

# Financial statements: contents

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## Independent auditors' report to the members of Pearson plc

### Report on the financial statements

#### Our opinion

In our opinion:

- › Pearson plc's consolidated financial statements and company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the company's affairs as at 31 December 2014 and of the Group's profit and the Group's and the company's cash flows for the year then ended
- › The consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union
- › The company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006
- › The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

#### Separate opinion in relation to IFRSs as issued by the IASB

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

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

#### What we have audited

Pearson plc's financial statements comprise:

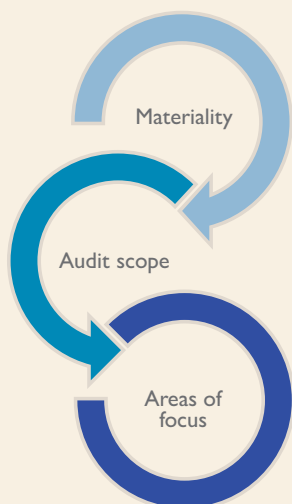
- › The consolidated and company balance sheets as at 31 December 2014
- › The consolidated income statement and consolidated statement of comprehensive income for the year then ended
- › The consolidated and company statements of changes in equity and cash flow statements for the year then ended
- › The notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

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

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

### Our audit approach

#### Overview



- › Overall Group materiality: £26m, which represents 4% of adjusted profit before tax as disclosed in note 8. Refer to page 119 for further details.
- › We conducted work in five key territories: US, UK, Brazil, China and South Africa. In addition we obtained an audit opinion on the financial information reported by the associate Penguin Random House (PRH)
- › The territories where we conducted audit procedures, together with work performed at corporate functions, shared service centres and consolidated Group level, accounted for approximately: 68% of the Group's revenue; 74% of the Group's statutory profit before tax; and 65% of the Group's adjusted profit before tax.
- › We focused on:
  - Revenue recognition for multiple element and long-term revenue contracts
  - Goodwill and intangible assets impairment reviews
  - Provision for uncertain tax liabilities
  - Returns provisions
  - Recoverability of pre-publication assets and inventories
  - Acquisitions and disposals.

### The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)).

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated and company financial statements. In particular, we looked at where management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as areas of focus in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the consolidated and company financial statements as a whole. Any comments we make on the results of our procedures should be read in this context. For each area of focus below, to the extent relevant, we evaluated the design and tested the operating effectiveness of key internal controls over financial reporting set in place by management, including testing the operation of IT systems from which financial information is generated. Each of the areas of focus below are also referred to in the audit committee report on pages 74 to 75 and in the accounting policies on pages 128 to 135. This is not a complete list of all risks identified by our audit.

#### Area of focus

#### How our audit addressed the area of focus

### Revenue recognition for multiple element and long-term revenue contracts

**Refer to note 1 to the consolidated financial statements** There are two types of complex contracts that require significant judgements and estimates, which could be subject to either accidental errors or deliberate fraud:

- › Multiple element arrangements, such as the sale of physical textbooks accompanied by digital content or supplementary workbooks, where revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its fair value
- › Certain long-term contracts that span year end, where revenue is recognised using estimated percentage of completion based on costs. These include contracts to design, develop and deliver testing and accreditation and contracts to secure students and support the online delivery of their teaching.

These complex contracts generate material deferred revenue and accrued income balances and are areas where misstatements in the underlying assumptions or estimation calculations could have a material effect on the financial statements.

Where books are sold together with workbooks delivered later or companion digital materials available online we assessed the basis for allocation of the purchase price between each element and then tested the detailed calculations supporting these revenue deferrals. We used our knowledge of the Group and its industry to assess the completeness of identification of such arrangements. We found the revenue deferrals to be based on reasonable estimates of the relative fair value of each element and the methods used to calculate the deferrals properly calculated and consistently applied.

For a selection of the larger, more judgemental and more recent long-term contracts, covering both testing activities and online delivery of teaching, we read the contracts and assessed the accounting policy and methodologies being applied to calculate the proportion of revenue being recognised. We also tested costs incurred to date and management's estimates of forecast costs and revenues by reference to historical experience and current contract status, including examining correspondence where contracts are experiencing disputes.

Our testing showed that revenue recognition practices are in accordance with Group policies with appropriate methods for calculating the revenue recognised.

## Independent auditors' report to the members of Pearson plc continued

### Area of focus

### How our audit addressed the area of focus

#### Goodwill and intangible assets impairment reviews

Refer to note 11 to the consolidated financial statements At year end the Group has £5,030m of goodwill and £1,280m of other intangible assets including software, acquired customer lists, contracts and relationships, acquired trademarks and brands and acquired publishing rights.

The carrying values of goodwill and intangible assets are contingent on future cash flows and there is risk that, if these cash flows do not meet the Group's expectations, the assets might be impaired. The impairment reviews performed by management contain a number of significant judgements and estimates including cash generating unit (CGU) identification, revenue growth, profit margins and discount rate.

As part of the Group restructuring during the year, management identified a new set of aggregated CGUs and reallocated goodwill accordingly. These changes included a new North America aggregated CGU and the disaggregation of the Growth segment into its main constituent countries (refer to note 11 for details).

For the larger aggregated CGUs management's model identified significant headroom. In respect of the India CGU management recorded an impairment charge of £77m.

We evaluated and challenged management's identification and aggregation of CGUs in light of the new Group structure and tested the allocation of goodwill to these aggregated CGUs. In our view management's decision to disaggregate the Growth segment into its main constituent countries appropriately reflects the relative independence of these operations. For the aggregated CGUs in North America and Core markets, management demonstrated reasonable bases for the aggregations, reflecting their relatively high levels of integration and synergies.

We tested the mathematical integrity of the forecasts and carrying values in management's impairment model. We obtained board approved cash flow forecasts to agree them to management's impairment analysis and challenged key judgements and estimates within them. We assessed the discount rates applied to each aggregated CGU by comparison to third-party data and to the Group's cost of capital and relevant risk factors. We compared short and long-term growth rates, including cash conversion, to historical trends and expectations. We also considered the accuracy of prior period forecasts.

We performed sensitivity analyses around these key assumptions to ascertain the extent of change either individually or collectively that would indicate impairment. We considered the likelihood of such a movement and the adequacy of the disclosures made regarding the assumptions and sensitivities.

For CGUs where headroom was limited we assessed management's sensitivity disclosures to check these were appropriate.

We checked for additional impairment triggers by reading board minutes, holding regular discussions with Group and local management, and examining the performance of recently acquired businesses to identify underperforming operations. We did not identify any further impairments.

## Area of focus

## How our audit addressed the area of focus

**Provision for uncertain tax liabilities**

Refer to notes 7 and 13 to the consolidated financial statements The Group is subject to several tax regimes due to the geographical diversity of its businesses.

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

Changes in assumptions about the views that might be taken by tax authorities can materially impact the level of provisions recorded in the financial statements and there are significant judgements in estimating the amount of any provision required.

We obtained an understanding of the Group's tax strategy to identify tax risks relating to business and legislative developments. To assess the adequacy of the Group's tax provisions we first recalculated the valuation of tax provisions and determined whether the treatments adopted were in line with the Group's tax policies and had been applied consistently.

We then evaluated key underlying assumptions about tax authority views on the Group's tax arrangements, particularly in the US and in territories with new cross-border tax structures. In doing this we considered the status of recent and current tax authority audits and enquiries, the outturn of previous claims, judgemental positions taken in tax returns and current year estimates, and developments in the tax environment.

We were satisfied that management's provision estimates for uncertain tax positions were consistent with our own assessment of the related risks and correspondence with the relevant tax authorities.

**Returns provisions**

There are material, judgemental provisions for anticipated book returns on the balance sheet as at 31 December 2014, particularly in US Higher Education.

As the Group transitions from print to digital the returns profile might change to either decrease (as less books are shipped) or increase (if bookstores underestimate the speed of digital change and over-order traditional textbooks).

We performed testing over returns provisions in a number of locations, including US Higher Education.

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

We also performed detailed testing of shipment and returns provisioning. This included checking cut-off at year end and evaluating whether any changes in shipping volumes around year end might increase the risk of returns. No misstatements were identified.

We evaluated changes in estimates to check they were not indicators of management bias. We found the estimates used by management in the determination of the returns provisions to appropriately reflect both past experience and changes in the business.

## Independent auditors' report to the members of Pearson plc continued

### Area of focus

#### Recoverability of pre-publication assets and inventories

Refer to notes 20 and 21 to the consolidated financial statements. The Group has £820m of pre-publication assets and £224m of inventories at 31 December 2014. Pre-publication assets represent direct costs incurred in the development of education programmes and titles prior to their publication and inventories are unsold stock, usually physical textbooks.

Judgement is required to assess the recoverability of these assets; this is further complicated by the transition to digital as the Group invests in new, less proven, digital content and platforms.

#### Acquisitions and disposals

Refer to notes 30 and 31 to the consolidated financial statements. In February 2014 the Group acquired Grupo Multi for £437m, recognising £240m of goodwill and £254m of intangible assets. This is a significant transaction requiring judgement to identify and value the intangible assets and assess their subsequent recoverability.

As part of the Penguin Random House transaction the Group recorded an estimated £59m provision in 2013 for the cost of transferring the pension liability guarantee for Penguin employees to Bertelsmann. It was concluded during 2014 that Pearson would retain responsibility for this pension liability. The provision has been released within discontinued operations in the current year.

In February 2014 the Group sold Mergermarket for £375m, resulting in a gain on disposal of £245m pre-tax and judgemental classification as discontinued operations.

### How our audit addressed the area of focus

We first selected a sample of costs deferred to the balance sheet as pre-publication assets or inventories to test their appropriateness and magnitude.

We then assessed the amortisation profiles of pre-publication assets against cash flows to test that the existing amortisation profiles remained appropriate in light of the transition towards digital products.

We challenged the carrying value of certain pre-publication assets and inventories where sales have been lower than originally anticipated. We assessed forecast cash flows against historical experience and obtained supporting evidence for management's explanations.

We found the Group's policies to be appropriate and consistently applied. While the carrying value of some assets depends on management's expectation of growth in future sales from them, overall we considered the carrying values of pre-publication assets and inventories to be reasonable.

The Group engagement team visited Brazil and met with local management of Grupo Multi to gain an understanding of the business.

We performed detailed testing over the acquisition accounting, including fair value adjustments such as identification and valuation of intangible assets. Post-acquisition performance and forecasts were assessed to identify potential impairment triggers.

We obtained the communication between Pearson and Bertelsmann confirming that Pearson will retain responsibility for the pension liability of the legacy Penguin employees. We tested the appropriate reversal of the provision within discontinued operations.

We tested the gain on disposal for Mergermarket by agreeing the consideration to sales documents and cash received and agreed the net assets disposed to underlying records. We also evaluated its presentation in the Annual report.

No material misstatements were identified by our testing and we found that relevant disclosures were included in the Annual report.

### How we tailored our audit scope

We tailored our audit scope to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group is organised into three reportable segments, being North America, Core and Growth, plus the investment in associate Penguin Random House. Each segment comprises a number of reporting units. The consolidated financial statements comprise these reporting units plus the Group's centralised functions.

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

During the year the Group engagement team visited each of the US, Brazilian, Chinese and South African component audit teams; held a planning meeting attended by partners from the Group engagement team and our UK and US component teams; and had regular dialogue with component teams throughout the year.

We identified two reporting units in the US and UK that required an audit of their complete financial information due to size alone, plus a further 13 reporting units in the US, UK, Brazil, China and South Africa that required either an audit or specified procedures on certain transactions and balances. We also obtained an audit opinion on the financial information of the associate Penguin Random House. The Group consolidation, financial statement disclosures and corporate functions were audited by the Group engagement team. This included our work over derivative financial instruments, hedge accounting, goodwill and intangible assets impairment reviews, litigation, pensions and share-based payments.

The reporting units where we performed audit work, together with work performed at corporate functions, shared service centres and consolidated Group level, accounted for approximately 74% of the Group's statutory profit before tax and 65% of adjusted profit before tax. This provided the evidence we needed for our opinion on the consolidated financial statements taken as a whole.

**Materiality** The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

<b>Overall group materiality</b>	£26m (2013: £32m)
<b>How we determined it</b>	4% of adjusted profit before tax of £658m
<b>Rationale for benchmark applied</b>	Note 8 explains that the Group's principal measure of performance is adjusted operating profit (£722m), which excludes one-off gains and losses and acquired intangible asset amortisation, in order to present results from operating activities on a consistent basis. From adjusted operating profit we deducted net finance costs of £64m (see note 8) because these reflect recurring finance charges. To the resulting adjusted profit before tax we then applied 4% (rather than the usual 5%) as our materiality calculation was based on this adjusted measure

We agreed with the audit committee that we would report to them misstatements identified during our audit above £2m (2013: £2m) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

## Independent auditors' report to the members of Pearson plc continued

**Going concern** Under the Listing Rules we are required to review the directors' statement, set out on page 107, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and company have adequate resources to remain in

operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

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

### Other required reporting

#### Consistency of other information

**Companies Act 2006 opinion** In our opinion, the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### ISAs (UK & Ireland) reporting

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

› Information in the Annual report is:

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

We have no exceptions to report arising from this responsibility.

› The statement given by the directors on page 108, in accordance with provision C.1.1 of the UK Corporate Governance Code (the 'Code'), that they consider the Annual report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and company's performance, business model and strategy is materially inconsistent with our knowledge of the Group and company acquired in the course of performing our audit.

We have no exceptions to report arising from this responsibility.

› The section of the Annual report on pages 74 and 75, as required by provision C.3.8 of the Code, describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

We have no exceptions to report arising from this responsibility.

#### Adequacy of accounting records and information and explanations received

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

- › We have not received all the information and explanations we require for our audit
- › Adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us

› The company financial statements and the part of the directors' remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.



## Directors' remuneration

**Directors' remuneration report – Companies Act 2006 opinion** In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

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

## Corporate governance statement

Under the Listing Rules we are required to review the part of the corporate governance statement relating to the company's compliance with ten provisions of the Code. We have nothing to report having performed our review.

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the directors

As explained more fully in the statement of directors' responsibilities set out on page 109, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- › Whether the accounting policies are appropriate to the group's and the company's circumstances and have been consistently applied and adequately disclosed
- › The reasonableness of significant accounting estimates made by the directors
- › The overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary, to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non financial information in the Annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Stuart Newman (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London, United Kingdom

9 March 2015

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

# Consolidated income statement

Year ended 31 December 2014

All figures in £ millions	Notes	2014	2013
Sales	2	4,874	5,069
Cost of goods sold	4	(2,202)	(2,312)
<b>Gross profit</b>		<b>2,672</b>	<b>2,757</b>
Operating expenses	4	(2,325)	(2,353)
Share of results of joint ventures and associates	12	51	54
<b>Operating profit</b>	2	<b>398</b>	<b>458</b>
Finance costs	6	(141)	(111)
Finance income	6	48	35
<b>Profit before tax</b>		<b>305</b>	<b>382</b>
Income tax	7	(63)	(87)
<b>Profit for the year from continuing operations</b>		<b>242</b>	<b>295</b>
Profit for the year from discontinued operations	3	228	244
<b>Profit for the year</b>		<b>470</b>	<b>539</b>
<b>Attributable to:</b>			
Equity holders of the company		471	538
Non-controlling interest		(1)	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	58.1p	66.6p
– diluted	8	58.0p	66.5p
<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	30.0p	36.4p
– diluted	8	29.9p	36.3p

# Consolidated statement of comprehensive income

Year ended 31 December 2014

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

# Consolidated balance sheet

As at 31 December 2014

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

# Consolidated balance sheet continued

As at 31 December 2014

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

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

Robin Freestone Chief financial officer

# Consolidated statement of changes in equity

Year ended 31 December 2014

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

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

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

# Consolidated cash flow statement

Year ended 31 December 2014

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

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

# Notes to the consolidated financial statements

## General information

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

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

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

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

## 1. Accounting policies

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

### a. Basis of preparation

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

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

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

- › Amendments to IFRS 10, IFRS 12 and IAS 27, 'Investment Entities', effective for annual reporting periods beginning on or after 1 January 2014. These amendments provide an exemption from consolidation of subsidiaries for entities which meet the definition of an investment entity.

- › Amendments to IAS 39, 'Novation of Derivatives and Continuation of Hedge Accounting', effective for annual reporting periods beginning on or after 1 January 2014. The amendments mean there would be no need to discontinue hedge accounting if a hedge derivative was novated and certain criteria met.

- › Amendments to IAS 32, 'Financial Instruments: Presentation', effective for annual reporting periods beginning on or after 1 January 2014. The amendments clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet.

- › IFRIC 21 'Levies', effective for annual reporting periods beginning on or after 1 January 2014. This details the accounting for an obligation to pay a levy that is not income tax.

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

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

- › IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities. The Group is yet to assess the full impact of IFRS 9.

- › IFRS 15 'Revenue from Contracts with Customers', effective for annual reporting periods beginning on or after 1 January 2017. The new standard specifies how and when an entity will recognise revenue, and requires more detailed disclosure. Adoption of the new standard is likely to have an impact on the Group and management is currently assessing the impact.

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



## I. Accounting policies continued

### a. Basis of preparation continued

Consolidation: Business combinations – determination of fair values

Consolidation: Business combinations – classification of investments

Intangible assets: Goodwill

Intangible assets: Pre-publication assets

Taxation

Employee benefits: Pensions

Revenue recognition

### b. Consolidation

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

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

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

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

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

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

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

### 3. Transactions with non-controlling interests

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

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

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

## Notes to the consolidated financial statements continued

### I. Accounting policies continued

#### b. Consolidation continued

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

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

#### c. Foreign currency translation

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

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

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

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

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

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

#### d. Property, plant and equipment

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

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

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

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

#### e. Intangible assets

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

## 1. Accounting policies continued

### e. Intangible assets continued

acquired. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

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

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

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

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

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

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

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

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

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

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.

## Notes to the consolidated financial statements continued

### I. Accounting policies continued

#### g. Inventories

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

#### h. Royalty advances

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

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

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

#### i. Cash and cash equivalents

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

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

#### j. Share capital

Ordinary shares are classified as equity.

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

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

#### k. Borrowings

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

#### l. Derivative financial instruments

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

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.

## I. Accounting policies continued

### I. Derivative financial instruments continued

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

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

### m. Taxation

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

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

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

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

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

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide

provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business.

The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

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

### n. Employee benefits

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

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

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

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

## Notes to the consolidated financial statements continued

### 1. Accounting policies continued

#### n. Employee benefits continued

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.

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

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

#### o. Provisions

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

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

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

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

#### p. Revenue recognition

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

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

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

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

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Percentage of completion is calculated on a cost basis using the proportion of the total estimated costs incurred to date. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.



## l. Accounting policies continued

### p. Revenue recognition continued

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

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

### q. Leases

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

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

### r. Dividends

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

### s. Assets and liabilities held for sale

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

### t. Trade receivables

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

## 2. Segment information

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

Continuing operations:

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

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

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

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

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

Figures for 2013 have been restated to reflect the new segments.

## Notes to the consolidated financial statements continued

## 2. Segment information continued

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

All figures in £ millions	Notes							2014
		North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
<b>Continuing operations</b>								
Sales		2,974	1,154	746	–	–	–	4,874
Adjusted operating profit		464	152	35	69	–	–	720
Intangible charges		(110)	(22)	(132)	(54)	–	–	(318)
Acquisition costs		(2)	(1)	(3)	–	–	–	(6)
Other net gains and losses		2	–	–	–	–	–	2
<b>Operating profit/(loss)</b>		<b>354</b>	<b>129</b>	<b>(100)</b>	<b>15</b>	<b>–</b>	<b>–</b>	<b>398</b>
Finance costs	6							(141)
Finance income	6							48
<b>Profit before tax</b>								<b>305</b>
Income tax	7							(63)
<b>Profit for the year from continuing operations</b>								<b>242</b>
Segment assets		6,646	1,566	1,407	–	660	–	10,279
Joint ventures	12	1	9	3	–	–	–	13
Associates	12	1	9	–	1,095	–	–	1,105
<b>Total assets</b>		<b>6,648</b>	<b>1,584</b>	<b>1,410</b>	<b>1,095</b>	<b>660</b>	<b>–</b>	<b>11,397</b>
<b>Other segment items</b>								
Share of results of joint ventures and associates	12	–	19	(3)	35	–	–	51
Capital expenditure	10, 11	97	48	49	–	–	–	194
Pre-publication investment	20	209	77	72	–	–	–	358
Depreciation	10	41	17	16	–	–	–	74
Amortisation	11, 20	309	112	121	–	–	–	542
Impairment	11	–	–	77	–	–	–	77



## 2. Segment information continued

								2013
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
<b>Continuing operations</b>								
Sales		3,073	1,258	738	–	–	–	5,069
Adjusted operating profit		474	120	38	50	–	–	682
Intangible charges		(106)	(27)	(33)	(30)	–	–	(196)
Acquisition costs		(2)	(3)	(7)	–	–	–	(12)
Other net gains and losses		–	(16)	–	–	–	–	(16)
<b>Operating profit/(loss)</b>		<b>366</b>	<b>74</b>	<b>(2)</b>	<b>20</b>	<b>–</b>	<b>–</b>	<b>458</b>
Finance costs	6							(111)
Finance income	6							35
<b>Profit before tax</b>								<b>382</b>
Income tax	7							(87)
<b>Profit for the year from continuing operations</b>								<b>295</b>
<b>Segment assets</b>								
Segment assets		6,326	1,450	981	–	859	223	9,839
Joint ventures	12	1	–	2	–	–	–	3
Associates	12	1	18	–	1,070	–	–	1,089
<b>Total assets</b>		<b>6,328</b>	<b>1,468</b>	<b>983</b>	<b>1,070</b>	<b>859</b>	<b>223</b>	<b>10,931</b>
<b>Other segment items</b>								
Share of results of joint ventures and associates	12	1	26	(4)	31	–	–	54
Capital expenditure	10, 11	95	46	33	–	–	1	175
Pre-publication investment	20	202	90	72	–	–	–	364
Depreciation	10	46	19	16	–	–	1	82
Amortisation	11, 20	287	143	103	–	–	2	535
Impairment		–	–	–	–	–	–	–

For further information on adjusted measures above, see note 8.

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

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

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

## Notes to the consolidated financial statements continued

### 2. Segment information continued

In 2014, sales from the provision of goods were £2,711m (2013: £2,867m) and sales from the provision of services were £2,163m (2013: £2,202m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing and other service businesses are classified as being from the provision of services. There were no material inter-segment sales.

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

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

The Group operates in the following main geographic areas:

All figures in £ millions	Sales		Non-current assets	
	2014	2013	2014	2013
<b>Continuing operations</b>				
UK	610	649	1,056	1,068
Other European countries	347	366	180	200
US	2,826	2,913	5,243	5,026
Canada	110	128	288	301
Asia Pacific	598	624	416	495
Other countries	383	389	661	215
<b>Total continuing</b>	<b>4,874</b>	<b>5,069</b>	<b>7,844</b>	<b>7,305</b>
<b>Discontinued operations</b>				
UK	4	97	–	–
Other European countries	–	49	–	–
US	4	369	–	–
Canada	–	24	–	–
Asia Pacific	1	74	–	–
Other countries	–	8	–	–
<b>Total discontinued</b>	<b>9</b>	<b>621</b>	<b>–</b>	<b>–</b>
<b>Total</b>	<b>4,883</b>	<b>5,690</b>	<b>7,844</b>	<b>7,305</b>

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.

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

All figures in £ millions	2014			2013		
	Penguin	Mergermarket	Total	Penguin	Mergermarket	Total
Sales	–	9	9	513	108	621
Operating profit	–	2	2	28	24	52
Finance income	–	–	–	1	–	1
<b>Profit before tax</b>	–	2	2	29	24	53
Income tax	–	(1)	(1)	(9)	(9)	(18)
<b>Profit after tax</b>	–	1	1	20	15	35
Profit on disposal of Penguin	29	–	29	202	–	202
Attributable tax benefit	–	–	–	15	–	15
Profit on disposal of Mergermarket	–	244	244	–	–	–
Attributable tax expense	–	(46)	(46)	–	–	–
Mergermarket transaction costs	–	–	–	–	(8)	(8)
<b>Profit for the year from discontinued operations</b>	29	199	228	237	7	244
Operating cash flows	–	2	2	36	22	58
Investing cash flows	–	–	–	(6)	(2)	(8)
Financing cash flows	–	–	–	(8)	(29)	(37)
<b>Total cash flows</b>	–	2	2	22	(9)	13

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

### 4. Operating expenses

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

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

## Notes to the consolidated financial statements continued

## 4. Operating expenses continued

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

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

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

#### 4. Operating expenses continued

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

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

#### 5. Employee information

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

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

Average number employed	2014	2013
<b>Employee numbers</b>		
North America	21,204	22,146
Core	7,887	8,807
Growth	11,603	10,975
Other	182	187
<b>Continuing operations</b>	<b>40,876</b>	<b>42,115</b>

The employee benefit expense relating to discontinued operations was £5m (2013: £168m) and the average number employed was 73 (2013: 3,592).

## Notes to the consolidated financial statements continued

## 6. Net finance costs

All figures in £ millions	Notes	2014	2013
Interest payable		(82)	(82)
Net finance costs in respect of retirement benefits	25	–	(3)
Finance cost of put options, deferred consideration associated with acquisitions and other interest charges related to transactions		–	(9)
Net foreign exchange losses		(53)	–
<b>Other losses on financial instruments not in a hedging relationship:</b>			
– derivatives		(6)	(17)
<b>Finance costs</b>		<b>(141)</b>	<b>(111)</b>
Interest receivable		18	10
Net finance income in respect of retirement benefits	25	1	–
Net foreign exchange gains		17	20
<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>			
– derivatives		12	4
<b>Finance income</b>		<b>48</b>	<b>35</b>
<b>Net finance costs</b>		<b>(93)</b>	<b>(76)</b>
<b>Analysed as:</b>			
Net interest payable reflected in adjusted earnings		(64)	(72)
Other net finance costs		(29)	(4)
<b>Total net finance costs</b>		<b>(93)</b>	<b>(76)</b>

Included in interest receivable is £1m (2013: £:nil) of interest receivable from related parties. The net movement of £nil on fair value hedges in 2014 (2013: net gain of £1m) comprises a loss of £27m (2013: gain of £95m) on the underlying bonds, offset by a gain of £27m (2013: loss of £94m) on the related derivative financial instruments.

For further information on adjusted measures above, see note 8.

## 7. Income tax

All figures in £ millions	Notes	2014	2013
<b>Current tax</b>			
Charge in respect of current year		(103)	(129)
Adjustments in respect of prior years		30	(7)
<b>Total current tax charge</b>		<b>(73)</b>	<b>(136)</b>
<b>Deferred tax</b>			
In respect of temporary differences		8	14
Other adjustments in respect of prior years		2	35
<b>Total deferred tax credit</b>	13	<b>10</b>	<b>49</b>
<b>Total tax charge</b>		<b>(63)</b>	<b>(87)</b>

The adjustments in respect of prior years in both 2014 and 2013 mainly relate to changes in estimates arising from uncertain tax positions following settlements with tax authorities in the year.

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

All figures in £ millions	2014	2013
Profit before tax	305	382
Tax calculated at UK rate (2014: 21.5%, 2013: 23.25%)	(66)	(89)
Effect of overseas tax rates	(12)	(13)
Joint venture and associate income reported net of tax	11	13
Net expense not subject to tax	(9)	(14)
Loss on sale of businesses not subject to tax	–	(6)
Utilisation of previously unrecognised tax losses and credits	–	1
Unutilised tax losses	(19)	(7)
Adjustments in respect of prior years	32	28
<b>Total tax charge</b>	<b>(63)</b>	<b>(87)</b>
UK	(6)	(13)
Overseas	(57)	(74)
<b>Total tax charge</b>	<b>(63)</b>	<b>(87)</b>
Tax rate reflected in earnings	20.7%	22.8%

## Notes to the consolidated financial statements continued

## 7. Income tax continued

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

All figures in £ millions	2014	2013
Profit before tax	305	382
<b>Adjustments:</b>		
Other net gains and losses	(2)	16
Acquisition costs	6	12
Amortisation of acquired intangibles	318	196
Other net finance costs	29	4
<b>Adjusted profit before tax – continuing operations</b>	<b>656</b>	<b>610</b>
Adjusted profit before tax – discontinued operations	2	54
<b>Total adjusted profit before tax</b>	<b>658</b>	<b>664</b>
Total tax charge	(63)	(87)
<b>Adjustments:</b>		
Tax charge on other net gains and losses	1	32
Tax benefit on acquisition costs	(1)	(2)
Tax benefit on intangible charges	(73)	(51)
Tax benefit on other net finance costs	(5)	(1)
Tax amortisation benefit on goodwill and intangibles	24	30
<b>Adjusted income tax charge – continuing operations</b>	<b>(117)</b>	<b>(79)</b>
Adjusted income tax charge – discontinued operations	(1)	(18)
<b>Total adjusted income tax charge</b>	<b>(118)</b>	<b>(97)</b>
Tax rate reflected in adjusted earnings	17.9%	14.6%

For further information on adjusted measures above, see note 8.

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

All figures in £ millions	2014	2013
Remeasurement of retirement benefit obligations	(1)	(23)
Net exchange differences on translation of foreign operations	(6)	6
	(7)	(17)

A tax charge of £3m (2013: tax charge £nil) 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.

All figures in £ millions	Notes	2014	2013
Profit for the year from continuing operations		242	295
Non-controlling interest		1	(1)
<b>Earnings from continuing operations</b>		<b>243</b>	<b>294</b>
Profit for the year from discontinued operations	3	228	244
<b>Earnings</b>		<b>471</b>	<b>538</b>
Weighted average number of shares (millions)		810.9	807.8
Effect of dilutive share options (millions)		1.0	1.1
Weighted average number of shares (millions) for diluted earnings		811.9	808.9
<b>Earnings per share from continuing and discontinued operations</b>			
Basic		58.1p	66.6p
Diluted		58.0p	66.5p
<b>Earnings per share from continuing operations</b>			
Basic		30.0p	36.4p
Diluted		29.9p	36.3p
<b>Earnings per share from discontinued operations</b>			
Basic		28.1p	30.2p
Diluted		28.1p	30.2p

### Adjusted

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

Adjusted earnings includes the results from continuing and discontinued operations. The following items are excluded from adjusted earnings:

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

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

## Notes to the consolidated financial statements continued

## 8. Earnings per share continued

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

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

**Non-controlling interest** for the above items is excluded from adjusted earnings. The following tables reconcile statutory earnings to adjusted earnings.

All figures in £ millions	2014								
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement	
Operating profit	398	2	(2)	6	318	–	–	722	
Net finance costs	(93)	–	–	–	–	29	–	(64)	
<b>Profit before tax</b>	<b>305</b>	<b>2</b>	<b>(2)</b>	<b>6</b>	<b>318</b>	<b>29</b>	<b>–</b>	<b>658</b>	
Income tax	(63)	(1)	1	(1)	(73)	(5)	24	(118)	
<b>Profit for the year from continuing operations</b>	<b>242</b>	<b>1</b>	<b>(1)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>540</b>	
Profit for the year from discontinued operations	228	(1)	(227)	–	–	–	–	–	
<b>Profit for the year</b>	<b>470</b>	<b>–</b>	<b>(228)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>540</b>	
Non-controlling interest	1	–	–	–	–	–	–	1	
<b>Earnings</b>	<b>471</b>	<b>–</b>	<b>(228)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>541</b>	
Weighted average number of shares (millions)								810.9	810.9
Weighted average number of shares (millions) for diluted earnings								811.9	811.9
<b>Earnings per share (basic)</b>								58.1p	66.7p
<b>Earnings per share (diluted)</b>								58.0p	66.6p

## 8. Earnings per share continued

								2013
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	458	54	16	12	196	–	–	736
Net finance costs	(76)	–	–	–	–	4	–	(72)
<b>Profit before tax</b>	<b>382</b>	<b>54</b>	<b>16</b>	<b>12</b>	<b>196</b>	<b>4</b>	<b>–</b>	<b>664</b>
Income tax	(87)	(18)	32	(2)	(51)	(1)	30	(97)
<b>Profit for the year from continuing operations</b>	<b>295</b>	<b>36</b>	<b>48</b>	<b>10</b>	<b>145</b>	<b>3</b>	<b>30</b>	<b>567</b>
Profit for the year from discontinued operations	244	(36)	(209)	–	2	(1)	–	–
<b>Profit for the year</b>	<b>539</b>	<b>–</b>	<b>(161)</b>	<b>10</b>	<b>147</b>	<b>2</b>	<b>30</b>	<b>567</b>
Non-controlling interest	(1)	–	–	–	–	–	–	(1)
<b>Earnings</b>	<b>538</b>	<b>–</b>	<b>(161)</b>	<b>10</b>	<b>147</b>	<b>2</b>	<b>30</b>	<b>566</b>
Weighted average number of shares (millions)	807.8							807.8
Weighted average number of shares (millions) for diluted earnings	808.9							808.9
<b>Earnings per share (basic)</b>	<b>66.6p</b>							<b>70.1p</b>
<b>Earnings per share (diluted)</b>	<b>66.5p</b>							<b>70.0p</b>

## 9. Dividends

All figures in £ millions	2014	2013
Final paid in respect of prior year 32.0p (2013: 30.0p)	259	242
Interim paid in respect of current year 17.0p (2013: 16.0p)	138	130
	397	372

The directors are proposing a final dividend in respect of the financial year ended 31 December 2014 of 34.0p per share which will absorb an estimated £276m of shareholders' funds. It will be paid on 1 May 2015 to shareholders who are on the register of members on 7 April 2015. These financial statements do not reflect this dividend.

## Notes to the consolidated financial statements continued

## 10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
<b>Cost</b>				
At 1 January 2013	352	597	18	967
Exchange differences	(5)	(14)	–	(19)
Additions	33	58	22	113
Disposals	(13)	(78)	–	(91)
Acquisition through business combination	–	3	–	3
Disposal through business disposal	(1)	(2)	–	(3)
Reclassifications	9	(1)	(8)	–
Transfer from software	–	3	–	3
Transfer from assets held for sale	–	9	–	9
Transfer to assets held for sale	–	(7)	–	(7)
<b>At 31 December 2013</b>	<b>375</b>	<b>568</b>	<b>32</b>	<b>975</b>
Exchange differences	11	17	–	28
Additions	10	58	19	87
Disposals	(9)	(46)	(2)	(57)
Acquisition through business combination	–	2	–	2
Disposal through business disposal	–	(1)	–	(1)
Reclassifications	1	3	(4)	–
Transfer to software	–	–	(16)	(16)
<b>At 31 December 2014</b>	<b>388</b>	<b>601</b>	<b>29</b>	<b>1,018</b>

## 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 2013	(195)	(445)	–	(640)
Exchange differences	3	13	–	16
Charge for the year	(25)	(57)	–	(82)
Disposals	7	64	–	71
Acquisition through business combination	–	(2)	–	(2)
Transfer from assets held for sale	–	(1)	–	(1)
Transfer to assets held for sale	–	5	–	5
<b>At 31 December 2013</b>	<b>(210)</b>	<b>(423)</b>	<b>–</b>	<b>(633)</b>
Exchange differences	(7)	(15)	–	(22)
Charge for the year	(23)	(51)	–	(74)
Disposals	9	36	–	45
<b>At 31 December 2014</b>	<b>(231)</b>	<b>(453)</b>	<b>–</b>	<b>(684)</b>
<b>Carrying amounts</b>				
At 1 January 2013	157	152	18	327
<b>At 31 December 2013</b>	<b>165</b>	<b>145</b>	<b>32</b>	<b>342</b>
<b>At 31 December 2014</b>	<b>157</b>	<b>148</b>	<b>29</b>	<b>334</b>

Depreciation expense of £16m (2013: £24m) has been included in the income statement in cost of goods sold and £58m (2013: £57m) in operating expenses. In 2014 £nil (2013: £1m) 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 £13m (2013: £11m).

## Notes to the consolidated financial statements continued

## II. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
<b>Cost</b>							
At 1 January 2013	5,077	466	729	258	207	394	7,131
Exchange differences	(122)	(6)	(25)	(8)	(12)	(11)	(184)
Additions – internal development	–	38	–	–	–	–	38
Additions – purchased	–	24	–	–	–	–	24
Disposals	–	(50)	–	–	–	–	(50)
Acquisition through business combination	(133)	–	190	–	3	7	67
Disposal through business disposal	(6)	–	–	–	–	(1)	(7)
Reclassifications	–	–	(10)	(1)	–	11	–
Transfer to PPE	–	(3)	–	–	–	–	(3)
Transfer to assets held for sale	(150)	–	(29)	(12)	–	(2)	(193)
<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>
Exchange differences	198	17	34	5	–	14	268
Impairment	(67)	–	–	–	–	–	(67)
Additions – internal development	–	54	–	–	–	–	54
Additions – purchased	–	53	–	–	–	–	53
Disposals	–	(7)	–	–	–	–	(7)
Acquisition through business combination	238	–	5	69	–	186	498
Disposal through business disposal	(5)	(5)	–	(3)	(1)	–	(14)
Transfer from PPE	–	16	–	–	–	–	16
<b>At 31 December 2014</b>	<b>5,030</b>	<b>597</b>	<b>894</b>	<b>308</b>	<b>197</b>	<b>598</b>	<b>7,624</b>

## 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 2013	–	(312)	(204)	(86)	(139)	(172)	(913)
Exchange differences	–	6	10	4	6	7	33
Charge for the year	–	(59)	(78)	(21)	(15)	(54)	(227)
Disposals	–	49	–	–	–	–	49
Disposal through business disposal	–	–	–	–	–	1	1
Transfer to assets held for sale	–	–	23	10	–	2	35
<b>At 31 December 2013</b>	<b>–</b>	<b>(316)</b>	<b>(249)</b>	<b>(93)</b>	<b>(148)</b>	<b>(216)</b>	<b>(1,022)</b>
Exchange differences	–	(13)	(11)	(3)	–	(12)	(39)
Impairment	–	–	(6)	(2)	–	(2)	(10)
Charge for the year	–	(63)	(83)	(25)	(12)	(67)	(250)
Disposals	–	5	–	–	–	–	5
Disposal through business disposal	–	1	–	1	–	–	2
<b>At 31 December 2014</b>	<b>–</b>	<b>(386)</b>	<b>(349)</b>	<b>(122)</b>	<b>(160)</b>	<b>(297)</b>	<b>(1,314)</b>
<b>Carrying amounts</b>							
At 1 January 2013	5,077	154	525	172	68	222	6,218
At 31 December 2013	4,666	153	606	144	50	182	5,801
<b>At 31 December 2014</b>	<b>5,030</b>	<b>211</b>	<b>545</b>	<b>186</b>	<b>37</b>	<b>301</b>	<b>6,310</b>

### Goodwill

The goodwill carrying value of £5,030m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

### Other intangible assets

Other intangibles acquired include content, technology and software rights.

Intangible assets are valued separately for each acquisition and the primary method of valuation used is the discounted cash flow method. The majority of acquired intangibles are amortised using an amortisation profile based on the projected cashflows underlying the acquisition date valuation of the intangible asset, which generally results in a larger proportion of amortisation being recognised in the early years of the assets' life. The Group keeps the expected pattern of consumption under review.

Amortisation of £12m (2013: £15m) is included in the income statement in cost of goods sold and £238m (2013: £210m) in operating expenses. In 2014 £nil (2013: £2m) of amortisation relates to discontinued operations.

## Notes to the consolidated financial statements continued

## 11. Intangible assets continued

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

Class of intangible asset	2014
	Useful economic life
Acquired customer lists, contracts and relationships	3–20 years
Acquired trademarks and brands	2–20 years
Acquired publishing rights	5–20 years
Other intangibles acquired	2–20 years

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

Class of intangible asset	2014			
	One to five years	Six to ten years	More than ten years	Total
All figures in £ millions				
Acquired customer lists, contracts and relationships	340	148	57	545
Acquired trademarks and brands	97	54	35	186
Acquired publishing rights	34	3	–	37
Other intangibles acquired	219	72	10	301

## Impairment tests for cash-generating units (CGUs) containing goodwill

Impairment tests have been carried out where appropriate as described below.

Following a reorganisation of the business effective 1 January 2014 goodwill was allocated to CGUs, or aggregation of CGUs where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs summarised below.

All figures in £ millions	2014	2013
North America	3,422	3,239
Core	618	624
Growth (includes China, Brazil, India and South Africa)	612	447
Pearson VUE	327	306
Financial Times Group	51	50
<b>Total</b>	<b>5,030</b>	<b>4,666</b>

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.



## 11. Intangible assets continued

### Impairment tests for cash-generating units containing goodwill continued

Following deterioration in the market conditions for the Group's online tutoring business based in India, it was determined in the course of the impairment review that the value in use of the India CGU no longer supported the carrying value of the goodwill in that CGU. An impairment of £67m was booked, thereby bringing the carrying value of goodwill in the India CGU down to £nil. An impairment of £10m was also booked in respect of other acquired intangibles in that CGU, bringing their carrying value to £nil. The India CGU incorporates all the Group's trading operations in India. A pre-tax discount rate of 13.6% was used to determine the value in use of the India CGU. No previous assessment had been made of the value in use of that CGU as the Group's India operations, prior to the 1 January 2014 reorganisation, were previously part of a larger Emerging Markets aggregated CGU.

### Key assumptions

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

**Discount rates** The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates range from 9.0% to 16.4%. Discount rates are lower for those businesses which operate in more mature markets with low inflation and higher for those operating in emerging markets with higher inflation.

**Perpetuity growth rates** A perpetuity growth rate of 2.0% (2013: 2.0%) was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historic growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 5.0% and 5.8% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historic growth rates in these markets.

The key assumptions used by management in setting the financial budgets for the initial five-year period were as follows:

**Forecast sales growth rates** Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key factors include the proportion of revenue expected to arise in emerging markets, the proportion of revenue expected to come from digital and services businesses relative to traditional print-based businesses and the changing product mix as a result of product investment. The five year sales forecasts use average nominal growth rates between 1.1% and 3.3% for mature markets and between 8.3% and 15.7% for emerging markets with high inflation.

**Operating profits** Operating profits are forecast based on historic experience of operating margins, adjusted for the impact of changes to product costs and cost saving initiatives, including the impact of the global restructuring programme undertaken in 2013 and 2014.

**Cash conversion** Cash conversion is the ratio of operating cashflow to operating profit. Management forecast cash conversion rates based on historic experience, adjusted for the impact of product investment priorities and the shift to digital and service based business.

### Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates. Based on the Group's sensitivity analysis, a reasonably possible increase of 0.8% pts in the discount rate or a decrease of 1.0% pt in the perpetuity growth rate could cause an impairment in respect of Brazil.

## Notes to the consolidated financial statements continued

## 12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2014	2013
Associates	1,105	1,089
Joint ventures	13	3
Total	1,118	1,092

The amounts recognised in the income statement are as follows:

All figures in £ millions	2014	2013
Associates	54	56
Joint ventures	(3)	(2)
Total	51	54

## Investment in associates

The Group has the following material associates:

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

\*None of the associates has a quoted market price.

**Note 1** – On 1 July 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. The shareholder agreement includes protection rights for Pearson as the minority shareholder including rights to dividends. Management considers ownership percentage, board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over Penguin Random House and Bertelsmann has the power to direct the relevant activities and therefore control.

**Note 2** – The Group has a 50% interest in The Economist Newspaper Ltd, publisher of one of the world's leading weekly business and current affairs magazines. The Economist has a unique structure of "A", "B" and Trustee shares, which was established to ensure its independence from proprietorial control. Pearson, as holder of the "B" shares, has never controlled the Economist by virtue of its shareholding or influence, and management assesses that it has significant influence over the company.

## 12. Investments in joint ventures and associates continued

### Investment in associates continued

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

All figures in £ millions	2014		2013 restated	
	Penguin Random House	Economist	Penguin Random House	Economist
<b>Assets</b>				
Current assets	1,355	110	1,210	103
Non-current assets	1,429	166	1,382	163
<b>Liabilities</b>				
Current liabilities	(1,113)	(190)	(905)	(190)
Non-current liabilities	(424)	(86)	(455)	(60)
<b>Net assets</b>	1,247	–	1,232	16
<b>Sales</b>	2,416	320	1,315	340
Profit from continuing operations	74	42	66	52
Other comprehensive (expense)/income	(11)	(20)	(34)	9
<b>Total comprehensive income</b>	63	22	32	61
Dividends received from associate	95	21	43	21

The information above reflects the amounts presented in the financial statements of the associates, adjusted for fair value and similar adjustments. The tax on Penguin Random House LLC is settled by the partners. For the purposes of clear and consistent presentation, the tax has been shown in the associate line items in the consolidated income statement and consolidated balance sheet, recording the Group's share of profit after tax consistently for the Penguin Random House associates.

## 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	2014		2013 restated	
	Penguin Random House	Economist	Penguin Random House	Economist
Opening net assets	1,232	16	–	–
Exchange differences	52	–	(68)	–
Profit for the period	74	42	66	52
Other comprehensive (expense)/income	(11)	(20)	(34)	9
Dividends, net of tax paid	(100)	(42)	(91)	(41)
Additions	–	–	1,359	–
Distribution from associate in excess of carrying value	–	4	–	–
Reversal of distribution from associate in excess of carrying value	–	–	–	(4)
<b>Closing net assets</b>	<b>1,247</b>	<b>–</b>	<b>1,232</b>	<b>16</b>
Share of net assets	586	–	579	8
Goodwill	509	–	491	–
<b>Carrying value of associate</b>	<b>1,095</b>	<b>–</b>	<b>1,070</b>	<b>8</b>

In 2013 the Group determined the fair value of the Penguin Random House venture for the purposes of accounting for the transaction. A valuation of the Penguin Random House ventures was determined during the negotiation of the transaction between Bertelsmann and Pearson. This valuation of the business was calculated using the income approach, discounting future cash flows to the present value. Cash flow projections were prepared for both businesses by country taking into account the front and backlist trends and extrapolated using long term growth rate assumptions. The cash flows were discounted using discount rates with risk premiums specific to each geographic region. A discount to the Group's share of the total value to reflect the Group's non-controlling minority ownership was applied.

The Group finalised its acquisition accounting for Penguin Random House in 2014 and an adjustment to the opening position with respect to deferred tax and goodwill was made. The overall carrying value of the associate in 2013 was unchanged however the additions and goodwill balances in the table above have been restated to reflect the final accounting.

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2014	2013
Loss from continuing operations	(2)	(1)
Other comprehensive income	–	–
<b>Total comprehensive expense</b>	<b>(2)</b>	<b>(1)</b>

## 12. Investments in joint ventures and associates continued

### Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2014 was £54m (2013: £44m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2014 was repaid in its entirety in January 2015.

The Group also has a current asset receivable of £41m (2013: £27m) from Penguin Random House arising from the provision of services. Included in other income (note 4) is £41m (2013: £28m) of service fees.

### Investment in joint ventures

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

All figures in £ millions	2014	2013
Loss from continuing operations	(3)	(2)
Other comprehensive income	–	–
<b>Total comprehensive expense</b>	<b>(3)</b>	<b>(2)</b>

## 13. Deferred income tax

All figures in £ millions	2014	2013
Deferred income tax assets	295	250
Deferred income tax liabilities	(714)	(612)
<b>Net deferred income tax</b>	<b>(419)</b>	<b>(362)</b>

Substantially all of the deferred income 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 2014 the Group has unrecognised deferred income tax assets of £4m (2013: £4m) in respect of UK losses, £14m (2013: £11m) in respect of US losses and approximately £44m (2013: £36m) in respect of losses in other territories. None of the unrecognised UK losses have expiry dates associated with them. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years.

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

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

All figures in £ millions	Notes	2014	2013
At beginning of year		(362)	(372)
Exchange differences		(22)	9
Income statement benefit	7	10	47
Acquisition through business combination	30	–	(37)
Disposal through business disposal	31	(1)	–
Tax charge to other comprehensive income or equity		(18)	(35)
Transfer to/from current tax		(26)	25
Transfer to assets held for sale		–	1
<b>At end of year</b>		<b>(419)</b>	<b>(362)</b>

Included in the income statement above for 2014 is a £nil charge (2013: £2m charge) relating to discontinued operations.

## Notes to the consolidated financial statements continued

## 13. Deferred income tax continued

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

All figures in £ millions	Trading losses	Returns provisions	Retirement benefit obligations	Other	Total
<b>Deferred income tax assets</b>					
At 1 January 2013	18	45	47	119	229
Exchange differences	–	(1)	(1)	(4)	(6)
Acquisition through business combination	21	–	–	–	21
Income statement (charge)/benefit	(24)	(5)	25	22	18
Tax charge to other comprehensive income or equity	–	–	(36)	–	(36)
Transfer to current tax	–	–	–	25	25
Transfer from assets held for sale	–	–	7	(7)	–
Transfer to assets held for sale	–	–	–	(1)	(1)
<b>At 31 December 2013</b>	<b>15</b>	<b>39</b>	<b>42</b>	<b>154</b>	<b>250</b>
Exchange differences	1	2	4	5	12
Acquisition through business combination	2	–	–	–	2
Income statement benefit	10	3	7	35	55
Tax benefit/(charge) to other comprehensive income or equity	–	–	10	(7)	3
Transfer to current tax	–	–	–	(26)	(26)
Disposal through business disposal	–	–	(1)	–	(1)
<b>At 31 December 2014</b>	<b>28</b>	<b>44</b>	<b>62</b>	<b>161</b>	<b>295</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 2013	(475)	(126)	(601)
Exchange differences	13	2	15
Acquisition through business combination	(61)	3	(58)
Income statement (charge)/benefit	(61)	90	29
Tax benefit to other comprehensive income or equity	–	1	1
Transfer to assets held for sale	–	2	2
<b>At 31 December 2013</b>	<b>(584)</b>	<b>(28)</b>	<b>(612)</b>
Exchange differences	(30)	(4)	(34)
Acquisition through business combination	(2)	–	(2)
Income statement benefit/(charge)	18	(63)	(45)
Tax charge to other comprehensive income or equity	–	(21)	(21)
<b>At 31 December 2014</b>	<b>(598)</b>	<b>(116)</b>	<b>(714)</b>

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

#### 14. Classification of financial instruments

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

All figures in £ millions	Notes	2014								
		Fair value				Amortised cost			Total carrying value	Total market value
		Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Other liabilities	Loans and receivables	Other liabilities			
Investments in listed securities	15	9	–	–	–	–	–	9	9	
Investments in unlisted securities	15	45	–	–	–	–	–	45	45	
Cash and cash equivalents	17	–	–	–	–	530	–	530	530	
Marketable securities		16	–	–	–	–	–	16	16	
Derivative financial instruments	16	–	6	108	–	–	–	114	114	
Trade receivables	22	–	–	–	–	989	–	989	989	
<b>Total financial assets</b>		<b>70</b>	<b>6</b>	<b>108</b>	<b>–</b>	<b>1,519</b>	<b>–</b>	<b>1,703</b>	<b>1,703</b>	
Derivative financial instruments	16	–	(33)	(41)	–	–	–	(74)	(74)	
Trade payables	24	–	–	–	–	–	(329)	(329)	(329)	
Bank loans and overdrafts	18	–	–	–	–	–	(42)	(42)	(42)	
Borrowings due within one year	18	–	–	–	–	–	(305)	(305)	(319)	
Borrowings due after more than one year	18	–	–	–	–	–	(1,878)	(1,878)	(1,888)	
<b>Total financial liabilities</b>		<b>–</b>	<b>(33)</b>	<b>(41)</b>	<b>–</b>	<b>–</b>	<b>(2,554)</b>	<b>(2,628)</b>	<b>(2,652)</b>	

## Notes to the consolidated financial statements continued

## 14. Classification of financial instruments continued

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

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

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

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

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

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



## 15. Other financial assets

All figures in £ millions	2014	2013
At beginning of year	94	31
Exchange differences	6	–
Acquisition of investments	12	63
Disposal of investments	(58)	–
<b>At end of year</b>	<b>54</b>	<b>94</b>

Other financial assets comprise listed securities of £9m (2013: £nil) and unlisted securities of £45m (2013:£94m).

## 16. Derivative financial instruments

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

All figures in £ millions	2014			2013		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,607	84	(5)	1,439	81	(32)
Interest rate derivatives – not in a hedge relationship	673	–	(7)	634	4	(16)
Cross-currency rate derivatives – in a hedge relationship	889	24	(36)	220	39	–
Cross-currency rate derivatives – not in a hedge relationship	451	6	(26)	–	–	–
<b>Total</b>	<b>3,620</b>	<b>114</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>
<b>Analysed as expiring:</b>						
In less than one year	200	24	(1)	312	13	–
Later than one year and not later than five years	1,386	67	(8)	1,377	111	–
Later than five years	2,034	23	(65)	604	–	(48)
<b>Total</b>	<b>3,620</b>	<b>114</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>

## 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 2014, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross-currency rate derivatives, was US dollar £(607)m, sterling £214m, euro £430m, Brazilian real £4m and South African rand £nil (2013: US dollar £(151)m, sterling £243m, euro £nil, Brazilian real £nil and South African rand £(16)m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2014 range from 1.10% to 14.48% (2013: 1.10% to 9.28%) and the floating rates are based on LIBOR in US dollar, euro and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

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

	2014			2013		
	Gross derivative assets	Gross derivative liabilities	Net derivative assets/liabilities	Gross derivative assets	Gross derivative liabilities	Net derivative assets/liabilities
All figures in £ millions						
Counterparties in an asset position	94	(28)	66	122	(12)	110
Counterparties in a liability position	20	(46)	(26)	2	(36)	(34)
Total as presented in the balance sheet	114	(74)	40	124	(48)	76

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

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

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

## 17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2014	2013
Cash at bank and in hand	483	521
Short-term bank deposits	47	208
<b>Continuing operations</b>	<b>530</b>	<b>729</b>
Cash at bank and in hand classified within assets held for sale	–	36
	<b>530</b>	<b>765</b>

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

At the end of 2014 the currency split of cash and cash equivalents was US dollar 18% (2013: 28%), sterling 13% (2013: 18%), euro 3% (2013: 5%), renminbi 28% (2013: 27%) and other 38% (2013: 22%).

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	2014	2013
Cash and cash equivalents – continuing operations	530	729
Cash at bank and in hand classified within assets held for sale	–	36
Bank overdrafts – continuing operations	(19)	(25)
	<b>511</b>	<b>740</b>

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	2014			2013		
	Offset asset	Offset liability	Net offset asset/liability	Offset asset	Offset liability	Net offset asset/liability
US dollars	267	(266)	1	298	(299)	(1)
Sterling	430	(427)	3	1,018	(1,027)	(9)
Euro	9	(8)	1	6	(5)	1
<b>Total for continuing operations as presented in the balance sheet</b>			<b>5</b>			<b>(9)</b>

At the end of 2013, the Group had offset US dollar, sterling and euro asset balances of £1m, £16m and £nil respectively in respect of discontinued operations.

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

## Notes to the consolidated financial statements continued

## 18. Financial liabilities – borrowings

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

All figures in £ millions	2014	2013
<b>Non-current</b>		
6.0% Sterling bonds 2015 (nominal amount £300m)	–	299
4.0% US dollar notes 2016 (nominal amount \$350m)	231	221
6.25% Global dollar bonds 2018 (nominal amount \$550m)	390	375
4.625% US dollar notes 2018 (nominal amount \$300m)	210	202
1.875% Euro notes 2021 (nominal amount €500m)	408	–
3.75% US dollar notes 2022 (nominal amount \$500m)	319	283
3.25% US dollar notes 2023 (nominal amount \$500m)	315	286
Bank loans and overdrafts	5	22
Finance lease liabilities	5	5
	<b>1,883</b>	<b>1,693</b>
<b>Current</b>		
Due within one year or on-demand:		
5.7% US dollar bonds 2014 (nominal amount \$400m)	–	248
7.0% Sterling bonds 2014 (nominal amount £250m)	–	254
6.0% Sterling bonds 2015 (nominal amount £300m)	300	–
Bank loans and overdrafts	37	25
Finance lease liabilities	5	6
	<b>342</b>	<b>533</b>
<b>Total borrowings</b>	<b>2,225</b>	<b>2,226</b>

Included in the non-current borrowings above is £13m of accrued interest (2013: £9m). Included in the current borrowings above is £1m of accrued interest (2013: £4m).

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

All figures in £ millions	2014	2013
Between one and two years	239	303
Between two and five years	602	821
Over five years	1,042	569
	<b>1,883</b>	<b>1,693</b>

## 18. Financial liabilities – borrowings continued

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

All figures in £ millions	2014		2013		
	Effective interest rate	Carrying value	Market value	Carrying value	Market value
Bank loans and overdrafts	n/a	42	42	47	47
5.7% US dollar bonds 2014	5.88%	–	–	248	246
7.0% Sterling bonds 2014	7.20%	–	–	254	262
6.0% Sterling bonds 2015	6.27%	300	314	299	325
4.0% US dollar notes 2016	4.26%	231	233	221	223
6.25% Global dollar bonds 2018	6.46%	390	397	375	376
4.625% US dollar notes 2018	4.69%	210	205	202	195
1.875% Euro notes 2021	2.04%	408	407	–	–
3.75% US dollar notes 2022	3.94%	319	327	283	286
3.25% US dollar notes 2023	3.36%	315	314	286	273
Finance lease liabilities	n/a	10	10	11	11
		2,225	2,249	2,226	2,244

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

All figures in £ millions	2014	2013
US dollar	1,491	1,645
Sterling	303	559
Euro	408	–
Other	23	22
	2,225	2,226

## Notes to the consolidated financial statements continued

## 18. Financial liabilities – borrowings continued

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

All figures in £ millions	2014	2013
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,122	1,057
	1,122	1,057

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.

The maturity of the Group's finance lease obligations is as follows:

All figures in £ millions	2014	2013
<b>Finance lease liabilities – minimum lease payments</b>		
Not later than one year	5	6
Later than one year and not later than two years	3	4
Later than two years and not later than three years	1	1
Later than three years and not later than four years	1	–
Later than four years and not later than five years	–	–
Later than five years	–	–
Future finance charges on finance leases	–	–
<b>Present value of finance lease liabilities</b>	<b>10</b>	<b>11</b>

The present value of finance lease liabilities is as follows:

All figures in £ millions	2014	2013
Not later than one year	5	6
Later than one year and not later than five years	5	5
Later than five years	–	–
	10	11

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

## 19. Financial risk management

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

### Treasury policy

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

The audit committee receives regular reports on the Group's treasury activities, policies and procedures.

The treasury department is not a profit centre and its activities are subject to regular internal audit.

### Liquidity and refinancing risk management

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective is to maintain the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) to be between three and ten years. At the end of 2014 the average maturity of gross borrowings was 4.7 years (2013: 4.2 years) of which bonds represented 97% (2013: 97%) of these borrowings.

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. All of the Group's credit ratings remained unchanged during the year, although in January 2014, Moody's changed the outlook on their short-term and long-term ratings from 'Stable' to 'Negative'. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group also uses a range of ratios to monitor and manage its finances internally. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2014 the committed facilities amounted to \$1,750m (£1,122m) and their weighted average maturity was 4.6 years.

### Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates.

The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2014 the fixed to floating hedging ratio, on the above basis, was approximately 38%:62%. Steps will be taken in early 2015 to bring the Group back into compliance with this policy objective. A simultaneous 1% change on 1 January 2015 in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have an £11m effect on profit before tax.

## Notes to the consolidated financial statements continued

### 19. Financial risk management continued

#### Interest rate risk management continued

The policy described above creates a further group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group's accounting objective in relation to its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

#### Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover the Group's total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

#### Foreign currency risk management

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross-currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to soften the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. The Group policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross-currency swaps) were: US dollar £2,005m and sterling £36m.

#### Use of currency debt and currency derivatives

The Group uses both currency denominated debt and derivative instruments to implement the above policy.

Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.



## 19. Financial risk management continued

### Analysis of Group debt, including the impact of derivatives

The following tables analyse the Group's sources of funding and the impact of derivatives on the Group's debt instruments.

The Group's net debt position is set out below:

All figures in £ millions	2014	2013
Cash and cash equivalents	530	729
Marketable securities	16	6
Derivative financial instruments	40	76
Bank loans, overdrafts and loan notes	(42)	(47)
Bonds	(2,173)	(2,168)
Finance lease liabilities	(10)	(11)
<b>Continuing operations</b>	<b>(1,639)</b>	<b>(1,415)</b>
Cash and cash equivalents classified within assets held for sale	–	36
<b>Net debt</b>	<b>(1,639)</b>	<b>(1,379)</b>

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

All figures in £ millions	2014	2013
Fixed rate	597	612
Floating rate	1,042	767
<b>Total</b>	<b>1,639</b>	<b>1,379</b>

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

All figures in £ millions	2014	2013
US dollar	2,099	1,849
Sterling	104	339
Other	22	38
<b>Total</b>	<b>2,225</b>	<b>2,226</b>

As at 31 December 2014 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows:

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	342	842	1,041	2,225
Effect of rate derivatives	1,254	(225)	(1,029)	–
<b>Total</b>	<b>1,596</b>	<b>617</b>	<b>12</b>	<b>2,225</b>

## Notes to the consolidated financial statements continued

## 19. Financial risk management continued

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

All figures in £ millions				2014
	USD	GBP	Other	Total
Not later than one year	398	160	99	657
Later than one year and not later than five years	877	–	–	877
Later than five years	1,126	–	–	1,126
<b>Total</b>	<b>2,401</b>	<b>160</b>	<b>99</b>	<b>2,660</b>
<b>Analysed as:</b>				
Bonds	1,711	318	439	2,468
Rate derivatives – inflows	(379)	(656)	(537)	(1,572)
Rate derivatives – outflows	893	444	98	1,435
Trade payables	176	54	99	329
<b>Total</b>	<b>2,401</b>	<b>160</b>	<b>99</b>	<b>2,660</b>

All figures in £ millions				2013
	USD	GBP	Other	Total
Not later than one year	434	316	113	863
Later than one year and not later than five years	1,000	106	–	1,106
Later than five years	648	–	–	648
<b>Total</b>	<b>2,082</b>	<b>422</b>	<b>113</b>	<b>2,617</b>
<b>Analysed as:</b>				
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 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.

## 19. Financial risk management continued

### Financial instruments – fair value measurement

The following table provides an analysis of those financial instruments that are measured subsequently to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All figures in £ millions	2014				2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Financial assets at fair value</b>								
Derivative financial assets	–	114	–	114	–	124	–	124
Marketable securities	–	16	–	16	–	6	–	6
<b>Available for sale financial assets</b>								
Investments in listed securities	–	9	–	9	–	–	–	–
Investments in unlisted securities	–	–	45	45	–	–	94	94
<b>Financial liabilities at fair value</b>								
Derivative financial liabilities	–	(74)	–	(74)	–	(48)	–	(48)
<b>Total</b>	–	65	45	110	–	82	94	176

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

All figures in £ millions	2014		2013	
	Investments in unlisted securities	Other financial liabilities	Investments in unlisted securities	Other financial liabilities
At beginning of year	94	–	31	(68)
Exchange differences	6	–	–	9
Additions	3	–	63	–
Fair value movements	–	–	–	(8)
Disposals	(58)	–	–	67
<b>At end of year</b>	<b>45</b>	<b>–</b>	<b>94</b>	<b>–</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.

## Notes to the consolidated financial statements continued

## 19. Financial risk management continued

## Financial instruments – sensitivity analysis

As at 31 December 2014 the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in listed securities	9	–	–	(1)	1
Investments in unlisted securities	45	–	–	(4)	5
Cash and cash equivalents	530	–	–	(67)	82
Marketable securities	16	–	–	–	–
Derivative financial instruments	40	(66)	85	16	(19)
Bonds	(2,173)	71	(84)	(170)	208
Other borrowings	(52)	–	–	6	(7)
Other net financial assets	660	–	–	(53)	64
<b>Total financial instruments</b>	<b>(925)</b>	<b>5</b>	<b>1</b>	<b>(273)</b>	<b>334</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.

## 20. Intangible assets – Pre-publication

All figures in £ millions	2014	2013
<b>Cost</b>		
At beginning of year	1,933	1,876
Exchange differences	80	(46)
Additions	358	364
Disposal through business disposal	–	(29)
Disposals	(234)	(234)
Acquisition through business combination	1	2
<b>At end of year</b>	<b>2,138</b>	<b>1,933</b>
<b>Amortisation</b>		
At beginning of year	(1,216)	(1,210)
Exchange differences	(60)	46
Charge for the year	(292)	(308)
Disposal through business disposal	–	23
Disposals	234	234
Acquisition through business combination	–	(1)
Transfer to receivables	16	–
<b>At end of year</b>	<b>(1,318)</b>	<b>(1,216)</b>
<b>Carrying amounts</b>		
<b>At end of year</b>	<b>820</b>	<b>717</b>

Included in the above are pre-publication assets amounting to £546m (2013: £480m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold. There was no amortisation within discontinued operations in either year.

## 21. Inventories

All figures in £ millions	2014	2013
Raw materials	9	15
Work in progress	10	13
Finished goods	205	196
	<b>224</b>	<b>224</b>

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £387m (2013: £472m). In 2014 £38m (2013: £53m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

## Notes to the consolidated financial statements continued

## 22. Trade and other receivables

All figures in £ millions	2014	2013
<b>Current</b>		
Trade receivables	963	863
Royalty advances	18	23
Prepayments and accrued income	107	101
Other receivables	222	186
	1,310	1,173
<b>Non-current</b>		
Trade receivables	26	19
Royalty advances	8	8
Prepayments and accrued income	30	33
Other receivables	18	10
	82	70

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	2014	2013
At beginning of year	(58)	(55)
Exchange differences	–	5
Income statement movements	(21)	(27)
Utilised	17	18
Acquisition through business combination	(11)	–
Transfer to assets classified as held for sale	–	1
<b>At end of year</b>	<b>(73)</b>	<b>(58)</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.

## 22. Trade and other receivables continued

The ageing of the Group's trade receivables is as follows:

All figures in £ millions	2014	2013
Within due date	869	783
Up to three months past due date	203	194
Three to six months past due date	40	36
Six to nine months past due date	15	22
Nine to 12 months past due date	15	9
More than 12 months past due date	11	1
<b>Total trade receivables</b>	<b>1,153</b>	<b>1,045</b>
Less: provision for sales returns	(164)	(163)
<b>Net trade receivables</b>	<b>989</b>	<b>882</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.

## 23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2014	58	11	67	53	189
Exchange differences	4	–	–	1	5
Charged to income statement	–	1	–	10	11
Released to income statement	–	(1)	(43)	(4)	(48)
Acquisition through business combination	–	–	–	14	14
Utilised	(5)	(4)	(4)	(23)	(36)
<b>At 31 December 2014</b>	<b>57</b>	<b>7</b>	<b>20</b>	<b>51</b>	<b>135</b>

Analysis of provisions:

All figures in £ millions	2014				
	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	7	4	20	22	53
Non-current	50	3	–	29	82
	57	7	20	51	135
	2013				
Current	5	10	67	30	112
Non-current	53	1	–	23	77
	58	11	67	53	189

Deferred consideration primarily relates to the formation of a venture in a North America business in 2011.

Disposals and closures include liabilities related to the disposal of Penguin. In 2013 a provision was established for amounts payable to Bertelsmann upon settlement of the transfer of Penguin's UK past service pension liabilities to the new Penguin Random House venture. During 2014 it was decided that this transfer would not go ahead as planned and therefore the provision has been released.

Legal and other includes legal claims, contract disputes and potential contract losses.

## Notes to the consolidated financial statements continued

## 24. Trade and other liabilities

All figures in £ millions	2014	2013
Trade payables	329	316
Social security and other taxes	21	23
Accruals	501	478
Deferred income	801	698
Interest payable	28	22
Other liabilities	231	225
	1,911	1,762
<b>Less: non-current portion</b>		
Accruals	22	25
Deferred income	201	155
Interest payable	19	21
Other liabilities	68	56
	310	257
<b>Current portion</b>	<b>1,601</b>	<b>1,505</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.

## 25. Retirement benefit and other post-retirement obligations

## Background

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

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

At 31 December 2014 the UK Group plan has approximately 26,500 members, analysed in the following table:

%	Active	Deferred	Pensioners	Total
Defined benefit	2	25	32	59
Defined contribution	18	23	–	41
<b>Total</b>	<b>20</b>	<b>48</b>	<b>32</b>	<b>100</b>



## 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.

%	2014			2013		
	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.0	2.5	2.5	3.4	2.5	2.5
Rate used to discount plan liabilities	3.6	3.7	3.7	4.4	4.4	4.4
Expected rate of increase in salaries	3.5	3.9	4.0	3.9	3.9	4.0
Expected rate of increase for pensions in payment and deferred pensions	1.9 to 5.05	–	–	2.3 to 5.1	–	–
Initial rate of increase in healthcare rate	–	–	7.0	–	–	7.5
Ultimate rate of increase in healthcare rate	–	–	5.0	–	–	5.0

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.0% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.0% has been used.

The expected rate of increase in salaries has been set at 3.5% for 2014 with a short-term assumption of 2.0% for three years.

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

For the US plans, the mortality table (RP – 2014) and 2014 Improvement scale (MP – 2014) with no adjustments have been adopted for 2014, reflecting the mortality assumption most prevalent in the US. In 2013 the RP2000 table projected to 2020 was used.

## 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	
	2014	2013	2014	2013
Male	24.4	24.3	21.6	19.2
Female	24.5	24.4	23.8	21.1

The remaining average life expectancy in years of a pensioner retiring at age 65, 15 years after the balance sheet date, for the UK and US Group plans is as follows:

	UK		US	
	2014	2013	2014	2013
Male	26.6	25.9	23.3	19.2
Female	26.4	25.9	25.5	21.1

Although the Group anticipates that plan surpluses will be utilised during the life of the plan to address member benefits, the Group recognises its pension surplus in full in respect of the UK Group plan on the basis that it is management's judgement that there are no substantive restrictions on the return of residual plan assets in the event of a winding up of the plan after all member obligations have been met.

## Financial statement information

The amounts recognised in the income statement are as follows:

	2014					
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
All figures in £ millions						
Current service cost	20	2	22	69	2	93
Curtailments	(5)	–	(5)	–	(13)	(18)
Administration expenses	4	–	4	–	–	4
<b>Total operating expense</b>	<b>19</b>	<b>2</b>	<b>21</b>	<b>69</b>	<b>(11)</b>	<b>79</b>
Interest on plan assets	(103)	(7)	(110)	–	–	(110)
Interest on plan liabilities	98	8	106	–	3	109
<b>Net finance (income)/expense</b>	<b>(5)</b>	<b>1</b>	<b>(4)</b>	<b>–</b>	<b>3</b>	<b>(1)</b>
<b>Net income statement charge/(income)</b>	<b>14</b>	<b>3</b>	<b>17</b>	<b>69</b>	<b>(8)</b>	<b>78</b>

## 25. Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

All figures in £ millions	2013					
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	22	3	25	72	4	101
Curtailments	–	–	–	–	(4)	(4)
Administration expenses	4	–	4	–	–	4
<b>Total operating expense</b>	<b>26</b>	<b>3</b>	<b>29</b>	<b>72</b>	<b>–</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>–</b>	<b>–</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>

Included within the 2014 results are discontinued operations consisting of a £5m credit (2013: £2m charge) relating to defined benefit schemes and a £nil m charge (2013: £6m charge) relating to defined contribution schemes.

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2014				2013			
	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
Fair value of plan assets	2,714	164	–	2,878	2,353	156	–	2,509
Present value of defined benefit obligation	(2,524)	(196)	(23)	(2,743)	(2,267)	(171)	(20)	(2,458)
<b>Net pension asset/(liability)</b>	<b>190</b>	<b>(32)</b>	<b>(23)</b>	<b>135</b>	<b>86</b>	<b>(15)</b>	<b>(20)</b>	<b>51</b>
Other post-retirement medical benefit obligation				(81)				(77)
Other pension accruals				(27)				(30)
<b>Net retirement benefit asset/(obligation)</b>				<b>27</b>				<b>(56)</b>
<b>Analysed as:</b>								
Retirement benefit assets				190				86
Retirement benefit obligations				(163)				(142)

## Notes to the consolidated financial statements continued

## 25. Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

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

All figures in £ millions	2014	2013
Amounts recognised for defined benefit plans	36	70
Amounts recognised for post-retirement medical benefit plans	(13)	9
<b>Total recognised in year</b>	<b>23</b>	<b>79</b>

The fair value of plan assets comprises the following:

%	2014			2013		
	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
Equities	26	2	28	28	2	30
Bonds	42	3	45	40	3	43
Property	9	–	9	9	–	9
Other	17	1	18	17	1	18

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

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

%	2014		2013	
	Quoted market price	No quoted market price	Quoted market price	No quoted market price
UK equities	5	1	6	1
Non-UK equities	20	2	20	3
Fixed-interest securities	19	–	19	–
Index-linked securities	26	–	24	–
Property	–	9	–	9
Other	–	18	–	18
<b>Total</b>	<b>70</b>	<b>30</b>	<b>69</b>	<b>31</b>

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

%	2014	2013
Liquid – call <1 month	72	72
Less liquid – call 1–3 months	2	2
Liquid – call > 3 months	26	26

## 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	2014			2013		
	UK Group plan	Other plans	Total	UK Group plan	Other plans	Total
<b>Fair value of plan assets</b>						
Opening fair value of plan assets	2,353	156	2,509	2,162	165	2,327
Exchange differences	–	4	4	–	(2)	(2)
Interest on plan assets	103	7	110	95	6	101
Return on plans assets excluding interest	286	9	295	103	6	109
Contributions by employer	62	4	66	77	5	82
Contributions by employee	2	–	2	2	–	2
Benefits paid	(92)	(16)	(108)	(86)	(24)	(110)
<b>Closing fair value of plan assets</b>	<b>2,714</b>	<b>164</b>	<b>2,878</b>	<b>2,353</b>	<b>156</b>	<b>2,509</b>
<b>Present value of defined benefit obligation</b>						
Opening defined benefit obligation	(2,267)	(191)	(2,458)	(2,181)	(220)	(2,401)
Exchange differences	–	(5)	(5)	–	4	4
Current service cost	(20)	(2)	(22)	(22)	(3)	(25)
Administration expenses	(4)	–	(4)	(4)	–	(4)
Curtailments	5	–	5	–	–	–
Interest cost	(98)	(8)	(106)	(94)	(7)	(101)
Actuarial gains/(losses) – experience	11	(1)	10	5	1	6
Actuarial gains/(losses) – demographic	–	(8)	(8)	–	1	1
Actuarial gains/(losses) – financial	(241)	(20)	(261)	(55)	9	(46)
Contributions by employee	(2)	–	(2)	(2)	–	(2)
Benefits paid	92	16	108	86	24	110
<b>Closing defined benefit obligation</b>	<b>(2,524)</b>	<b>(219)</b>	<b>(2,743)</b>	<b>(2,267)</b>	<b>(191)</b>	<b>(2,458)</b>

The weighted average duration of the defined benefit obligation is 16.5 years for the UK and 9.7 years for the US.

## Notes to the consolidated financial statements continued

## 25. Retirement benefit and other post-retirement obligations continued

## Financial statement information continued

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

All figures in £ millions	2014	2013
Opening defined benefit obligation	(77)	(89)
Exchange differences	(4)	1
Current service cost	(2)	(4)
Curtailments	13	4
Interest cost	(3)	(3)
Actuarial gains/(losses) – demographic	(7)	–
Actuarial gains/(losses) – financial	(6)	9
Benefits paid	5	5
<b>Closing defined benefit obligation</b>	<b>(81)</b>	<b>(77)</b>

## Funding

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

The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2012 and this valuation revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by June 2017. In 2014 the Group contributed £43m (2013: £56m) towards the funding shortfall. Following the completion of the triennial funding valuation the Group has agreed to contribute £41m per annum until 2017 in excess of regular contributions. In addition, a mechanism has been agreed for the Group to make supplementary payments up to a maximum of £15m per annum if certain conditions are met. If such payments are made they are expected to accelerate the end date for extinguishing the deficit. Regular contributions to the plan in respect of the defined benefit sections are estimated to be £17m for 2015.

The Group expects to contribute \$10m in 2015 and \$11m in 2016 to its US defined benefit pension plans.

## 25. Retirement benefit and other post-retirement obligations continued

### Sensitivities

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

All figures in £ millions	2014	
	1% increase	1% decrease
<b>Effect:</b>		
(Decrease)/increase in defined benefit obligation – UK Group plan	(371)	467
(Decrease)/increase in defined benefit obligation – US plan	(19)	22

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

All figures in £ millions	2014	
	1 year increase	1 year decrease
<b>Effect:</b>		
Increase/(decrease) in defined benefit obligation – UK Group plan	88	(85)
Increase/(decrease) in defined benefit obligation – US plan	7	(6)

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

All figures in £ millions	2014	
	0.5% increase	0.5% decrease
<b>Effect:</b>		
Increase/(decrease) in defined benefit obligation – UK Group plan	111	(104)
Increase/(decrease) in defined benefit obligation – US plan	–	–

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

## Notes to the consolidated financial statements continued

## 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	2014	2013
Pearson plans	32	35

Share-based payment charges included in discontinued operations amounted to £nil (2013: £2m). The Group operates the following equity-settled employee option and share plans:

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

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

**Long-Term Incentive Plan** This plan was first introduced in 2001, renewed in 2006 and again in 2011. The plan consists of restricted shares. The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in May 2014 and May 2013, vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. Restricted shares awarded to senior management in November 2014 vest dependent on earnings per share growth. Other restricted shares awarded in 2014 and 2013 vest depending on continuing service over a three-year period.

**Annual Bonus Share Matching Plan** This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis of up to one matching share for every invested share, i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares. Awards under this plan ceased in 2013.

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

	2014		2013	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	2,792	8.73	3,373	8.24
Granted during the year	1,985	8.11	763	9.14
Exercised during the year	(727)	8.24	(820)	7.12
Forfeited during the year	(538)	8.76	(516)	8.75
Expired during the year	(5)	7.43	(8)	5.75
<b>Outstanding at end of year</b>	<b>3,507</b>	<b>8.48</b>	<b>2,792</b>	<b>8.73</b>
<b>Options exercisable at end of year</b>	<b>43</b>	<b>8.24</b>	<b>35</b>	<b>6.95</b>



## 26. Share-based payments continued

Options were exercised regularly throughout the year. The weighted average share price during the year was £11.41 (2013: £12.42). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

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

Range of exercise prices £	2014		2013	
	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	–	–	–	–
5 – 10	3,507	2.68	2,792	2.31
>10	–	–	–	–
	3,507	2.68	2,792	2.31

In 2014 and 2013 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

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

	2014 Weighted average	2013 Weighted average
Fair value	£2.41	£2.27
Weighted average share price	£11.09	£11.71
Weighted average exercise price	£8.11	£9.14
Expected volatility	21.27%	22.05%
Expected life	3.9 years	3.8 years
Risk free rate	1.3%	0.53%
Expected dividend yield	4.33%	3.84%
Forfeiture rate	3.4%	3.3%

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

The following shares were granted under restricted share arrangements:

	2014		2013	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	5,875	11.44	3,482	11.52
Annual Bonus Share Matching Plan	–	–	99	12.06

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Participants under both plans are entitled to dividends during the vesting period and therefore the share price is not discounted.

## Notes to the consolidated financial statements continued

## 26. Share-based payments continued

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

## 27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2013	817,043	204	2,555
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>
Issue of ordinary shares – share option schemes	1,303	–	11
<b>At 31 December 2014</b>	<b>819,883</b>	<b>205</b>	<b>2,579</b>

The ordinary shares have a par value of 25p per share (2013: 25p per share). All issued shares are fully paid. All shares have the same rights.

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

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

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

## 28. Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2013	10,102	103
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
<b>At 31 December 2013</b>	<b>9,282</b>	<b>98</b>
Purchase of treasury shares	907	9
Release of treasury shares	(2,997)	(32)
<b>At 31 December 2014</b>	<b>7,192</b>	<b>75</b>

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 0.9% (2013: 1.1%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £1.8m (2013: £2.3m).

At 31 December 2014 the market value of Pearson plc treasury shares was £85.6m (2013: £124.4m).

## 29. Other comprehensive income

All figures in £ millions	2014				
	Attributable to equity holders of the company			Non-controlling interest	Total
	Translation reserve	Retained earnings	Total		
<b>Items that may be reclassified to the income statement</b>					
Net exchange differences on translation of foreign operations – Group	150	–	150	–	150
Net exchange differences on translation of foreign operations – associate	25	–	25	–	25
Currency translation adjustment disposed – subsidiaries	(2)	–	(2)	–	(2)
Attributable tax	–	(6)	(6)	–	(6)
<b>Items that are not reclassified to the income statement</b>					
Remeasurement of retirement benefit obligations – Group	–	23	23	–	23
Remeasurement of retirement benefit obligations – associate	–	(15)	(15)	–	(15)
Attributable tax	–	(1)	(1)	–	(1)
<b>Other comprehensive expense for the year</b>	<b>173</b>	<b>1</b>	<b>174</b>	<b>–</b>	<b>174</b>

All figures in £ millions	2013				
	Attributable to equity holders of the company			Non-controlling interest	Total
	Translation reserve	Retained earnings	Total		
<b>Items that may be reclassified to the income statement</b>					
Net exchange differences on translation of foreign operations – Group	(202)	–	(202)	(4)	(206)
Net exchange differences on translation of foreign operations – associate	(11)	–	(11)	–	(11)
Currency translation adjustment disposed – subsidiaries	(18)	–	(18)	–	(18)
Attributable tax	–	6	6	–	6
<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>

## Notes to the consolidated financial statements continued

## 30. Business combinations

On 11 February 2014, the Group acquired 100% of Grupo Multi, the leading adult English language training company in Brazil. Fair values for the assets and liabilities arising from the Grupo Multi acquisition and other smaller acquisitions completed in the year are set out below. There were no material adjustments to prior year acquisitions. There were no significant acquisitions in 2013. Adjustments were made in respect of prior year acquisitions in 2013 and included the recognition of intangibles of £185m on the EmbanetCompass acquisition.

Fair values for the assets and liabilities arising from acquisitions completed in the year are as follows:

All figures in £ millions	Notes	2014			2013
		Grupo Multi fair value	Other fair value	Total fair value	Total fair value
Property, plant and equipment	10	1	1	2	1
Intangible assets	11	254	6	260	200
Intangible assets – pre-publication	20	1	–	1	1
Inventories		4	–	4	1
Trade and other receivables		35	1	36	9
Cash and cash equivalents (excluding overdrafts)		3	–	3	2
Financial liabilities – borrowings		(49)	–	(49)	–
Net deferred income tax assets/(liabilities)	13	2	(2)	–	(37)
Provisions for other liabilities and charges	23	(13)	(1)	(14)	–
Trade and other liabilities		(21)	(3)	(24)	(7)
Current income tax liabilities		(20)	–	(20)	–
<b>Net assets acquired at fair value</b>		<b>197</b>	<b>2</b>	<b>199</b>	<b>170</b>
Goodwill	11	240	(2)	238	(133)
Fair value of previously held interest arising on stepped acquisition		–	–	–	(7)
<b>Total</b>		<b>437</b>	<b>–</b>	<b>437</b>	<b>30</b>
<b>Satisfied by:</b>					
Cash		(437)	–	(437)	(31)
Deferred consideration		–	–	–	(2)
Net prior year adjustments		–	–	–	3
<b>Total consideration</b>		<b>(437)</b>	<b>–</b>	<b>(437)</b>	<b>(30)</b>

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

Goodwill of £240m arising on 2014 acquisitions is expected to be deductible for tax purposes (2013: £6m).

Intangible assets acquired in 2014 have the following useful economic lives: customer lists, contracts and relationships four years; trademarks and brands 20 years, and other acquired intangibles 12 years. Intangible assets recognised in 2013 have the following useful economic lives: customer lists, contracts and relationships 3-17 years, and trademarks and brands two years.

### 30. Business combinations continued

All figures in £ millions	2014	2013
<b>Cash flow on acquisitions</b>		
Cash – current year acquisitions	(437)	(25)
Deferred payments for prior year acquisitions and other items	(5)	(6)
Cash and cash equivalents acquired	3	2
Acquisition costs and other acquisition liabilities paid	(9)	(19)
<b>Net cash outflow</b>	<b>(448)</b>	<b>(48)</b>

In total, acquisitions completed in the year contributed an additional £70m of sales and £29m of adjusted operating profit. If the acquisitions had completed on 1 January 2014 then the Group estimates that sales for the year would have been £4,880m and total adjusted operating profit would have been £725m.

### 31. Disposals including business closures

All figures in £ millions	2014				2013		
	Mergermarket	Penguin	Other	Total	Penguin	Other	Total
<b>Disposal of subsidiaries</b>							
Property, plant and equipment	(2)	–	(1)	(3)	(39)	(3)	(42)
Intangible assets	(12)	–	–	(12)	(43)	–	(43)
Investments in joint ventures and associates	–	–	–	–	(22)	–	(22)
Other financial assets	–	–	–	–	(1)	–	(1)
Intangible assets – pre-publication	–	–	–	–	(20)	(6)	(26)
Inventories	–	–	–	–	(91)	(3)	(94)
Trade and other receivables	(23)	–	(2)	(25)	(447)	(6)	(453)
Cash and cash equivalents (excluding overdrafts)	(19)	–	(11)	(30)	(34)	(3)	(37)
Net deferred income tax liabilities/(assets)	1	–	–	1	(22)	–	(22)
Retirement benefit obligations	–	–	–	–	–	4	4
Provisions for other liabilities and charges	4	–	–	4	7	–	7
Trade and other liabilities	69	–	12	81	224	10	234
Current income tax liabilities	6	–	–	6	–	–	–
Non-controlling interest	–	–	(2)	(2)	3	–	3
Attributable goodwill	(156)	–	(1)	(157)	(370)	(6)	(376)
Cumulative translation adjustment	2	–	–	2	18	–	18
<b>Net assets disposed</b>	<b>(130)</b>	<b>–</b>	<b>(5)</b>	<b>(135)</b>	<b>(837)</b>	<b>(13)</b>	<b>(850)</b>
Cash received	375	–	–	375	–	3	3
Deferred proceeds	–	–	6	6	–	–	–
Fair value of associate acquired	–	–	–	–	1,160	–	1,160
Costs	(1)	29	(2)	26	(121)	(14)	(135)
<b>Gain/(loss) on disposal</b>	<b>244</b>	<b>29</b>	<b>(1)</b>	<b>272</b>	<b>202</b>	<b>(24)</b>	<b>178</b>

The gain on disposal of Penguin in 2013 arises from the measurement at fair value of the associate investment acquired in Penguin Random House. Determination of fair value is described in note 12.

## Notes to the consolidated financial statements continued

## 31. Disposals including business closures continued

All figures in £ millions	2014	2013
<b>Cash flow from disposals</b>		
Cash – current year disposals	375	3
Cash and cash equivalents disposed	(30)	(37)
Costs and other disposal liabilities paid	(18)	(98)
<b>Net cash inflow/(outflow)</b>	<b>327</b>	<b>(132)</b>

## 32. Held for sale

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

All figures in £ millions	Notes	2014	2013
Property, plant and equipment	10	–	2
Intangible assets	11	–	158
Deferred income tax assets	13	–	1
Trade and other receivables		–	26
Cash and cash equivalents (excluding overdrafts)	17		36
<b>Assets classified as held for sale</b>		<b>–</b>	<b>223</b>
Deferred income tax liabilities	13	–	(2)
Provisions for other liabilities and charges		–	(4)
Trade and other liabilities		–	(71)
Current income tax liabilities		–	(5)
<b>Liabilities directly associated with assets classified as held for sale</b>		<b>–</b>	<b>(82)</b>
<b>Net assets classified as held for sale</b>		<b>–</b>	<b>141</b>

## 33. Purchase of non-controlling interest

There were no purchases of non-controlling interests in 2014. In 2013 the Group purchased non-controlling interests in the South African business for £65m, and in the Indian business for £11m.

### 34. Cash generated from operations

All figures in £ millions	Notes	2014	2013
Profit		470	539
<b>Adjustments for:</b>			
Income tax		110	90
Depreciation	10	74	82
Amortisation and impairment of acquired intangibles and goodwill	11	264	168
Amortisation of software	11	63	59
Net finance costs		93	75
Share of results of joint ventures and associates	12	(51)	(54)
Profit on disposals		(272)	(187)
Acquisition costs		6	12
Net foreign exchange adjustment from transactions		27	(40)
Share-based payment costs	26	32	37
Pre-publication		(52)	(77)
Inventories		6	18
Trade and other receivables		(69)	(50)
Trade and other liabilities		72	72
Retirement benefit obligations		(58)	(57)
Provisions for other liabilities and charges		(11)	(3)
<b>Net cash generated from operations</b>		<b>704</b>	<b>684</b>
Dividends from joint ventures and associates		120	64
Purchase of property, plant and equipment		(75)	(118)
Purchase of intangible assets		(107)	(64)
Proceeds from sale of property, plant and equipment		9	28
Proceeds from sale of intangible assets		2	2
Finance lease principal payments		(4)	(8)
<b>Operating cash flow</b>		<b>649</b>	<b>588</b>
Operating tax paid		(163)	(191)
Net operating finance costs paid		(73)	(73)
<b>Operating free cash flow</b>		<b>413</b>	<b>324</b>
Non operating tax paid		–	(55)
<b>Free cash flow</b>		<b>413</b>	<b>269</b>
Dividends paid (including to non-controlling interests)		(398)	(372)
<b>Net movement of funds from operations</b>		<b>15</b>	<b>(103)</b>
Acquisitions and disposals (net of tax)		(137)	(326)
Loans advanced (including to related parties)		(12)	(49)
Purchase of treasury shares	28	(9)	(47)
New equity		11	14
Other movements on financial instruments		15	(9)
<b>Net movement of funds</b>		<b>(117)</b>	<b>(520)</b>
Exchange movements on net debt		(143)	59
<b>Total movement in net debt</b>		<b>(260)</b>	<b>(461)</b>

## Notes to the consolidated financial statements continued

### 34. Cash generated from operations continued

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

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

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

All figures in £ millions	2014	2013
Net book amount	12	19
(Loss)/profit on sale of property, plant and equipment	(3)	9
<b>Proceeds from sale of property, plant and equipment</b>	<b>9</b>	<b>28</b>

### 35. Contingencies

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

### 36. Commitments

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

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £157m (2013: £183m).

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

All figures in £ millions	2014	2013
Not later than one year	161	161
Later than one year and not later than two years	150	149
Later than two years and not later than three years	126	133
Later than three years and not later than four years	122	118
Later than four years and not later than five years	115	105
Later than five years	701	737
	<b>1,375</b>	<b>1,403</b>



### 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

From 1 January 2014 the key management personnel are deemed to be the members of the Pearson Executive (see page 9). It is this committee which had responsibility for planning, directing and controlling the activities of the Group in 2014. Key management personnel compensation is disclosed below:

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

There were no other material related party transactions. No guarantees have been provided to related parties.

### 38. Events after the balance sheet date

There were no material events after the balance sheet date.

## Notes to the consolidated financial statements continued

## 39. Accounts and audit exemptions

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

	Company number		Company number
Aldwych Finance Limited	04720439	Pearson Education Limited	00872828
ASET Limited	04231636	Pearson Funding Four plc	07970304
ASET Group Limited	03964551	Pearson Funding One plc	02911143
ASET Management Limited	03139404	Pearson Funding Two plc	07210654
ASET Solutions Limited	03849880	Pearson Heinemann Limited	03099304
Blue Wharf Limited	04344573	Pearson in Practice ATA Limited	07679091
Burmedia Investments Limited	03060487	Pearson in Practice Holdings Limited	06337129
Edexcel Limited	04496750	Pearson in Practice Skills Based Learning Limited	03755464
Education Development International plc	03914767	Pearson in Practice Technology Limited	03786989
Embankment Finance Limited	04460625	Pearson International Finance Limited	02496206
eNVQ Limited	03985948	Pearson Loan Finance No. 2 Unlimited	05632021
EQL Assessment Limited	05224778	Pearson Loan Finance No. 3 Limited	05052661
Financial Times (ASC) Limited	00519261	Pearson Loan Finance No. 4 Limited	02635107
Financial Times Group Limited	00879531	Pearson Loan Finance Unlimited	05144467
Frontier UK Limited	05737591	Pearson Management Services Limited	00096263
FT Business Information Limited	00758738	Pearson Overseas Holdings Limited	00145205
FT Labs Limited	04701650	Pearson PRH Holdings Limited	08561316
FT Personal Finance Limited	03855520	Pearson Professional Holdings Limited	00149375
Goal Limited	03566588	Pearson Services Limited	01341060
Green Wharf Limited	07009228	Pearson Shared Services Limited	04623186
Icodeon Limited	05068195	Peter Honey Publications Limited	03754757
Joint Examining Board Limited	03278422	Sector Training Limited	05342448
Longman Group (Overseas Holdings) Limited	00690236	St Clements Press (1988) Limited	02174119
Midlands Educational Technology Limited	01448842	Testchange Limited	02496240
Pearson Affordable Learning Fund Limited	08038068	The Coaching Space Limited	05333023
Pearson Amsterdam Finance Limited	03041245	The Financial Times (Benelux) Limited	01613899
Pearson Australia Finance Unlimited	05578463	The Financial Times (France) Limited	00867316
Pearson Books Limited	02512075	The Financial Times (Japan) Limited	01613900
Pearson Brazil Finance Ltd	08848874	The Financial Times (M-M UK) Limited	01398449
Pearson Canada Finance Unlimited	05578491	The Financial Times (Spain) Limited	01214411
Pearson Dollar Finance plc	05111013	TQ Catalis Limited	07307943
Pearson Dollar Finance Two plc	06507766	TQ Clapham Limited	07307925
Pearson Education Holdings Limited	00210859	TQ Global Limited	07802458
Pearson Education Investments Limited	08444933		

### 39. Accounts and audit exemptions continued

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

	Company number		Company number
Exec-Appointments Limited	04010964	Medley Global Advisors Limited	00931507
FDI Intelligence Limited	NI040129	The Financial News Limited	00607228
Financial Times Business Limited	00202281	The Financial Times (Switzerland) Limited	01613901
Financial Times Electronic Publishing Limited	02749250	The Financial Times (Zhongwen) Limited	01900030
Financial Times Investor Limited	04005565	Throgmorton Publications Limited	00905696
Mandatewire Limited	03855296		

# Company balance sheet

As at 31 December 2014

All figures in £ millions	Notes	2014	2013
<b>Assets</b>			
<b>Non-current assets</b>			
Investments in subsidiaries	2	8,740	8,537
Amounts due from subsidiaries		27	2,009
Financial assets – derivative financial instruments	6	84	111
		8,851	10,657
<b>Current assets</b>			
Amounts due from subsidiaries		5,220	380
Amounts due from related parties		54	44
Current income tax assets		28	24
Financial assets – derivative financial instruments	6	24	13
Cash and cash equivalents (excluding overdrafts)	4	13	394
Other assets		2	–
		5,341	855
<b>Total assets</b>		<b>14,192</b>	<b>11,512</b>
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Amounts due to subsidiaries		(2,346)	(3,553)
Financial liabilities – borrowings	5	(210)	(202)
Financial liabilities – derivative financial instruments	6	(73)	(48)
		(2,629)	(3,803)
<b>Current liabilities</b>			
Amounts due to subsidiaries		(4,414)	(1,256)
Financial liabilities – borrowings	5	(629)	(766)
Financial liabilities – derivative financial instruments	6	(1)	–
Other liabilities		(2)	–
Provisions for other liabilities and charges	7	–	(42)
		(5,046)	(2,064)
<b>Total liabilities</b>		<b>(7,675)</b>	<b>(5,867)</b>
<b>Net assets</b>		<b>6,517</b>	<b>5,645</b>
<b>Equity</b>			
Share capital	8	205	205
Share premium	8	2,579	2,568
Treasury shares	9	1	(22)
Special reserve		447	447
Retained earnings		3,285	2,447
<b>Total equity attributable to equity holders of the company</b>		<b>6,517</b>	<b>5,645</b>

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

Robin Freestone Chief financial officer

# Company statement of changes in equity

Year ended 31 December 2014

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2014	205	2,568	(22)	447	2,447	5,645
Profit for the year	–	–	–	–	1,267	1,267
Issue of ordinary shares under share option schemes*	–	11	–	–	–	11
Purchase of treasury shares	–	–	(9)	–	–	(9)
Release of treasury shares	–	–	32	–	(32)	–
Dividends	–	–	–	–	(397)	(397)
<b>At 31 December 2014</b>	<b>205</b>	<b>2,579</b>	<b>1</b>	<b>447</b>	<b>3,285</b>	<b>6,517</b>

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

The special reserve represents the cumulative effect of cancellation of the company's share premium account.

Included within retained earnings is an amount of £131m (2013: £131m) relating to profit on intra-Group disposals that is not distributable.

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

# Company cash flow statement

Year ended 31 December 2014

All figures in £ millions	Notes	2014	2013
<b>Cash flows from operating activities</b>			
Net profit		1,267	802
<b>Adjustments for:</b>			
Income tax		(9)	(51)
Net finance costs		24	167
Amounts due to subsidiaries		(1,058)	(1,053)
<b>Net cash generated/(used in) from operations</b>		<b>224</b>	<b>(135)</b>
Interest paid		(73)	(82)
Tax received		6	14
<b>Net cash generated/(used in) from operating activities</b>		<b>157</b>	<b>(203)</b>
<b>Cash flows from investing activities</b>			
Disposal of subsidiaries, net of cash disposed		–	482
Loans to related parties		(10)	(44)
Interest received		15	10
<b>Net cash received from investing activities</b>		<b>5</b>	<b>448</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of ordinary shares	8	11	14
Net purchase of treasury shares		(9)	(48)
Repayment of borrowings		(250)	–
Dividends paid to company's shareholders		(397)	(372)
<b>Net cash used in financing activities</b>		<b>(645)</b>	<b>(406)</b>
Effects of exchange rate changes on cash and cash equivalents		(15)	18
<b>Net decrease in cash and cash equivalents</b>		<b>(498)</b>	<b>(143)</b>
Cash and cash equivalents at beginning of year		(118)	25
<b>Cash and cash equivalents at end of year</b>	4	<b>(616)</b>	<b>(118)</b>

# Notes to the company financial statements

## 1. Accounting policies

The financial statements on pages 196 to 204 comprise the separate financial statements of Pearson plc.

As permitted by section 408 of the Companies Act 2006, only the consolidated income statement and statement of comprehensive income have been presented.

The company has no employees.

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the consolidated financial statements with the addition of the following:

### Investments

Investments in subsidiaries are stated at cost less provision for impairment, with the exception of certain hedged investments that are held in a foreign currency and revalued at each balance sheet date.

## 2. Investments in subsidiaries

All figures in £ millions	2014	2013
At beginning of year	8,537	9,108
Subscription for share capital in subsidiaries	138	424
Disposals/liquidations	–	(985)
Currency revaluations	65	(10)
<b>At end of year</b>	<b>8,740</b>	<b>8,537</b>

## 3. Financial risk management

The company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments and current and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. The company's approach to the management of financial risks is consistent with the Group's treasury policy, as discussed in note 19 to the consolidated financial statements. The company believes the value of its financial assets to be fully recoverable.

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

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in a £66m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £85m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £169m, while a 10% weakening in the value of sterling would increase the carrying value by £89m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

## Notes to the company financial statements continued

## 3. Financial risk management continued

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

All figures in £ millions				2014
	USD	GBP	Other	Total
Not later than one year	172	(212)	(16)	(56)
Later than one year and not later than five years	224	–	(97)	127
Later than five years	418	–	(403)	15
<b>Total</b>	<b>814</b>	<b>(212)</b>	<b>(516)</b>	<b>86</b>
<b>Analysed as:</b>				
Bonds	224	–	–	224
Rate derivatives – inflows	(303)	(656)	(537)	(1,496)
Rate derivatives – outflows	893	444	21	1,358
<b>Total</b>	<b>814</b>	<b>(212)</b>	<b>(516)</b>	<b>86</b>

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

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.



#### 4. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2014	2013
Cash at bank and in hand	2	269
Short-term bank deposits	11	125
	13	394

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

At the end of 2014 the currency split of cash and cash equivalents was US dollar 33% (2013: 76%), sterling 54% (2013: 24%) and other 13% (2013: nil).

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

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

All figures in £ millions	2014	2013
Cash and cash equivalents	13	394
Bank overdrafts	(629)	(512)
	(616)	(118)

#### 5. Financial liabilities – borrowings

All figures in £ millions	2014	2013
<b>Non-current</b>		
4.625% US dollar notes 2018 (nominal amount \$300m)	210	202
	210	202
<b>Current</b>		
<b>Due within one year or on-demand:</b>		
7.0% Sterling bonds 2014 (nominal amount £250m)	–	254
Bank loans and overdrafts	629	512
	629	766
<b>Total borrowings</b>	<b>839</b>	<b>968</b>

Included in non-current borrowings above is £nil of accrued interest (2013: £nil). Included in current borrowings above is £nil of accrued interest (2013: £3m).

## Notes to the company financial statements continued

## 5. Financial liabilities – borrowings continued

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

All figures in £ millions	2014	2013
Between one and two years	–	–
Between two and five years	210	202
Over five years	–	–
	210	202

As at 31 December 2014 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows:

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	629	210	–	839
Amounts due to subsidiaries	4,414	960	1,386	6,760
Effect of rate derivatives	1,254	(225)	(1,029)	–
	6,297	945	357	7,599

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

All figures in £ millions	Effective interest rate	2014		2013	
		Carrying amount	Market value	Carrying amount	Market value
Bank loans and overdrafts	n/a	629	629	512	512
7.0% Sterling bonds 2014	7.20%	–	–	254	262
4.625% US dollar notes 2018	4.69%	210	205	202	195
		839	834	968	969

The market values are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the company's borrowings are denominated in the following currencies:

All figures in £ millions	2014	2013
US dollar	477	202
Sterling	354	762
Euro	8	4
	839	968

## 6. Derivative financial instruments

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

All figures in £ millions	2014			2013		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	192	18	–	231	22	–
Interest rate derivatives – not in a hedge relationship	2,404	67	(31)	1,842	63	(48)
Cross-currency derivatives	952	23	(43)	220	39	–
<b>Total</b>	<b>3,548</b>	<b>108</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>
<b>Analysed as expiring:</b>						
In less than one year	200	24	(1)	312	13	–
Later than one year and not later than five years	1,314	61	(8)	1,377	111	–
Later than five years	2,034	23	(65)	604	–	(48)
<b>Total</b>	<b>3,548</b>	<b>108</b>	<b>(74)</b>	<b>2,293</b>	<b>124</b>	<b>(48)</b>

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

## 7. Provisions for other liabilities and charges

Provisions in the prior year were comprised of liabilities assumed on the closure of the business of a Group subsidiary. As anticipated, the provisions were utilised during the year.

## 8. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2013	817,403	204	2,555
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>
Issue of ordinary shares – share option schemes	1,303	–	11
<b>At 31 December 2014</b>	<b>819,883</b>	<b>205</b>	<b>2,579</b>

The ordinary shares have a par value of 25p per share (2013: 25p per share). All issued shares are fully paid. All shares have the same rights.

## Notes to the company financial statements continued

## 9. Treasury shares

	Number of shares 000s	£m
At 1 January 2013	10,102	27
Purchase of treasury shares	4,111	47
Release of treasury shares	(4,931)	(52)
<b>At 31 December 2013</b>	<b>9,282</b>	<b>22</b>
Purchase of treasury shares	907	9
Release of treasury shares	(2,997)	(32)
<b>At 31 December 2014</b>	<b>7,192</b>	<b>(1)</b>

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £1.8m (2013: £2.3m). At 31 December 2014 the market value of the company's treasury shares was £85.6m (2013: £124.4m). The gross book value of the shares at 31 December 2014 amounts to £75m. This value has been netted off with contributions received from operating companies of £76m, resulting in a net credit value of £1m.

## 10. Contingencies

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

## 11. Audit fees

Statutory audit fees relating to the company were £35,000 (2013: £35,000).

## 12. Related party transactions

## Subsidiaries

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

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £143m (2013: £144m) and interest receivable from subsidiaries for the year of £73m (2013: £59m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £19m (2013: £55m). Dividends received from subsidiaries were £1,300m (2013: £1,363m).

## Associates

Amounts due from related parties, disclosed on the face of the company balance sheet, relate to loans to Penguin Random House, an associate of the Group. These loans are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2014 was £54m (2013: £44m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2014 was repaid in its entirety in January 2015.

## Key management personnel

From 1 January 2014, key management personnel are deemed to be the members of the Pearson Executive.

It is this committee which had responsibility for planning, directing and controlling the activities of the company in 2014. Key management personnel compensation is disclosed in note 37 to the consolidated financial statements.

There were no other material related party transactions. No guarantees have been provided to related parties.

## Principal subsidiaries

The principal operating subsidiaries at 31 December 2014 are listed below. They operate mainly in the countries of incorporation or registration. The investments are in equity share capital and they are all 100% owned.

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

The company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements. A complete list of subsidiary and associated undertakings will be included in the next Pearson plc annual return filed with the Registrar of Companies.

## Five-year summary

All figures in £ millions	2010	2011	2012	2013 restated	2014
<b>Sales: By geography*</b>					
North America				3,073	2,974
Core				1,258	1,154
Growth				738	746
<b>Continuing</b>	4,532	4,728	4,959	5,069	4,874
Discontinued	1,427	1,134	1,153	621	9
<b>Total sales</b>	5,959	5,862	6,112	5,690	4,883

<b>Sales: By line of business*</b>					
School				2,303	2,027
Higher Education				1,664	1,695
Professional				1,102	1,152
<b>Continuing</b>	4,532	4,728	4,959	5,069	4,874
Discontinued	1,427	1,134	1,153	621	9
<b>Total sales</b>	5,959	5,862	6,112	5,690	4,883

<b>Adjusted operating profit: By geography*</b>					
North America				474	464
Core				120	152
Growth				38	35
Penguin Random House	–	–	–	50	69
<b>Continuing</b>	732	806	809	682	720
Discontinued	206	132	123	54	2
<b>Total adjusted operating profit</b>	938	938	932	736	722

<b>Adjusted operating profit: By line of business*</b>					
School				268	236
Higher Education				295	309
Professional				69	106
Penguin Random House	–	–	–	50	69
<b>Continuing</b>	732	806	809	682	720
Discontinued	206	132	123	54	2
<b>Total adjusted operating profit</b>	938	938	932	736	722

\*Periods prior to 2013 have not been restated to reflect the new organisation structure as there is no appropriate basis for restatement of those periods. 2011 onwards reflect the adoption of IAS 19 revised and have been restated, as appropriate. Prior periods have not been restated.

All figures in £ millions	2010	2011	2012	2013 restated	2014
<b>Operating margin – continuing</b>	16.2%	17.0%	16.3%	13.5%	14.8%
<b>Adjusted earnings</b>					
Total adjusted operating profit	938	938	932	736	722
Net finance costs	(85)	(55)	(65)	(72)	(64)
Income tax	(215)	(196)	(200)	(97)	(118)
Non-controlling interest	(17)	1	(3)	(1)	1
<b>Adjusted earnings</b>	621	688	664	566	541
Weighted average number of shares (millions)	801.2	800.2	804.3	807.8	810.9
<b>Adjusted earnings per share</b>	77.5p	86.0p	82.6p	70.1p	66.7p

All figures in £ millions	2010	2011	2012	2013	2014
<b>Cash flow</b>					
Operating cash flow	1,057	983	788	588	649
Operating cash conversion	113%	105%	85%	80%	90%
Operating free cash flow	904	772	657	324	413
Operating free cash flow per share	112.8p	96.5p	81.7p	40.1p	50.9p
Total free cash flow	904	772	657	269	413
Total free cash flow per share	112.8p	96.5p	81.7p	33.3p	50.9p

Net assets	5,605	5,962	5,710	5,706	5,985
Net debt	430	499	918	1,379	1,639

#### Return on invested capital (gross basis)

Total adjusted operating profit	938	938	932	736	722
Cash tax paid	(85)	(151)	(65)	(191)	(163)
<b>Return</b>	853	787	867	545	559
Average invested capital	8,315	8,731	9,578	10,130	9,900
Return on invested capital	10.3%	9.0%	9.1%	5.4%	5.6%
Dividend per share	38.7p	42.0p	45.0p	48.0p	51.0p

## Corporate and operating measures

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

### Sales – underlying and constant exchange rate movement

Sales movements exclude Penguin, the impact of acquisitions, disposals and movements in exchange rates.

All figures in £ millions	2014
Underlying decrease	(2)
Portfolio changes	79
Exchange differences	(272)
<b>Total sales decrease</b>	<b>(195)</b>
Underlying decrease	0%
Constant exchange rate increase	2%

### Adjusted income statement

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

All figures in £ millions	2014							
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	398	2	(2)	6	318	–	–	722
Net finance costs	(93)	–	–	–	–	29	–	(64)
Profit before tax	305	2	(2)	6	318	29	–	658
Income tax	(63)	(1)	1	(1)	(73)	(5)	24	(118)
<b>Profit for the year from continuing operations</b>	<b>242</b>	<b>1</b>	<b>(1)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>540</b>
Profit for the year from discontinued operations	228	(1)	(227)	–	–	–	–	–
<b>Profit for the year</b>	<b>470</b>	<b>–</b>	<b>(228)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>540</b>
Non-controlling interest	1	–	–	–	–	–	–	1
<b>Earnings</b>	<b>471</b>	<b>–</b>	<b>(228)</b>	<b>5</b>	<b>245</b>	<b>24</b>	<b>24</b>	<b>541</b>



## Adjusted income statement continued

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

## Adjusted operating profit – underlying and constant exchange rate movement

Operating profit movement excluding the impact of acquisitions, disposals and movements in exchange rates.

All figures in £ millions	2014
Underlying increase	35
Portfolio changes	–
Exchange differences	(49)
<b>Total adjusted operating profit decrease</b>	<b>(14)</b>
Underlying increase	5%
Constant exchange rate increase	5%

## Corporate and operating measures continued

### Free cash flow per share

Operating cash flow for continuing and discontinued operations before tax and finance charges, divided by the weighted average number of shares in issue.

All figures in £ millions	2014	2013
Adjusted operating profit	722	736
Cash conversion	90%	80%
Operating cash flow	649	588
Operating tax paid	(163)	(191)
Net operating finance costs paid	(73)	(73)
<b>Total operating free cash flow</b>	<b>413</b>	<b>324</b>
Non operating tax paid	–	(55)
<b>Total free cash flow</b>	<b>413</b>	<b>269</b>
Weighted average number of shares in issue (millions)	810.9	807.8
Operating free cash flow per share	50.9p	40.1p
<b>Total free cash flow per share</b>	<b>50.9p</b>	<b>33.3p</b>

### Return on invested capital

All figures in £ millions	Invested capital	
	2014	2013
Total adjusted operating profit	722	736
Operating tax paid	(163)	(191)
<b>Return</b>	<b>559</b>	<b>545</b>
Average goodwill and other intangibles	8,557	8,903
Average net operating assets	1,343	1,227
<b>Average invested capital</b>	<b>9,900</b>	<b>10,130</b>
<b>Return on invested capital</b>	<b>5.6%</b>	<b>5.4%</b>

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

# Shareholder information

Pearson ordinary shares are listed on the London Stock Exchange and on the New York Stock Exchange in the form of American Depositary Receipts.

## Corporate website

The investors' section of our corporate website [www.pearson.com/investors](http://www.pearson.com/investors) provides a wealth of information for shareholders. It is also possible to sign up to receive email alerts for reports and press releases relating to Pearson at [www.pearson.com/news/newsletter-subscribe.html](http://www.pearson.com/news/newsletter-subscribe.html)

## Shareholder information online

Shareholder information can be found on our website [www.pearson.com/investors/shareholder-information](http://www.pearson.com/investors/shareholder-information)

Our registrar, Equiniti also provides a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at [www.shareview.co.uk](http://www.shareview.co.uk). For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2233\* or, for those shareholders with hearing difficulties, textphone number 0871 384 2255\*.

## Information about the Pearson share price

The company's share price can be found on our website at [www.pearson.com](http://www.pearson.com). It also appears in the financial columns of the national press.

## 2014 dividends

	Payment date	Amount per share
Interim	12 September 2014	17 pence
Final	1 May 2015	34 pence

## Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0871 384 2043\*.

## Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0871 384 2268\*.

## Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to [www.shareview.co.uk/dealing](http://www.shareview.co.uk/dealing) or call customer services on 0845 300 0430\*.

## Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact their telephone dealing helpline on 08456 037 037\* (weekdays only) or, for online dealing, log on to [www.shareview.co.uk/dealing](http://www.shareview.co.uk/dealing). You will need your shareholder reference number as shown on your share certificate.

A postal dealing service is also available through Equiniti. Please telephone 0871 384 2248\* for details or log on to [www.shareview.co.uk](http://www.shareview.co.uk) to download a form.

## ShareGift

Shareholders with small holdings of shares, whose value makes them uneconomic to sell, may wish to donate them to ShareGift, the share donation charity (registered charity number 1052686). Further information about ShareGift and the charities it has supported may be obtained from their website, [www.ShareGift.org](http://www.ShareGift.org) or by contacting them at ShareGift, PO Box 72253, London, SW1P 9LQ.

## American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact Bank of New York Mellon, Shareholder Correspondence (ADR), PO Box 30170, College Station, TX 77842-3170, telephone 1 (866) 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively, you may email [shrrelations@cpushareownerservices.com](mailto:shrrelations@cpushareownerservices.com). Voting rights for registered ADR holders can be exercised through Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

\*Calls to these numbers are charged at 8p per minute plus network extras. Lines open 8.30am to 5.30pm Monday to Friday.

## Shareholder information continued

### Share register fraud: protecting your investment

Pearson does not contact its shareholders directly to provide recommendation advice and neither does it appoint third parties to do so. As required by law, our shareholder register is available for public inspection but we cannot control the use of information obtained by persons inspecting the register. Please treat any approaches purporting to originate from Pearson with caution.

For more information, please log on to our website at [www.pearson.com/investors/shareholder-information.html](http://www.pearson.com/investors/shareholder-information.html)

### Tips on protecting your shares

- › Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation.
- › Inform our registrar, Equiniti, promptly when you change address.
- › Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or better still, make arrangements to have the dividend paid directly into your bank account.
- › Consider holding your shares electronically in a CREST account via a nominee.

### 2015 financial calendar

Ex-dividend date	2 April
Record date	7 April
Last date for dividend reinvestment election	10 April
Payment date for dividend and share purchase date for dividend reinvestment	1 May
Annual General Meeting	24 April
Interim results	24 July
Payment date for interim dividend	11 September

## Reliance on this document

Our strategic report on pages 2 to 56 has been prepared in accordance with section 414 ('Duty to prepare a strategic report') of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. It also incorporates much of the guidance set out in the Accounting Standards Board's Reporting Statement on the Operating and Financial Review.

The intention of this document is to provide information to shareholders and is not designed to be relied upon by any other party or for any other purpose.

## Forward-looking statements

Except for the historical information contained herein, the matters discussed in this document include forward-looking statements. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing, anticipated costs savings and synergies and the execution of Pearson's strategy, are forward-looking statements. By their nature, forward-looking statements involve risks and uncertainties

because they relate to events and depend on circumstances that will occur in future. They are based on numerous assumptions regarding Pearson's present and future business strategies and the environment in which it will operate in the future. There are a number of factors which could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including a number of factors outside Pearson's control. These include international, national and local conditions, as well as competition. They also include other risks detailed from time to time in Pearson's publicly-filed documents and you are advised to read, in particular, the risk factors set out in this document or otherwise in Pearson's latest annual report and accounts, which can be found on its website ([www.pearson.com/investors](http://www.pearson.com/investors)). Any forward-looking statements speak only as of the date they are made, and Pearson gives no undertaking to update forward-looking statements to reflect any changes in its expectations with regard thereto or any changes to events, conditions or circumstances on which any such statement is based. No reliance should be placed on forward-looking statements.



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Pearson has supported the planting of 167 square metres of new native woodland with the Woodland Trust, helping to remove 6.7 tonnes of carbon dioxide emissions generated by the production of this report and associated documents.

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