic and Chinese. We also launched the Online Assessment Readiness Tool for the PARCC and the Smarter Balance Assessment Consortium (SBAC) Common Core consortia to help 45 states prepare for the transition to online assessments. We won new state contracts in Colorado and Missouri and a new contract with the College Board to deliver ReditStep, a middle school assessment that measures and tracks college readiness skills. We extended our contract with the College Board to deliver the ACCUPLACER assessment, a computer-adaptive diagnostic, placement and online intervention system that supports 1,300 institutions and 7 million students annually. We won five Race To The Top state deals (Kentucky, Florida, Colorado, North Carolina and New York) led by Schoolnet. PowerSchool won three state/province-level contracts (North Carolina, New Brunswick and Northwest Territories). We launched our mobile PowerSchool applications and grew our third party partner ecosystems to over 50 partners. PowerSchool supports more than 12 million students up more than 20% on 2011 while Schoolnet supports 8.3 million students, up almost 160% on 2011. Our clinical assessment business was boosted by strong growth at AIMSweb, our progress monitoring service which enables early intervention and remediation for struggling students. AIMSweb delivered 58 million assessments in 2012, up 12%.

In Higher Education, the publishing market declined 6% net in 2012, according to the Association of American Publishers. Total US College enrolments were 2% lower in 2012 than in 2011, affected by rising employment rates, state budget pressures and regulatory change affecting the for-profit sector. In a difficult trading environment Pearson gained share for the 14<sup>th</sup> consecutive year, again benefitting from our lead in technology and customization. Student registrations at e-College grew 3% to 8.7 million, despite pressure in the for-profit college market. We won new online enterprise learning contracts with California State University and Rutgers University. Our strong managed enrolment services and student marketing product offering, coupled with continued strong growth at Arizona State University, helped our online enterprise learning business to grow 150% to almost 44,000 enrolments. During the year we acquired EmbanetCompass which provides a full range of services targeted towards online graduate programmes. Pearson's pioneering My Lab digital learning, homework and assessment programmes grew well with student registrations in North America up 11% to almost 10 million with strong usage growth with graded submissions up 12% to almost 320 million across the globe. OpenClass, Pearson's free learning management system, has been installed by almost 1,300 K-12 and College institutions in the US and now serves approximately 100,000 users. During 2012 we launched Project Blue Sky, a cloud-based content service that allows college instructors to combine Open Educational Resources with instructor-created and Pearson content. We also launched Pearson Workforce Education which delivers more than 60 online courses in high demand occupational training areas from IT and Healthcare to management and soft skills courses; and Propero, which combines on-demand tutoring, student support and online courses to expand access to higher education and support degree completion.

### *International Education*

International Education sales increased by £144m, or 10%, to £1,568m in 2012, from £1,424m in 2011 and adjusted operating profit increased by £20m, or 10%, to £214m in 2012 from £194m in 2011. At constant exchange and after taking account of the contribution from acquisitions there was underlying growth in sales of 7% and an increase in profits of 11%.

Overall adjusted operating margins in the International Education business remained constant at 13.6% in both 2011 and 2012.

Our businesses in emerging markets continued to perform strongly, supported by good enrolment trends and sustained investment. Our UK business was resilient during the year despite significant regulatory and policy changes across vocational and general qualifications, apprenticeships and higher education. In the rest of the world, a recovery in Japan following the 2011 tsunami and a strong competitive performance in Italy more than offset weak market conditions in Spain.



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In English Language Learning, Wall Street English, Pearson's worldwide chain of English language centres for professionals, opened a net of 11 new centres around the world, bringing the total number to 460. Student numbers fell by 2% to more than 191,000, primarily due to the closure of a large franchise centre in Chile with approximately 7,000 students. MyEnglishLabs enrolments grew 60% to 263,000 supported by the launch of our next generation platform which supports 12 languages and 43 new courses. We acquired Global English during the year which is a leading provider of cloud-based, on-demand Business English learning, assessment and performance support software. More than 1.1 million students registered for our MyLab digital learning, homework and assessment programmes, an increase of 18%, with good growth in school, ELT and institutional selling in higher education.

In the UK, we marked more than 6.3 million GCSE, A/AS level and other examinations with 90% using onscreen technology and more than 3.8 million test scripts for over half a million pupils taking National Curriculum Tests at Key Stage Two in 2012. We launched our Next Generation BTECs which are now the leading vocational qualification on the new funding and accountability frameworks in schools. Our Vocational qualifications business grew well with the continued popularity of BTEC amongst employers and universities and a strong performance in work-based learning (with registrations now up to 170,000) further boosted by a good performance from EDI, our provider of education and training qualifications and assessment services.

In China, student enrolments at Wall Street English increased 15% to almost 61,000, boosted by good underlying demand and the launch of ten new centres taking the total to 66. Our students rapidly acquire high-level English skills with average grade levels achieved rising 8% during 2012. Enrolments at Global Education, our test preparation services for English language qualifications, increased 16% to more than 1 million, through 73 owned and 372 franchised learning centres.

In South Africa we held share in school publishing in market conditions which were tougher than expected despite a year of major curriculum reform. Student enrolments grew strongly at CTI, our South African University, up 19% to more than 10,000. We partnered with UNISA, South Africa's largest university and the largest distance learning provider in Africa, to provide 30,000 students with access to our MyLabs software, digital resources and customized eBooks.

In Brazil we ended 2012 with 533,000 students in our public and private sistemas (or learning systems) and added 24,000 students in our two largest private sistemas, COC and Dom Bosco, up 8% on 2011. Our public sistema, NAME, includes the top performing lower secondary school in Brazil and test scores for our public school students are, on average, 20% above the 2011 national IDEB standard for 4th and 8th grade students. In Mexico, we partnered with local curriculum and technology experts INITE to launch UTEL, a new university enabling Mexicans to enroll in online degree courses in management, IT, marketing, engineering and computer science. UTEL enrolled 2,500 undergraduate students and 4,000 learners in shorter corporate training or continuing professional education courses. UTEL's services arm, Scala, signed its first contract to provide online learning services to an existing higher education institution.

In India, TutorVista is now managing 35 schools and its multimedia teaching solution Digiclass is installed in approximately 17,000 classrooms. ActiveTeach, our digital learning platform for schools, was adopted by 200 schools serving approximately 100,000 students. In the Middle East, the Abu Dhabi Education Council purchased our print and digital Math and Science resources for all schools from grades 6 to 10, the American University of Sharjah adopted MyLabs for four mathematics courses and three science courses, and we are providing access to digital course content for 5,000 students at Abu Dhabi's Higher Colleges of Technology through our Pearson e-texts iPad app. In Italy, 6,000 students registered for MyEnglishLab Italiano, our new digital curriculum, helping us gain share in upper secondary adoptions and to see good growth overall.

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### *Professional*

Professional sales increased by £8m, or 2%, to £390m in 2012 from £382m in 2011. Adjusted operating profit decreased by £29m or 44% to £37m in 2012, from £66m in 2011. The UK training business Pearson in Practice had a significant negative impact on the 2012 performance, while other parts of the professional division performed well.

Overall adjusted operating margins in the Professional business were significantly lower at 9.5% in 2012 compared to 17.3% in 2011 as margins fell due to the poor performance at the Pearson in Practice business.

Professional training was very weak with our UK adult training business Pearson in Practice, facing a dramatic fall in demand as a result of changes to the apprenticeships programme. Pearson believes that this business no longer has a sustainable model and announced in January that we are to exit Pearson in Practice. The cost of exit and impairment is £113m and is reported as a loss on closure in the 2012 financial statements.

Within professional training, TQ however continues to make significant progress in the direct delivery of training services overseas. In Saudi Arabia, we extended the contract to operate the Saudi Petroleum Services Institute for five years and won a five-year contract to run a new Institute at Al Khafji. In Oman, a TQ-led consortium won the bid to provide training to BP, including a wide range of technical and English language training for BP workers as they prepare to open up the Khazzan oilfield for full scale production in 2016.

Professional publishing grew modestly with good profit growth. In the US, the growth of eBook sales and other digital products and services continued to outpace ongoing challenges in the traditional retail channel.

Professional testing continued to see good revenue and profit growth with test volumes at Pearson VUE up 7% on 2011 to almost 8 million with Certiport adding an additional 2.3 million tests, up 13% on 2011. There were key renewals of the National Council of State Boards of Nursing contract running until 2019 and the Computing Technology Industry Association contract was secured with Pearson VUE as the single vendor running through to 2017. We won a number of new contracts including a 10 year contract to administer all computer and paper based tests for the Australia CPA Professional exams and five year contracts with the National Center for Assessment in Saudi Arabia and the National Council of State Boards of Nursing to provide the NCLEX-RN in Canada beginning in 2015 for ten Canadian registered nurse regulatory bodies. The partnership with the American Council on Education to develop an online General Educational Development (GED) test aligned with new Common Core standards has now launched computer based testing in 37 jurisdictions.

### *FT Group*

Sales at FT Group increased by £5m or 1%, from £338m in 2011 to £343m in 2012. Adjusted operating profit decreased by £31m, from £53m in 2011 to £22m in 2012. Included in the 2011 figure is the share of profit from the investment in FTSE together with royalties received from FTSE prior to the date of sale. Together these totaled £20m and were included in adjusted operating profit.

Overall adjusted operating margins at FT Group decreased from 15.6% in 2011 to 6.4% in 2012 as the effect of the FTSE disposal in 2011 impacted 2012.

Within the FT Group, digital and service revenues accounted for 50% of revenues, compared with 31% in 2008. Content comprised 61% of revenues and advertising accounted for 39%; these compare to 48% for content and 52% advertising in 2008.

The *Financial Times* (FT) digital readership continues to grow strongly with digital subscriptions increasing 18% to almost 316,000 and with 3.5 million FT Web App users. The FT's total paid circulation was more than 602,000 across print and online, modestly up on 2011, with digital subscriptions exceeding print circulation for

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the first time. Mobile devices now account for 30% of FT.com traffic and 15% of new subscriptions. The FT now has almost 2,800 direct corporate licenses, up 40% on 2011. We continued to invest in new products and innovation, including launching a Windows 8 app and the FT Web App on Chrome for Android; a bespoke web app for Latin America; a re-brand of the conferences division, FT Live, with the introduction of live streaming at key events; and the launch of GatekeeperIQ, a new subscription service to track large, retail investment platforms.

Advertising was generally weak and volatile with poor visibility but the FT grew market share with mobile, luxury and business education showing good growth. Digital revenues benefited from the launch of FT SmartMatch, which automatically puts client content such as articles, white papers and videos in front of FT.com users while they are reading related FT new stories.

FT Live, our events business, continued to grow strongly and launch new events, including the Global Commodities Summit, delivering more than 200 events that attracted over 17,000 delegates. We launched a digital portal that offers on-demand webinars, live-streamed events and social media tools. Educational services are an important area of expansion. The FT Non-Executive Director Certificate (in partnership with Pearson Learning Studio and Edexcel) was attended by over 150 candidates across five intakes. FT Newslines, an annotations tool on FT.com that allows students and faculties from around the world to create and share annotations on FT articles, is now being used at many business schools. The new FTChinese MBA Gym App, which features tailored training courses categorized by topic, has ranked among the top paid-for education apps on the iTunes Store and was recognized as one of the App Store Best of 2012 by Apple in China.

Money-Media revenues and profits continued to grow well boosted by a strong subscription performance, with the number of individual users growing 6% year on year to 220,000, and new product launches, including Ignites Retirement Research which broadens Money-Media's product offering into the investment industry research sector.

In the Economist Group, in which Pearson owns a 50% stake, *The Economist* launched three HTML5-powered apps in collaboration with FT Labs. *The Economist*'s worldwide print and digital circulation increased by 2% to 1.67m (at 31 December 2012) of which 150,000 customers bought digital-only copies. The Economist Intelligence Unit acquired Clearstate in Singapore and Bazian, a London-based healthcare research company, as part of its strategy to build a healthcare information business.

### *The Penguin Group*

The results of the Penguin Group are included in discontinued operations for 2011 and 2012. Penguin sales increased by £8m or 1%, from £1,045m in 2011 to £1,053m in 2012 as the business faced tough conditions in the physical book market and adjusted operating profit was down 12% to £98m in 2012 from £111m in 2011. Penguin adjusted operating margins reduced from 10.6% in 2011 to 9.3% in 2012.

In market conditions that remained challenging, Penguin had a solid year with momentum and share improving in the second half of the year. It also made several moves to offer a broader range of services to more authors across more platforms in more markets.

In the United States, Penguin published 255 *New York Times* best sellers (254 in 2011) including *No Easy Day: The Firsthand Account of the Mission that Killed Osama bin Laden* by Mark Owen, *Bared to You* by Sylvia Day and Nate Silver's *The Signal and the Noise* as well as new titles from bestselling authors including Ken Follett, Nora Roberts, Tom Clancy and Harlan Coben. In the UK, we published 90 Bookscan bestsellers, our best year on record (compared to 78 in 2011) including Sylvia Day's *Bared to You*; Jamie Oliver's *15 Minute Meals*; Clare Balding's *My Animals and Other Family* and Daniel Kahneman's *Thinking Fast and Slow*.

eBook revenue grew strongly in 2012 and accounted for 17% of Penguin's global revenue (12% in 2011), and almost 30% in the US (20% in 2011). Penguin continued to invest in digital publishing programmes, making eBooks available in new markets including Australia, India, Brazil and China; launching a number of digital-only

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imprints around the world and expanding our eSpecials list. Global app sales grew by more than 200% driven by brands including Wreck this App, Mad Libs, Moshi Monsters and LEGO®. DK was Apple's only trade publisher launch partner for the January launch of the iBooks Author 2 platform and now has more than 50 interactive titles available.

In Brazil, Penguin acquired 45% of Companhia das Letras, a leading trade book publisher, and in India we launched a local eBook programme and enjoyed considerable success in commercial fiction with bestselling authors including Ravinder Singh and Shobhaa De. In China, we expanded our local publishing programmes in both Chinese and English with more than 100 titles now available, including its first local language top ten title, tennis player Li Na's autobiography and launched its first list of eBooks.

DK performed strongly and grew share globally led by our LEGO® publishing list. In the UK, DK celebrated a number one bestseller with *Mary Berry's Complete Cookbook*, which has sold more than one million copies worldwide. BradyGames had best sellers with *Borderlands 2*, *Skylanders Giants* and *Call of Duty: Black Ops II*. Author Solutions, which we acquired in July 2012 had a good start. It is the world's leading provider of professional self-publishing services and broadens our expertise in online marketing, consumer analytics, professional services and user-generated content.

## **Liquidity and capital resources**

### ***Cash flows and financing***

Net cash generated from operations decreased by £232m (or 25%) to £684m in 2013 from £916m in 2012. This decrease reflected restructuring activity undertaken in 2013 and additional investment (particularly in North America) ahead of the transition to Common Core and to enhance the Group's technology capabilities in advance of the next generation of digital products. Net cash generated from operations decreased by £177m (or 16%) to £916m in 2012 from £1,093m in 2011. This decrease in cash generated from operations reflected a later sales profile in the second half of 2012 compared to 2011 (causing the corresponding cash collections to fall into 2013) and increased investment in pre-publication as more of our education programs are updated for digital delivery and adverse currency effects. The average working capital to sales ratio improved to 13.4% in 2013 from 13.8% in 2012 reflecting the part-year impact of the sale of Penguin. Average working capital is the average month end balance in the year of inventory (including pre-publication), receivables and payables.

Net interest paid increased to £73m in 2013 from £66m in 2012 due to higher average net debt levels following acquisitions completed in late 2012. Net interest paid increased to £66m in 2012 from £60m in 2011 due to higher average net debt following recent acquisitions, with some offset provided from receipt of the proceeds from the sale of FTSE International at the end of 2011.

Capital expenditure on property, plant and equipment and software intangibles was £182m in 2013, £151m in 2012 and £144m in 2011. Expenditure has been prioritized towards information technology and software to support the digital capability of the Group.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £58m in 2013 against £755m in 2012 and £788m in 2011. There were no major acquisitions in 2013, with the cash outflow relating to various minor acquisitions and costs associated with prior period acquisitions. The expenditure in 2012 and 2011 reflects the re-shaping of the portfolio following the sales of Interactive Data and FTSE International. The principal acquisitions in 2012 were of EmbanetCompass for £411m, Certiport for £88m, Author Solutions, Inc for £69m and GlobalEnglish Corporation for £63m. The principal acquisitions in 2011 were of Schoolnet for £141m, Education Development International for £108m, Connections Education for £244m, Global Education for £97m and TutorVista for £75m.

The sale of subsidiaries and associates produced a net cash outflow of £130m in 2013 against an outflow of £11m in 2012 and an inflow of £422m in 2011. The cash outflow in 2013 primarily relates to the cash disposed

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with Penguin upon formation of Penguin Random House. The cash outflow in 2012 primarily related to expenses incurred in advance of the formation of Penguin Random House. The proceeds in 2011 relate to the sale of the Group's 50% holding in FTSE International.

The cash outflow from financing of £444m in 2013 reflects a further 7% increase in the dividend, the repayment of a \$350m US Dollar Note during the year and the buy-out of various non-controlling interests, with some offset from the proceeds of a \$500m US Dollar Note issued in the year. The cash outflow from financing of £23m in 2012 reflects a further 9% increase in the dividend, offset by the proceeds from a \$500m US Dollar Note issued during the year. The cash outflow from financing of £790m in 2011 reflects the repayment of a \$500m bond, a further 9% increase in the dividend and the final payment of £108m in the stepped acquisition of Sistema Educacional Brasileiro.

**Capital resources**

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

At December 31, 2013, our net debt was £1,379m compared to net debt of £918m at December 31, 2012. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash, cash equivalents and liquid resources. Cash equivalents comprise short-term deposits with a maturity of up to 90 days, while liquid resources comprise short-term deposits with maturities of more than 90 days and other marketable instruments which are readily realizable and held on a short-term basis. Total Short-term, medium-term and long-term borrowing amounted to £2,226m at December 31, 2013, compared to £2,279m at December 31, 2012 reflecting the new \$500m US Dollar note issued during the year and exchange movements, offset by the repayment of a \$350m US Dollar Note. At December 31, 2013, total cash and liquid resources were £765m, compared to £1,177m at December 31, 2012. This decrease is due to cash disposed with Penguin upon the formation of Penguin Random House, restructuring activity and additional investment in products and technology capability.

**Contractual obligations**

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

	At December 31, 2013				
	Total £m	Less than one year £m	One to two years £m	Two to five years £m	After five years £m
<b>Gross borrowings:</b>					
Bank loans, overdrafts and commercial paper	47	25	22		
Bonds	2,168	502	299	798	569
Finance lease obligations	11	6	4	1	
Operating lease obligations	1,403	161	149	356	737
UK Pension funding obligations	143	41	41	61	
<b>Total</b>	<b>3,772</b>	<b>735</b>	<b>515</b>	<b>1,216</b>	<b>1,306</b>

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At December 31, 2013 the Group had capital commitments for fixed assets, including finance leases already under contract, of £11m (2012: £17m). 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, 2013, the full \$1.75bn was available under this facility. This credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

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

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

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

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

### ***Treasury policy***

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

### ***Related parties***

There were no significant or unusual related party transactions in 2013, 2012 or 2011. Refer to note 37 in *Item 18. Financial Statements*.

### ***Accounting principles***

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

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

The following table sets forth information concerning directors, as of March 2014.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Glen Moreno	70	Chairman
John Fallon	51	Chief Executive
David Arculus	67	Non-executive Director
Vivienne Cox	54	Senior Independent Director
Robin Freestone	55	Chief Financial Officer
Ken Hydon	69	Non-executive Director
Josh Lewis	51	Non-executive Director
Linda Lorimer	61	Non-executive Director
Harish Manwani	60	Non-executive Director
<b>Glen Moreno</b>		

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

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

**John Fallon**

Appointed October 3, 2012. Member of the nomination committee.

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

**David Arculus**

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

David has experience in banking, telecommunications and publishing in a long career in business. Currently he is chairman of Numis Corporation plc and the Advisory Board of the British Library and is a member of council of Cranfield University. David's previous roles include the chairmanship of Aldermore Bank plc, O2 plc, Severn Trent plc and IPC Group, as well as chief operating officer of United Business Media plc, group

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managing director of EMAP plc and a non-executive director of Telefonica S.A. David served from 2002 to 2006 as chairman of the UK government's Better Regulation Task Force, which worked on reducing burdens on business.

### **Vivienne Cox**

Appointed on January 1, 2012. Member of the audit, remuneration and nomination committees.

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

### **Robin Freestone**

Appointed on June 12, 2006.

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

### **Ken Hydon**

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

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

### **Josh Lewis**

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

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



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**Linda Lorimer**

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

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

**Harish Manwani**

Appointed October 1, 2013. Member of the nomination committee.

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

The following table sets forth information concerning the executive committee, as of March 2014. The executive committee was effective from January 1, 2014.

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

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

**Tim Bozik**

Tim is President, Higher Education and has extensive knowledge of all aspects of higher education as well experience in moving Pearson towards being a more digital, data and services-led business. Tim joined Pearson

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in 1983 as a sales representative and has since held several leadership roles in product development and general management, including his most recent post as chief executive of U.S. higher education. His work has included a focus on the role of technology, data and analytics to improve access, achievement and affordability.

### **Rod Bristow**

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

### **Albert Hitchcock**

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

### **Phil Hoffman**

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

### **Kate James**

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

### **Don Kilburn**

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

### **Douglas Kubach**

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

### **Tamara Minick-Scokalo**

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

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### **John Ridding**

John is President, Professional & MD, FT Group. He started his Pearson career in the FT's editorial department, working through a series of editing and international reporting roles before becoming Managing Editor and Deputy Editor. John set up the FT's operation in Asia and launched FTChinese.com, the Chinese language edition of the FT. He was appointed President of Pearson Asia in 2003 and CEO of the FT in 2006. Since then he has led the transformation strategy and digital development of the FT. John is a board member of Room to Read, the US-based charity focused on driving literacy, especially for girls, in developing countries.

### **Luke Swanson**

Luke is Chief Transformation Officer and is responsible for developing and implementing Pearson's global education strategy and organization design. Prior to this, Luke worked as Director of Communications, a role he held since 2003. His background includes corporate communications, branding, relations with investors, governments and the media, public policy, corporate responsibility. Luke is a nominee director of the Economist Group.

### **Melinda Wolfe**

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

### **Compensation of senior management**

It is the role of the remuneration committee (the committee) to approve the remuneration and benefits packages of the executive directors and other members of the Pearson Executive. The 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 starting point continues to be that total remuneration should reward both short and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional performance.

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

For benchmarking purposes, we review remuneration by reference to different comparator groups. We look at survey data from: FTSE 100 companies with significant international exposure, excluding financial services; the FTSE 20-50, excluding financial services; a broad media industry group of US companies; select UK human capital-intensive businesses; and UK and US media convergence companies with a focus on media, information

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services and technology. These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Towers Watson, use to make comparisons on remuneration takes this variation in size into account. We also look at publicly disclosed and proxy data for global media convergence comparators with a focus on media and technology. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

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

### ***Base salary***

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

### ***Allowances and benefits***

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

### ***Retirement benefits***

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

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

Under the 401(k) plan in the US, which is a defined contribution plan, account balances will be used to provide benefits at retirement. Company contributions amount to 100% of the first 3% of eligible compensation contributed by the employee and 50% of the next 3%, plus a basic annual company contribution of 1.25% of eligible compensation. Pearson Inc. Pension Plan participants who were at least age 40 at December 31, 2001 can receive an additional 0.5% - 1.5% of pay. In the event of death before retirement, the account balances will be used to provide benefits for designated beneficiaries.

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

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

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

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit was abolished by the Finance Act 2004. However the Pearson Group Pension Plan has retained its own cap, which will increase annually in line with the UK Government's Index of Retail Prices (All Items). The cap was £141,000 effective April 6, 2013.

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

The pension entitlements of each director are as follows:

John Fallon	Member of the Pearson Group Pension Plan. His pension accrual rate is 1/30th of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.
Robin Freestone	Member of the Money Purchase 2003 section of the Pearson Group Pension Plan. Company contributions are 16% of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.
Will Ethridge (stepped down December 31, 2013)	Member of the Pearson Inc. Pension Plan (under which he continues to accrue benefits under the alternative formula because he satisfied criteria of age and service) 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 (stepped down April 30, 2013)	Until leaving the company on 30 April, 2013, Rona Fairhead was a member of the Pearson Group Pension Plan. Her pension accrual rate was 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 received a taxable and non-pensionable cash supplement in replacement of the FURBS.

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John Makinson (stepped down July 1, 2013)  
 Member of the Pearson Group Pension Plan under which his pensionable salary is restricted to the plan earnings cap. The company ceased contributions on 31 December 2001 to his FURBS arrangement and the benefits were withdrawn in 2012, reducing the benefits payable under the UURBS. During 2002 it set up an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for him. The UURBS tops up the pension payable from the Pearson Group Pension Plan and the closed FURBS to target a pension of two-thirds of a revalued base salary on retirement at age 62. The revalued base salary is defined as £450,000 effective at 1 June 2002, increased at 1 January each year by reference to the increase in the UK Government's Index of Retail Prices (All Items). In the event of his death a pension from the Pearson Group Pension Plan and the UURBS will be paid to his spouse or nominated financial dependent. Early retirement is currently possible from age 55, with company consent.  
**Annual incentives**

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

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

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

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

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

Annual incentives will not exceed 200% of base salary.

For the chief executive, the individual maximum opportunity that will apply for 2014 is 180% of base salary (which is the same as applied for 2013).

For other executive directors and other members of the Pearson Executive, individual incentive opportunities take into account their membership of that committee and the relative contribution of their businesses or roles to the company's overall goals. The individual maximum opportunity that will apply for 2014 varies by individual but will be no more than 170% of base salary.

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

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

For 2014 and onwards, the funding of annual incentives will normally be related to the performance against targets for Pearson's adjusted earnings per share (or operating profit), sales, and operating cash flow.

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

Details of performance measures, weightings and targets will be disclosed in the annual remuneration report for the relevant financial year if and to the extent that the committee deems them to be no longer commercially sensitive.

2013 opportunities were as follows:

Name	Pearson plc	Operating company	Personal objectives
John Fallon	90%		10%
Robin Freestone	80%		20%
Will Ethridge	30%	60%	10%
		(North America)	
John Makinson	30%	60%	10%

(Penguin Group)

For Pearson plc, the performance measures were sales, pre- and post-restructuring earnings per share growth, average working capital to sales ratio and operating cash flow. Average working capital to sales and operating cash flow were below threshold. Sales and underlying growth in adjusted earnings per share at constant exchange rates post-restructuring were between threshold and target. Underlying growth in earnings per share at constant exchange rates pre-restructuring were between target and maximum.

For Pearson North America, the performance measures were sales, pre- and post-restructuring operating profit, average working capital to sales ratio and operating cash flow. Operating profit, average working capital to sales and operating cash flow were below threshold. Sales were between threshold and target.

For Penguin Group, the performance measures were sales, operating profit, average working capital to sales ratio and operating cash flow. Sales, operating profit and average working capital to sales were between target and maximum and operating cash flow was above maximum.

***Legacy arrangements under annual bonus share matching plan***

Up to and including 2013 in respect of annual incentives for 2012, awards were made under the annual bonus share matching plan. This plan encouraged executive directors and other senior managers to acquire and hold Pearson shares and aligned the interests of executives and shareholders. Senior managers across the company were invited to invest up to 50% of their after-tax annual incentive in Pearson shares purchased in the market and hold these shares for three years, in return for the opportunity to earn additional free matching shares and dividend shares, depending on performance against a real growth in earnings per share performance condition. Where matching shares vest, participants also receive additional shares representing the gross value of dividends that would have been paid on the matching shares during the performance period and reinvested. The maximum matching award is equal to the number of shares that could have been acquired with the amount of pre-tax annual bonus invested in Pearson shares (i.e. one matching share for every one invested share, grossed up for tax).

***Long-term incentives***

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

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Awards of restricted shares are made on an annual basis.

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

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

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

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

The long-term incentive plan also provides for the grant of stock options. Whilst it is not the committee's intention to grant stock options in 2014 or the foreseeable future, the committee believes that it should retain the flexibility of granting stock options in addition to, or instead of, restricted stock awards in the right circumstances. Any decision by the committee to grant stock options in the future would take account of best practice prevailing at the time. The committee would consult with shareholders before granting stock options to executive directors.

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

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

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

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

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

the face value of individual awards at the time of grant, assuming that performance targets are met in full;

market practice for comparable companies and market assessments of total remuneration from our independent advisers;

individual roles and responsibilities; and

company and individual performance.

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



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

For 2014 and onwards, awards will normally be subject to the achievement of targets for growth in earnings per share, return on invested capital and relative total shareholder return. We will set targets for the 2014 awards that are consistent with the company's strategic objectives over the period to 2016 and that are no less stretching than in previous years.

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

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

### ***Shareholding policy***

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership. Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children plus any shares vested but held pending release under a restricted share plan. In 2013, the target holding was 200% of salary for the chief executive and 125% of salary for the other executive directors. However, this increases to 300% and 200% respectively from 2014. Details of individual directors' shareholding are set out at the end of this section.

### ***Service agreements***

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

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

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

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

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

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

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

awards that are subject to performance conditions will stay in force as if the participant had not ceased employment and shall vest on the original vesting date



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awards that are not subject to a performance condition will be released on cessation of employment

the number of shares that are released shall be prorated for the period of the participant's service in the restricted period (although the committee may in its absolute discretion waive or vary the prorating)

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

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

**Executive directors non-executive directorships**

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

In 2013, Rona Fairhead served as a non-executive director and received fees of £83,333 from HSBC Holdings plc. Other executive directors served as non-executive directors elsewhere but either waived or did not receive fees.

**Chairman's and non-executive directors remuneration**

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

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

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

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

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

	<b>Current</b>	<b>With effect from May 1, 2014</b>
Non-executive director	£ 65,000	£ 70,000
Chairmanship of audit committee	£ 25,000	£ 27,500
Chairmanship of remuneration committee	£ 20,000	£ 22,000
Chairmanship of reputation and responsibility committee		£ 10,000
Membership of audit committee	£ 10,000	£ 15,000
Membership of remuneration committee	£ 5,000	£ 10,000
Membership of reputation and responsibility committee		£ 5,000
Senior independent director	£ 20,000	£ 22,000

Notes:

- (1) The fee paid to the chairman remains unchanged at £500,000.



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

**Remuneration of senior management**

The remuneration received by executive directors in respect of the financial year ending December 31, 2013 was as follows:

	Base Salary/ Fees £000	Allowances & Benefits(1) £000	Annual Incentives £000	Retirement Benefits £000	Long-term Incentives £000	Total £000
<b>Chairman</b>						
Glen Moreno	500					500
<b>Executive directors</b>						
John Fallon	750	43	463	330	141	1,727
Robin Freestone	545	14	341	163	181	1,244
Will Ethridge (stepped down December 31, 2013)	681	7	227	247	177	1,339
Rona Fairhead (stepped down April 30, 2013)	176	14		110	47	347
John Makinson (stepped down July 1, 2013)	274	122	301	298	69	1,064
<b>Senior management as a group</b>	<b>2,926</b>	<b>200</b>	<b>1,332</b>	<b>1,148</b>	<b>615</b>	<b>6,221</b>

Notes:

- (1) John Makinson was entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US and received £105,469 for 2013.
- (2) Benefits include company car, car allowance and UK health care premiums. Allowances and benefits for Will Ethridge include US health benefits. Such benefits are self-insured and the value shown here is the fully insured equivalent. There is no employee tax on this value.
- (3) Life cover and long-term disability insurance not covered by the retirement plans were previously reported as pension-related benefits last year but now appear alongside all other benefits.

**Share options for senior management**

This table sets forth for each director the number of share options held as of December 31, 2013 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
John Fallon	1,930	805.6p	08/01/15	02/01/16
Robin Freestone	990	909.0p	08/01/15	02/01/16

Notes:

- (1) These awards were made under the worldwide save for shares plan.
- (2) No variations to the terms and conditions of share options were made during the year.
- (3) The acquisition of shares under the worldwide save for shares plan is not subject to a performance condition.
- (4) The market price on December 31, 2013 was 1,341p per share and the range during the year was 1,119p to 1,365p.

**Share ownership of senior management**

The table overleaf shows the number of ordinary shares and conditional shares held by continuing directors and their connected persons as at December 31, 2013.

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

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

Additional information with respect to share options held by, and bonus awards for, these persons is set out above in Remuneration of Senior Management and Share Options of Senior Management. The total number of ordinary shares held by senior management as of December 31, 2013 was 1,330,061.

As at 31 December 2013	Ordinary shares(1)	Conditional Shares
Glen Moreno	150,000	
John Fallon	262,569	43,639
Robin Freestone	478,507	37,077
Will Ethridge	397,017	43,639
David Arculus	16,301	
Vivienne Cox	1,351	
Ken Hydon	17,818	
Josh Lewis	5,681	
Linda Lorimer	637	
Harish Manwani	180	

## Notes:

- (1) Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals investing part of their own after-tax annual bonus in Pearson shares under the annual bonus share matching plan.
- (2) The register of directors' interests (which is open to inspection during normal office hours) contains full details of directors' shareholdings and options to subscribe for shares. The market price on December 31, 2013 was 1,341p per share and the range during the year was 1,119p to 1,365p.
- (3) 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 or five years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the commencement of the employee's participation in the plan.

The plan now requires renewal. As the underlying UK legislation has not changed materially, Pearson is proposing to extend the life of the existing UK plan by a further ten years, until 2024. In addition, Pearson wishes to renew the directors' authority to continue to operate equivalent arrangements for non-UK employees. The relevant resolution will be put to shareholders for approval at the AGM. We will take this opportunity to increase the savings limit for the UK HMRC-approved part of the plan (which forms the basis of the plan in the rest of the world outside the US) from £250 to £500 per month.

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





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which they have the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period. The maximum employee contribution under the plan is \$1,000 per month.

### **Board practices**

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

However in accordance with the UK Corporate Governance Code, the board has resolved that all directors should offer themselves for re-election on an annual basis at the company's annual general meeting. Accordingly, all of the directors will offer themselves for re-election, (or re-appointment in the case of directors who were appointed since the last meeting), at the forthcoming annual general meeting on April 25, 2014.

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 formal committees, all of which report to the board. Each committee has its own written terms of reference setting out its authority and duties. These can be found on our website ([www.pearson.com/investors/shareholder-information/governance](http://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, Linda Lorimer and Vivienne Cox. Ken Hydon is also the designated audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission. Our internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee.

### ***Remuneration committee***

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

### ***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 John Fallon and all of the non-executive directors.

**Table of Contents****Employees**

The average number of persons employed by us in continuing operations during each of the three fiscal years ended 2013 were as follows:

42,115 in fiscal 2013,

42,135 in fiscal 2012, and

37,254 in fiscal 2011.

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 2013, 2012 and 2011 the average number of persons employed in each of our operating divisions.

Average number employed	2013	2012	2011
North American Education	19,670	18,552	16,133
International Education	16,113	16,751	13,646
Professional	3,357	3,706	4,561
FT Group	2,216	2,243	2,055
Other	759	883	859
Continuing operations	<b>42,115</b>	<b>42,135</b>	<b>37,254</b>

The average number employed in discontinued operations was 3,592 in 2013, 5,387 in 2012, and 4,267 in 2011.

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

As at February 28, 2014, the company had been notified under the Financial Conduct Authority's Disclosure and Transparency Rules of the following significant voting rights in its shares:

Name of shareholder	Number of ordinary shares held	% of outstanding ordinary shares represented by number of shares held
Harbor International Fund	24,598,034	3.01%
Libyan Investment Authority	24,431,000	3.01%

On February 28, 2014, record holders with registered addresses in the United States held 51,261,694 ADRs, which represented 6.26% 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, 2013 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 2013.

**ITEM 8. FINANCIAL INFORMATION**

The financial statements filed as part of this Annual Report are included on pages F-1 through F-71 hereof.

Other than those events described in note 38 in Item 18. Financial Statements of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to our financial condition or results of operations since December 31, 2013. Our borrowings fluctuate by season due to the effect of the school year on

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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 depository. 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		Average daily trading volume (Ordinary shares)
	High (In pence)	Low	
<i>Five most recent fiscal years</i>			
2013	1365	1119	2,065,900
2012	1294	1111	2,174,000
2011	1222	983	2,012,900
2010	1051	855	2,424,600
2009	893	578	4,030,500
<i>Most recent quarter and two most recent fiscal years</i>			
2013 Fourth quarter	1365	1225	1,663,400
Third quarter	1350	1162	1,816,400
Second quarter	1265	1119	2,254,100
First quarter	1238	1145	2,554,800
2012 Fourth quarter	1255	1168	1,942,100
Third quarter	1294	1162	2,085,800
Second quarter	1266	1111	2,325,300
First quarter	1255	1155	2,393,700
<i>Most recent six months</i>			
February 2014			
January 2014	1341	1104	2,419,800
December 2013	1350	1271	1,266,400
November 2013	1352	1292	1,802,100

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October 2013	1365	1225	1,911,700
September 2013	1301	1253	1,688,900

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**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, 2013. 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

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(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.

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

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

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

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

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

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

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

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

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

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

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

any proposal relating to another company in which he and any persons connected with him do not to his knowledge hold an interest in shares (as that term is used in sections 820 to 825 of the Companies Act 2006) representing one per cent or more of either any class of the equity share capital, or the voting rights, in such company;



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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

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separately and each of these directors, if not prohibited from voting under the provisions of the eighth paragraph before this one, will be entitled to vote and be counted in the quorum with respect to each resolution except that concerning his or her own appointment.

### ***Borrowing powers***

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

### ***Other provisions relating to directors***

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

### ***Annual general meetings***

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

approving final dividends;

consideration of the accounts and balance sheet;

ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;

as holders of ordinary shares vote for the election of one-third of the members of the board of directors at every annual general meeting, the appointment or election of directors in the place of those retiring by rotation or otherwise;

appointment or reappointment of, and determination of the remuneration of, the auditors; and

the renewal, limitation, extension, variation or grant of any authority to the board in relation to the allotment of securities.

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

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

If a quorum for a meeting convened at the request of shareholders is not present within fifteen minutes of the appointed time, the meeting will be dissolved. In any other case, the general meeting will be adjourned to the



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

### ***Share Certificates***

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

### ***Share capital***

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

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

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

### ***Changes in capital***

We may from time to time, by ordinary resolution:

consolidate and divide our share capital into shares of a larger amount than its existing shares; or

sub-divide all of or any of our existing shares into shares of smaller amounts, subject to the Companies Act 2006; or

cancel any shares which, at the date of passing of the resolution, have not been taken, or agreed to be taken, by any person and diminish the amount of our share capital by the amount of the shares so cancelled.

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

### ***Voting rights***

Every holder of ordinary shares present in person at a meeting of shareholders has one vote on a vote taken by a show of hands. On a poll, every holder of ordinary shares who is present in person or by proxy has one vote

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for every ordinary share of which he or she is the holder. Voting at any meeting of shareholders is by a show of hands unless a poll is properly demanded before the declaration of the results of a show of hands. A poll may be demanded by:

the chairman of the meeting;

at least three shareholders present in person or by proxy and entitled to vote;

any shareholder or shareholders present in person or by proxy representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting; or

any shareholder or shareholders present in person or by proxy holding shares conferring a right to vote at the meeting being shares on which the aggregate sum paid up is equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

### ***Dividends***

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

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

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

### ***Liquidation rights***

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

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

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

In the event that a shareholder or other person appearing to the board of directors to be interested in ordinary shares fails to comply with a notice requiring him or her to provide information with respect to their interest in voting shares pursuant to section 820 of the Companies Act 2006, we may serve that shareholder with a notice of default. After service of a default notice, that shareholder shall not be entitled to attend or vote at any general meeting or at a separate meeting of holders of a class of shares or on a poll until he or she has complied in full with our information request.

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

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

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

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

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

a non-material interest equal to or in excess of 10%,

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

### ***Limitations affecting holders of ordinary shares or ADSs***

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

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

### **Material contracts**

Pearson has not entered into any contracts outside the ordinary course of business during the two year period immediately preceding the date of this annual report. The Indenture entered into in 2012 with respect to \$500.0 million aggregate principal amount of 3.75% guaranteed notes due 2022 and the Indenture entered into in 2013 with respect to \$500.0 million aggregate principal amount of 3.250% guaranteed notes due 2023, in each case, issued by a subsidiary and guaranteed by Pearson, are filed as Exhibits 2.8 and 2.9 of this report, respectively.

### ***Executive employment contracts***

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

It is the company's policy that the company may terminate the executive directors' service agreements by giving no more than 12 months' notice. As an alternative, the company may at its discretion pay in lieu of that notice. Payment-in-lieu of notice may be made in equal monthly installments from the date of termination to the end of any unexpired notice period. In the case of the CEO, payment-in-lieu of notice in installments may also be subject to mitigation and reduced taking into account earnings from alternative employment. For executive directors, pay in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. In limited circumstances, in addition to making a full payment in lieu of notice, the company may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective hand-over and/or allow time for a successor to be appointed. The company may, depending on the circumstances of the termination, determine that it will not pay the director in lieu of notice and may instead terminate a director's contract in breach and make a damages payment, taking into account as appropriate the director's ability to mitigate his or her loss.

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### **Exchange controls**

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

### **Tax considerations**

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

an individual citizen or resident of the US, or

a corporation created or organized in or under the laws of the US or any of its political subdivisions, or

an estate or trust the income of which is subject to US federal income taxation regardless of its source.

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

dealers or traders in securities or currencies,

financial institutions or other US holders that treat income in respect of the ordinary shares or ADSs as financial services income,

insurance companies,

tax-exempt entities,

persons acquiring shares or ADSs in connection with employment,

US holders that hold the ordinary shares or ADSs as a part of a straddle or conversion transaction or other arrangement involving more than one position,

US holders that own, or are deemed for US tax purposes to own, 10% or more of the total combined voting power of all classes of our voting stock,

US holders that have a principal place of business or tax home outside the United States, or

US holders whose functional currency is not the US dollar.



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

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

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

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***UK income taxation of distributions***

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

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

***US income taxation of distributions***

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

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

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

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

***UK taxation of capital gains***

A US holder that is not resident in the UK for UK tax purposes and who does not carry on a trade, profession or vocation in the UK through a branch or agency (or in the case of a company a permanent establishment) to which the ordinary shares or ADSs are attributable will not generally be liable for UK taxation on capital gains or eligible for relief for allowable losses, realized on the sale or other disposal of the ordinary shares or ADSs.

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

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

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

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

### ***Estate and gift tax***

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

### ***Stamp duty***

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

Following litigation, HM Revenue & Customs (HMRC) has accepted that it will no longer seek to apply the 1.5% SDRT charge when new shares are issued to a clearance service or depository receipt system on the basis that the charge is not compatible with EU law. HMRC's view is that the 1.5% SDRT or stamp duty charge will continue to apply to transfers of shares into a clearance service or depository receipt system, unless they are an integral part of an issue of share capital. This view is currently being challenged in further litigation. **Accordingly, specific professional advice should be sought before paying the 1.5% SDRT or stamp duty charge in any circumstances.**

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

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### ***Close company status***

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

### **Documents on display**

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

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

### **Introduction**

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

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

We have formulated policies for hedging exposures to interest rate and foreign exchange risk, and have used derivatives to ensure compliance with these policies. Although a proportion of our derivative contracts were transacted without regard to existing IFRS requirements on hedge accounting, during 2013 and 2012 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.

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

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

### **Currency exchange rates**

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

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

At December 31, 2013 the Group's net borrowings/(cash) in our main currencies (taking into account the effect of cross currency rate swaps) were: US dollar £1,631m, sterling £202m, and South African rand £(21)m.

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.

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### **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 2013 and 2012 the Group met the prescribed designation requirements and hedge effectiveness tests under IFRS for some of its derivative contracts. As a result, the movements in the fair value of the effective portion of fair value hedges and net investment hedges have been offset in earnings and reserves respectively by the corresponding movement in the fair value of the underlying hedged item.

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

### **Quantitative information about market risk**

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

## ***ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES AMERICAN DEPOSITARY SHARES***

### **Fees paid by ADR holders**

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

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

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

**Person depositing or withdrawing shares must pay to**

**the depository:**

\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

\$.02 (or less) per ADS

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

\$.02 (or less) per ADS per calendar year

Registration of transfer fees

Expenses of the depository

Taxes and other governmental charges the depository or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depository or its agents for servicing the deposited securities

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

The Company received payments from the depository with respect to 2013 of \$400,000 for standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing the annual and interim financial of reports, printing and distributing dividend cheques, electronic filing of U.S. Federal tax information, mailing required the forms, stationary, postage, facsimile and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees. In addition, the Company received a payment from the depository of \$80,649 as reimbursement of the 2013 continuing annual stock exchange listing fees.

The depository has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS programme. The depository has agreed to reimburse the Company for its continuing annual stock exchange listing fees. The depository has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consists of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend cheques, electronic filing of 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 depository has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depository will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depository collects from investors.

**For:**

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

Any cash distribution to ADS registered holders

Distribution of securities by the depository to ADS registered holders of deposited securities

Depository services

Transfer and registration of shares on the share register to or from the name of the depository or its agent when shares are deposited or withdrawn

Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)

Converting foreign currency to U.S. dollars

As necessary

As necessary





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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.

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**PART II**

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

None.

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

None.

**ITEM 15. *CONTROLS AND PROCEDURES***

**Disclosure controls and procedures**

An evaluation of the effectiveness our disclosure controls and procedures as of December 31, 2013 was carried out by management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as at December 31, 2013 at a reasonable assurance level. A controls system, no matter how well designed and operated, cannot provide absolute assurance to achieve its objectives.

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

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management has assessed the effectiveness of internal control over financial reporting as of December 31, 2013 based on the framework in *Internal Control - Integrated framework* (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as a December 31, 2013 based on criteria in *Internal Control - Integrated Framework* (1992) issued by the COSO.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the effectiveness of the Company's internal control over financial reporting as of December 31, 2013, as stated in their report which appears on page F-2.

**Change in internal control over financial reporting**

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

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

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

**Table of Contents****ITEM 16B. CODE OF ETHICS**

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

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

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

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

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

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

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

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

The following table sets forth remuneration paid to PwC for 2012 and 2013:

Auditors' Remuneration	2013 £m	2012 £m
Audit fees	6	6
Tax fees	4	2
All other fees	1	1

Audit fees include £35,000 (2012: £35,000) of audit fees relating to the audit of the parent company.

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

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

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

Not applicable.

**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
February 1, 2013 - February 28, 2013	1,000,000	£ 11.64	N/A	N/A
April 1, 2013 - April 30, 2013	1,000,000	£ 11.53	N/A	N/A
June 1, 2013 - June 30, 2013	1,972,725	£ 11.61	N/A	N/A
September 1, 2013 - September 30, 2013	139,192	£ 12.57	N/A	N/A

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

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

Not applicable.

**ITEM 16G. CORPORATE GOVERNANCE**

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

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not applicable.

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**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-71 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. l
2.8	Indenture dated May 8, 2012 between Pearson Funding Four plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. f
2.9	Indenture dated May 8, 2013 between Pearson Funding Five plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent.
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.

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

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

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**Report of Independent Registered Public Accounting Firm**

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated income statements, statements of comprehensive income, statements of changes in equity and cash flow statements present fairly, in all material respects, the financial position of Pearson plc and its subsidiaries (the Group) at December 31, 2013 and December 31, 2012 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with International Financial Reporting Standards as adopted by the European Union. Also in our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control Integrated Framework (1992) 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) and International Standards on Auditing. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control 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.

As discussed in note 1 to the financial statements, the Group has changed its method of accounting for employee benefits in each of the three years in the period ended December 31, 2013 due to the adoption of IAS 19 Employee Benefits (2011).

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

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

**/s/PricewaterhouseCoopers LLP**

**London**

**United Kingdom**

**March 27, 2014**



**Table of Contents****Consolidated income statement****Year ended 31 December 2013**

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
Sales	2	<b>5,069</b>	4,959	4,728
Cost of goods sold	4	<b>(2,312)</b>	(2,187)	(2,039)
<b>Gross profit</b>		<b>2,757</b>	2,772	2,689
Operating expenses	4	<b>(2,353)</b>	(2,181)	(2,035)
Profit on sale of associate				412
Loss on closure of subsidiary			(113)	
Share of results of joint ventures and associates	12	<b>54</b>	9	33
<b>Operating profit</b>	2	<b>458</b>	487	1,099
Finance costs	6	<b>(111)</b>	(115)	(103)
Finance income	6	<b>35</b>	19	22
<b>Profit before tax</b>		<b>382</b>	391	1,018
Income tax	7	<b>(87)</b>	(138)	(154)
<b>Profit for the year from continuing operations</b>		<b>295</b>	253	864
Profit for the year from discontinued operations	3	<b>244</b>	61	81
<b>Profit for the year</b>		<b>539</b>	314	945
<b>Attributable to:</b>				
Equity holders of the company		<b>538</b>	311	946
Non-controlling interest		<b>1</b>	3	(1)
<b>Earnings per share for profit from continuing and discontinued operations attributable to equity holders of the company during the year</b> (expressed in pence per share)				
basic	8	<b>66.6p</b>	38.7p	118.2p
diluted	8	<b>66.5p</b>	38.6p	118.0p
<b>Earnings per share for profit from continuing operations attributable to equity holders of the company during the year</b> (expressed in pence per share)				
basic	8	<b>36.4p</b>	31.1p	108.1p
diluted	8	<b>36.3p</b>	31.0p	107.9p

**Table of Contents****Consolidated statement of comprehensive income**

Year ended 31 December 2013

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
Profit for the year		<b>539</b>	314	945
<b>Items that may be reclassified to the income statement</b>				
Net exchange differences on translation of foreign operations	Group	<b>(206)</b>	(238)	(44)
Net exchange differences on translation of foreign operations	associates	<b>(11)</b>		
Currency translation adjustment disposed	Group	<b>(18)</b>		
Attributable tax	7	<b>6</b>	1	(4)
<b>Items that are not reclassified to the income statement</b>				
Remeasurement of retirement benefit obligations	Group	<b>25</b>	(100)	(42)
Remeasurement of retirement benefit obligations	associates		(3)	(8)
Attributable tax	7	<b>(23)</b>	50	4
<b>Other comprehensive expense for the year</b>		<b>(173)</b>	(290)	(94)
<b>Total comprehensive income for the year</b>		<b>366</b>	24	851
<b>Attributable to:</b>				
Equity holders of the company		<b>369</b>	23	858
Non-controlling interest		<b>(3)</b>	1	(7)

**Table of Contents****Consolidated balance sheet**

As at 31 December 2013

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

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<b>Net assets</b>		<b>5,706</b>	5,710
<b>Equity</b>			
Share capital	27	<b>205</b>	204
Share premium	27	<b>2,568</b>	2,555
Treasury shares	28	<b>(98)</b>	(103)
Translation reserve		<b>(103)</b>	128
Retained earnings		<b>3,128</b>	2,902
<b>Total equity attributable to equity holders of the company</b>		<b>5,700</b>	5,686
Non-controlling interest		<b>6</b>	24
<b>Total equity</b>		<b>5,706</b>	5,710

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

**Robin Freestone Chief financial officer**

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**Table of Contents****Consolidated statement of changes in equity****Year ended 31 December 2013**

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

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

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All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Restated Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2011	203	2,524	(137)	402	2,546	5,538	67	5,605
Profit for the year					946	946	(1)	945
Other comprehensive expense				(38)	(50)	(88)	(6)	(94)
Equity-settled transactions					40	40		40
Tax on equity-settled transactions					3	3		3
Issue of ordinary shares under share option schemes	1	20				21		21
Purchase of treasury shares			(60)			(60)		(60)
Release of treasury shares			48		(48)			
Put options over non-controlling interest					(63)	(63)		(63)
Changes in non-controlling interest					(76)	(76)	(40)	(116)
Dividends					(318)	(318)	(1)	(319)
<b>At 31 December 2011</b>	<b>204</b>	<b>2,544</b>	<b>(149)</b>	<b>364</b>	<b>2,980</b>	<b>5,943</b>	<b>19</b>	<b>5,962</b>

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.

**Table of Contents****Consolidated cash flow statement****Year ended 31 December 2013**

All figures in £ millions	Notes	2013	2012	2011
<b>Cash flows from operating activities</b>				
Net cash generated from operations	34	684	916	1,093
Interest paid		(82)	(75)	(70)
Tax paid		(246)	(65)	(151)
<b>Net cash generated from operating activities</b>		<b>356</b>	<b>776</b>	<b>872</b>
<b>Cash flows from investing activities</b>				
Acquisition of subsidiaries, net of cash acquired	30	(48)	(716)	(779)
Acquisition of joint ventures and associates		(10)	(39)	(9)
Purchase of investments		(64)	(10)	(12)
Purchase of property, plant and equipment		(118)	(78)	(67)
Purchase of intangible assets		(64)	(73)	(77)
Disposal of subsidiaries, net of cash disposed	31	(132)	(11)	(6)
Proceeds from sale of associates		2		428
Proceeds from sale of investments		2		75
Proceeds from sale of property, plant and equipment	34	28	1	9
Proceeds from sale of intangible assets		2	3	3
Proceeds from sale of liquid resources		13	23	
Investment in liquid resources		(14)	(19)	
Interest received		9	9	10
Dividends received from joint ventures and associates		64	27	30
<b>Net cash used in investing activities</b>		<b>(330)</b>	<b>(883)</b>	<b>(395)</b>
<b>Cash flows from financing activities</b>				
Proceeds from issue of ordinary shares	27	14	11	21
Purchase of treasury shares	28	(47)		(60)
Proceeds from borrowings		319	327	
Proceeds from the sale of liquid resources				2
Loans to related parties		(44)		
Loans advanced		(5)		
Liquid resources acquired			(1)	
Repayment of borrowings		(225)		(318)
Finance lease principal payments		(8)	(8)	(8)
Dividends paid to company's shareholders	9	(372)	(346)	(318)
Dividends paid to non-controlling interest			(2)	(1)
Transactions with non-controlling interest	33	(76)	(4)	(108)
<b>Net cash used in financing activities</b>		<b>(444)</b>	<b>(23)</b>	<b>(790)</b>
Effects of exchange rate changes on cash and cash equivalents		21	(24)	(60)
<b>Net decrease in cash and cash equivalents</b>		<b>(397)</b>	<b>(154)</b>	<b>(373)</b>
Cash and cash equivalents at beginning of year		1,137	1,291	1,664
<b>Cash and cash equivalents at end of year</b>	17	<b>740</b>	<b>1,137</b>	<b>1,291</b>

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





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### **Notes to the consolidated financial statements**

#### **General information**

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 10 March 2014.

#### **1. Accounting policies**

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

##### **a. Basis of preparation**

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

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

##### *1. Interpretations and amendments to published standards effective 2013*

The following amendments and interpretations were adopted in 2013:

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

Operating profit reduced by £4m.

Net finance costs increased by £15m.

Income tax charge reduced by £4m.

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

The 2011 results have been restated for IAS 19 (2011) with the results as follows:

Operating profit reduced by £4m

Net finance costs increased by £10m

Income tax charge reduced by £3m

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The remeasurement of retirement benefit obligations charge in the statement of other comprehensive income reduced by £11m

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

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### **Notes to the consolidated financial statements continued**

#### **1. Accounting policies continued**

##### **a. Basis of preparation continued**

Amendments to IAS 1 Presentation of Financial Statements Presentation of Items and Other Comprehensive Income, effective for annual reporting periods beginning on or after 1 July 2012. The amendments require the grouping of items in other comprehensive income into those that may be reclassified to the income statement in subsequent periods, and those that will not. The statement of other comprehensive income has been updated to present this information.

The IASB issued a package of five new and amended standards together. IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosures of Involvement with Other Entities have been issued. IAS 27 Separate Financial Statements (Revised 2011) has been amended following the issuance of IFRS 10 and retains the guidance for separate financial statements. IAS 28 Investments in Associates and Joint Ventures (Revised 2011) has been amended following the issuance of IFRS 10 and IFRS 11. All three new standards and two amended standards are not mandatory for the Group until 1 January 2014. However, the Group has early adopted these standards and amendments as of 1 January 2013.

IFRS 13 Fair Value Measurement, effective for annual reporting periods beginning on or after 1 January 2013. The standard defines fair value, provides guidance on its determination, and introduces disclosure requirements on fair value measurements.

Amendments to IFRS 7, Financial Instruments Disclosures regarding asset and liability offsetting. Amendments to IAS 36, Impairment of assets, on the recoverable amount disclosures for non-financial assets. This amendment removed certain disclosures of the recoverable amount of CGUs which had been included in IAS 36 by the issue of IFRS 13. The amendment is not mandatory for the Group until 1 January 2014. However, the Group has early adopted the amendments as of 1 January 2013.

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

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

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

IFRS 9 Financial Instruments, effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities. The Group is yet to assess the full impact of IFRS 9, and will do so once the remaining sections of the standard are completed.

IFRIC 21, Levies details the accounting for an obligation to pay a levy that is not income tax. As the Group is not currently subjected to significant levies the impact on the Group is not material.

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

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

Intangible assets: Goodwill

Intangible assets: Pre-publication assets

Taxation

Employee benefits: Pension obligations

Revenue recognition

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**Table of Contents****Notes to the consolidated financial statements continued****1. Accounting policies continued****b. Consolidation**

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

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

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

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

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

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

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

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

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**Notes to the consolidated financial statements continued**

**1. Accounting policies continued**

**c. Foreign currency translation**

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

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

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

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

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

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.57 (2012: \$1.59) and the year end rate was \$1.66 (2012: \$1.63).

**d. Property, plant and equipment**

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

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

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

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

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**Notes to the consolidated financial statements continued****1. Accounting policies continued****e. Intangible assets**

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

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

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

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

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

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

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

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

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### **Notes to the consolidated financial statements continued**

#### **1. Accounting policies continued**

##### **e. Intangible assets continued**

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

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

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

##### **f. Other financial assets**

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

##### **g. Inventories**

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

##### **h. Royalty advances**

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

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

##### **i. Cash and cash equivalents**

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

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





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### **Notes to the consolidated financial statements continued**

#### **1. Accounting policies continued**

##### **j. Share capital**

Ordinary shares are classified as equity.

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

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

##### **k. Borrowings**

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

##### **l. Derivative financial instruments**

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

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

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

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

##### **m. Taxation**

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

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



## **Table of Contents**

### **Notes to the consolidated financial statements continued**

#### **1. Accounting policies continued**

##### **m. Taxation continued**

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

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

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

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

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

##### **n. Employee benefits**

*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 and longevity.

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

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

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

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**Notes to the consolidated financial statements continued**

**1. Accounting policies continued**

**n. Employee benefits continued**

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

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

**o. Provisions**

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

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

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

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

**p. Revenue recognition**

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

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

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

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

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a



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### **Notes to the consolidated financial statements continued**

#### **1. Accounting policies continued**

##### **p. Revenue recognition continued**

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.

##### **q. Leases**

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

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

##### **r. Dividends**

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

##### **s. Assets and liabilities held for sale**

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

##### **t. Trade receivables**

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

**Table of Contents****Notes to the consolidated financial statements continued****2. Segment information**

The Group is organised into the following business segments:

Continuing operations:

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

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

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

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

In addition the Group separately discloses the results of the Penguin Random House (PRH) associate. The results of the Penguin segment to 30 June 2013 and the Mergermarket business (previously included as part of the FT Group) are shown as discontinued in 2011, 2012 and 2013.

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

All figures in £ millions	Notes	2013							Group
		North American Education	International Education	Professional	FT Group	PRH	Corporate	Discontinued operations	
<b>Continuing operations</b>									
Sales (external)		2,779	1,539	410	341				5,069
Sales (inter-segment)		3	1	15					19
<b>Operating profit</b>		312	55	45	26	20			458
Finance costs	6								(111)
Finance income	6								35
<b>Profit before tax</b>									382
Income tax	7								(87)
<b>Profit for the year from continuing operations</b>									295
Segment assets		5,544	2,311	609	293		859	223	9,839
Joint ventures	12		3						3
Associates	12	1	9		8	1,070	1		1,089
<b>Total assets</b>		5,545	2,323	609	301	1,070	860	223	10,931
<b>Other segment items</b>									
Share of results of joint ventures and associates	12	(1)	(4)	2	26	31			54
Capital expenditure	10, 11	92	37	23	22			1	175



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Pre-publication investment	20	<b>288</b>	<b>69</b>	<b>7</b>			<b>364</b>
Depreciation	10	<b>43</b>	<b>21</b>	<b>8</b>	<b>9</b>	<b>1</b>	<b>82</b>
Amortisation	11, 20	<b>355</b>	<b>141</b>	<b>22</b>	<b>15</b>	<b>2</b>	<b>535</b>

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**Table of Contents****Notes to the consolidated financial statements continued****2. Segment information continued**

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

**Table of Contents****Notes to the consolidated financial statements continued****2. Segment information continued**

All figures in £ millions	Notes	2011 Restated					Discontinued operations	Group
		North American Education	International Education	Professional	FT Group	Corporate		
<b>Continuing operations</b>								
Sales (external)		2,584	1,424	382	338			4,728
Sales (inter-segment)		3		9				12
<b>Operating profit</b>		463	119	55	462			1,099
Finance costs	6							(103)
Finance income	6							22
<b>Profit before tax</b>								1,018
Income tax	7							(154)
<b>Profit for the year from continuing operations</b>								<b>864</b>
Segment assets		5,198	2,388	626	196	1,555	1,249	11,212
Joint ventures	12		16		1		1	18
Associates	12	1	8		4		1	14
<b>Total assets</b>		<b>5,199</b>	<b>2,412</b>	<b>626</b>	<b>201</b>	<b>1,555</b>	<b>1,251</b>	<b>11,244</b>
<b>Other segment items</b>								
Share of result of joint ventures and associates	12		(2)	1	34			33
Capital expenditure	10,11	75	33	17	18		13	156
Pre-publication investment	20	237	60	2			32	331
Depreciation	10	36	14	8	3		9	70
Amortisation	11,20	309	128	16	14		51	518

In 2013, sales from the provision of goods were £2,867m (2012: £2,946m; 2011: £3,009m) and sales from the provision of services were £2,202m (2012: £2,013m; 2011: £1,719m). 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 including discontinued operations on an appropriate basis depending on the nature of the cost and therefore the segment result is equal to the Group operating profit. Inter-segment pricing is determined on an arm's-length basis. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

**Table of Contents****Notes to the consolidated financial statements continued****2. Segment information continued**

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

The Group operates in the following main geographic areas:

All figures in £ millions	Sales			Non-current assets		
	2013	2012	2011	2013	2012	2011
<b>Continuing operations</b>						
UK	649	678	690	1,068	803	1,237
Other European countries	366	377	381	200	234	225
USA	2,913	2,756	2,667	5,026	4,496	4,325
Canada	128	144	150	301	307	226
Asia Pacific	624	633	504	495	524	570
Other countries	389	371	336	215	275	325
<b>Total continuing</b>	<b>5,069</b>	4,959	4,728	<b>7,305</b>	6,639	6,908
<b>Discontinued operations</b>						
UK	97	187	175			
Other European countries	49	92	90			
USA	369	647	646			
Canada	24	57	59			
Asia Pacific	74	153	142			
Other countries	8	17	22			
<b>Total discontinued</b>	<b>621</b>	1,153	1,134			
<b>Total</b>	<b>5,690</b>	6,112	5,862	<b>7,305</b>	6,639	6,908

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. The geographical split of non-current assets is based on the subsidiary's country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

**3. Discontinued operations**

Discontinued operations relate to Penguin and Mergermarket.

**Table of Contents****Notes to the consolidated financial statements continued****3. Discontinued operations continued**

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

All figures in £ millions	2013			2012			2011		
	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total
Sales	513	108	621	1,053	100	1,153	1,045	89	1,134
Operating profit	28	24	52	62	24	86	108	15	123
Finance income	1		1						
<b>Profit before tax</b>	<b>29</b>	<b>24</b>	<b>53</b>	62	24	86	108	15	123
Attributable tax expense	(9)	(9)	(18)	(19)	(6)	(25)	(37)	(5)	(42)
<b>Profit after tax</b>	<b>20</b>	<b>15</b>	<b>35</b>	43	18	61	71	10	81
Profit on disposal of Penguin before tax	202		202						
Attributable tax benefit	15		15						
Mergermarket transaction costs		(8)	(8)						
<b>Profit for the year from discontinued operations</b>	<b>237</b>	<b>7</b>	<b>244</b>	43	18	61	71	10	81
Operating cash flows	36	22	58	83	26	109	107	24	131
Investing cash flows	(6)	(2)	(8)	(81)	(24)	(105)	(13)	(1)	(14)
Financing cash flows	(8)	(29)	(37)	10	(6)	4	(71)	(15)	(86)
<b>Total cash flows</b>	<b>22</b>	<b>(9)</b>	<b>13</b>	12	(4)	8	23	8	31

**4. Operating expenses**

All figures in £ millions	2013	2012 Restated	2011 Restated
<b>By function:</b>			
Cost of goods sold	2,312	2,187	2,039
<b>Operating expenses</b>			
Distribution costs	90	82	88
Selling, marketing and product development costs	1,027	925	863
Administrative and other expenses	1,162	1,242	1,201
Restructuring costs	176		
Other net gains and losses	16	10	(23)
Other income	(118)	(78)	(94)
<b>Total net operating expenses</b>	<b>2,353</b>	<b>2,181</b>	<b>2,035</b>
<b>Total</b>	<b>4,665</b>	<b>4,368</b>	<b>4,074</b>



**Table of Contents****Notes to the consolidated financial statements continued****4. Operating expenses continued**

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

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
<b>By nature:</b>				
Royalties expensed		256	245	260
Other product costs		793	865	827
Employee benefit expense	5	2,100	1,866	1,731
Contract labour		194	137	114
Employee related expense		177	168	161
Promotional costs		167	155	121
Depreciation of property, plant and equipment	10	81	72	62
Amortisation of software		59	49	45
Amortisation of intangible assets Other		166	179	130
Amortisation of intangible assets Pre-publication	20	308	283	292
Property and facilities		229	188	156
Technology and communications		104	80	78
Professional and outsourced services		259	253	307
Other general and administrative costs		61	38	34
Capitalised costs		(199)	(162)	(139)
Acquisition costs		12	20	12
Other net gains and losses		16	10	(23)
Other income		(118)	(78)	(94)
<b>Total</b>		<b>4,665</b>	4,368	4,074

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

All figures in £ millions	2013	2012	2011
The audit of parent company and consolidated financial statements	4	4	4
The audit of the company's subsidiaries	2	2	2
<b>Total audit fees</b>	<b>6</b>	<b>6</b>	<b>6</b>
Other assurance services	1	1	
<b>Total assurance services</b>	<b>1</b>	<b>1</b>	
Tax compliance services	2	1	1
Tax advisory services	2	1	1
<b>Total tax services</b>	<b>4</b>	<b>2</b>	<b>2</b>
<b>Corporate finance services not covered above</b>			<b>1</b>
<b>Total non-audit services</b>	<b>5</b>	<b>3</b>	<b>3</b>
<b>Total</b>	<b>11</b>	<b>9</b>	<b>9</b>

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

All figures in £ millions	2013	2012	2011
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	6	6	6
Non-audit fees	5	3	3
<b>Total</b>	<b>11</b>	<b>9</b>	<b>9</b>

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

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**Table of Contents****Notes to the consolidated financial statements continued****5. Employee information**

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
<b>Employee benefit expense</b>				
Wages and salaries (including termination benefits and restructuring costs)		<b>1,836</b>	1,610	1,485
Social security costs		<b>136</b>	129	123
Share-based payment costs	26	<b>35</b>	28	36
Retirement benefits – defined contribution plans	25	<b>66</b>	69	60
Retirement benefits – defined benefit plans	25	<b>27</b>	26	24
Other post-retirement benefits	25		4	3
<b>Total</b>		<b>2,100</b>	1,866	1,731

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

Average number employed	2013	2012	2011
<b>Employee numbers</b>			
North American Education	<b>19,670</b>	18,552	16,133
International Education	<b>16,113</b>	16,751	13,646
Professional	<b>3,357</b>	3,706	4,561
FT Group	<b>2,216</b>	2,243	2,055
Other	<b>759</b>	883	859
<b>Continuing operations</b>	<b>42,115</b>	42,135	37,254

The employee benefit expense relating to discontinued operations was £168m (2012: £265m; 2011: £256m) and the average number employed was 3,592 (2012: 5,387; 2011: 4,267).

**6. Net finance costs**

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
Interest payable		<b>(82)</b>	(75)	(65)
Net finance costs in respect of retirement benefits	25	<b>(3)</b>	(2)	(7)
Finance cost of put options, deferred consideration associated with acquisitions and other interest charges related to transactions		<b>(9)</b>	(27)	(4)
Net foreign exchange losses			(8)	(22)
<b>Other losses on financial instruments in a hedging relationship:</b>				
fair value hedges			(1)	
<b>Other losses on financial instruments not in a hedging relationship:</b>				
derivatives		<b>(17)</b>	(2)	(5)
<b>Finance costs</b>		<b>(111)</b>	(115)	(103)

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Interest receivable	10	10	10
Net foreign exchange gains	20	9	11
<b>Other gains on financial instruments in a hedging relationship:</b>			
fair value hedges	1		
<b>Other gains on financial instruments not in a hedging relationship:</b>			
amortisation of transitional adjustments on bonds			1
derivatives	4		
<b>Finance income</b>	<b>35</b>	<b>19</b>	<b>22</b>
<b>Net finance costs</b>	<b>(76)</b>	<b>(96)</b>	<b>(81)</b>

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**Table of Contents****Notes to the consolidated financial statements continued****6. Net finance costs continued**

The net gain of £1m on fair value hedges in 2013 (2012: net loss of £1m; 2011: £nil) comprises a gain of £95m (2012: gain of £7m; 2011: loss of £39m) on the underlying bonds, offset by a loss of £94m (2012: loss of £8m; 2011: gain of £39m) on the related derivative financial instruments.

**7. Income tax**

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
<b>Current tax</b>				
Charge in respect of current year		(129)	(147)	(180)
Adjustments in respect of prior years		(7)	18	36
<b>Total current tax charge</b>		<b>(136)</b>	<b>(129)</b>	<b>(144)</b>
<b>Deferred tax</b>				
In respect of temporary differences		14	(45)	(14)
Other adjustments in respect of prior years		35	36	4
<b>Total deferred tax credit/(charge)</b>	13	<b>49</b>	<b>(9)</b>	<b>(10)</b>
<b>Total tax charge</b>		<b>(87)</b>	<b>(138)</b>	<b>(154)</b>

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

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

All figures in £ millions	2013	2012 Restated	2011 Restated
Profit before tax	382	391	1,018
Tax calculated at UK rate (2013: 23.25%, 2012: 24.5%, 2011: 26.5%)	(89)	(96)	(270)
Effect of overseas tax rates	(13)	(51)	(26)
Joint venture and associate income reported net of tax	13	2	9
Net (expense)/income not subject to tax	(14)	(15)	7
(Loss)/gain on sale of businesses not subject to tax	(6)	(28)	88
Utilisation of previously unrecognised tax losses and credits	1	2	1
Unutilised tax losses	(7)	(6)	(3)
Adjustments in respect of prior years	28	54	40
<b>Total tax charge</b>	<b>(87)</b>	<b>(138)</b>	<b>(154)</b>
<b>UK</b>	<b>(13)</b>	<b>(14)</b>	<b>(5)</b>
<b>Overseas</b>	<b>(74)</b>	<b>(124)</b>	<b>(149)</b>

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<b>Total tax charge</b>	<b>(87)</b>	<b>(138)</b>	<b>(154)</b>
Tax rate reflected in earnings	<b>22.8%</b>	35.3%	15.1%

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**Table of Contents****Notes to the consolidated financial statements continued****7. Income tax continued**

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

<b>All figures in £ millions</b>	<b>2013</b>	2012 Restated	2011 Restated
Remeasurement of retirement benefit obligations	(23)	50	4
Net exchange differences on translation of foreign operations	6	1	(4)
	(17)	51	

A tax charge of £nil (2012: tax benefit £6m; 2011: tax benefit £3m) 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.

<b>All figures in £ millions</b>	Notes	<b>2013</b>	2012 Restated	2011 Restated
Profit for the year from continuing operations		295	253	864
Non-controlling interest		(1)	(3)	1
<b>Earnings from continuing operations</b>		<b>294</b>	250	865
Profit for the year from discontinued operations	3	244	61	81
Non-controlling interest				
<b>Earnings</b>		<b>538</b>	311	946
Weighted average number of shares (millions)		807.8	804.3	800.2
Effect of dilutive share options (millions)		1.1	1.3	1.7
Weighted average number of shares (millions) for diluted earnings		808.9	805.6	801.9
<b>Earnings per share from continuing and discontinued operations</b>				
Basic		66.6p	38.7p	118.2p
Diluted		66.5p	38.6p	118.0p

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<b>Earnings per share from continuing operations</b>			
Basic	<b>36.4p</b>	31.1p	108.1p
Diluted	<b>36.3p</b>	31.0p	107.9p
<b>Earnings per share from discontinued operations</b>			
Basic	<b>30.2p</b>	7.6p	10.1p
Diluted	<b>30.2p</b>	7.6p	10.1p

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**Table of Contents****Notes to the consolidated financial statements continued****9. Dividends**

All figures in £ millions	2013	2012	2011
Final paid in respect of prior year 30.0p (2012: 28.0p; 2011: 25.7p)	242	225	206
Interim paid in respect of current year 16.0p (2012: 15.0p; 2011: 14.0p)	130	121	112
	372	346	318

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

**10. Property, plant and equipment**

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

**Table of Contents****Notes to the consolidated financial statements continued****10. Property, plant and equipment continued**

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

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

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



**Table of Contents****Notes to the consolidated financial statements continued****11. Intangible assets**

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

**Table of Contents****Notes to the consolidated financial statements continued****11. Intangible assets continued**

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

**Goodwill**

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

**Other intangible assets**

Other intangibles acquired include content, technology and software rights.

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



**Table of Contents****Notes to the consolidated financial statements continued****11. Intangible assets continued****Other intangible assets continued**

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

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

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

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

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

**Impairment tests for cash-generating units containing goodwill**

Impairment tests have been carried out where appropriate as described below. The recoverable amount for each unit tested exceeds its carrying value.

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

All figures in £ millions	2013	2012
US Education Publishing	2,225	2,384
US School Assessment and Information	750	773
Canada	173	188
International Emerging Markets	423	463
International UK	444	450
International Rest of World	253	267
Professional Publishing	14	15
Professional Assessment and Training	334	334
<b>Pearson Education total</b>	<b>4,616</b>	<b>4,874</b>

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Financial Times	50	51
<b>Continuing operations</b>	<b>4,666</b>	4,925
Mergermarket		152
<b>Discontinued operations</b>		152
<b>Total</b>	<b>4,666</b>	5,077

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**Table of Contents****Notes to the consolidated financial statements continued****11. Intangible assets continued****Impairment tests for cash-generating units containing goodwill continued**

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

**Key assumptions**

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

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

**Perpetuity growth rates** A perpetuity growth rate of 2.0% was used for cash flows subsequent to the approved budget period for all CGUs in 2013 (2012: 2.0%). This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates.

**Cash flow growth rates** The cash flow growth rates are derived from management's latest forecast of sales taking into consideration experience of operating margins achieved in the CGU. Historically, such forecasts have been reasonably accurate.

**Sensitivities**

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group's sensitivity analysis, a reasonably possible change in any of these assumptions is unlikely to cause an impairment in any of the CGUs.

**12. Investments in joint ventures and associates**

The amounts recognised in the balance sheet are as follows:

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

The amounts recognised in the income statement are as follows:

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

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**Table of Contents****Notes to the consolidated financial statements continued****12. Investments in joint ventures and associates continued****Investment in associates**

The Group has the following material associates:

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

\*Neither associate has a quoted market price.

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

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

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

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

Gross profit for Penguin Random House for 2013 was £697m.



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

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**Table of Contents****Notes to the consolidated financial statements continued****12. Investments in joint ventures and associates continued****Investment in associates continued**

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

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

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2013	2012
Loss from continuing operations	(1)	
Other comprehensive income		
<b>Total comprehensive expense</b>	<b>(1)</b>	

**Transactions with material associates**

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

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

**Investment in joint ventures**

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

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

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**Table of Contents****Notes to the consolidated financial statements continued****13. Deferred income tax**

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

Substantially all of the deferred tax assets are expected to be recovered after more than one year.

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. At 31 December 2013 the Group has unrecognised deferred income tax assets of £4m (2012: £13m) in respect of UK losses, £11m (2012: £14m) in respect of US losses and approximately £36m (2012: £30m) in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them. The US losses relate to state taxes and therefore have expiry periods of between 5 and 20 years.

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

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

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

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

**Table of Contents****Notes to the consolidated financial statements continued****13. Deferred income tax continued**

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

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

Other deferred income tax assets include temporary differences on share-based payments, inventory and other provisions.

All figures in £ millions	Goodwill and intangibles	Other	Total
<b>Deferred income tax liabilities</b>			
At 1 January 2012	(464)	(156)	(620)
Exchange differences	18	5	23
Acquisition through business combination	(65)	(21)	(86)
Disposal through business disposal	11		11
Income statement benefit	15	35	50
Tax benefit to other comprehensive income or equity		1	1
Transfer to assets held for sale	10	10	20
<b>At 31 December 2012</b>	<b>(475)</b>	<b>(126)</b>	<b>(601)</b>
Exchange differences	13	2	15
Acquisition through business combination	(61)	3	(58)
Income statement (charge)/benefit	(61)	90	29
Tax benefit to other comprehensive income or equity		1	1
Transfer to assets held for sale		2	2

<b>At 31 December 2013</b>	<b>(584)</b>	<b>(28)</b>	<b>(612)</b>
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Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

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**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:

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

**Table of Contents****Notes to the consolidated financial statements continued****14. Classification of financial instruments continued**

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

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.



**Table of Contents****Notes to the consolidated financial statements continued****14. Classification of financial instruments continued**

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

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

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

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

**15. Other financial assets**

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

Other financial assets comprise non-current unlisted securities.

**16. Derivative financial instruments**

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

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

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Later than five years	604		(48)	830	105
<b>Total</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>	<b>1,746</b>	<b>178</b>

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**Table of Contents****Notes to the consolidated financial statements continued****16. Derivative financial instruments continued**

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

At the end of 2013, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross-currency rate derivatives, was US dollar £(151)m, sterling £243m and South African rand £(16)m (2012: US dollar £(59)m, sterling £257m and South African rand £(20)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2013 range from 1.10% to 9.28% (2012: 3.65% to 9.28%) and the floating rates are based on LIBOR in US dollar and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

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

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

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

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

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

**17. Cash and cash equivalents (excluding overdrafts)**

<b>All figures in £ millions</b>	<b>2013</b>	2012
Cash at bank and in hand	<b>521</b>	372

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Short-term bank deposits	208	690
<b>Continuing operations</b>	<b>729</b>	<b>1,062</b>
Cash at bank and in hand classified within assets held for sale	36	115
	<b>765</b>	<b>1,177</b>

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**Table of Contents****Notes to the consolidated financial statements continued****17. Cash and cash equivalents (excluding overdrafts) continued**

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

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

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

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

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

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

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

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

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

**Table of Contents****Notes to the consolidated financial statements continued****18. Financial liabilities Borrowings**

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

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

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

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

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



**Table of Contents****Notes to the consolidated financial statements continued****18. Financial liabilities – Borrowings continued**

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

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

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

All figures in £ millions	2013	2012
US dollar	1,645	1,684
Sterling	559	573
Other	22	22
	<b>2,226</b>	2,279

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

All figures in £ millions	2013	2012
<b>Floating rate</b>		
expiring within one year		
expiring beyond one year	1,057	1,077
	<b>1,057</b>	1,077



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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.

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**Table of Contents****Notes to the consolidated financial statements continued****18. Financial liabilities – Borrowings continued**

The maturity of the Group's finance lease obligations is as follows:

All figures in £ millions	2013	2012
<b>Finance lease liabilities – minimum lease payments</b>		
Not later than one year	6	10
Later than one year and not later than two years	4	4
Later than two years and not later than three years	1	3
Later than three years and not later than four years		
Later than four years and not later than five years		
Later than five years		
Future finance charges on finance leases		
<b>Present value of finance lease liabilities</b>	<b>11</b>	<b>17</b>

The present value of finance lease liabilities is as follows:

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

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

**19. Financial risk management**

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

**Treasury policy**

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

The audit committee receives reports on the Group's treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.



**Table of Contents****Notes to the consolidated financial statements continued****19. Financial risk management continued****Interest rate risk management**

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39 Financial Instruments: Recognition and Measurement) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2013 the fixed to floating hedging ratio, on the above basis, was approximately 45%:55%. A simultaneous 1% change on 1 January 2014 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £11m effect on profit before tax.

**Use of interest rate derivatives**

The policy described in the section above creates a group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a second group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates. The Group's accounting objective in its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces sharply the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

**Liquidity and refinancing risk management**

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2013 the average maturity of gross borrowings was 4.2 years (2012: 3.9 years) of which bonds represented 97% (2012: 97%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of the Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. In January 2014 Moody's changed the outlook on their short-term and long-term ratings from Stable to Negative. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2013 the committed facilities amounted to £1,057m and their weighted average maturity was 1.9 years.

**Table of Contents****Notes to the consolidated financial statements continued****19. Financial risk management continued****Analysis of Group debt, including the impact of derivatives**

The following tables analyse the Group's sources of funding and the impact of derivatives on the Group's debt instruments.

The Group's net debt position is set out below:

<b>All figures in £ millions</b>	<b>2013</b>	<b>2012</b>
Cash and cash equivalents	<b>729</b>	1,062
Marketable securities	<b>6</b>	6
Derivative financial instruments	<b>76</b>	178
Bank loans, overdrafts and loan notes	<b>(47)</b>	(55)
Bonds	<b>(2,168)</b>	(2,200)
Finance lease liabilities	<b>(11)</b>	(17)
<b>Continuing operations</b>	<b>(1,415)</b>	(1,026)
Cash and cash equivalents classified within assets held for sale	<b>36</b>	115
Bank loans, overdrafts and loan notes classified within liabilities held for sale		(7)
<b>Net debt</b>	<b>(1,379)</b>	(918)

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

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

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

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

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

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<b>All figures in £ millions</b>	<b>Less than one year</b>	<b>One to five years</b>	<b>More than five years</b>	<b>Total</b>
Re-pricing profile of borrowings	533	1,124	569	2,226
Effect of rate derivatives	1,026	(422)	(604)	
<b>Total</b>	<b>1,559</b>	<b>702</b>	<b>(35)</b>	<b>2,226</b>

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**Table of Contents****Notes to the consolidated financial statements continued****19. Financial risk management continued****Analysis of Group debt, including the impact of derivatives continued**

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

All figures in £ millions	2013			Total
	USD	GBP	Other	
Not later than one year	434	316	113	863
Later than one year and not later than five years	1,000	106		1,106
Later than five years	648			648
<b>Total</b>	<b>2,082</b>	<b>422</b>	<b>113</b>	<b>2,617</b>

**Analysed as:**

Bonds	1,918	604		2,522
Rate derivatives inflows	(350)	(248)		(598)
Rate derivatives outflows	359	1	16	376
Trade payables	155	65	97	317
<b>Total</b>	<b>2,082</b>	<b>422</b>	<b>113</b>	<b>2,617</b>

All figures in £ millions	2012			Total
	USD	GBP	Other	
Not later than one year	489	126	142	757
Later than one year and not later than five years	726	357	21	1,104
Later than five years	863			863
<b>Total</b>	<b>2,078</b>	<b>483</b>	<b>163</b>	<b>2,724</b>

**Analysed as:**

Bonds	1,837	639		2,476
Rate derivatives inflows	(326)	(264)		(590)
Rate derivatives outflows	328	3	22	353
Trade payables	239	105	141	485
<b>Total</b>	<b>2,078</b>	<b>483</b>	<b>163</b>	<b>2,724</b>

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**

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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.

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**Table of Contents****Notes to the consolidated financial statements continued****19. Financial risk management continued****Foreign currency risk management**

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross-currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. Our policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross-currency swaps) were: US dollar £1,631m, sterling £202m and South African rand £(21)m.

**Use of currency debt and currency derivatives**

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

**Financial instruments fair value measurement**

The following table provides an analysis of those financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

**Table of Contents****Notes to the consolidated financial statements continued****19. Financial risk management continued****Financial instruments fair value measurement continued**

All figures in £ millions	2013				2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Financial assets at fair value</b>								
Derivative financial assets		124		124		178		178
Marketable securities		6		6		6		6
<b>Available for sale financial assets</b>								
Investments in unlisted securities continuing operations			94	94			30	30
Investments in unlisted securities classified within assets held for sale							1	1
<b>Financial liabilities at fair value</b>								
Derivative financial liabilities		(48)		(48)				
Other financial liabilities put options over non-controlling interest							(68)	(68)
<b>Total</b>		<b>82</b>	<b>94</b>	<b>176</b>		<b>184</b>	<b>(37)</b>	<b>147</b>

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

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

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets. In 2012, the fair value of other financial liabilities represents the present value of the estimated future liability, which is defined in contractual agreements and is usually based on an earnings multiple.

**Table of Contents****Notes to the consolidated financial statements continued****19. Financial risk management continued****Financial instruments sensitivity analysis**

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

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

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

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

**Table of Contents****Notes to the consolidated financial statements continued****20. Intangible assets Pre-publication**

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

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

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

**21. Inventories**

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

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £472m (2012: £512m). In 2013 £53m (2012: £71m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.



**Table of Contents****Notes to the consolidated financial statements continued****22. Trade and other receivables**

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

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns. The movements on the provision for bad and doubtful debts are as follows:

All figures in £ millions	2013	2012
At beginning of year	(55)	(102)
Exchange differences	5	4
Income statement movements	(27)	(21)
Utilised	18	53
Acquisition through business combination		(1)
Transfer to assets classified as held for sale	1	12
<b>At end of year</b>	<b>(58)</b>	<b>(55)</b>

Concentrations of credit risk with respect to trade receivables are limited due to the Group's large number of customers, who are internationally dispersed.

The ageing of the Group's trade receivables is as follows:

All figures in £ millions	2013	2012
Within due date	783	774
Up to three months past due date	194	231
Three to six months past due date	36	43
Six to nine months past due date	22	10
Nine to 12 months past due date	9	7
More than 12 months past due date	1	5

<b>Total trade receivables</b>	<b>1,045</b>	<b>1,070</b>
Less: provision for sales returns	(163)	(187)
<b>Net trade receivables</b>	<b>882</b>	<b>883</b>

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.

**Table of Contents****Notes to the consolidated financial statements continued****23. Provisions for other liabilities and charges**

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

Analysis of provisions:

All figures in £ millions	Deferred consideration	Property	2013 Disposals and closures	Legal and other	Total
Current	5	10	67	30	112
Non-current	53	1		23	77
	<b>58</b>	<b>11</b>	<b>67</b>	<b>53</b>	<b>189</b>

			2012		
Current	6	12	15	5	38
Non-current	58	14		38	110
	<b>64</b>	<b>26</b>	<b>15</b>	<b>43</b>	<b>148</b>

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



**Table of Contents****Notes to the consolidated financial statements continued****24. Trade and other liabilities**

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

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

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

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

**25. Retirement benefit and other post-retirement obligations****Background**

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

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

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

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<i>%</i>	<b>Active</b>	<b>Deferred</b>	<b>Pensioners</b>	<b>Total</b>
Defined benefit	<b>3</b>	<b>25</b>	<b>32</b>	<b>60</b>
Defined contribution	<b>17</b>	<b>23</b>		<b>40</b>
<b>Total</b>	<b>20</b>	<b>48</b>	<b>32</b>	<b>100</b>

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**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Background continued**

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

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

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

**Assumptions**

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

%	2013			2012			2011		
	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.4	2.5	2.5	3.0	2.5	2.5	3.0	2.5	2.5
Rate used to discount plan liabilities	4.4	4.4	4.4	4.4	3.6	3.6	4.9	4.2	4.2
Expected rate of increase in salaries	3.9	3.9	4.0	3.5	3.9		4.0	4.0	
Expected rate of increase for pensions in payment and deferred pensions	2.3 to 5.1			2.3 to 5.1			2.4 to 4.3		
Initial rate of increase in healthcare rate			7.5			8.0			7.5
Ultimate rate of increase in healthcare rate			5.0			5.0			5.0

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.4% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.6% has been used.

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

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

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

**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Assumptions continued**

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows:

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

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

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

**Financial statement information**

The amounts recognised in the income statement are as follows:

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

All figures in £ millions	UK Group plan	Defined benefit other	2012 Restated			Total
			Sub-total	Defined contribution	PRMB	

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Current service cost	23	3	26	78	4	108
Administration expenses	4		4			4
<b>Total operating expense</b>	<b>27</b>	<b>3</b>	<b>30</b>	<b>78</b>	<b>4</b>	<b>112</b>
Interest on plan assets	(98)	(6)	(104)			(104)
Interest on plan liabilities	96	7	103		3	106
<b>Net finance (income)/expense</b>	<b>(2)</b>	<b>1</b>	<b>(1)</b>		<b>3</b>	<b>2</b>
<b>Net income statement charge</b>	<b>25</b>	<b>4</b>	<b>29</b>	<b>78</b>	<b>7</b>	<b>114</b>

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**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Financial statement information continued**

All figures in £ millions	UK Group plan	Defined benefit other	2011 Restated		PRMB	Total
			Sub-total	Defined contribution		
Current service cost	21	3	24	69	3	96
Administration expenses	4		4			4
<b>Total operating expense</b>	<b>25</b>	<b>3</b>	<b>28</b>	<b>69</b>	<b>3</b>	<b>100</b>
Expected return on plan assets	(97)	(7)	(104)			(104)
Interest on plan liabilities	100	8	108		3	111
<b>Net finance (income)/expense</b>	<b>3</b>	<b>1</b>	<b>4</b>		<b>3</b>	<b>7</b>
<b>Net income statement charge</b>	<b>28</b>	<b>4</b>	<b>32</b>	<b>69</b>	<b>6</b>	<b>107</b>

Included within the 2013 results are discontinued operations consisting of a £2m charge (2012: £4m charge; 2011: £4m charge) relating to defined benefit schemes and a £6m charge (2012: £9m charge; 2011: £9m charge) relating to defined contribution schemes.

The amounts recognised in the balance sheet are as follows:

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

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

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

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<b>All figures in £ millions</b>	<b>2013</b>	2012 Restated	2011 Restated
Amounts recognised for defined benefit plans	<b>70</b>	(95)	(33)
Amounts recognised for post-retirement medical benefit plans	<b>9</b>	(5)	(9)
<b>Total recognised in year</b>	<b>79</b>	(100)	(42)

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**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Financial statement information continued**

The fair value of plan assets comprises the following:

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

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

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

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

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

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



**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Financial statement information continued**

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

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

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

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

All figures in £ millions	2013	2012
Opening defined benefit obligation	(89)	(85)
Exchange differences	1	4
Current service cost	(4)	(4)
Curtailments	4	
Interest cost	(3)	(3)

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Actuarial gains/(losses) experience		2
Actuarial gains/(losses) financial	9	(7)
Benefits paid	5	4
<b>Closing defined benefit obligation</b>	<b>(77)</b>	<b>(89)</b>

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**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Funding**

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

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

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

**Sensitivities**

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

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

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

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

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

All figures in £ millions	2013 0.5% increase	2013 0.5% decrease
<b>Effect:</b>		
Increase/(decrease) in defined benefit obligation UK Group plan	106.1	(99.5)

Increase/(decrease) in defined benefit obligation	US plan	<b>0.2</b>	<b>(0.3)</b>
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**Table of Contents****Notes to the consolidated financial statements continued****25. Retirement benefit and other post-retirement obligations continued****Sensitivities continued**

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

**26. Share-based payments**

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

All figures in £ millions	2013	2012	2011
Pearson plans	35	28	36

Share-based payment charges included in discontinued operations amounted to £2m (2012: £4m; 2011: £4m).

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

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

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

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

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

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

**Table of Contents****Notes to the consolidated financial statements continued****26. Share-based payments continued**

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

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

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

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

	2013		2012	
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				
5 - 10	2,792	2.31	3,373	2.56
>10				
	<b>2,792</b>	<b>2.31</b>	<b>3,373</b>	<b>2.56</b>

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

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

	2013 Weighted average	2012 Weighted average
Fair value	£ 2.27	£ 2.38

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Weighted average share price	£	<b>11.71</b>	£	11.51
Weighted average exercise price	£	<b>9.14</b>	£	9.09
Expected volatility		<b>22.05%</b>		23.62%
Expected life		<b>3.8 years</b>		3.8 years
Risk free rate		<b>0.53%</b>		0.74%
Expected dividend yield		<b>3.84%</b>		3.65%
Forfeiture rate		<b>3.3%</b>		3.3%

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**Table of Contents****Notes to the consolidated financial statements continued****26. Share-based payments continued**

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

The following shares were granted under restricted share arrangements:

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

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Participants under both plans are entitled to dividends during the vesting period and therefore the share price is not discounted.

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

**27. Share capital and share premium**

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

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

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

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



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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.

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**Table of Contents****Notes to the consolidated financial statements continued****28. Treasury shares**

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

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

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

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

**29. Other comprehensive income**

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

**Table of Contents****Notes to the consolidated financial statements continued****29. Other comprehensive income continued**

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

		2011 Restated			Non- controlling interest	Total
		Translation reserve	Attributable to equity holders of the company Retained earnings	Total		
All figures in £ millions						
<b>Items that may be reclassified to the income statement</b>						
Net exchange differences on translation of foreign operations	Group	(38)		(38)	(6)	(44)
Attributable tax			(4)	(4)		(4)
<b>Items that are not reclassified to the income statement</b>						
Remeasurement of retirement benefit obligations	Group		(42)	(42)		(42)
Remeasurement of retirement benefit obligations	associate		(8)	(8)		(8)
Attributable tax			4	4		4
<b>Other comprehensive expense for the year</b>		(38)	(50)	(88)	(6)	(94)

**30. Business combinations**

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

**Table of Contents****Notes to the consolidated financial statements continued****30. Business combinations continued**

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

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

**Table of Contents****Notes to the consolidated financial statements continued****30. Business combinations continued**

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

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

Intangible assets acquired in 2012 and recognised in 2013 have the following useful economic lives:

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

All figures in £ millions	2013	2012	2011
<b>Cash flow on acquisitions</b>			
Cash Current year acquisitions	(25)	(682)	(913)
Deferred payments for prior year acquisitions and other items	(6)	(31)	(5)
Cash and cash equivalents acquired	2	34	151
Acquisition costs and other acquisition liabilities paid	(19)	(37)	(12)
<b>Net cash outflow</b>	<b>(48)</b>	<b>(716)</b>	<b>(779)</b>

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

**31. Disposals including business closures**

All figures in £ millions	Penguin	2013 Other	Total	2012 Total	2011 Total
<b>Disposal of subsidiaries</b>					
Property, plant and equipment	(39)	(3)	(42)	(3)	
Intangible assets	(43)		(43)	(45)	(4)
Investment in joint ventures and associates	(22)		(22)		
Other financial assets	(1)		(1)		
Intangible assets Pre-publication	(20)	(6)	(26)		
Inventories	(91)	(3)	(94)		(7)
Trade and other receivables	(447)	(6)	(453)		(5)
Cash and cash equivalents (excluding overdrafts)	(34)	(3)	(37)		(6)
Net deferred income tax (assets)/liabilities	(22)		(22)	11	1
Retirement benefit obligations		4	4		1
Provisions for other liabilities and charges	7		7		
Trade and other liabilities	224	10	234		2
Current income tax liabilities					1
Non-controlling interest	3		3		7
Attributable goodwill	(370)	(6)	(376)	(50)	(4)
Cumulative translation adjustment	18		18		
<b>Net assets disposed</b>	<b>(837)</b>	<b>(13)</b>	<b>(850)</b>	<b>(87)</b>	<b>(14)</b>
Cash received		3	3		

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Fair value of associate acquired	<b>1,160</b>		<b>1,160</b>		
Costs	(121)	(14)	(135)	(26)	
<b>Gain/(loss) on disposal</b>	<b>202</b>	<b>(24)</b>	<b>178</b>	(113)	(14)

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**Table of Contents****Notes to the consolidated financial statements continued****31. Disposals including business closures continued**

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

All figures in £ millions	2013	2012	2011
<b>Cash flow from disposals</b>			
Cash – current year disposals	<b>3</b>		
Cash and cash equivalents disposed	<b>(37)</b>		(6)
Costs and other disposal liabilities paid	<b>(98)</b>	(11)	
<b>Net cash outflow</b>	<b>(132)</b>	(11)	(6)

The disposal in 2012 includes the write down of assets resulting from the closure of Pearson in Practice. The disposal in 2011 relates to Longman Nigeria.

**32. Held for sale**

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

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

**33. Transactions with non-controlling interest**

In 2013 the Group purchased non-controlling interests in the Southern African business for £65m, and in the Indian business for £11m. In 2012 the Group increased its investments in its subsidiaries in China at a cost of £4m. In 2011 the remaining non-controlling interest in Sistema Educational Brasileiro was acquired for £108m.





**Table of Contents****Notes to the consolidated financial statements continued****34. Cash generated from operations**

All figures in £ millions	Notes	2013	2012 Restated	2011 Restated
Profit		<b>539</b>	314	945
<b>Adjustments for:</b>				
Income tax		<b>90</b>	163	196
Depreciation	10	<b>82</b>	80	70
Intangible charges	11	<b>168</b>	183	139
Amortisation of other intangible assets	11	<b>59</b>	54	48
Net finance costs		<b>75</b>	96	81
Share of results of joint ventures and associates	12	<b>(54)</b>	(9)	(33)
(Profit)/loss on disposals		<b>(187)</b>	113	(435)
Acquisition costs		<b>12</b>	21	12
Costs on formation of Penguin Random House			32	
Net foreign exchange adjustment from transactions		<b>(40)</b>	(21)	24
Share-based payment costs	26	<b>37</b>	32	40
Pre-publication		<b>(77)</b>	(55)	2
Inventories		<b>18</b>	49	15
Trade and other receivables		<b>(50)</b>	(94)	(9)
Trade and other liabilities		<b>72</b>		31
Retirement benefit obligations		<b>(57)</b>	(37)	(61)
Provisions for other liabilities and charges		<b>(3)</b>	(5)	28
<b>Net cash generated from operations</b>		<b>684</b>	916	1,093

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.

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

All figures in £ millions	2013	2012	2011
Net book amount	<b>19</b>	1	9
Profit on sale of property, plant and equipment	<b>9</b>		
<b>Proceeds from sale of property, plant and equipment</b>	<b>28</b>	1	9

**35. Contingencies**

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

**36. Commitments**

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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

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**Table of Contents****Notes to the consolidated financial statements continued****36. Commitments continued**

have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £183m (2012: £169m; 2011: £162m).

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

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

**37. Related party transactions****Joint ventures and associates**

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

**Key management personnel**

Key management personnel are deemed to be the members of the board of directors of Pearson plc. It is this board which had responsibility for planning, directing and controlling the activities of the Group in 2013. Key management personnel compensation is disclosed in Item 6. Directors, Senior Management and Employees Compensation of Senior Management.

There were no other material related party transactions.

No guarantees have been provided to related parties.

**38. Events after the balance sheet date**

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

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**SIGNATURES**

The registrant hereby certifies that it meets the requirements for filing a form 20-F and that it has caused and authorized the undersigned for sign this annual report on its behalf.

Pearson plc

/s/ Robin Freestone  
Robin Freestone  
Chief Financial Officer

Date: March 27, 2014