Governance and financial statements

Board of directors

Chairman

Dennis Stevenson●▲ – chairman, aged 58, was appointed a non-executive director of Pearson in 1986 and became chairman in 1997. He is also chairman of HBOS plc and a non-executive director of Manpower Inc. in the US.

Executive directors

Marjorie Scardino● – chief executive, aged 57, joined the Pearson board in January 1997. She trained and practised as a lawyer, and was chief executive of The Economist Group from 1993 until joining Pearson. She is also a non-executive director of Nokia Corporation.

David Bell● – director for people, aged 57, became a director of Pearson in March 1996. He is chairman of the Financial Times Group, having been chief executive of the Financial Times from 1993 to 1998. In July 1998 he was appointed Pearson's director for people with responsibility for the recruitment, motivation, development and reward of employees across the Pearson Group. He is also a non-executive director of VITEC Group plc and chairman of the International Youth Foundation.

John Makinson● – chairman and chief executive officer of The Penguin Group, aged 49, joined the Pearson board in March 1996 and was finance director until June 2002. From 1994 to 1996 he was managing director of the Financial Times, and prior to that he founded and managed the investor relations firm Makinson Cowell. He was appointed chairman of The Penguin Group in May 2001. He is also chairman of Interactive Data Corporation in the US and a non-executive director of George Weston Limited in Canada.

Rona Fairhead▲● – chief financial officer, aged 42, joined the Pearson board and became chief financial officer in June 2002. She also served as deputy finance director from October 2001. From 1996 until 2001 she worked at ICI, where she served as executive vice president, group control and strategy. Prior to that, she worked for Bombardier Inc. in finance, strategy and operational roles. She is also a non-executive director of HSBC Holdings plc, and of Harvard Business School Publishing in the US.

Peter Jovanovich● – chief executive of Pearson Education, aged 55, joined the Pearson board in June 2002. He became chief executive of Pearson Education in 1998. Prior to this he was president of the McGraw-Hill Educational and Professional Group and chairman and CEO of Harcourt Brace Jovanovich. He also serves on the boards of the Association of American Publishers and the Alfred Harcourt Foundation.

Non-executive directors

Terry Burns*†● – aged 59, was the UK government's chief economic adviser from 1980 until 1991 and Permanent Secretary of HM Treasury from 1991 until 1998. He is non-executive chairman of Abbey National plc and Glas Cymru Limited, and a non-executive director of The British Land Company PLC. He was appointed a non-executive director of Pearson in May 1999, and our senior independent director in February this year.

Reuben Mark*†● – aged 65, is chairman and chief executive of the Colgate-Palmolive Company and a non-executive director of Time Warner Inc. He became a non-executive director of Pearson in 1988.

Vernon Sankey*●▲ – aged 54, was previously chief executive of Reckitt & Colman plc and is deputy chairman of Photo-Me International plc and Beltpacker plc. He is also a non-executive director of Taylor Woodrow plc, Zurich Financial Services AG and a board member of the UK's Food Standards Agency. He became a non-executive director of Pearson in 1993.

Rana Talwar†●▲ – aged 55, was previously group chief executive of Standard Chartered plc. He became a non-executive director of Pearson in March 2000.

Patrick Cescau● – aged 55, is a director of Unilever plc and Unilever NV. He will become chairman of Unilever plc and vice chairman of Unilever NV with effect from 30 September 2004. He became a non-executive director of Pearson in April 2002.

* a member of the audit committee.
† a member of the personnel committee.
● a member of the nomination committee.
▲ a member of the treasury committee.

Directors' report

The directors are pleased to present their report to shareholders, together with the financial statements for the year ended 31 December 2003 on pages 70 to 73 and 75 to 112 respectively. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given on pages 12 to 19 and 34 to 40 of this annual report. Sales and profits of the different sectors and geographical markets are given on pages 77 and 78.

Results and dividend
The profit for the financial year ended 31 December 2003 was £55m (2002: £111m loss). The loss retained for the year was £137m (2002: £298m loss) and has been transferred to reserves. A final dividend of 14.8p per share is recommended for the year ended 31 December 2003. This, together with the interim dividend already paid, makes a total for the year of 24.2p (2002: 23.4p). The final dividend will be paid on 7 May 2004 to shareholders on the register at the close of business on 13 April 2004, the record date.

Significant acquisitions and disposals
Details of these transactions can be found in notes 25 and 26 to the accounts on pages 106 to 107.

Transactions with related parties
Details of transactions with related parties, which are reportable under FRS 8 'Related party transactions', are given in note 30 to the accounts on page 110.

Capital expenditure
The analysis of capital expenditure and details of capital commitments are shown in note 12 to the accounts on page 93.

Post balance sheet events
There were no significant post balance sheet events.

Directors
The present members of the board, together with their biographical details, are shown on page 48. Details of directors' remuneration and interests in ordinary shares and options of the company are contained in the report on directors' remuneration on pages 55 to 69. Four directors, Dennis Stevenson, John Makinson, Reuben Mark and Vernon Sankey will retire by rotation at the forthcoming Annual General Meeting (AGM) on 30 April 2004. All four, being eligible, will offer themselves for re-election. Details of directors' service contracts can be found on page 59. No director was materially interested in any contract of significance to the company's business.

Corporate governance
Introduction Reflecting our support for governance reforms, we will implement the new Combined Code this year. A detailed account of how we comply with its provisions can be found on our website at www.pearson.com/investor/corpgov.htm, or by telephoning our company secretarial department on 020 7010 2257 or 2253.

Compliance involves modest changes since we already conformed to most of the new Code's provisions. The main changes have been the appointment of a senior independent director; modifications to the board's committees and their terms of reference; and a more formal process for board evaluation (including the chairman and chief executive).

Under both the existing Combined Code and the revisions enacted this year the three areas where explanation is required are the independence of two of the non-executive directors, Reuben Mark and Vernon Sankey, the composition of our nomination committee and Peter Jovanovich's service contract. Each of these are covered below. Except for these areas the board believes that we are in compliance with the existing Code.

Composition of the board The board consists of the chairman, Dennis Stevenson, five executive directors and five non-executive directors. Terry Burns has been appointed as the senior independent director.

We are currently in what we hope are the final stages of making appointments of new non-executive directors, partly to bring new skills on to the board and partly to have board succession plans in place.

Independence of directors Since Reuben Mark (16 years) and Vernon Sankey (11 years) have both been on the board for more than the allotted nine years under the new Combined Code, they can be counted as independent directors only if the board deems them to be so. This we do without hesitation. Neither wishes to stay unless considered independent, and we are quite clear that their leaving would not be in the shareholders' interest. Reuben Mark, one of the most consistently successful chief executives in the world, has a reputation for robust independence and makes a considerable, constructively critical, contribution to the Pearson board. Vernon Sankey is an outstanding, diligent chairman of our audit committee and also an aggressively questioning, thoughtful and vocal director.

This leaves us in the position of having five independent directors, five executive directors and Dennis Stevenson, our chairman, who is part time and so is not formally considered 'independent'. When we have appointed at least one new independent director, as we intend to do this year, independent directors will be in a majority, a situation we intend to maintain.

Directors' report continued

Board meetings The board meets six times a year and at other times as appropriate.

The following table sets out the attendance of our directors at the board and committee meetings during 2003:

	Board meetings (maximum 6)	Audit committee meetings (maximum 4)	Treasury committee meetings (maximum 1)	Personnel committee meetings (maximum 5)
Chairman				
Dennis Stevenson	6		1	
Executive directors				
Marjorie Scardino	6			
David Bell	6			
Peter Jovanovich	3*			
Rona Fairhead	6		1	
John Makinson	6			
Non-executive directors				
Terry Burns	6	4		5
Reuben Mark	6	4		5
Vernon Sankey	6	4	1	
Rana Talwar	6		1	4 and part of 1
Patrick Cescau	6			

* Peter Jovanovich missed three board meetings due to illness.

The role and business of the board The formal matters reserved for the board's decision and approval are: the company's strategy; acquisitions, disposals and capital expenditure projects above certain thresholds; all guarantees over £10m; treasury policies; the interim and final dividends and the financial statements; borrowing powers; appointments to the board; and the appointment and removal of the company secretary.

The board receives timely, regular and necessary management and other information to fulfil its duties. Directors can obtain independent professional advice at the company's expense in performance of their duties as directors. All directors have access to the advice and the services of the company secretary.

In addition to these formal roles, we aim to give the non-executive directors access to the senior managers of the business via involvement at both formal and informal meetings. In this way we hope that the experience and expertise of the non-executive directors can be garnered to the benefit of the company. At the same time, the non-executive directors will develop an understanding of the abilities of the most senior managers that will help them judge the company's prospects and plans for succession.

Board evaluation At the end of 2003 the board undertook what will become an annual process for evaluating its effectiveness and that of its committees. The results of this first evaluation are being reviewed in early 2004 and will be reported back to the board. We also have in place a process for the chairman's appraisal of the performance of individuals on the board. In 2003, the chief executive's performance was appraised by the chairman, reviewed with the non-executive directors and discussed with the chief executive in a meeting of all non-executive directors. During the year the executive directors were evaluated by the chief executive under the company's standard appraisal mechanism; their performance, and that of the company's major executives, is also reviewed by the chief executive with the chairman and non-executive directors as part of an annual succession planning meeting. We have also established a process for our newly appointed senior independent director to review the performance of the chairman, which will begin this year.

The chairman's commitments In line with the requirement of the Code, we report that Dennis Stevenson's commitments have not changed throughout the year. Under the new Combined Code he is allowed to remain as chairman of two FTSE 100 companies, and the board is pleased to say that in their view there is no conflict of interest or time whatsoever to the disadvantage of the company.

Directors' training Directors receive an induction programme and a range of information about the company when they join the board; and continuing updates on that programme through presentations about the company's operations at the board meetings as well as ongoing information. We plan to supplement the existing directors' training programme by making available to the directors the opportunity for additional visits to operating company divisions and meetings with local management, as well as to facilitate access to externally run courses should a director wish to make use of them.

Executive directors' service contracts The board is strongly supportive of 12 months being the longest period of notice in directors' service contracts. The contract for Peter Jovanovich, the American head of our education business, provides two years' severance pay in the event of termination without cause. This anomaly arises from the contract being agreed before he joined the board. We fully intend to alter this arrangement to fall in line with those for other executive directors. Discussions with Peter Jovanovich have been held up by his absence on ill-health grounds, but will resume on his return.

Dialogue with institutional shareholders There is an extensive programme for executive directors and top managers to meet with institutional shareholders, and the non-executive directors meet informally with shareholders both before and after the AGM, and respond to shareholder queries and requests. The chairman makes himself available to meet any significant shareholder, as required. Makinson Cowell reports to the board each year the results of an extensive survey on major shareholders' views and each month on changes in market positions and shareholders' views.

Board committees

The board has established four committees. Chairmen and members of these committees are appointed by the board on the recommendation (where appropriate) of the nomination committee and in consultation with each requisite committee chairman.

i Audit committee Vernon Sankey (chairman), Terry Burns, Reuben Mark.

All of the committee members are independent non-executive directors and have significant financial experience due to the senior positions they hold or held in other listed or publicly traded companies.

The committee has written terms of reference which clearly set out its authority and duties, these can be found on the company website at www.pearson.com/investor/corpgov.htm. With the issuance in 2003 of the new UK Combined Code, the New York Stock Exchange Corporate Governance Rules, and the Sarbanes-Oxley Act of 2002, a revised audit committee charter and terms of reference reflecting the new requirements has been approved by the board and implemented with effect from 1 January 2004.

The committee provides the board with the means to appraise Pearson's financial management and reporting, and to assess the integrity of the Group's accounting procedures and financial controls. The Group's internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee. The committee reports to the full board of Pearson. The committee also reviews the objectivity of the external auditors, including non-audit services supplied, and ensures that there is an appropriate audit relationship.

The committee met four times during the year with the chief financial officer, head of group control and other members of the senior management team, together with the external auditors, in attendance. The committee meets privately with the external auditors and the head of group control at least once a year.

ii Personnel committee Reuben Mark (chairman), Terry Burns, Rana Talwar.

The committee is comprised solely of independent non-executive directors and meets at least three times a year and on other occasions when circumstances require.

The committee has responsibility for determining the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the management committee, as well as recommending the chairman's remuneration to the board for its decision. It also reviews the company's management development, diversity and succession plans. The committee takes independent advice from consultants when required. No executive director takes part in any discussion or decision concerning their own remuneration. The committee reports to the full board and its report on directors' remuneration, which has been considered and adopted by the board, is set out on pages 55 to 69.

iii Nomination committee The full board currently acts as the nomination committee, with Dennis Stevenson as chairman. Following the introduction of the new Combined Code, the board has agreed to review the composition of this committee to ensure that it is made up of a majority of independent non-executive directors and to put in place terms of reference which clearly set out its authority and duties. The committee's purpose will be to make recommendations to the board on all proposed appointments of directors through a formal procedure. The committee will meet as and when required. In accordance with the company's articles of association, directors are subject to reappointment at the AGM immediately following the date of their appointment, and thereafter they must seek re-election no more than three years from the date they were last re-elected. The committee will recommend to the board the names of the directors who are to seek re-election at the AGM.

iv Treasury committee Dennis Stevenson (chairman), Rona Fairhead, Vernon Sankey, Rana Talwar.

The committee sets the policies for the company's treasury department and reviews its procedures on a regular basis. The treasury committee schedules one meeting a year and arranges to meet at other times, if necessary.

Internal control

The directors are responsible for the Group's system of internal control and have reviewed its effectiveness in accordance with the provisions of the Combined Code. They consider that the system of internal control is appropriately designed to manage the risk environment facing the Group and to provide reasonable, but not absolute, assurance against material misstatement or loss.

They confirm that there is an ongoing process, embedded in the Group's integrated internal control system, allowing for the identification, evaluation and management of significant business risks, as well as a reporting process to the board. The board requires operating companies to undertake semi-annual reviews to identify new or potentially under-managed risks. The results of these reviews are reported to the board via the audit committee. This process has been in place throughout 2003 and up to the date of the approval of this annual report, and it accords with the Turnbull guidance.

The main elements of the Group's internal control system including risk identification are as follows:

i Board – The board of directors has overall responsibility for the Group's system of internal control and exercises control through an organisational structure with clearly defined levels of responsibility and authority as well as appropriate reporting procedures. The board meets regularly and has a schedule of matters that are brought to it, or its duly authorised committees, for decision aimed at maintaining effective control over strategic, financial, operational and compliance issues. This structure includes the audit committee, which with the chief financial officer, reviews the effectiveness of the internal financial and operating control environment of the Group. The audit committee meets regularly and considers reports from both the internal and external auditors.

ii Operating company controls – The identification and mitigation of major business risks is the responsibility of operating company management. Each operating company maintains controls and procedures appropriate to its own business environment while conforming to Group standards and guidelines, including procedures to identify and mitigate all types of risk. To this end operating companies undertake risk reviews, semi-annually, to identify new or potentially under-managed risks.

iii Financial reporting – There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the board of directors. Monthly financial information, including trading results, balance sheets, cash flow statements and indebtedness, are reported against the corresponding figures for the plan and prior years, with corrective action outlined by operating company executives as appropriate. Quarterly, Group senior management meet with operating company management to review their business and financial performance against budget and forecast. Major business risks relevant to each operating company are reviewed in these meetings.

iv Treasury management – The treasury department operates within policies approved by the board and its procedures are reviewed regularly by the treasury committee. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the chief financial officer and regular reports are prepared for the treasury committee.

v Group control – The group control function is responsible for risk reviews and internal audit, which it exercises through teams located in the UK and US. The department reviews business risks, processes and procedures in all the main operating companies, agreeing with operating company management plans to mitigate those risks and improve internal controls and processes. It monitors operating companies' progress in implementing its recommendations and provides regular reports on its findings to executive management and, via the audit committee, to the board. Annually the department specifically reviews and reports on business risk to executive management and, via the audit committee, to the board.

vi Insurance – Insurance is provided through Pearson's insurance subsidiary or externally, depending on the scale of the risk and the availability of cover in the external market, with the objective of achieving the most cost effective balance between insured and uninsured risks.

Going concern

Having reviewed the Group's liquid resources and borrowing facilities, and the 2004 and 2005 cash flow forecasts contained in the Group budget for 2004, the directors believe that the Group has adequate resources to continue as a going concern for the foreseeable future. For this reason, the financial statements have, as usual, been prepared on that basis.

Shareholder communication

Pearson has an extensive programme of communication with all its shareholders – large and small, institutional and private. We also make a particular effort to communicate regularly with our employees, a large majority of whom are shareholders in the company. We post all company announcements on our website, www.pearson.com, as soon as they are released, and major shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes information about all of our businesses, links to their websites, and details of our corporate responsibility policies and activities.

In 2003, we began a programme of educational seminars for our institutional shareholders focusing on individual parts of Pearson. Last year this covered the No Child Left Behind education bill, our asset pricing business IDC and our Higher Education business. The seminars are available to all shareholders via webcast on www.pearson.com.

Our AGM – which will be held on 30 April this year – includes opportunities to meet the company's managers, presentations about Pearson's businesses and the previous year's results as well as general AGM business.

People

The average number of people employed in Pearson during 2003 was 30,868 across 62 countries. Each business has detailed employment practices for recruitment, remuneration, employee relations, health and safety, and terms and conditions designed for the different sectors and countries in which it operates.

We are committed to equality of opportunity for all regardless of gender, race, age, physical ability, religion or sexual orientation. This philosophy applies equally to recruitment and to the promotion, development and training of people who are already part of Pearson. The company takes seriously its statutory obligations to the disabled and seeks not to discriminate against current or prospective employees because of any disability. We are always willing to make reasonable adjustments to premises or employment arrangements if these substantially disadvantage a disabled employee or prospective employee. Every effort is made to find suitable alternative jobs for those who are unable to continue in their existing role due to disability.

Pearson is committed to clear and timely communication with its people concerning business performance. It works hard to maintain effective channels of communication as detailed in the section entitled 'standing up' starting on page 22 and supports employee representation to help positive employee relations. Twice a year, the European Employee Forum meets to discuss issues of importance to staff in their businesses.

Supplier payment policy

Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. It is company policy that suppliers are aware of such terms of payment and that payments to them are made in accordance with these, provided that the supplier is also complying with all relevant terms and conditions. Group trade creditors at 31 December 2003 were equivalent to 37 days of purchases during the year ended on that date. The company does not have any significant trade creditors and therefore is unable to disclose average supplier payment terms.

External giving

In 2003, Pearson's charitable giving totalled £2.1m (2002: £2.8m). This was split between the UK (£605,000; £868,000 in 2002), and the rest of the world (£1,508,000; £1,929,000 in 2002). In addition to cash donations, Pearson provides in-kind support such as books, publishing expertise, advertising space and staff time. We encourage our employees to support their personal charities by matching donations and payroll giving.

We focus our charitable giving on projects related to education.

More details can be found in the section entitled 'standing up' starting on page 22.

Share capital

Details of share issues are given in note 23 to the accounts on pages 104 and 105. At the AGM held on 25 April 2003, the company was authorised, subject to certain conditions, to acquire up to 80 million of its ordinary shares by market purchase. Although circumstances have not merited using this authority and there are no plans at present to do so, shareholders will be asked to renew this authority at the AGM on 30 April 2004.

At 27 February 2004, beneficial interests amounting to 3% or more of the issued ordinary share capital of the company notified to the company comprised:

	Number of shares	Percentage
Legal & General	24,046,759	3.00%
Telefónica Contenidos, SA	38,853,403	4.84%
Franklin Resources, Inc.	48,400,695	6.03%
The Capital Group Companies Inc.	104,380,995	13.01%

Directors' report continued

Annual general meeting – The notice convening the AGM to be held at 12 noon on Friday, 30 April 2004 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, is contained in a circular to shareholders to be dated 25 March 2004.

Registered auditors – In accordance with section 384 of the Companies Act 1985 (the Act) resolutions proposing the reappointment of PricewaterhouseCoopers LLP as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the directors.

Auditor independence – In line with best practice, the audit committee has introduced a policy that defines those non-audit services that the independent auditors, PricewaterhouseCoopers LLP, may or may not provide to Pearson. The policy requires the provision of these services to be approved in advance by the audit committee. The policy also establishes other procedures to ensure that the auditors' independence has not been compromised. A full statement of the fees for audit and non-audit services is provided in note 3 to the accounts.

Statement of directors' responsibilities – Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group as at the end of the year and of the profit or loss of the Group for that period. The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time, the financial position of the company and the Group and to enable them to ensure that the financial statements comply with the Act. They are also responsible for safeguarding the assets of the Group, and hence for taking reasonable steps towards preventing and detecting fraud and other irregularities. In preparing the financial statements on pages 70 to 73 and 75 to 112 inclusive, the directors consider that appropriate accounting policies have been used and applied in a consistent manner, supported by reasonable and prudent judgements and estimates, and that all relevant accounting standards have been followed.

Approved by the board on 27 February 2004 and signed on its behalf by:

Philip Hoffman, secretary

Report on directors' remuneration

Introduction

The directors' remuneration report is presented to shareholders by the board and contains the following information:

- a description of the duties of the personnel committee;
- a summary of the company's remuneration policy, including a statement of the company's policy on directors' remuneration;
- details of the terms of the service contracts and the remuneration of each director for the preceding financial year;
- details of the awards under long-term incentive plans held by the directors;
- details of each director's interest in shares in the company; and
- a graph illustrating the performance of the company relative to the FTSE All-Share index for the last five years.

This report complies with the Directors' Remuneration Report Regulations 2002. This report also sets out how the principles of the Combined Code relating to directors' remuneration are applied.

A resolution will be put to shareholders at the annual general meeting on 30 April 2004 inviting them to consider and approve this report.

The personnel committee

Reuben Mark chairs the personnel committee; the other members of the committee during 2003 were Terry Burns and Rana Talwar. All three members of the committee are independent non-executive directors. All members attended all five meetings of the committee held during 2003.

The committee's duties are:

- to determine and review regularly the remuneration policy and the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee who report directly to the CEO. This includes base salary, annual and long-term incentive entitlements and awards, and pension arrangements;
- together with the other independent directors (as directed by the board), to review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and determine and approve the CEO's compensation level based on this evaluation;
- to review, when appropriate with external assistance, the remuneration and benefits packages of comparable companies to ensure that the company's senior executives are fairly and competitively remunerated;
- to approve the company's long-term incentive and other share plans, including guidelines for the operation of such plans as a whole and, where relevant, the determination of performance measures and targets;
- to advise and decide on general and specific arrangements in connection with the termination of employment of executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee;
- to review the company's management development, training and succession plans;
- to recommend to the full board for its approval the remuneration and benefits package of the chairman of the board;
- to ensure that all provisions regarding disclosure as set out in the Directors' Remuneration Report Regulations 2002 and the Combined Code are fulfilled;
- to be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee.

Dennis Stevenson, chairman, Marjorie Scardino, chief executive, David Bell, director for people, and Robert Head, compensation and benefits director, provided material assistance to the committee during the year. They attend meetings of the committee, although no director is present when his or her own position is being considered.

To ensure that it received independent advice, the committee has appointed Towers Perrin to supply survey data and advise on market trends, long-term incentives and other general remuneration matters.

Other external remuneration and benefits specialists also advised the committee. Watson Wyatt advised on retirement benefits. They were also actuaries for the Pearson Group Pension Plan and advisors to the company on general retirement and benefit matters in the UK and the US. Freshfields Bruckhaus Deringer provided legal advice on long-term incentives. They were the company's main UK legal advisor. The committee did not appoint these firms.

Report on directors' remuneration continued

Compliance
The committee believes that the company has complied with the provisions regarding remuneration matters of the Combined Code on corporate governance as required by the UK Listing Authority of the Financial Services Authority.

Items subject to audit
The items subject to audit in this report comprise the sections on directors' remuneration, directors' pensions and movements in directors' interests in restricted shares and share options set out in tables 1, 2, 4 and 5 together with the accompanying notes set out below.

Remuneration policy
This report sets out the company's policy on directors' remuneration. This policy will continue to apply to each director for 2004 and, so far as practicable, for subsequent years. The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the company's business environment and in remuneration practice. Any changes in policy for years after 2004 will be described in future reports, which will continue to be subject to shareholder approval. All statements in this report in relation to remuneration policy for years after 2004 should be considered in this context.

Pearson seeks to generate a performance culture by developing programmes that support its business goals and rewarding their achievement. It is the company's policy that total remuneration (base compensation plus short-term and long-term incentives) should reward both short and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional company performance.

The company's policy is that base compensation should provide the appropriate rate of remuneration for the job, taking into account relevant recruitment markets and business sectors and geographic regions. Benefit programmes should ensure that Pearson retains a competitive recruiting advantage.

Share ownership is encouraged throughout the company. Equity-based reward programmes align the interests of directors, and employees in general, with those of shareholders by linking rewards with Pearson's financial success.

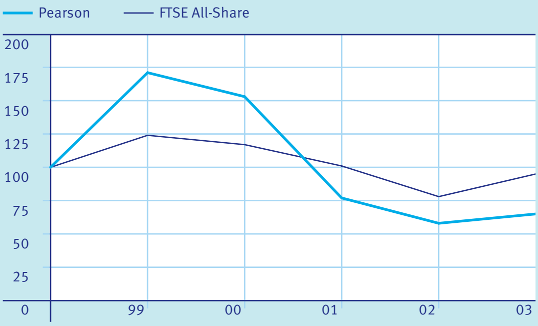
The committee selects performance measures and establishes targets for the company's various performance-related annual or long-term incentive plans based on an assessment of the interests of shareholders and the company and taking into account an appropriate balance of risk and reward for the directors and other participants.

The committee determines whether or not targets have been met under the company's various performance-related annual or long-term incentive plans based on the relevant information and input from advisors and auditors as appropriate.

Performance
We set out below Pearson's total shareholder return performance on two bases.

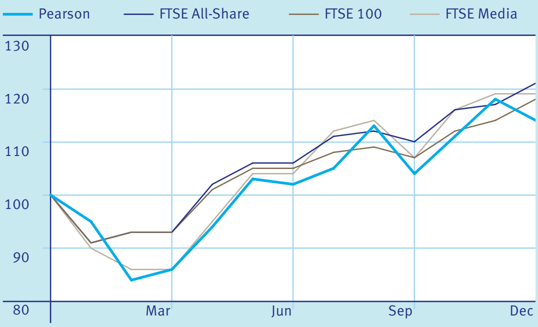
First, we show Pearson's total shareholder return relative to the FTSE All-Share index (of which Pearson is a constituent) on an annual basis over the five-year period 1998 to 2003. We have chosen this index on the basis that it is a recognisable reference point and appropriate comparator for the majority of our investors.

Total shareholder return



We also show Pearson's shareholder return performance relative to the FTSE All-Share, 100 and Media indices on a monthly basis over 2003, the period to which this report relates. Pearson is a constituent of all these indices.

Total shareholder return

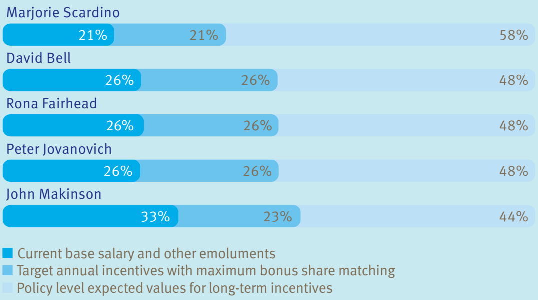


Main elements of remuneration

Total remuneration is made up of fixed and performance-linked elements. Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual bonus, bonus share matching and long-term incentives.

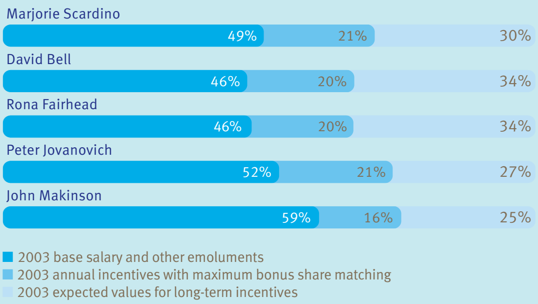
Based on the details set out in this report, our policy is that the relative importance of fixed and performance-related remuneration for each of the directors should be as follows:

Proportion of total compensation



In practice, because the commercial circumstances of the business meant that annual bonuses were significantly below target and long-term incentive awards were well below policy levels, for 2003 the position was as follows:

Proportion of total compensation



The differences in the proportions in each case also reflect the differences in the benefit packages of the individual directors consistent with the company's policy on other emoluments set out below.

The committee will continue to review the mix of fixed and performance-linked remuneration on an annual basis consistent with its overall philosophy.

Base salary

Our policy is that the base salaries of the executive directors should be competitive with those of directors and executives in similar positions in comparable companies. We use a range of companies of comparable size and global reach in different sectors including the media sector in the UK and selected media companies in North America to make this comparison. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our salaries were not competitive.

Our policy is to review salaries annually.

Other emoluments

It is the company's policy that its benefit programmes should be competitive in the context of the local labour market, but as an international company we recognise the requirements, circumstances and mobility of individual executives.

Annual bonus

The committee establishes the annual bonus plans for the executive directors, chief executives of the company's principal operating companies and other members of the Pearson Management Committee, including performance measures and targets and the amount of bonus that can be earned.

The performance targets relate to the company's main drivers of business performance at both the corporate and operating company level. Performance is measured separately for each item.

Although at the date of publication of this report no decisions had been made, for 2004 the performance measures for Pearson plc are likely to be drawn from those in previous years, namely growth in underlying sales and adjusted earnings per share, operating cash conversion and working capital as a ratio to sales, and return on invested capital. For subsequent years, the measures will be set at the time.

Following the committee's review of executive remuneration and the increase in annual bonus opportunities described to shareholders in the 2003 report, for 2004 the target annual bonus opportunity for executive directors and other members of the Pearson Management Committee is 75% of salary. Individuals may receive up to twice their target bonus (i.e. a maximum of 150% of salary) based on performance in excess of target.

The committee may award individual discretionary bonuses.

Details of actual pay-outs for 2003, which averaged 31% of salary, are set out in table 1 and the notes on page 62 of this report.

The committee will continue to review the bonus plans on an annual basis and to revise the bonus limits and targets in light of the current conditions.

In the UK, bonuses do not form part of pensionable earnings. In the US, bonuses up to 50% of base salary are pensionable under the supplemental executive retirement plan, consistent with US market practice.

Bonus share matching

The company encourages executive directors and other senior executives to hold Pearson shares.

The annual bonus share matching plan permits executive directors and senior executives around the company to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the company's adjusted earnings per share increase in real terms by at least 3% per annum, the company will match them on a gross basis of one share for every two held after three years, and another one for two originally held (i.e. a total of one-for-one) after five years. This measure of performance is consistent with the test of company performance used in the executive option plan.

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

Long-term incentives

Executive directors, senior and other executives and managers are eligible to participate in Pearson's long-term incentive plan introduced in 2001. The plan consists of two parts: stock options and/or restricted stock. The aim is to give the committee a range of tools with which to link corporate performance to management's long-term reward in a flexible way. The principles underlying it are as follows:

- the committee uses an accepted economic valuation model to determine the impact of any performance conditions and calculate the relative value of both stock options and restricted stock;
- based on these values, the committee establishes guidelines each year for the expected value of awards i.e. their net present value after taking into account all the conditions and in particular, the probability that any performance conditions will be met;
- the maximum expected value of awards for executive directors is based on an assessment of market practice for comparable companies. Current policy is for annual long-term incentive awards with maximum expected values of 300% of salary for the CEO and 200% of salary for the other executive directors. Details of actual awards for 2003 which were below these maximum policy levels are set out in table 4 and notes on pages 64 to 66 of this report;
- no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans in any 10-year period commencing in January 1997;
- awards of restricted stock are satisfied using existing shares.

Our stock option grant performance test is designed to provide a direct link between the amount of equity allocated to option grants and the company's financial progress.

Within the 10% limit on the issue of new equity, up to 1.5% may be placed under option in any year. No options may be granted unless our adjusted earnings per share increase in real terms by at least 3% per annum over the three-year period prior to grant. Grants may be made at the maximum level only if real earnings per share growth exceeds 3% per annum by a substantial margin.

Real growth is measured against the UK Government's Index of Retail Prices (All Items).

Having consulted institutional investors, we chose a pre-grant performance condition because we operate in a global environment where pre-exercise performance conditions are not common. Accordingly, there are no further performance conditions governing the exercise of options.

Earnings per share growth was chosen as the most appropriate measure of our ability to fund the issue of new equity and we chose to test our earnings per share growth against UK inflation over three years to ensure that option funding is is released only when the real value of shareholders' earnings has increased over a sustained period.

The vesting of restricted stock is normally dependent on the satisfaction of a stretching corporate performance target as determined by the committee for each award. Restricted stock may be granted without performance conditions to satisfy recruitment and retention objectives. Details of the performance periods, measures and targets for outstanding restricted stock awards are set out in the notes to table 4 on pages 65 and 66 of this report.

For 2004, awards made under the long-term incentive plan will be in the form of restricted stock although, at the date of publication of this report, no decisions had been made on the amount of stock to be awarded or the terms that might apply.

All-employee share plans

Executive directors are eligible to participate in the company's all-employee share plans on the same terms as other employees. These plans comprise share acquisition programmes in the UK and the US. These plans operate within specific tax legislation (including a requirement to finance acquisition of shares using the proceeds of a monthly savings contract) and the acquisition of shares under these plans is not subject to the satisfaction of a performance target.

Shareholding policy

As previously noted, in line with the policy of encouraging widespread employee ownership, the company encourages executive directors to build up a substantial shareholding in the company. Although, in view of the volatility of the stock market, we do not think it is appropriate to specify a particular relationship of shareholding to salary, we describe separately here both the number of shares that the executive directors and the chairman hold and the value expressed as a percentage of base salary. The current value of holdings based on the middle market value of Pearson shares of 620p on 27 February 2004 against the base salary set out in this report is as follows:

	Number of shares	Value (% of base salary)
Dennis Stevenson	163,268	368%
Marjorie Scardino	93,733	93%
David Bell	56,492	97%
Rona Fairhead	9,622	16%
Peter Jovanovich	56,450	66%
John Makinson	39,214	54%

Service agreements

Executive directors have rolling service agreements with one or more group companies. Other than by termination in accordance with the terms of these agreements, employment continues until retirement.

In accordance with policy, with the exception of Peter Jovanovich, all executive directors have service agreements under which the company may terminate these agreements by giving 12 months' notice and which specify the compensation payable by way of liquidated damages in circumstances where the company terminates the agreements without notice or cause. We feel that these notice periods and provisions for liquidated damages are adequate, but not excessive, compensation for loss of office.

In the case of Peter Jovanovich, his service agreement provides for compensation on termination of employment by the company without cause of 200% of annual salary plus target bonus reflecting US employment practice and the terms agreed with him in October 2000 before his appointment as a director of the company.

In 2003, the chairman of the board wrote to institutional investors on the matter of Peter Jovanovich's severance terms. He said that we were completely supportive of 12 months being the longest period of notice in directors' contracts. We intend that after a further period this arrangement will fall in line with those for the other executive directors. Discussions with Peter Jovanovich have been held up by his absence on ill-health grounds, but will resume on his return.

We summarise the agreements as follows:

Name	Date of agreement	Notice periods	Compensation on termination by the company without notice or cause
Dennis Stevenson	13 May 1997	six months from the director; 12 months from the company	100% of salary at the date of termination
Marjorie Scardino	27 February 2004	six months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus
David Bell	15 March 1996	six months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus
Rona Fairhead	24 January 2003	six months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus
Peter Jovanovich	9 October 2000	Employment may be terminated by either party at any time, subject to three months' notice from the director in the case of voluntary resignation	200% of annual salary and target bonus
John Makinson	24 January 2003	six months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus

Retirement benefits

We describe in turn the retirement benefits for each of the executive directors. Details of directors' pension arrangements are set out in table 2 on pages 62 and 63 of this report.

Marjorie Scardino

Marjorie Scardino has both defined benefit and defined contribution pension arrangements.

The Pearson Inc. Pension Plan (the US Plan) is an approved defined benefit plan providing a lump sum convertible to a pension on retirement. The lump sum accrued at 6% of capped compensation, but accruals of benefit ceased on 31 December 2001.

The US Plan has a normal retirement age of 65. Early retirement is possible with a reduced pension for early payment.

The US Plan does not guarantee any increases to the pension once it comes into payment.

The US Plan also provides a spouse's pension on death in service and the option of a death in retirement pension by reducing the member's pension.

The defined contribution arrangements are an approved 401(k) plan in the US and an unfunded unapproved defined contribution plan. In addition, from 2004 a funded defined contribution plan to be approved by the UK Inland Revenue as a corresponding scheme replaces part of the unfunded plan.

The account balance of the unfunded unapproved defined contribution plan is determined by reference to the value of a notional cash account which increases annually by a specified notional interest rate. From 2004, this plan gives Marjorie Scardino the opportunity to convert a proportion of this notional cash account into a notional share account reflecting the value of a number of Pearson ordinary shares. The number of shares in the notional share account is determined by reference to the market value of Pearson shares at the date of conversion. On 1 March 2004, Marjorie Scardino will convert $1.2m of the value of the notional cash account into notional Pearson shares. The number of notional shares will be determined by reference to the middle market value of Pearson shares on that date.

At retirement, the account balances of the defined contribution arrangements will be used to provide benefits. Benefits under the notional share account can be satisfied by the transfer of Pearson shares.

In the event of death before retirement, the account balances in the defined contribution arrangements will be used to provide benefits for dependants.

David Bell

David Bell is a member of the Final Pay Section of the Pearson Group Pension Plan (the UK Plan).

He is eligible for a pension from the UK Plan of two-thirds of his final base salary at normal retirement age due to his previous service with the Financial Times.

The UK Plan has a normal retirement age of 62. Early retirement after age 50 is possible with company consent and on a pension that is scaled down to reflect the shorter period of service completed. If retiring before age 60, the pension will be further reduced by an actuarial factor to reflect the longer period over which it is expected to be paid.

Pensions in payment under the UK Plan are guaranteed to increase each year at 5% or the increase in the Index of Retail Prices, if lower.

On death in service before normal retirement age, a pension will be paid to the spouse, or in the absence of a spouse to a financial dependant nominated by the member. The pension will be one-third of annual base salary.

On death after leaving service but before retirement, a pension of 50% of the deferred pension will be payable to the spouse or nominated financial dependant.

On death in retirement, the pension payable is 60% of the director's pension (ignoring any pension commuted for a lump sum at retirement).

Children's pensions may also be payable to dependent children.

Rona Fairhead

Rona Fairhead is a member of the Final Pay Section of the UK Plan. Her pensionable salary is restricted to the earnings cap introduced by the Finance Act 1989. The UK Plan provides her with a pension that accrues at one-thirtieth of the earnings cap for each year of service.

In addition, the company contributes into a Funded Unapproved Retirement Benefits Scheme (FURBS).

The UK Plan has a normal retirement age of 62. Early retirement after age 50 is possible, with company consent, and on a pension from the plan that is scaled down to reflect the shorter period of service completed. If retiring before age 60, the pension will be further reduced by an actuarial factor to reflect the longer period over which it is expected to be paid.

Pensions in payment under the UK Plan are guaranteed to increase each year at 5% or the increase in the Index of Retail Prices, if lower.

Under the company's FURBS arrangements, early retirement is possible with company consent from age 50 onwards. The benefit payable will be the amount of the member's fund at the relevant date.

On death before normal retirement age, a pension from the UK Plan will be paid to the spouse, or in the absence of a spouse to a financial dependant nominated by the member. The pension will be one-third of the earnings cap at the time of death.

On death after leaving service but before retirement, a pension of 50% of the deferred pension will be payable to the spouse or nominated financial dependant.

On death in retirement, the pension payable is 60% of the director's pension (ignoring any pension commuted for a lump sum at retirement).

Children's pensions may also be payable to dependent children.

In the event of death before retirement, the proceeds of the FURBS account will be used to provide benefits for dependants.

Peter Jovanovich

Peter Jovanovich has both defined benefit and defined contribution pension arrangements in the US.

The Pearson Inc. Pension Plan (the US Plan) is an approved defined benefit plan providing a lump sum convertible to a pension on retirement. The lump sum accrued at 6% of capped compensation, but accruals of benefit ceased on 31 December 2001.

In addition, he participates in an unfunded, unapproved Supplemental Executive Retirement Plan (the US SERP) providing an annual pension accrual of 2% of final average earnings, less benefits accrued in the US Plan and US Social Security. He ceased to build up additional benefits in the US SERP at 31 December 2002.

The defined contribution arrangements are an approved 401(k) plan and a funded, unapproved 401(k) excess plan. For 2003, Peter Jovanovich's pension arrangements include a new unfunded, unapproved, defined contribution plan as his participation in the US SERP ceased.

The US Plan has a normal retirement age of 65. Early retirement is possible with a reduced pension for early payment. The US Plan does not guarantee any increases to the pension once it comes into payment.

At retirement, the account balances of the defined contribution arrangements will be used to provide benefits.

The US Plan and the US SERP also provide a spouse's pension on death in service and the option of a death in retirement pension by reducing the member's pension.

In the event of death before retirement, the account balances in the defined contribution arrangements will be used to provide benefits for dependants.

John Makinson

John Makinson is a member of the Final Pay Section of the UK Plan. His pensionable salary is restricted to the earnings cap.

The company had been paying contributions into a FURBS on his behalf, but those contributions ceased on 31 December 2001.

During 2002, the company established an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for John Makinson.

The UURBS tops up the pensions payable from the UK Plan and the closed FURBS to target a pension of two-thirds of Revalued Base Salary on retirement at age 62. Revalued Base Salary is defined as £450,000 increased at 1 January each year by reference to the increase in the Index of Retail Prices over the previous year.

The UK Plan has a normal retirement age of 62. Early retirement after age 50 is possible, with company consent based on a uniform accrual from 1 April 1994. The pension from the UK Plan, the FURBS and the UURBS in aggregate will be scaled down to reflect the shorter period of service completed. If retiring before age 60, the pension will be further reduced by an actuarial factor to reflect the longer period over which it is expected to be paid.

The pension in payment is guaranteed to increase each year at 5% or the increase in the Index of Retail Prices, if lower.

On death in service before normal retirement age, a pension from the UK Plan, the FURBS and the UURBS in aggregate will be paid to the spouse, or in the absence of a spouse to a financial dependant nominated by the member. The pension will be one-third of Revalued Base Salary.

On death after leaving service but before retirement, a pension of 50% of the deferred pension will be payable to the spouse or nominated financial dependant.

On death in retirement, the pension payable is 60% of the director's pension (ignoring any pension commuted for a lump sum at retirement).

Children's pensions may also be payable to dependent children.

Executive directors' non-executive directorships

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

Chairman's remuneration

Our policy is that the chairman's pay should be set at a level that is competitive with those of chairmen in similar positions in comparable companies.

He is not entitled to an annual bonus, retirement or other benefits. He is eligible to participate in the company's worldwide save for shares plan on the same terms as all other eligible employees.

The chairman's salary has remained unchanged since 1999 at £275,000 per year. He has voluntarily given up any consideration for awards under the long-term incentive plans that have been developed since then and for which he might have been eligible. During 2003, the committee reviewed his remuneration with advice from Towers Perrin on practice relating to chairmen's remuneration and on the increase in the remuneration of chairmen in comparable positions since the last review. After considering all the circumstances, the committee's view was that the current appropriate total pay level was around £425,000 per year.

Having been informed of the committee's view, the chairman indicated that he thought it was not appropriate for him to receive an increase of this magnitude in cash – a view which the committee accepted. Instead, the committee recommended to the board that the chairman's salary should be increased to £325,000 with effect from 1 January 2004 and that he should receive a share award of 30,000 shares in 2004. This award is linked to the company's share price and will not be released to him unless the Pearson share price reaches £9.00 within a maximum period of three years.

Non-executive directors

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

Since January 2000, non-executive directors have received an annual fee of £35,000 each. One overseas-based director is paid a supplement of £7,000 per annum. The non-executive directors who chair the personnel and audit committees each receive an additional fee of £5,000 per annum.

In the case of Patrick Cescau, his fee is paid over to his employer. For those non-executive directors who retain their fees personally, £10,000 of the total fee, or all of the fee in the case of Rana Talwar, is payable in the form of Pearson shares which the non-executive directors have committed to retain for the period of their directorships.

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

Report on directors' remuneration continued

Table 1: Remuneration of the directors

Excluding contributions to pension funds and related benefits set out in table 2, directors' remuneration was as follows:

	2003 Salaries/ fees £000	2003 Bonus £000	2003 Other £000	2003 Total £000	2002 Total £000	2002 Total* £000
Chairman						
Dennis Stevenson	275	–	–	275	275	275
Executive directors						
Marjorie Scardino	625	200	54	879	852	852
David Bell	360	115	16	491	487	487
Rona Fairhead (appointed 1 June 2002)	363	116	14	493	301	496
Peter Jovanovich (appointed 1 June 2002)	530	156	9	695	570	978
John Makinson	450	127	232	809	855	855
Non-executive directors						
Terry Burns	35	–	–	35	35	35
Patrick Cescau (appointed 1 April 2002)	35	–	–	35	26	26
Reuben Mark	47	–	–	47	47	47
Vernon Sankey	40	–	–	40	40	40
Rana Talwar	35	–	–	35	35	35
Total	2,795	714	325	3,834	3,523	4,126
Total 2002	2,230	1,053	240	–	3,523	4,126

* Includes remuneration for Rona Fairhead and Peter Jovanovich prior to their appointment as directors on 1 June 2002.

Note 1 For Pearson plc, the 2003 performance measures in the annual bonus plan were growth in underlying sales, growth in adjusted earnings per share, trading cash conversion and average working capital as a ratio to sales.

In the case of Peter Jovanovich and John Makinson, part of their bonuses also related to the performance of Pearson Education and Penguin Group respectively. For both businesses, the performance measures were growth in underlying sales, trading margin, trading cash conversion and average working capital as a ratio to sales.

Note 2 Other emoluments include company car and healthcare benefits and, in the case of Marjorie Scardino, include £37,030 in respect of housing costs.

John Makinson is entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US. He received £206,586 for 2003.

Marjorie Scardino, Rona Fairhead, David Bell and John Makinson have the use of a chauffeur.

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

Note 4 The following executive directors served as non-executive directorships elsewhere and received fees as follows: Marjorie Scardino (Nokia Corporation – €100,000); David Bell (VITEC Group plc – £27,500); Rona Fairhead (Harvard Business School Publishing – nil); John Makinson (George Weston Limited – C$59,750).

Table 2: Directors' pensions

	Age at 31 Dec 03	Increase In accrued pension over the period £000	Accrued pension at 31 Dec 03 £000[1]	Transfer value at 31 Dec 02 £000[2]	Transfer value at 31 Dec 03 £000	Increase in transfer value† £000	Increase in accrued pension over the period* £000	Transfer value of increase in accrued pension at 31 Dec 03*† £000
Marjorie Scardino	56	(0.5)	4.0	32.0	30.2	(1.8)	(0.6)	(4.5)
David Bell	57	36.9	216.0	1,965.7	2,805.7	822.0	31.9	396.0
Rona Fairhead	42	3.3	7.3	19.9	44.2	19.5	3.2	14.6
Peter Jovanovich	54	(6.8)	61.6	392.5	442.3	49.8	(8.7)	(62.5)
John Makinson	49	35.0	132.2	648.0	1,189.2	536.3	32.3	285.5

* Net of inflation

† Less directors' contributions

Table 2: Directors’ pensions continued

	Other pension costs to the company over the period £000[3]	Other pension related benefits £000[4]
Marjorie Scardino	474.8	29.4
David Bell	–	–
Rona Fairhead	94.4	–
Peter Jovanovich	270.0	2.8
John Makinson	–	4.2

Note 1 The accrued pension at 31 December 2003 is that which would become payable from normal retirement age if the member left service at 31 December 2003. For Marjorie Scardino it relates only to the pension from the US Plan and the impact is negative because of exchange rate changes over the year. For David Bell and Rona Fairhead it relates to the pension payable from the UK Plan. For John Makinson it relates to the pension from the UK Plan, the FURBS and the UURBS in aggregate. For Peter Jovanovich it relates to the pension from the US Plan and the US SERP and the increase is negative because of exchange rate changes over the year.

Note 2 The UK transfer values at 31 December 2003 are calculated using the assumptions for cash equivalents payable from the UK Plan and are based on the accrued pension at that date. For the US SERP, transfer values are calculated using a discount rate equivalent to current US government long-term bond yields. The US Plan is a lump sum plan and the accrued balance is shown.

Note 3 This column comprises pension supplements for UK benefits. For US benefits it includes company contributions to funded defined contribution plans and notional contributions to unfunded defined contribution plans. The notional accumulated value of the unfunded defined contribution plans is calculated by reference to US prime rates of interest.

Note 4 This column comprises life cover and long-term disability insurance not provided by the retirement plans.

Table 3: Interests of directors

	Ordinary shares at 1 Jan 03	Ordinary shares at 31 Dec 03
Dennis Stevenson	161,894	163,268
Marjorie Scardino	86,121	93,733
David Bell	50,939	56,492
Terry Burns	1,712	3,133
Patrick Cescau	–	–
Rona Fairhead	560	9,622
Peter Jovanovich	54,986	56,450
John Makinson	29,333	39,214
Reuben Mark	11,837	13,561
Vernon Sankey	1,666	2,992
Rana Talwar	5,935	4,346

Note 1 Ordinary shares includes both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals under the annual bonus share matching plan.

Note 2 Executive directors of the company, as possible beneficiaries, are also deemed to be interested in the Pearson Employee Share Trust and the Pearson Employee Share Ownership Trust, the trustees of which held 206,769 and 7,371,290 Pearson ordinary shares of 25p each respectively at 31 December 2003 and also at 27 February 2004.

Note 3 At 31 December 2003, Marjorie Scardino, John Makinson and David Bell each held 1,000 shares in Recoletos Grupo de Comunicación S.A. Dennis Stevenson held 8,660 shares. John Makinson held 1,000 shares in Interactive Data Corporation.

Note 4 With effect from 1 March 2004, Marjorie Scardino will be deemed to be interested in a further number of shares under her unfunded pension arrangement described on page 60 of this report.

Note 5 The register of directors’ interests (which is open to inspection during normal office hours) contains full details of directors’ shareholdings and options to subscribe for shares. The market price on 31 December 2003 was 622p per share and the range during the year was 429.5p to 680p.

Table 4: Movements in directors' interests in restricted shares

Date of award	1 Jan 03	Awarded	Released	Lapsed	31 Dec 03	Market value at date of award	Latest vesting date	Date of release	Price paid on release
Marjorie Scardino									
a* 8/6/99	54,029				54,029				
b 25/6/98	3,900		(3,900)		–			27/6/03	0p
b 29/4/99	23,476			(23,476)	–				
b 19/5/00	13,676				13,676				
b 11/5/01	14,181				14,181				
c 9/5/01	55,400				55,400				
c 19/11/02	5,869			(5,869)	–				
c 16/12/02	362,040				362,040				
c 26/9/03		144,240			144,240	582p	26/9/10		
Total	532,571	144,240	(3,900)	(29,345)	643,566				
David Bell									
a* 8/6/99	26,890				26,890				
b 29/04/99	9,763			(9,763)	–				
b 19/5/00	6,371				6,371				
b 11/5/01	6,371				6,371				
b 17/4/03		6,105			6,105	541p	17/4/08		
c 9/5/01	21,800				21,800				
c 19/11/02	2,440			(2,440)	–				
c 16/12/02	159,678				159,678				
c 26/9/03		98,880			98,880	582p	26/9/10		
Total	233,313	104,985	–	(12,203)	326,095				
Rona Fairhead									
b 19/4/02	933				933				
b 17/4/03		15,103			15,103	541p	17/4/08		
c 8/4/02	5,000				5,000				
c 16/12/02	159,678				159,678				
c 26/9/03		98,880			98,880	582p	26/9/10		
Total	165,611	113,983	–	–	279,594				

Table 4: Movements in directors' interests in restricted shares continued

Date of award	1 Jan 03	Awarded	Released	Lapsed	31 Dec 03	Market value at date of award	Latest vesting date	Date of release	Price paid on release
Peter Jovanovich									
a* 8/6/99	46,586				46,586				
b 29/4/99	8,889			(8,889)	–				
b 19/5/00	9,822				9,822				
b 3/1/01	58,343				58,343				
c 9/5/01	41,560				41,560				
c 19/11/02	2,222			(2,222)	–				
c 16/12/02	198,396				198,396				
c 26/9/03		98,880			98,880	582p	26/9/10		
Total	365,818	98,880	–	(11,111)	453,587				
John Makinson									
a* 8/6/99	30,874				30,874				
b 25/6/98	2,293		(2,293)		–			27/6/03	0p
b 29/4/99	11,630			(11,630)	–				
b 19/5/00	9,117				9,117				
b 11/5/01	9,553				9,553				
b 17/4/03		12,210			12,210	541p	17/4/08		
c 9/5/01	26,380				26,380				
c 19/11/02	2,907			(2,907)	–				
c 16/12/02	206,880				206,880				
c 26/9/03		98,880			98,880	582p	26/9/10		
Total	299,634	111,090	(2,293)	(14,537)	393,894				

Note 1 Prices have been rounded to the nearest whole penny.

Note 2 The number of shares shown represents the maximum number of shares that may vest, subject to any performance conditions being met.

Note 3 No variations to the terms and conditions of plan interests were made during the year.

Note 4 Restricted shares designated as: a reward plan; b annual bonus share matching plan; and c long-term incentive plan; and * where shares have vested and are held pending release.

Each plan is described below in relation to its status during the year i.e. whether awards have been released or lapsed, have vested and are held, are outstanding or were granted.

› Awards released The annual bonus share matching plan permits executive directors and senior executives around the Company to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the company's adjusted earnings per share increase in real terms by at least 3% per annum, the company will match them on a gross basis of one share for every two held after three years, and another one for two originally held (i.e. a total of one for one) after five years. For the award made on 25 June 1998, since the real growth in earnings per share target for the period 1997 to 2002 was not met, participants did not become entitled to the second one-for-two matching shares and these awards lapsed. Participants were, however, already entitled to the first one-for-two matching shares based on 1997 to 2000 performance and these shares were released on 27 June 2003. No consideration was payable by participants for these shares. Marjorie Scardino and John Makinson held shares under this plan. Details of these awards are set out in table 4 and itemised as b on pages 64 and 65 of this report.

› Awards lapsed Since the earnings per share target for 1998 to 2003 was not met, the annual bonus share matching plan awards made in 1999 and the long-term incentive plan shares awarded on 19 November 2002 lapsed.

Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson held awards under these plan. Details of these awards are set out in table 4 and itemised as b and c on pages 64 and 65 of this report.

› Awards vested and held Pearson Equity Incentives awarded in 1999 under the reward plan vested on 8 June 2002. Following vesting, the shares remain subject to a two-year retention period and will be released in 2004. Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson hold PEIs under this plan. Details of these awards are set out in table 4 and itemised as a* on pages 64 and 65 of this report.

› Awards outstanding Outstanding awards from 2000, 2001 and 2002 under the annual bonus share matching plan for Marjorie Scardino, David Bell, Rona Fairhead, Peter Jovanovich and John Makinson are set out in table 4 and itemised as b on pages 64 and 65 of this report. These shares will vest subject to the real growth in earnings per share targets being met for the relevant three or five year periods.

Outstanding awards from 2001 and 2002 under the long-term incentive plan for Marjorie Scardino, David Bell, Rona Fairhead, Peter Jovanovich and John Makinson are set out in table 4 and itemised as c on pages 64 and 65 of this report.

Report on directors' remuneration continued

The vesting of restricted stock awards under the long-term incentive plan made in 2001 was related to free cash flow per share performance over the period 2001 to 2003 consistent with the performance measure used in relation to vesting of restricted stock under the previous reward plan. The committee considered that free cash flow was the most appropriate performance measure to determine the vesting of restricted shares at the time because the cash the businesses generate provided a transparent and accurate measure of Pearson's achievements and was recognised by shareholders as a significant driver of value. This target is met if the company's cumulative free cash flow per share for the three financial years of the performance period exceeds the target set by the committee for growth over the free cash flow per share for the financial year prior to the start of the period (free cash flow being defined as our operating cash flow as stated in each year's accounts less tax liabilities on operating activities and tax paid).

The target for all of the shares awarded to vest was cumulative free cash flow per share of 116.9p and the threshold for 50% of the shares to vest was 95.9p. These represented compound annual growth rates over free cash flow per share of 23.0p in 2000 equivalent to 28.8% and 17.4%. At the year-end, there was an outstanding receivable due from the TSA contract in 2002. The committee has deemed this to be an exceptional situation outside the control of the participants concerned and intends that the vesting of shares be triggered by the actual reported FCF per share over the period 2001 through 2003 plus the FCF per share that would have derived from the TSA cash had it been received in 2003. Any vesting would be triggered in May 2004 (the third anniversary of the award) or after the cash is actually received in 2004, whichever is the later. If no, or insufficient, TSA cash is received in 2004, the awards will lapse in their entirety.

A participant may call for three-quarters of the shares that vest within six months of the vesting date. However, the remaining one-quarter of the shares that vest may be called within six months of the second anniversary of the vesting date but only if the participant has not disposed of any shares in the first three-quarters, other than those that may be released in order to satisfy personal tax liabilities.

The long-term incentive plan shares awarded to Rona Fairhead on 8 April 2002 will vest on 8 October 2004, being three years from the date of her appointment, in accordance with the terms agreed with her when she joined the company.

The long-term incentive plan shares awarded on 16 December 2002 will vest in tranches. The first tranche of shares will vest on 28 June 2005. The second, third, fourth and fifth tranches will vest no earlier than 28 June 2005 subject to the Pearson share price reaching £9, £11, £13 and £18 respectively for a period of 20 consecutive business days prior to 28 June 2009.

› Awards granted The annual bonus share matching plan shares awarded on 17 April 2003 will vest in full on 17 April 2008 if the company's adjusted earnings per share increase in real terms by at least 3% per annum over the period 2002 to 2007. Half this number of shares will vest on 17 April 2006 if the company's adjusted earnings per share increase in real terms by at least 3% per annum over the period 2002 to 2005. The market price of the shares on the date of the award was 541p. The latest vesting date of this award is 17 April 2008. David Bell, Rona Fairhead and John Makinson hold shares under this plan. Details of these awards are set out in table 4 and itemised as b on pages 64 and 65 of this report.

The long-term incentive plan shares awarded on 26 September 2003 will vest in tranches as set out in the table below. The first tranche of shares shown in A will vest on 26 September 2006. The second, third, fourth and fifth tranches shown in B, C, D and E will vest no earlier than 26 September 2006 subject to the Pearson share price reaching £9, £11, £13 and £18 respectively for a period of 20 consecutive business days prior to 26 September 2010. Although their value was below policy levels, the committee considered that these awards and stretching share price targets, which focus on the restoration of shareholder value, provide meaningful incentives to the executives concerned while recognising the long-term interests of shareholders. The market price of the shares on the date of the award was 582p. The latest vesting date of this award is 26 September 2010.

Long Term Incentive Plan Award 26 September 2003	A	B	C	D	E
Marjorie Scardino	24,040	24,040	24,040	24,040	48,080
David Bell	16,480	16,480	16,480	16,480	32,960
Rona Fairhead	16,480	16,480	16,480	16,480	32,960
Peter Jovanovich	16,480	16,480	16,480	16,480	32,960
John Makinson	16,480	16,480	16,480	16,480	32,960

Table 5: Movements in directors' interests in share options

Date of grant		1 Jan 03	Granted	Exercised	Lapsed	31 Dec 03	Option price	Earliest exercise date	Expiry date
Dennis Stevenson									
b	15/5/98	2,512				2,512	687p	1/8/03	1/2/04
Total		2,512				2,512			
Marjorie Scardino									
a*	14/9/98	176,556				176,556	974p	14/9/01	14/9/08
a*	14/9/98	5,660				5,660	1090p	14/9/01	14/9/08
b	15/5/98	2,839				2,839	687p	1/8/05	1/2/06
b	9/5/03		2,224			2,224	425p	1/8/06	1/2/07
c	8/6/99	37,583				37,583	1373p	8/6/02	8/6/09
c	8/6/99	37,583				37,583	1648p	8/6/02	8/6/09
c	8/6/99	37,583				37,583	1922p	8/6/02	8/6/09
c	3/5/00	36,983			(36,983)	–	2303p	3/5/03	3/5/10
c	3/5/00	36,983				36,983	2764p	3/5/03	3/5/10
c	3/5/00	36,983				36,983	3225p	3/5/03	3/5/10
d*	9/5/01	41,550				41,550	1421p	9/5/02	9/5/11
d*	9/5/01	41,550				41,550	1421p	9/5/03	9/5/11
d	9/5/01	41,550				41,550	1421p	9/5/04	9/5/11
d	9/5/01	41,550				41,550	1421p	9/5/05	9/5/11
Total		574,953	2,224	–	(36,983)	540,194			
David Bell									
a*	14/9/98	20,496				20,496	974p	14/9/01	14/9/08
b*	15/5/98	501				501	687p	1/8/03	1/2/04
b	16/5/99	184				184	913p	1/8/04	1/2/05
b	13/5/00	202				202	1428p	1/8/03	1/2/04
b	9/5/01	202				202	957p	1/8/04	1/2/05
b	10/5/02	272				272	696p	1/8/05	1/2/06
b	9/5/03		444			444	425p	1/8/06	1/2/07
c	8/6/99	18,705				18,705	1373p	8/6/02	8/6/09
c	8/6/99	18,705				18,705	1648p	8/6/02	8/6/09
c	8/6/99	18,705				18,705	1922p	8/6/02	8/6/09
c	3/5/00	18,686			(18,686)	–	2303p	3/5/03	3/5/10
c	3/5/00	18,686				18,686	2764p	3/5/03	3/5/10
c	3/5/00	18,686				18,686	3225p	3/5/03	3/5/10
d*	9/5/01	16,350				16,350	1421p	9/5/02	9/5/11
d*	9/5/01	16,350				16,350	1421p	9/5/03	9/5/11
d	9/5/01	16,350				16,350	1421p	9/5/04	9/5/11
d	9/5/01	16,350				16,350	1421p	9/5/05	9/5/11
Total		199,430	444	–	(18,686)	181,188			
Rona Fairhead									
d*	1/11/01	19,997				19,997	822p	1/11/02	1/11/11
d*	1/11/01	19,998				19,998	822p	1/11/03	1/11/11
d	1/11/01	20,005				20,005	822p	1/11/04	1/11/11
Total		60,000	–	–	–	60,000			

Report on directors' remuneration continued

Table 5: Movements in directors' interests in share options (continued)

Date of grant		1 Jan 03	Granted	Exercised	Lapsed	31 Dec 03	Option price	Earliest exercise date	Expiry date
Peter Jovanovich									
a*	12/9/97	8,250				8,250	758p	12/9/00	12/9/07
a*	12/9/97	102,520				102,520	677p	12/9/00	12/9/07
c	8/6/99	32,406				32,406	1373p	8/6/02	8/6/09
c	8/6/99	32,406				32,406	1648p	8/6/02	8/6/09
c	8/6/99	32,406				32,406	1922p	8/6/02	8/6/09
c	3/5/00	33,528			(33,528)	–	2303p	3/5/03	3/5/10
c	3/5/00	33,528				33,528	2764p	3/5/03	3/5/10
c	3/5/00	33,528				33,528	3225p	3/5/03	3/5/10
d*	9/5/01	31,170				31,170	$21.00	9/5/02	9/5/11
d*	9/5/01	31,170				31,170	$21.00	9/5/03	9/5/11
d	9/5/01	31,170				31,170	$21.00	9/5/04	9/5/11
d	9/5/01	31,170				31,170	$21.00	9/5/05	9/5/11
d*	1/11/01	19,998				19,998	$11.97	1/11/02	1/11/11
d*	1/11/01	19,998				19,998	$11.97	1/11/03	1/11/11
d	1/11/01	20,004				20,004	$11.97	1/11/04	1/11/11
Total		493,252	–	–	(33,528)	459,724			
John Makinson									
a*	6/5/94	56,000				56,000	567p	6/5/97	6/5/04
a*	20/4/95	20,160				20,160	487p	20/4/98	20/4/05
a*	8/8/96	36,736				36,736	584p	8/8/99	8/8/06
a*	12/9/97	73,920				73,920	677p	12/9/00	12/9/07
a*	14/9/98	30,576				30,576	974p	14/9/01	14/9/08
b	9/5/01	1,920				1,920	957p	1/8/08	1/2/09
b	9/5/03		4,178			4,178	425p	1/8/10	1/2/11
c	8/6/99	21,477				21,477	1373p	8/6/02	8/6/09
c	8/6/99	21,477				21,477	1648p	8/6/02	8/6/09
c	8/6/99	21,477				21,477	1922p	8/6/02	8/6/09
c	3/5/00	21,356			(21,356)	–	2303p	3/5/03	3/5/10
c	3/5/00	21,356				21,356	2764p	3/5/03	3/5/10
c	3/5/00	21,356				21,356	3225p	3/5/03	3/5/10
d*	9/5/01	19,785				19,785	1421p	9/5/02	9/5/11
d*	9/5/01	19,785				19,785	1421p	9/5/03	9/5/11
d	9/5/01	19,785				19,785	1421p	9/5/04	9/5/11
d	9/5/01	19,785				19,785	1421p	9/5/05	9/5/11
Total		426,951	4,178	–	(21,356)	409,773			

Note 1 Prices have been rounded up to the nearest whole penny.

Note 2 No variations to the terms and conditions of share options were made during the year.

Note 3 No share options were exercised during the year.

Note 4 For outstanding options, the market price of Pearson shares during the year ranged between 429.5p and 680p.

Note 5 Shares under option are designated as: a executive; b worldwide save for shares; c premium priced; and d long-term incentive; and * where options are exercisable.

a Executive – The plans under which these options were granted were replaced with the introduction of the Long-Term Incentive Plan in 2001. No executive options have been granted to the directors since 1998 and the terms set out below relate to options already granted that remain outstanding.

Subject to any performance condition being met, executive options become exercisable on the third anniversary of the date of grant and lapse if they remain unexercised at the tenth. Options granted prior to 1996 are not subject to performance conditions representing market best practice at that time.

The exercise of options granted since 1996 is subject to a real increase in the company's adjusted earnings per share over any three-year period prior to exercise. This measure of performance represented market best practice and was in accordance with institutional investors 'guidelines for option plans of that period.

Real growth is measured against the UK Government's Index of Retail Prices (All Items).

Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson hold options under this plan. Details of these awards are set out in table 5 and itemised as a on pages 67 and 68 of this report.

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

Dennis Stevenson, Marjorie Scardino, David Bell and John Makinson hold options under this plan. Details of these holdings are set out in table 5 and itemised as b on pages 67 and 68 of this report.

c Premium priced – The plan under which these options were granted was replaced with the introduction of the Long-Term Incentive Plan in 2001. No premium priced options have been granted to the directors since 1999 and the terms set out below relate to options already granted that remain outstanding.

Subject to the performance conditions being met, Premium Priced Options (PPOs) become exercisable on the third anniversary of the date of grant and lapse if they remain unexercised at the tenth.

PPOs were granted in three tranches. For these to become exercisable, the Pearson share price has to stay above the option price for 20 consecutive days within three, five and seven years respectively. The share price targets for the three-and five-year tranches of PPOs granted in 1999 were met in 2000. The share price target for the three-year tranche of PPOs granted in 2000 were not met in 2003 and the options lapsed.

In addition, for options to be exercisable, the company's adjusted earnings per share have to increase in real terms by at least 3% per annum over the three-year period prior to exercise. Real growth is measured against the UK Government's Index of Retail Prices (All Items). These targets for the three-year periods 1998 to 2001, 1999 to 2002 and 2000 to 2003 were not met.

Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson hold PPOs under this plan. Details of these awards are set out in table 5 and itemised as c on pages 67 and 68 of this report.

d Long-term incentive – Options granted in 2001 were based on pre-grant earnings per share growth of 75% against a target of 16.6% over the period 1997 to 2000 and are not subject to further performance conditions on exercise.

Long-term incentive options granted on 9 May 2001 become exercisable in tranches on the first, second, third and fourth anniversary of the date of grant and lapse if they remain unexercised at the tenth. The fourth tranche lapses if any of the options in the first, second or third tranche are exercised prior to the fourth anniversary of the date of grant.

Long-term incentive options granted on 1 November 2001 become exercisable in tranches on the first, second and third anniversary of the date of grant and lapse if they remain unexercised at the tenth.

Details of the option grants under this plan for Marjorie Scardino, David Bell, Rona Fairhead, Peter Jovanovich and John Makinson are set out in table 5 itemised as d on pages 67 and 68 of this report.

In addition, Marjorie Scardino and Peter Jovanovich both contribute US$1,000 per month (the maximum allowed) to the US employee stock purchase plan. The terms of this plan allow participants to make monthly contributions for one year and to acquire shares at the end of that period at a price that is the lower of the market price at the beginning or the end of the period, both less 15%. Based on the market price at the start of the period, Marjorie Scardino and Peter Jovanovich would have the right to acquire 1,484 American Depositary Receipts.

Reuben Mark, Director
27 February 2004

Consolidated profit and loss account
year ended 31 December 2003

All figures in £ millions	Note	2003 Results from operations	2003 Other items	2003 Total	2002 Results from operations	2002 Other items	2002 Total
Sales (including share of joint ventures)		4,066	–	4,066	4,331	–	4,331
Less: share of joint ventures		(18)	–	(18)	(11)	–	(11)
Sales	2a	4,048	–	4,048	4,320	–	4,320
Group operating profit		483	(257)	226	496	(302)	194
Share of operating profit/(loss) of joint ventures and associates	2c/d	7	(7)	–	(3)	(48)	(51)
Total operating profit	2b	490	(264)	226	493	(350)	143
Loss on sale of fixed assets and investments	4a	–	(2)	(2)	–	(13)	(13)
Profit/(loss) on sale of subsidiaries and associates	4b	–	8	8	–	(27)	(27)
Profit on sale of a subsidiary by an associate	4c	–	–	–	–	3	3
Non operating items		–	6	6	–	(37)	(37)
Profit before interest and taxation		490	(258)	232	493	(387)	106
Net finance costs	5	(80)	–	(80)	(94)	(37)	(131)
Profit/(loss) before taxation		410	(258)	152	399	(424)	(25)
Taxation	7	(128)	53	(75)	(131)	67	(64)
Profit/(loss) after taxation		282	(205)	77	268	(357)	(89)
Equity minority interests		(28)	6	(22)	(27)	5	(22)
Profit/(loss) for the financial year		254	(199)	55	241	(352)	(111)
Dividends on equity shares	8			(192)			(187)
Loss retained				(137)			(298)
Adjusted earnings per share	9			32.0p			30.3p
Basic earnings/(loss) per share	9			6.9p			(13.9)p
Diluted earnings/(loss) per share	9			6.9p			(13.9)p
Dividends per share	8			24.2p			23.4p

There is no difference between the profit/(loss) before taxation and the loss retained for the year stated above and their historical cost equivalents.

Consolidated balance sheet
as at 31 December 2003

All figures in £ millions	Note	2003	2002
Fixed assets			
Intangible assets	11	3,260	3,610
Tangible assets	12	468	503
Investments: joint ventures	13		
Share of gross assets		7	7
Share of gross liabilities		(1)	–
		6	7
Investments: associates	14	58	106
Investments: other	15	80	84
		3,872	4,310
Current assets			
Stocks	16	683	734
Debtors	17	1,132	1,057
Deferred taxation	21	145	174
Investments		2	2
Cash at bank and in hand	18	561	575
		2,523	2,542
Creditors – amounts falling due within one year			
Short-term borrowing	19	(575)	(249)
Other creditors	20	(1,129)	(1,114)
		(1,704)	(1,363)
Net current assets		819	1,179
Total assets less current liabilities		4,691	5,489
Creditors – amounts falling due after more than one year			
Medium and long-term borrowing	19	(1,347)	(1,734)
Other creditors	20	(45)	(60)
		(1,392)	(1,794)
Provisions for liabilities and charges	22	(152)	(165)
Net assets		3,147	3,530
Capital and reserves			
Called up share capital	23	201	200
Share premium account	24	2,469	2,465
Profit and loss account	24	282	673
Equity shareholders' funds		2,952	3,338
Equity minority interests		195	192
		3,147	3,530

The company balance sheet is shown in note 32.

The financial statements were approved by the board of directors on 27 February 2004 and signed on its behalf by

Dennis Stevenson, Chairman
Rona Fairhead, Chief financial officer

Consolidated cash flow statement
year ended 31 December 2003

All figures in £ millions	Note	2003	2002
Net cash inflow from operating activities	27	359	529
Dividends from joint ventures and associates		9	6
Interest received		11	11
Interest paid		(86)	(151)
Debt issue costs		(1)	–
Dividends paid to equity minority interests		(19)	(1)
Returns on investments and servicing of finance		(95)	(141)
Taxation		(44)	(55)
Purchase of tangible fixed assets		(105)	(126)
Sale of tangible fixed assets		8	7
Purchase of investments		(4)	(21)
Sale of investments		–	3
Capital expenditure and financial investment		(101)	(137)
Purchase of subsidiaries	25	(94)	(87)
Net cash acquired with subsidiaries		34	1
Purchase of joint ventures and associates		(5)	(40)
Sale of subsidiaries	26	(4)	3
Net overdrafts/(cash) disposed with subsidiaries		1	(1)
Sale of associates		57	920
Acquisitions and disposals		(11)	796
Equity dividends paid		(188)	(181)
Net cash (outflow)/inflow before management of liquid resources and financing		(71)	817
Liquid resources acquired		(85)	(65)
Collateral deposit reimbursed		–	22
Management of liquid resources		(85)	(43)
Issue of equity share capital		5	6
Capital element of finance leases		(3)	(5)
Loan facility advanced/(repaid)		1	(507)
Bonds advanced		180	–
Bonds repaid		(159)	(167)
Collateral deposit reimbursed		54	17
Net movement in other borrowings		(13)	(7)
Financing		65	(663)
(Decrease)/increase in cash in the year	27	(91)	111

Statement of total recognised gains and losses
year ended 31 December 2003

All figures in £ millions	2003	2002
Profit/(loss) for the financial year	55	(111)
Other net gains and losses recognised in reserves		
Exchange differences	(254)	(317)
Taxation on exchange differences	–	5
Total recognised gains and losses relating to the year	(199)	(423)
Prior year adjustment	–	209
Total recognised gains and losses	(199)	(214)

Included within profit/(loss) for the financial year is a loss for the year of £10m (2002: loss of £13m) relating to joint ventures and a profit of £6m (2002: a loss of £39m) relating to associates. The prior year adjustment in 2002 related to the adoption of FRS 19 'Deferred tax'.

Reconciliation of movements in equity shareholders' funds
year ended 31 December 2003

All figures in £ millions	2003	2002
Profit/(loss) for the financial year	55	(111)
Dividends on equity shares	(192)	(187)
	(137)	(298)
Exchange differences net of taxation	(254)	(312)
Goodwill written back on sale of subsidiaries and associates	–	144
Shares issued	5	6
Replacement options granted on acquisition of subsidiary	–	1
Net movement for the year	(386)	(459)
Equity shareholders' funds at beginning of the year	3,338	3,797
Equity shareholders' funds at end of the year	2,952	3,338