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.

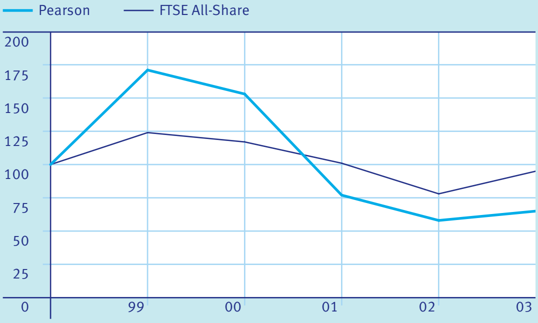
The committee selects performance measures and establishes targets for the company's various performance-related annual or long-term incentive plans based on an assessment of the interests of shareholders and the company and taking into account an appropriate balance of risk and reward for the directors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

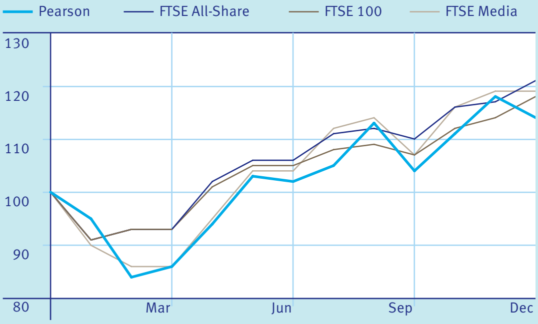
First, we show Pearson's total shareholder return relative to the FTSE All-Share index (of which Pearson is a constituent) on an annual basis over the five-year period 1998 to 2003. We have chosen this index on the basis that it is a recognisable reference point and appropriate comparator for the majority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

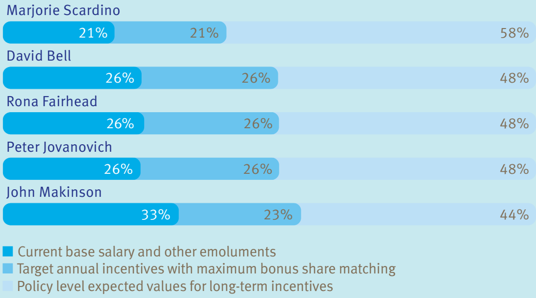


Main elements of remuneration

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.

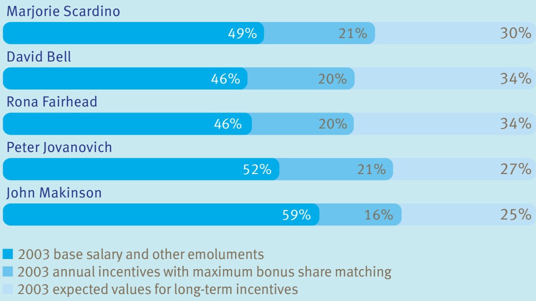
Based on the details set out in this report, our policy is that the relative importance of fixed and performance-related remuneration for each of the directors should be as follows:

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.

Report on directors' remuneration continued

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.

Report on directors' remuneration continued

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

Independent auditors' report to the members of Pearson plc

We have audited the financial statements which comprise the consolidated profit and loss account, the consolidated balance sheet, the consolidated cash flow statement, the statement of total recognised gains and losses, the reconciliation of movements in equity shareholders' funds and the notes to the accounts. We have also audited the disclosures required by Part 3 of Schedule 7a to the Companies Act 1985, contained in the report on directors' remuneration ('the auditable part').

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities. The directors are also responsible for preparing the report on directors' remuneration.

Our responsibility is to audit the financial statements and the auditable part of the report on directors' remuneration in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, have been prepared for and only for, the company's members as a body in accordance with section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the report on directors' remuneration have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the financial highlights, the chairman's statement, the chief executive's review, the section entitled 'growing our own', the report on corporate social responsibility entitled 'standing up', the operating and financial review entitled 'getting stronger' and the governance section including the board of directors, the directors' report and the unaudited part of the report on directors' remuneration.

We review whether the corporate governance statement within the directors' report reflects the Group's compliance with the seven provisions of the Combined Code issued in June 1998 specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the report on directors' remuneration. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the report on directors' remuneration are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion – In our opinion

› the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 2003 and the result and cash flows of the Group for the year then ended;

› the financial statements have been properly prepared in accordance with the Companies Act 1985; and

› those parts of the report on directors' remuneration required by Part 3 of Schedule 7a to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP, Chartered Accountants and Registered Auditors, London
27 February 2004

Notes to the accounts

1 Accounting policies
Accounting policies have been consistently applied and the amendment to FRS 5 – Application Note G 'Revenue recognition' has been applied in respect of multiple element arrangements as set out in note 1d below. The impact of this revision has not given rise to a material adjustment to these financial statements. The transitional arrangements of FRS 17 'Retirement benefits' which require additional disclosures in respect of retirement benefits have been adopted, as set out in note 10.

a. Basis of accounting – The accounts are prepared under the historical cost convention and in accordance with the Companies Act and applicable accounting standards. A summary of the significant accounting policies is set out below.

b. Basis of consolidation – The consolidated accounts include the accounts of all subsidiaries made up to 31 December. Where companies have become or ceased to be subsidiaries or associates during the year, the Group results include results for the period during which they were subsidiaries or associates.

The results of the Group includes the Group's share of the results of joint ventures and associates, and the consolidated balance sheet includes the Group's interest in joint ventures and associates at the book value of attributable net assets and attributable goodwill.

c. Goodwill – From 1 January 1998 goodwill, being either the net excess of the cost of shares in subsidiaries, joint ventures and associates over the value attributable to their net assets on acquisition or the cost of other goodwill by purchase, is capitalised and amortised through the profit and loss account on a straight-line basis over its estimated useful life not exceeding 20 years. Estimated useful life is determined after taking into account such factors as the nature and age of the business and the stability of the industry in which the acquired business operates, as well as typical life spans of the acquired products to which the goodwill attaches. Goodwill is subject to an impairment review at the end of the first full year following an acquisition, and at any other time if events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill arising on acquisitions before 1 January 1998 has been deducted from reserves and is charged or credited to the profit and loss account on disposal or closure of the business to which it relates.

d. Sales – Sales represent the amount of goods and services, net of value added tax and other sales taxes, and excluding trade discounts and anticipated returns, provided to external customers and associates.

Revenue from the sale of books is recognised when the goods are shipped. Anticipated returns are based primarily on historical return rates.

Circulation and advertising revenue is recognised when the newspaper or other publication is published.

Subscription revenue is recognised on a straight-line basis over the life of the subscription.

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

Revenue from long-term contracts, such as contracts to process qualifying tests for individual professions and government departments, is recognised over the contract term based on the percentage of services provided during the period, compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated direct and indirect costs of the contract exceed the estimated total revenues that will be generated by the contract.

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

e. Pension costs – The regular pension cost of the Group's defined benefit pension schemes is charged to the profit and loss account in accordance with SSAP 24 'Accounting for pension costs' in order to apportion the cost of pensions over the service lives of employees in the schemes. Variations arising from a significant reduction in the number of employees are adjusted in the profit and loss account to the extent that the year's regular pension cost, reduced by other variations, exceeds contributions payable for that year. Other variations are apportioned over the expected service lives of current employees in the schemes. The pension cost of the Group's defined contribution schemes is the amount of contributions payable for the year.

f. Post-retirement benefits other than pensions – Post-retirement benefits other than pensions are accounted for on an accruals basis to recognise the obligation over the expected service lives of the employees concerned.

g. Tangible fixed assets – The cost of tangible fixed assets other than freehold land is depreciated over estimated economic lives in equal annual amounts. Generally, freeholds are depreciated at 1% to 5% per annum, leaseholds at 2% per annum, or over the period of the lease if shorter, and plant and equipment at various rates between 5% and 33% per annum.

Notes to the accounts continued

1 Accounting policies continued

h. Leases – Finance lease rentals are capitalised at the net present value of the total amount of rentals payable under the leasing agreement (excluding finance charges) and depreciated in accordance with policy g above. Finance charges are written off over the period of the lease in reducing amounts in relation to the written down carrying cost. Operating lease rentals are expensed as incurred.

i. Fixed asset investments – Fixed asset investments are stated at cost less provisions for diminution in value.

j. Share schemes – Shares held by employee share ownership trusts are shown at cost less any provision for permanent diminution in value. The costs of funding and administering the trusts are charged to the profit and loss account in the period to which they relate. The cost of shares acquired by the trusts or the fair market value of the shares at the date of the grant, less any consideration to be received from the employee, is charged to the profit and loss account over the period to which the employee's performance relates. Where awards are contingent upon future events (other than continued employment) an assessment of the likelihood of these conditions being achieved is made at the end of each reporting period and an appropriate provision made.

k. Stocks – Stocks and work in progress are stated at the lower of cost and net realisable value.

l. Pre-publication costs – Pre-publication costs represent direct costs incurred in the development of titles prior to their publication. These costs are carried forward in stock where the title to which they relate has a useful life in excess of one year. These costs are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected life cycle of the title, with a higher proportion of the amortisation taken in the earlier years.

m. Royalty advances – Advances of royalties to authors are included within debtors when the advance is paid less any provision required to bring the amount down to its net realisable value. The royalty advance is expensed at the contracted royalty rate as the related revenues are earned.

n. Newspaper development costs – Revenue investment in the development of newspaper titles consists of measures to increase the volume and geographical spread of circulation. These measures include additional and enhanced editorial content, extended distribution and remote printing. These extra costs arising are expensed as incurred.

o. Deferred taxation – Provision is made in full for deferred tax that arises from timing differences that have originated but not reversed by the balance sheet date on transactions or events that result in an obligation to pay more tax in the future. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be taxable profits from which the underlying timing differences can be deducted. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax assets and liabilities are not discounted. No deferred tax is provided in respect of any future remittance of earnings of foreign subsidiaries or associates where no commitment has been made to remit such earnings.

p. Financial instruments – Interest and the premium or discount on the issue of financial instruments is taken to the profit and loss account so as to produce a constant rate of return over the period to the date of expected redemption.

The Group uses derivative financial instruments to manage its exposure to interest rate and foreign exchange risks. These include interest rate swaps, currency swaps and forward currency contracts. Amounts payable or receivable in respect of interest rate derivatives are accrued with net interest payable over the period of the contract. Where the derivative instrument is terminated early, the gain or loss is spread over the remaining maturity of the original instrument. Where the underlying exposure ceases to exist, any termination gain or loss is taken to the profit and loss account. Foreign currency borrowings and their related derivatives are carried in the balance sheet at the relevant exchange rates at the balance sheet date. Gains or losses in respect of the hedging of overseas subsidiaries are taken to reserves. Gains or losses arising from foreign exchange contracts are taken to the profit and loss account in line with the transactions which they are hedging. Premiums paid on contracts designed to manage currency exposure on specific acquisitions or disposals are charged to the profit and loss account.

The company participates in offset arrangements with certain banks whereby cash and overdraft amounts are offset against each other.

q. Foreign currencies – Profit and loss accounts in overseas currencies are translated into sterling at average rates. Balance sheets are translated into sterling at the rates ruling at 31 December. Exchange differences arising on consolidation are taken directly to reserves. Other exchange differences are taken to the profit and loss account where they relate to trading transactions and directly to reserves where they relate to investments.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.63 (2002: \$ 1.51) and the year end rate was \$1.79 (2002: \$1.61).

r. Liquid resources – Liquid resources comprise short-term deposits of less than one year and investments which are readily realisable and held on a short-term basis.

s. Retained profits of overseas subsidiaries and associates – No provision is made for any additional taxation, less double taxation relief, which would arise on the remittance of profits retained where there is no intention to remit such profits.

2a Analysis of sales

All figures in £ millions	2003	2002
Business sectors		
Pearson Education	2,451	2,756
FT Group	757	726
The Penguin Group	840	838
Continuing operations	4,048	4,320
Geographical markets supplied		
United Kingdom	474	411
Continental Europe	463	419
North America	2,742	3,139
Asia Pacific	255	249
Rest of world	114	102
Continuing operations	4,048	4,320

	2003			2002		
All figures in £ millions	Total by source	Inter-regional	Total sales	Total by source	Inter-regional	Total sales
Geographical source of sales						
United Kingdom	720	(29)	691	644	(25)	619
Continental Europe	339	(4)	335	304	(4)	300
North America	2,758	(39)	2,719	3,144	(36)	3,108
Asia Pacific	230	(1)	229	226	(2)	224
Rest of world	77	(3)	74	69	–	69
Continuing operations	4,124	(76)	4,048	4,387	(67)	4,320

Note The table above analyses sales by the geographical region from which the products and services originate. Inter-regional sales are those made between Group companies in different regions.

Included within sales for 2003 is an amount of £127m attributable to acquisitions made during the year.

2b Analysis of total operating profit

All figures in £ millions	Results from operations	Integration costs	Goodwill amortisation	Goodwill impairment	Operating profit
					2003
Business sectors					
Pearson Education	313	–	(207)	–	106
FT Group	86	–	(36)	–	50
The Penguin Group	91	–	(21)	–	70
Continuing operations	490	–	(264)	–	226
Geographical markets supplied					
United Kingdom	(46)	–	(31)	–	(77)
Continental Europe	29	–	(10)	–	19
North America	466	–	(218)	–	248
Asia Pacific	33	–	(5)	–	28
Rest of world	8	–	–	–	8
Continuing operations	490	–	(264)	–	226

All figures in £ millions	Results from operations	Integration costs	Goodwill amortisation	Goodwill impairment	Operating profit
					2002
Business sectors					
Pearson Education	326	(7)	(244)	–	75
FT Group	80	–	(65)	(10)	5
The Penguin Group	87	(3)	(18)	–	66
Continuing operations	493	(10)	(327)	(10)	146
Discontinued operations	–	–	(3)	–	(3)
	493	(10)	(330)	(10)	143
Geographical markets supplied					
United Kingdom	(72)	(5)	(25)	–	(102)
Continental Europe	40	–	(8)	–	32
North America	495	(5)	(288)	–	202
Asia Pacific	31	–	(6)	–	25
Rest of world	(1)	–	–	(10)	(11)
Continuing operations	493	(10)	(327)	(10)	146
Discontinued operations	–	–	(3)	–	(3)
	493	(10)	(330)	(10)	143

Note Integration costs in 2002 include amounts in respect of the Dorling Kindersley and NCS acquisitions. Integration costs, goodwill amortisation and goodwill impairment are included as 'other items' in the profit and loss account. Discontinued operations related to the withdrawal of the Group from the television business.

Included within operating profit for 2003 is an amount of £12m attributable to acquisitions made during the year.

2c Share of operating loss of joint ventures

All figures in £ millions	Results from operations	Integration costs	Goodwill amortisation	Goodwill impairment	Operating loss
					2003
Business sectors					
Pearson Education	–	–	–	–	–
FT Group	(11)	–	–	–	(11)
The Penguin Group	1	–	–	–	1
Continuing operations	(10)	–	–	–	(10)

All figures in £ millions	Results from operations	Integration costs	Goodwill amortisation	Goodwill impairment	Operating loss
					2002
Business sectors					
Pearson Education	(1)	–	–	–	(1)
FT Group	(13)	–	–	–	(13)
The Penguin Group	1	–	–	–	1
Continuing operations	(13)	–	–	–	(13)

2d Share of operating profit/(loss) of associates

All figures in £ millions	Results from operations	Integration costs	Goodwill amortisation	Goodwill impairment	Operating profit
					2003
Business sectors					
Pearson Education	1	–	–	–	1
FT Group	16	–	(7)	–	9
The Penguin Group	–	–	–	–	–
Continuing operations	17	–	(7)	–	10

All figures in £ millions	Results from operations	Integration costs	Goodwill amortisation	Goodwill impairment	Operating loss
					2002
Business sectors					
Pearson Education	3	–	(1)	–	2
FT Group	7	–	(44)	–	(37)
The Penguin Group	–	–	–	–	–
Continuing operations	10	–	(45)	–	(35)
Discontinued operations	–	–	(3)	–	(3)
	10	–	(48)	–	(38)

2e Analysis of capital employed

All figures in £ millions	Note	2003	2002
Business sectors			
Pearson Education		3,487	3,914
FT Group		432	410
The Penguin Group		596	605
Continuing operations		4,515	4,929
Geographical location			
United Kingdom		464	557
Continental Europe		219	258
North America		3,691	3,971
Asia Pacific		120	125
Rest of world		21	18
Continuing operations		4,515	4,929
Reconciliation of capital employed to net assets			
Capital employed		4,515	4,929
Add: deferred taxation	21	145	174
Less: provisions for liabilities and charges	22	(152)	(165)
Less: net debt excluding finance leases	27	(1,361)	(1,408)
Net assets		3,147	3,530

3 Analysis of consolidated profit and loss account

All figures in £ millions	2003	2002
Cost of sales	(1,910)	(2,064)
Gross profit	2,138	2,256
Distribution costs	(239)	(233)
Administration and other expenses	(1,724)	(1,888)
Other operating income (see below)	51	59
Net operating expenses	(1,912)	(2,062)
Analysed as		
Net operating expenses – before other items	(1,655)	(1,760)
Net operating expenses – other items		
– Integration costs	–	(10)
– Goodwill amortisation	(257)	(282)
– Goodwill impairment	–	(10)
Net operating expenses	(1,912)	(2,062)

Note Other items are all included in administration and other expenses.

All figures in £ millions	2003	2002
Other operating income		
Income from other investments		
Unlisted	4	2
Other operating income (mainly royalties, rights and commission income)	47	57
	51	59
Profit/(loss) before taxation is stated after charging		
Amortisation of pre-publication costs	158	170
Depreciation	111	122
Operating lease rentals		
– Plant and machinery	14	11
– Properties	113	101
– Other	9	13
Auditors' remuneration		
Statutory audit and audit-related regulatory reporting services	3	3
Non-audit services	2	3
Non-audit services were as follows		
Tax compliance services	1	2
Tax advisory services	1	1

Note Included in statutory audit fees are amounts relating to the parent company of £20,000 (2002: £20,000). Audit-related regulatory reporting fees are £200,000 (2002: £200,000). Non-audit fees in the UK in 2003 are £341,000 (2002: £231,000) and are in respect of tax advisory and tax compliance services. The remainder of the non-audit fees relate to overseas subsidiaries.

Notes to the accounts continued

4a Loss on sale of fixed assets and investments

All figures in £ millions	2003	2002
Net loss on sale of property	(1)	(3)
Net loss on sale of investments	(1)	(10)
Continuing operations	(2)	(13)
Taxation	–	6

4b Profit/(loss) on sale of subsidiaries and associates

All figures in £ millions	2003	2002
Profit on sale of Unidesa	12	–
Loss on sale of Forum	(1)	(40)
Loss on sale of PH Direct	–	(8)
Net (loss)/profit on sale of other subsidiaries and associates	(3)	3
Continuing operations	8	(45)
Profit on sale of the RTL Group – discontinued operations	–	18
	8	(27)
Taxation	(3)	(6)

4c Profit on sale of a subsidiary by an associate

All figures in £ millions	2003	2002
Profit on sale of Journal of Commerce by the Economist – continuing operations	–	3

5 Net finance costs

		2003			2002		
All figures in £ millions	Note	Results from operations	Other items	Total	Results from operations	Other items	Total
Net interest payable							
– Group	6	(81)	–	(81)	(94)	–	(94)
– Associates		1	–	1	–	–	–
Early repayment of debt and termination of swap contracts		–	–	–	–	(37)	(37)
Total net finance costs		(80)	–	(80)	(94)	(37)	(131)

6 Net interest payable – Group

All figures in £ millions	2003	2002
Interest payable and similar charges		
Bank loans, overdrafts and commercial paper		
On borrowing repayable wholly within five years not by instalments	(60)	(54)
On borrowing repayable wholly or partly after five years	(31)	(51)
Other borrowings		
On borrowing repayable wholly within five years not by instalments	(2)	–
	(93)	(105)
Interest receivable and similar income		
On deposits and liquid funds	12	11
Net interest payable	(81)	(94)

7 Taxation

All figures in £ millions	2003	2002
Analysis of (charge)/benefit in the year		
Current taxation		
UK corporation tax for the year	(9)	11
Adjustments in respect of prior years	10	58
	1	69
Overseas tax for the year	(59)	(63)
Adjustments in respect of prior years	3	–
Associates	(5)	(4)
	(60)	2
Deferred taxation		
Origination and reversal of timing differences		
UK	(4)	(11)
Overseas	(54)	(56)
Adjustments in respect of prior years	43	1
	(15)	(66)
Taxation	(75)	(64)

Note Included in the adjustment in respect of prior years in 2003 is a tax benefit of £44m (2002: £45m) relating to a prior year acquisition of a subsidiary and the disposal of a subsidiary and a fixed asset investment.

The current tax charge for the year is different from the standard rate of corporation tax in the UK (30%). The differences are explained below:

All figures in £ millions	2003	2002
Profit/(loss) before tax	152	(25)
Expected (charge)/benefit at UK corporation tax rate of 30% (2002: 30%)	(46)	8
Effect of overseas tax rates	8	11
Effect of tax losses	(5)	(7)
Timing differences	64	55
Non-deductible goodwill amortisation	(90)	(111)
US state taxes	(4)	(10)
Adjustments in respect of prior years and other items	13	56
Current tax (charge)/benefit for the year	(60)	2

7 Taxation continued

All figures in percentages	2003	2002
Tax rate reconciliation		
UK tax rate	30.0	30.0
Effect of overseas tax rates	1.3	2.8
Other items	(0.1)	–
Tax rate reflected in adjusted earnings	31.2	32.8

Note Both the current and the total tax charge on profit (or loss) before tax will continue to be affected by the fact that there is only very limited tax relief available on the goodwill amortisation charged in the accounts.

The current tax charge will continue to be affected by the utilisation of tax losses and by the impact of other timing differences, in both cases mainly in the United States. Following the adoption of FRS 19 these factors will have only a very limited impact on the total tax rate; as shown in note 21, the Group has recognised a total deferred tax asset of £145m at 31 December 2003 (2002: £174m).

In both 2003 and 2002 the tax charge was materially affected by adjustments in respect to prior years; it is not practicable to forecast the possible effect of such items in future years as this will depend on progress in agreeing the Group's tax returns with the tax authorities.

The total charge in future years will also be affected by any changes to corporation tax rates and/or any other relevant legislative changes in the jurisdictions in which the Group operates and by the mix of profits between the different jurisdictions.

8 Dividends on equity shares

	2003		2002	
	Pence per share	£m	Pence per share	£m
Interim paid	9.4	73	9.1	72
Final proposed	14.8	119	14.3	115
Dividends for the year	24.2	192	23.4	187

Note Dividends in respect of the company's shares held by employee share trusts (see note 15) have been waived.

9 Earnings/(loss) per share

In order to show results from operations on a comparable basis, an adjusted earnings per share is presented which excludes certain items as set out below. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

		2003		2002	
	Note	£m	Earnings/ (loss) per share (p)	£m	Earnings/ (loss) per share (p)
Profit/(loss) for the financial year		55	6.9	(111)	(13.9)
Adjustments					
– Non operating items		(6)	(0.8)	37	4.6
– Integration costs	2b	–	–	10	1.3
– Goodwill amortisation	2b	264	33.3	330	41.4
– Goodwill impairment	2b	–	–	10	1.3
– Other net finance costs	5	–	–	37	4.6
Taxation on above items		(53)	(6.6)	(67)	(8.4)
Minority interest share of above items		(6)	(0.8)	(5)	(0.6)
Adjusted earnings		254	32.0	241	30.3
Weighted average number of shares (millions) – for basic earnings and adjusted earnings Effect of dilutive share options		 794.4 0.9		 796.3 –	
Weighted average number of shares (millions) – for diluted earnings		795.3		796.3	

Note In 2002 the Group made a loss for the financial year (after taking into account goodwill amortisation). Consequently, the effect of share options was anti-dilutive and there was no difference between the loss per share and the diluted loss per share.

There is no difference between the profit for the financial year and the diluted profit for the financial year. Therefore the diluted earnings per share is 6.9p (2002: a loss of 13.9p). The weighted average number of shares in 2003 is lower than in 2002 as a result of own shares purchased to hedge share schemes.

10a Employee information

The details of the emoluments of the directors of Pearson plc are shown on pages 55 to 69.

All figures in £ millions	2003	2002
Staff costs		
Wages and salaries	1,027	1,106
Social security costs	99	106
Post-retirement costs	62	59
	1,188	1,271

	UK	US	Other	Total
Average number employed 2003				
Pearson Education	1,443	14,438	4,097	19,978
FT Group	1,885	1,397	2,362	5,644
The Penguin Group	1,223	2,115	980	4,318
Other	414	513	1	928
	4,965	18,463	7,440	30,868
Average number employed 2002				
Pearson Education	1,326	14,459	4,250	20,035
FT Group	1,914	1,140	2,169	5,223
The Penguin Group	1,305	2,167	890	4,362
Other	204	534	1	739
	4,749	18,300	7,310	30,359

10b Pensions

SSAP 24 accounting The Group operates a number of pension schemes throughout the world, the principal ones being in the UK and US. The major schemes are self-administered with the schemes' assets being held independently of the Group. Pension costs are assessed in accordance with the advice of independent qualified actuaries. The UK scheme is a hybrid scheme with both defined benefit and defined contribution sections but, predominantly, consisting of defined benefit liabilities. There are a number of defined contribution schemes, principally overseas. The cost of the schemes is as follows:

All figures in £ millions	2003	2002
UK Group scheme		
Regular pension cost		
– Defined benefit sections	10	11
– Defined contribution sections	7	7
Variation cost	6	–
	23	18
Other schemes		
Defined benefit schemes	7	6
Defined contribution schemes	27	30
	34	36
	57	54

Note From 1 January 2003 the UK Group scheme only offers defined contribution benefits to new joiners. The main US defined benefit scheme was closed to the majority of active members in 2001. The changes to these schemes will give rise to a reduction in defined benefit and an increase in defined contribution costs.

10b Pensions continued
Included in note 22, there is a pension provision of £29m (2002: £36m) as measured in accordance with SSAP 24.

A full actuarial valuation of the UK Group scheme was performed as at 1 January 2001 using the projected unit method of valuation. This valuation has been updated to 1 January 2003 for the purposes of determining the 2003 SSAP 24 cost for the UK Group scheme. The market value of the assets of the scheme at 1 January 2003 was £976m. The major assumptions used to determine the SSAP 24 charge are as follows:

All figures in percentages	UK Group scheme
Inflation	2.5
Rate of increase in salaries	4.5
Rate of inflation-linked increase for pensions in payment and deferred pensions	2.5
Return on investments	7.0
Level of funding	96.0

The funding policy differs from the accounting policy to the extent that more conservative assumptions are used for funding purposes. Furthermore, in 2003 the Group paid an additional one-off contribution of £5m into the scheme which was designed to ensure that the scheme was fully funded. The next full triennial valuation is due to be carried out as at 1 January 2004.

The date of the most recent valuation of the US plan was 31 December 2002.

FRS 17 disclosures The disclosures required under the transitional arrangements of FRS 17 for the Group's defined benefit schemes and the UK Group hybrid scheme are set out below. The disclosures for the UK Group hybrid scheme are in respect of both the defined benefit and defined contribution sections.

For the purpose of these disclosures, the latest full actuarial valuations of the UK Group scheme and other schemes have been updated by independent actuaries to 31 December 2003. The assumptions used are shown below. Weighted average assumptions have been shown for the other schemes.

	2003		2002		2001	
All figures in percentages	UK Group scheme	Other schemes	UK Group scheme	Other schemes	UK Group scheme	Other schemes
Inflation	2.75	3.00	2.25	3.00	2.50	3.00
Rate of increase in salaries	4.75	4.50	4.25	4.50	4.50	4.50
Rate of inflation-linked increase for pensions in payment and deferred pensions	2.75	–	2.25	–	2.50	–
Rate used to discount scheme liabilities	5.50	6.10	5.70	6.75	6.00	7.20

10b Pensions continued

The assets of the UK Group scheme and the expected rate of return on these assets, and the assets of the other defined benefit schemes and the expected rate of return on these assets shown as a weighted average, are as follows:

	Long-term rate of return expected at 31 Dec 2003 %	Value at 31 Dec 2003 £m	Long-term rate of return expected at 31 Dec 2002 %	Value at 31 Dec 2002 £m	Long-term rate of return expected at 31 Dec 2001 %	Value at 31 Dec 2001 £m
UK Group scheme						
Equities	7.75	589	8.00	472	7.50	657
Bonds	5.00	262	4.75	284	5.30	293
Properties	6.50	107	6.50	112	6.30	102
Other	6.50	133	6.50	108	6.30	42
Total market value of assets		1,091		976		1,094
Present value of scheme liabilities		(1,316)		(1,189)		(1,167)
Deficit in the scheme		(225)		(213)		(73)
Related deferred tax asset		68		64		22
Net pension liability		(157)		(149)		(51)
Other schemes						
Equities	9.00	41	9.75	33	9.50	37
Bonds	6.00	25	6.00	23	6.50	24
Other	2.80	1	2.75	1	–	–
Total market value of assets		67		57		61
Present value of scheme liabilities		(104)		(96)		(95)
Deficit in the schemes		(37)		(39)		(34)
Related deferred tax asset		13		14		12
Net pension liability		(24)		(25)		(22)

Note The measurement of the deficit in the scheme for FRS 17 follows a different approach to SSAP 24. The FRS 17 measurement date is 31 December 2003. Although the rise in stock markets in 2003 increased the market value of the UK Group scheme assets, this is more than offset by the increase in the present value of the UK Group scheme liabilities, which is largely caused by the fall in bond yields and increase in the inflation assumption in 2003. This has resulted in an increased deficit in the UK Group scheme under FRS 17.

10b Pensions continued

All figures in £ millions	UK Group scheme	Defined benefit other	Total	Defined contribution	2003 Total
Operating charge					
Current service cost	(20)	(1)	(21)	(27)	(48)
Past service cost	–	(1)	(1)	–	(1)
Total operating charge	(20)	(2)	(22)	(27)	(49)
Other finance income/(charge)					
Expected return on pension scheme assets	65	5	70	–	70
Interest on pension scheme liabilities	(66)	(7)	(73)	–	(73)
Net charge	(1)	(2)	(3)	–	(3)
Net profit and loss impact	(21)	(4)	(25)	(27)	(52)
Statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	80	8	88		
Experience losses arising on the scheme liabilities	(1)	(8)	(9)		
Changes in assumptions underlying the present value of the scheme liabilities	(95)	(6)	(101)		
Exchange differences	–	3	3		
Actuarial loss	(16)	(3)	(19)		
Movement in deficit during the year					
Deficit in scheme at beginning of the year	(213)	(39)	(252)		
Current service cost	(20)	(1)	(21)		
Past service cost	–	(1)	(1)		
Contributions	25	9	34		
Other finance charge	(1)	(2)	(3)		
Actuarial loss	(16)	(3)	(19)		
Deficit in scheme at end of the year	(225)	(37)	(262)		
Related deferred tax asset	68	13	81		
Net pension deficit	(157)	(24)	(181)		

In 2003, the company contributions to the UK Group scheme were 17.1% of pensionable salaries, plus £1m in respect of the new Money Purchase section introduced with effect from 1 January 2003. In addition, a one-off contribution of £5m was paid into this scheme to improve the funding position. The 17.1% contribution rate will be reviewed following completion of the 1 January 2004 funding actuarial valuation.

10b Pensions continued

All figures in £ millions	UK Group scheme	Defined benefit other	Total	Defined contribution	2002 Total
Operating charge					
Current service cost	(19)	(3)	(22)	(30)	(52)
Past service cost	–	(1)	(1)	–	(1)
Total operating charge	(19)	(4)	(23)	(30)	(53)
Other finance income/(charge)					
Expected return on pension scheme assets	73	5	78	–	78
Interest on pension scheme liabilities	(68)	(6)	(74)	–	(74)
Net income/(charge)	5	(1)	4	–	4
Net profit and loss impact	(14)	(5)	(19)	(30)	(49)
Statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	(165)	(11)	(176)		
Experience gains and (losses) arising on the scheme liabilities	17	(1)	16		
Changes in assumptions underlying the present value of the scheme liabilities	3	(4)	(1)		
Exchange differences	–	2	2		
Actuarial loss	(145)	(14)	(159)		
Movement in deficit during the year					
Deficit in scheme at beginning of the year	(73)	(34)	(107)		
Current service cost	(19)	(3)	(22)		
Past service cost	–	(1)	(1)		
Contributions	19	14	33		
Other finance income/(charge)	5	(1)	4		
Actuarial loss	(145)	(14)	(159)		
Deficit in scheme at end of the year	(213)	(39)	(252)		
Related deferred tax asset	64	14	78		
Net pension deficit	(149)	(25)	(174)		

The contribution rate for 2002 for the UK Group scheme was 17.1% of pensionable salaries.

Notes to the accounts continued

10b Pensions continued

The experience gains and losses of both the UK Group scheme and other schemes are shown below:

All figures in £ millions	2003	2002
History of experience gains and losses		
Difference between the actual and expected return on scheme assets	£88m	£(176)m
As a percentage of year end assets	8%	17%
Experience gains and (losses) on scheme liabilities	£(9)m	£16m
As a percentage of year end liabilities	1%	1%
Total amount recognised in statement of total recognised gains and losses	£(19)m	£(159)m
As a percentage of year end liabilities	1%	12%

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserve at 31 December 2003 would be as follows:

All figures in £ millions	2003	2002
Net assets excluding pension liability (see note below)	3,176	3,566
FRS 17 pension liability	(181)	(174)
Net assets including FRS 17 pension liability	2,995	3,392
Profit and loss reserve excluding pension reserve (see note below)	311	709
FRS 17 pension reserve	(181)	(174)
Profit and loss reserve including FRS 17 pension reserves	130	535

Note The net assets and profit and loss reserve exclude the pension liability of £29m (2002: £36m) included within provisions (see note 22).

10c Other post-retirement benefits

UITF 6 accounting The Group provides certain healthcare and life assurance benefits principally for retired US employees and their dependents. These plans are unfunded. Retirees are eligible for participation in the plans if they meet certain age and service requirements. Plans that are available vary depending on the business division in which the retiree worked. Plan choices and retiree contributions are dependent on retirement date, business division, option chosen and length of service. The valuation and costs relating to other post-retirement benefits are assessed in accordance with the advice of independent qualified actuaries. The cost of the benefits and the major assumptions used, based on a measurement date of 31 December 2002, are as follows:

All figures in £ millions	2003	2002
Other post-retirement benefits	5	5

All figures in percentages	
Inflation	3.0
Initial rate of increase in healthcare rates	12.0
Ultimate rate of increase in healthcare rates (2007)	5.0
Rate used to discount scheme liabilities	6.8

Included in note 22, there is a post-retirement medical benefits provision of £51m (2002: £56m). In accordance with UITF 6, the cost of post-retirement benefits, and related provisions, are based on the equivalent US GAAP standard, FAS 106.

FRS 17 disclosures The disclosures required under the transitional arrangements of FRS 17 are set out below. For the purpose of these disclosures the valuation of the schemes has been updated to 31 December 2003 using the assumptions listed below.

All figures in percentages	2003	2002	2001
Inflation	3.00	3.00	3.00
Initial rate of increase in healthcare rates	12.00	12.00	10.00
Ultimate rate of increase in healthcare rates (2008; 2007; 2007)	5.00	5.00	5.00
Rate used to discount scheme liabilities	6.10	6.75	7.20

10c Other post-retirement benefits continued

The value of the unfunded liability is as follows:

All figures in £ millions	2003	2002	2001
Present value of unfunded liabilities	(61)	(63)	(63)
Related deferred tax asset	21	22	22
Net post-retirement healthcare liability	(40)	(41)	(41)
Operating charge			
Current service cost	(1)	(1)	
Past service cost	–	–	
Total operating charge	(1)	(1)	
Other finance charge			
Interest on pension scheme liabilities	(4)	(4)	
Net charge	(4)	(4)	
Net profit and loss impact	(5)	(5)	
Statement of total recognised gains and losses			
Experience gains arising on the scheme liabilities	3	3	
Changes in assumptions underlying the present value of the scheme liabilities	(6)	(7)	
Exchange differences	6	5	
Actuarial gain	3	1	
Movement in deficit during the year			
Deficit in scheme at beginning of the year	(63)	(63)	
Current service cost	(1)	(1)	
Contributions	4	4	
Other finance charge	(4)	(4)	
Actuarial gain	3	1	
Deficit in scheme at end of the year	(61)	(63)	
Related deferred tax asset	21	22	
Net post-retirement deficit	(40)	(41)	
The experience gains and losses for the schemes are shown below:			
History of experience gains and losses			
Experience gains on scheme liabilities	£3m	£3m	
As a percentage of year end liabilities	5%	4%	
Total amount recognised in statement of total recognised gains and losses	£3m	£1m	
As a percentage of year end liabilities	5%	2%	

10c Other post-retirement benefits continued

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserves at 31 December 2003 would be as follows:

All figures in £ millions	2003	2002
Net assets excluding post-retirement healthcare liability (see note below)	3,198	3,586
FRS 17 post-retirement healthcare liability	(40)	(41)
Net assets including FRS 17 post-retirement healthcare liability	3,158	3,545
Profit and loss reserve excluding post-retirement healthcare reserve (see note below)	333	729
FRS 17 post-retirement healthcare reserve	(40)	(41)
Profit and loss reserve including FRS 17 post-retirement healthcare reserve	293	688

Note The net assets and profit and loss reserve exclude the post-retirement healthcare liability of £51m (2002: £56m) included within provisions (see note 22).

11 Intangible fixed assets

All figures in £ millions	Goodwill
Cost	
At 31 December 2002	4,487
Exchange differences	(321)
Additions	157
Disposals	(99)
At 31 December 2003	4,224
Amortisation	
At 31 December 2002	(877)
Exchange differences	75
Provided in the year	(257)
Disposals	95
At 31 December 2003	(964)
Net carrying amount	
At 31 December 2002	3,610
At 31 December 2003	3,260

12 Tangible fixed assets

All figures in £ millions	Freehold and leasehold property	Plant and equipment	Assets in course of construction	Total
Cost				
At 31 December 2002	311	714	20	1,045
Exchange differences	(19)	(33)	(3)	(55)
Reclassifications	1	9	(10)	–
Owned by subsidiaries acquired	5	19	–	24
Owned by subsidiaries disposed	(2)	(6)	–	(8)
Capital expenditure	12	77	15	104
Disposals	(15)	(63)	–	(78)
At 31 December 2003	293	717	22	1,032
Depreciation				
At 31 December 2002	(96)	(446)	–	(542)
Exchange differences	10	27	–	37
Provided in the year	(16)	(95)	–	(111)
Owned by subsidiaries acquired	–	(14)	–	(14)
Owned by subsidiaries disposed	1	4	–	5
Disposals	7	54	–	61
At 31 December 2003	(94)	(470)	–	(564)
Net book value				
At 31 December 2002	215	268	20	503
At 31 December 2003	199	247	22	468

Freehold and leasehold property – Net book value includes freehold of £120m (2002: £130m) and short leases of £79m (2002: £85m).

Capital commitments – The Group had capital commitments for fixed assets, including finance leases, already under contract amounting to £1m at 31 December 2003 (2002: £12m).

Other notes – The net book value of Group tangible fixed assets includes £5m (2002: £7m) in respect of assets held under finance leases. Depreciation on these assets charged in 2003 was £2m (2002: £2m).

13 Joint ventures

	2003		2002	
All figures in £ millions	Valuation	Book value	Valuation	Book value
Unlisted joint ventures	6	6	7	7

Note The valuations of unlisted joint ventures are directors' valuations as at 31 December 2003. If realised at these values there would be an estimated liability for taxation of £nil (2002: £nil). The Group had no capital commitments to subscribe for further capital and loan stock.

All figures in £ millions	Share of equity	Reserves	Total net assets
Summary of movements			
At 31 December 2002	61	(54)	7
Exchange differences	7	(5)	2
Additions	7	–	7
Retained loss for the year	–	(10)	(10)
At 31 December 2003	75	(69)	6

Notes to the accounts continued

13 Joint ventures continued

All figures in £ millions	2003 Operating loss	2003 Total net assets	2002 Operating loss	2002 Total net assets
Business sectors				
Pearson Education	–	–	(1)	–
FT Group	(11)	2	(13)	3
The Penguin Group	1	4	1	4
	(10)	6	(13)	7
Geographical markets supplied and location of net assets				
United Kingdom	1	4	1	4
Continental Europe	(11)	2	(13)	3
North America	–	–	(1)	–
	(10)	6	(13)	7

All figures in £ millions	2003	2002
Reconciliation to retained loss		
Operating loss of joint ventures	(10)	(13)
Taxation	–	–
Retained loss for the year	(10)	(13)

14 Associates

	2003 Valuation	2003 Book value	2002 Valuation	2002 Book value
Listed associates	27	9	17	17
Unlisted associates	192	49	214	88
Loans	–	–	1	1
	219	58	232	106

Note Principal associates are listed in note 34. The valuations of unlisted associates are directors' valuations as at 31 December 2003. If realised at these values there would be an estimated liability for taxation of £nil (2002: £nil). The Group had no capital commitments to subscribe for further capital and loan stock.

All figures in £ millions	Share of equity	Loans	Reserves	Total	Goodwill	Total net assets
Summary of movements						
At 31 December 2002	64	1	9	74	32	106
Exchange differences	1	1	–	2	(1)	1
Disposals	(16)	–	(5)	(21)	(24)	(45)
Loan repayment	–	(2)	–	(2)	–	(2)
Retained profit for the year	–	–	5	5	–	5
Goodwill amortisation	–	–	–	–	(7)	(7)
At 31 December 2003	49	–	9	58	–	58

14 Associates continued

All figures in £ millions	2003 Operating profit	2003 Total net assets	2002 Operating loss	2002 Total net assets
Business sectors				
Pearson Education	1	4	2	8
FT Group	9	54	(37)	98
Continuing operations	10	58	(35)	106
Discontinued operations	–	–	(3)	–
	10	58	(38)	106
Geographical markets supplied and location of net assets/(liabilities)				
United Kingdom	10	20	11	9
Continental Europe	2	39	(1)	92
North America	(3)	(7)	(45)	(5)
Rest of world	1	6	–	10
Continuing operations	10	58	(35)	106
Discontinued operations	–	–	(3)	–
	10	58	(38)	106

All figures in £ millions	2003	2002
Reconciliation to retained profit		
Operating profit of associates (before goodwill amortisation)	17	10
Interest	1	–
Profit on sale of subsidiaries	–	3
Taxation	(5)	(4)
Dividends (including tax credits) from unlisted associates	(8)	(7)
Retained profit for the year	5	2

The aggregate of the Group's share in its associates is shown below:

All figures in £ millions	2003	2002
Sales	234	141
Fixed assets	24	28
Current assets	116	130
Liabilities due within one year	(70)	(76)
Liabilities due after one year or more	(12)	(8)
Net assets	58	74

15 Other fixed asset investments

All figures in £ millions	2003 Valuation	2003 Book value	2002 Valuation	2002 Book value
Listed	73	59	67	64
Unlisted	21	21	20	20
	94	80	87	84

Note The valuations of unlisted investments are directors' valuations as at 31 December 2003. If realised at valuation there would be an estimated liability for taxation of £nil (2002: £nil).

All figures in £ millions	Own shares held	Other	Total
Cost			
At 31 December 2002	108	97	205
Exchange differences	–	(5)	(5)
Additions	–	4	4
Disposals	(2)	–	(2)
At 31 December 2003	106	96	202
Provision			
At 31 December 2002	(66)	(55)	(121)
Provided during the year	(3)	–	(3)
Disposals	2	–	2
At 31 December 2003	(67)	(55)	(122)
Net book value			
At 31 December 2002	42	42	84
At 31 December 2003	39	41	80

Note The Pearson Employee Share Trust and Pearson plc Employee Share Ownership Trusts hold 7.5m (2002: 7.9m) Pearson plc ordinary shares which had a market value of £46m at 31 December 2003 (2002: £45m) and a nominal value of £2m at 31 December 2003 (2002: £2m). These shares have been acquired by the trusts, using funds provided by Pearson plc, to meet obligations under various executive and employee option and restricted share plans. Under these plans the participants become entitled to shares after a specified number of years and subject to certain performance criteria being met. Pearson aims to hedge its liability under the plans by buying shares through the trusts to meet the anticipated future liability. Dividends on the shares held by the trusts have been waived. The amount of dividend waived on the ESOP shares was £2m (2002: £1m)

The Group operates a worldwide Save As You Earn scheme together with a similar scheme for US employees that allows the grant of share options at a discount to the market price of the option granted. The Group has made use of the exemption under UITF 17 not to recognise any compensation charge in respect of these options.

Employer's National Insurance and similar taxes arise on the exercise of certain share options. In accordance with UITF 25 a provision is made, calculated using the market price of the company's shares at the balance sheet date, pro-rated over the vesting period of the options.

16 Stocks

All figures in £ millions	2003	2002
Raw materials	24	22
Work in progress	30	36
Finished goods	270	297
Pre-publication costs	359	379
	683	734

Note The replacement cost of stocks is not materially different from book value.

17 Debtors

All figures in £ millions	2003	2002
Amounts falling due within one year		
Trade debtors	822	778
Associates	1	1
Royalty advances	110	109
Other debtors	61	51
Prepayments and accrued income	38	44
	1,032	983
Amounts falling due after more than one year		
Royalty advances	83	63
Other debtors	16	10
Prepayments and accrued income	1	1
	100	74
	1,132	1,057

18 Cash at bank and in hand

	2003		2002	
All figures in £ millions	Group	Company	Group	Company
Cash, bank current accounts and overnight deposits	309	–	417	–
Certificates of deposit and commercial paper	8	–	15	–
Term bank deposits	244	75	143	8
	561	75	575	8

19 Financial instruments

A full discussion on treasury policy is given in the Financial Review on pages 43 to 45. Short-term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures as set out in table e.

a. Maturity of borrowings and other financial liabilities

The maturity profile of the Group's borrowings and other financial liabilities is shown below:

	2003		2002	
All figures in £ millions	Group	Company	Group	Company
Maturity of borrowings				
Short-term				
Bank loans and overdrafts	119	262	101	175
5% Euro Bonds 2003	–	–	148	148
9.5% Sterling Bonds 2004	108	–	–	–
4.625% Euro Bonds 2004	348	348	–	–
Total due within one year, or on demand	575	610	249	323
Medium and long-term				
Loans or instalments thereof repayable:				
From one to two years	85	–	458	338
From two to five years	582	443	616	371
After five years not by instalments	680	680	660	660
Total due after more than one year	1,347	1,123	1,734	1,369
Total borrowings	1,922	1,733	1,983	1,692

Note At 31 December 2003 £85m (2002: £91m) of debt, including commercial paper, currently classified from one to two years would be repayable within one year if refinancing contracts were not in place. The short-term bank loans and overdrafts of the Group are lower than those of the company because of bank offset arrangements.

	2003			2002		
All figures in £ millions	Group finance leases	Group other financial liabilities	Group total	Group finance leases	Group other financial liabilities	Group total
Maturity of other financial liabilities						
Amounts falling due:						
In one year or less or on demand	3	5	8	4	11	15
In more than one year but not more than two years	1	14	15	2	8	10
In more than two years but not more than five years	1	7	8	1	16	17
In more than five years	–	21	21	–	22	22
	5	47	52	7	57	64

19 Financial instruments continued

b. Borrowings by instrument

All figures in £ millions	Group 2003	Company 2003	Group 2002	Company 2002
Unsecured				
5% Euro Bonds 2003	–	–	148	148
9.5% Sterling Bonds 2004	108	–	120	–
4.625% Euro Bonds 2004	348	348	338	338
7.375% US Dollar notes 2006	139	–	154	–
6.125% Euro Bonds 2007	343	343	370	370
10.5% Sterling Bonds 2008	100	100	100	100
7% Global Dollar Bonds 2011	278	278	310	310
7% Sterling Bonds 2014	235	235	250	250
4.625% US Dollar notes 2018	167	167	–	–
Variable rate loan notes	–	–	1	1
Bank loans and overdrafts and commercial paper	204	262	192	175
Total borrowings	1,922	1,733	1,983	1,692

c. Undrawn committed borrowing facilities

All figures in £ millions	2003	2002
Expiring within one year	–	–
Expiring between one and two years	950	–
Expiring in more than two years	–	1,059
	950	1,059

Note All of the above committed borrowing facilities incur commitment fees at market rates. In addition to the above facilities, there are a number of short-term overdrafts that are utilised in the normal course of the business.

d. Currency and interest rate risk profile

2003	Borrowings £m	Total variable rate £m	Total fixed rate £m	Fixed rate borrowings: Weighted average interest rate %	Fixed rate borrowings: Weighted average period for which rate is fixed – years
Currency and interest rate risk profile of borrowings					
US dollar	1,427	864	563	5.9	3.2
Sterling	201	61	140	8.0	9.0
Euro	292	166	126	5.3	1.7
Other currencies	2	2	–	–	–
	1,922	1,093	829		

19 Financial instruments continued
d. Currency and interest rate risk profile continued

	2002				
				Fixed rate borrowings	
	Borrowings £m	Total variable rate £m	Total fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed – years
Currency and interest rate risk profile of borrowings					
US dollar	1,350	752	598	5.9	4.0
Sterling	241	161	80	10.5	5.5
Euro	380	305	75	5.2	1.5
Other currencies	12	12	–	–	–
	1,983	1,230	753		

Note The figures shown in the tables above take into account interest rate, currency swaps and forward rate contracts entered into by the Group. Variable rate borrowings bear interest at rates based on relevant national LIBOR equivalents.

All figures in £ millions	2003 Other financial liabilities	Total fixed rate	Total no interest paid
Currency and interest rate risk profile of other financial liabilities			
US dollar	35	4	31
Sterling	5	1	4
Euro	12	–	12
	52	5	47

All figures in £ millions	2002 Other financial liabilities	Total fixed rate	Total no interest paid
Currency and interest rate risk profile of other financial liabilities			
US dollar	45	5	40
Sterling	8	2	6
Euro	11	–	11
	64	7	57

All figures in £ millions	2003 US dollar	Sterling	Euro	Other currencies	Total
Currency and interest rate risk profile of financial assets					
Cash at bank and in hand	150	54	40	65	309
Short-term deposits	112	20	104	16	252
Other financial assets	44	7	7	1	59
	306	81	151	82	620
Fixed rate	6	2	–	–	8
Floating rate	259	72	144	78	553
No interest received	41	7	7	4	59
	306	81	151	82	620

Note The US dollar fixed rate asset is fixed for 12 years at a rate of 8.2%. The Sterling fixed rate asset is fixed for 6 years at a rate of 7.0%.

19 Financial instruments continued
d. Currency and interest rate risk profile continued

All figures in £ millions	US dollar	Sterling	Euro	Other currencies	Total
					2002
Currency and interest rate risk profile of financial assets					
Cash at bank and in hand	279	9	67	62	417
Short-term deposits	2	18	127	11	158
Other financial assets	28	6	–	–	34
	309	33	194	73	609
Floating rate	281	27	193	73	574
No interest received	28	6	1	–	35
	309	33	194	73	609

e. Currency exposures The table below shows the extent to which Group companies have monetary assets and liabilities in currencies other than their local currency.

All figures in £ millions	US dollar	Sterling	Euro	Other currencies	Total
	2003 Net foreign monetary assets/(liabilities)				
Functional currency of entity					
US dollar	–	3	–	6	9
Sterling	20	–	7	6	33
Euro	–	–	–	5	5
Other currencies	5	(8)	5	–	2
	25	(5)	12	17	49

All figures in £ millions	US dollar	Sterling	Euro	Other currencies	Total
	2002 Net foreign monetary assets/(liabilities)				
Functional currency of entity					
US dollar	–	2	–	2	4
Sterling	48	–	41	8	97
Euro	–	1	–	6	7
Other currencies	4	4	5	–	13
	52	7	46	16	121

19 Financial instruments continued

f. Fair values of financial assets and financial liabilities
The table below shows the book value and the fair value of the Group's financial assets and financial liabilities.

All figures in £ millions	2003 Book value	2003 Fair value	2002 Book value	2002 Fair value
Primary financial instruments held or issued to finance the Group's operations				
Other financial assets	59	59	34	34
Other financial liabilities	(52)	(52)	(64)	(64)
Cash at bank and in hand	309	309	417	417
Short-term deposits	252	252	158	158
Short-term borrowings	(575)	(619)	(249)	(253)
Medium and long-term borrowings	(1,347)	(1,553)	(1,734)	(1,877)
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	–	(4)	–	26
Currency swaps	–	26	–	32
Foreign exchange contracts	–	–	–	4

Note Other financial assets, other financial liabilities, cash at bank and in hand and short-term deposits: the fair value approximates to the carrying value due to the short maturity periods of these financial instruments. Medium and long-term borrowings: the fair value is based on market values or, where these are not available, on the quoted market prices of comparable debt issued by other companies. Interest rate swaps: the fair value of interest rate swaps is based on market values. At 31 December 2003 the notional principal value of these swaps was £2,394m (2002: £1,605m). Currency swaps: the fair value of these contracts is based on market values. At 31 December 2003 the Group had £1,096m (2002: £758m) of such contracts outstanding.

g. Hedges The Group's policy on hedges is explained on page 43. The table below shows the extent to which the Group has off-balance sheet (unrecognised) gains and losses in respect of financial instruments used as hedges at the beginning and end of the year. It also shows the amount of such gains and losses which have been included in the profit and loss account for the year and those gains and losses which are expected to be included in next year's or later profit and loss accounts.

All figures in £ millions	Unrecognised gains	Unrecognised losses	Unrecognised total net gains/ (losses)
Gains and losses on hedges at 31 December 2002	113	(51)	62
Gains and losses arising in previous years that were recognised in 2003	(9)	–	(9)
Gains and losses arising before 31 December 2002 that were not recognised in 2003	104	(51)	53
Gains and losses arising in 2003 that were not recognised in 2003	(22)	(9)	(31)
Unrecognised gains and losses on hedges at 31 December 2003	82	(60)	22
Of which:			
Gains and losses expected to be recognised in 2004	4	–	4
Gains and losses expected to be recognised in 2005 or later	78	(60)	18

20 Other creditors

All figures in £ millions	2003	2002
Amounts falling due within one year		
Trade creditors	407	376
Taxation	55	24
Social security and other taxes	4	13
Other creditors	85	83
Accruals and deferred income	456	499
Obligations under finance leases	3	4
Dividends	119	115
	1,129	1,114
Amounts falling due after more than one year		
Other creditors	34	31
Accruals and deferred income	9	26
Obligations under finance leases	2	3
	45	60

21 Deferred taxation

All figures in £ millions	
Summary of movements	
At 31 December 2002	174
Exchange differences	(39)
Held by subsidiary acquired	(15)
Transfers	40
Net release in the year	(15)
At 31 December 2003	145

All figures in £ millions	2003	2002
Deferred taxation derives from		
Capital allowances	(21)	(47)
Tax losses carried forward	168	170
Taxation on unremitted overseas earnings	(4)	(16)
Other timing differences	2	67
	145	174
Deferred taxation not provided		
Relating to gains subject to roll-over relief	1	1

Note The Group has calculated deferred tax not provided on rolled over gains in 2003, taking into account the indexation allowance which would be deductible on a disposal of the asset into which the gain was rolled. The recovery of the deferred tax asset relating to tax losses carried forward is dependent on future taxable profits arising mainly in the US. The Group regularly reviews its projections of these future taxable profits to ensure that recoverability of the asset is still foreseeable.

22 Provisions for liabilities and charges

All figures in £ millions	Post-retirement	Deferred consideration	Integration	Reorganisations	Leases	Other	Total
At 31 December 2002	92	11	17	19	18	8	165
Exchange differences	(13)	–	–	(1)	(1)	1	(14)
Subsidiaries acquired	4	–	–	–	–	–	4
Transfers	–	1	3	(4)	–	–	–
Deferred consideration arising on acquisitions	–	24	–	–	–	–	24
Released	–	–	–	–	(1)	(1)	(2)
Provided	62	–	–	8	3	1	74
Utilised	(65)	(7)	(11)	(10)	(5)	(1)	(99)
At 31 December 2003	80	29	9	12	14	8	152

Note

a Post-retirement provisions are in respect of pensions, £29m (2002: £36m) and post-retirement medical benefits, £51m (2002: £56m).

b Deferred consideration. During the year, additional deferred consideration of £24m was incurred mainly relating to the acquisition of Lesson Lab.

c Integration. During the year, £11m of this balance has been utilised, primarily in relation to properties, severance and IT systems. The remaining provision should be utilised in the next two years.

d Reorganisations. £8m has been provided during the year mostly relating to redundancies at the Financial Times and the relaunch of Les Echos in Berlinois format. £10m has been utilised, mainly in respect of redundancies.

e Lease commitments. These relate primarily to onerous lease contracts, acquired as part of the purchase of subsidiaries, which have various expiry dates up to 2010. The provision is based on current occupancy estimates.

23 Share capital

	Number of shares (000's)	£m
Authorised		
Ordinary shares of 25p each		
At 31 December 2003	1,178,000	295
Called up, allotted and fully paid		
At 31 December 2002	801,662	200
Issued under share option and employee share schemes	726	1
At 31 December 2003	802,388	201

Note The consideration received in respect of shares issued during the year was £5m (2002: £6m).

23 Share capital continued

	When granted	Number of shares (000's)	Price (p)	Original subscription exercise period
Options outstanding at 31 December 2003				
Worldwide Save for Shares plans	1996	9	517	2003 – 04
	1997	39	530	2004 – 05
	1998	319	687	2003 – 06
	1999	137	913 – 926	2004 – 07
	2000	169	688 – 1,644	2003 – 08
	2001	350	957 – 1,096	2004 – 09
	2002	573	696	2005 – 10
	2003	2,273	425 – 426	2006 – 11
		3,869		
Discretionary share option plans	1994	148	567 – 635	1997 – 04
	1995	154	487 – 606	1998 – 05
	1996	248	584 – 654	1999 – 06
	1997	1,023	677 – 758	2000 – 07
	1998	1,637	847 – 1,090	2001 – 08
	1999	3,260	1,081 – 1,922	2002 – 09
	2000	8,510	64 – 3,224	2000 – 10
	2001	13,437	822 – 1,421	2002 – 11
		28,417		

Note The subscription prices have been rounded up to the nearest whole penny. The figures include replacement options granted to employees of Dorling Kindersley and the Family Education Network following their acquisition. The discretionary share option plans include all options granted under the Pearson Executive Share Option Plans, the Pearson Reward Plan, the Pearson Special Share Option Plan and the Pearson Long Term Incentive Plan.

24 Reserves

All figures in £ millions	Share premium account	Profit and loss account
Summary of movements		
At 31 December 2002	2,465	673
Exchange differences net of taxation	–	(254)
Premium on issue of equity shares	4	–
Loss retained for the year	–	(137)
At 31 December 2003	2,469	282
Analysed as		
Joint ventures and associates		(60)
Group excluding joint ventures and associates		342

Note Cumulative goodwill relating to acquisitions made prior to 1998, which was deducted from reserves, amounts to £961m (2002: £1,031m). During 2003 Pearson plc received £5m on the issue of shares in respect of the exercise of options awarded under various share option plans. Employees paid £5m to the Group for the issue of these shares. The Group has taken advantage of the exemption available by UITF 17 and has not incurred a charge on options granted at a discount to market value for its Inland Revenue approved SAYE schemes and similar overseas schemes. Included in exchange differences are exchange gains of £74m (2002: £70m) arising on borrowings denominated in, or swapped into, foreign currencies designated as hedges of net investments overseas.

Notes to the accounts continued

25 Acquisitions
All acquisitions have been consolidated applying acquisition accounting principles.

a. Acquisition of subsidiaries

All figures in £ millions	2003	2002
Tangible fixed assets	10	–
Associates	–	(3)
Stocks	–	(2)
Debtors	32	2
Creditors	(95)	(4)
Provisions	(4)	(3)
Deferred taxation	(15)	–
Net cash and short-term deposits acquired	34	25
	(38)	15
Equity minority interests	(8)	(4)
Net (liabilities)/assets acquired at fair value	(46)	11
Fair value of consideration		
Cash	(87)	(74)
Deferred cash consideration	(24)	(3)
Net prior year adjustments	–	3
Total consideration	(111)	(74)
Goodwill arising	157	63

All figures in £ millions	2003	2002
Acquisition fair values		
Book value of net (liabilities)/assets acquired	(32)	25
Fair value adjustments	(14)	(14)
Fair value to the Group	(46)	11

Note All the fair value adjustments above relate to acquisitions made in 2003. They include a write-off of certain fixed assets and recognition of a pension scheme liability. These fair value adjustments are provisional and will be finalised in the 2004 financial statements.

b. Cash flow from acquisitions

All figures in £ millions	2003	2002
Cash – current year acquisitions	87	74
Deferred payments for prior year acquisitions and other items	7	13
Net cash outflow	94	87

26 Disposals

a. Disposal of subsidiaries

All figures in £ millions	2003	2002
Intangible fixed assets	(4)	(41)
Tangible fixed assets	(3)	–
Stocks	(2)	(3)
Debtors	(9)	(2)
Creditors	10	(3)
Provisions	–	1
Net overdraft/(cash)	1	(1)
Equity minority interest	–	3
Net assets disposed of	(7)	(46)
Proceeds received	1	11
Deferred consideration	2	–
Costs	(1)	(7)
Net prior year adjustments	1	(3)
Loss on sale	(4)	(45)

b. Cash flow from disposals

All figures in £ millions	2003	2002
Cash – current year disposals	1	11
Costs paid	(2)	(3)
Deferred receipts and payments from prior year disposals and other amounts	(3)	(5)
Net cash (outflow)/inflow	(4)	3

Notes to the accounts continued

27 Notes to consolidated cash flow statement

All figures in £ millions	2003	2002
a. Reconciliation of operating profit to net cash inflow from operating activities		
Total operating profit	226	143
Share of operating loss of joint ventures and associates	–	51
Depreciation	111	122
Goodwill amortisation and impairment	257	292
(Increase)/decrease in stocks	(8)	43
Increase in debtors	(96)	(111)
(Decrease)/increase in creditors	(68)	64
Decrease in operating provisions	(20)	(50)
Other and non-cash items	(43)	(25)
Net cash inflow from operating activities	359	529
Dividends from joint ventures and associates	9	6
Purchase of tangible fixed assets	(105)	(126)
Capital element of finance leases	(3)	(5)
Sale of tangible fixed assets	8	7
Add back: cash received relating to acquired deferred income	42	–
Add back: non operating capital expenditure	2	–
Add back: integration costs	8	44
Operating cash flow	320	455
Operating tax paid	(34)	(46)
Operating finance charges	(76)	(104)
Operating free cash flow	210	305
Non operating tax paid	(10)	(9)
Non operating finance charges	–	(37)
Integration costs	(8)	(44)
Total free cash flow	192	215
Dividends paid (including minorities)	(207)	(182)
Net movement of funds from operations	(15)	33
Acquisitions of businesses and investments	(112)	(124)
Disposals of businesses, investments and property	52	930
New equity	5	6
Other non operating items	–	(5)
Net movement of funds	(70)	840
Exchange movements on net debt	117	131
Total movement in net debt	47	971

Note Operating cash flow, operating free cash flow and total free cash flow have been disclosed as they are part of Pearson's corporate and operating measures. Tax payments that can be clearly identified with disposals, integration and exchange differences taken to reserves are allocated as non operating tax payments. Cash received relating to acquired deferred income is an adjustment in Pearson's operating cash flow to match pre acquisition cash received with post acquisition revenue recognised following the acquisition of London Qualifications and more accurately reflect the substance of the transaction. A contra entry to this adjustment is included in 'Acquisitions of businesses and investments'.

27 Notes to consolidated cash flow statement continued

All figures in £ millions	Cash	Overdrafts	Sub-total	Short-term deposits	Debt due within one year	Debt due after one year	Finance leases	Total
b. Analysis of net debt								
At 31 December 2002	417	(77)	340	158	(172)	(1,734)	(7)	(1,415)
Exchange differences	6	31	37	9	(40)	111	–	117
Other non-cash items	–	–	–	–	(459)	458	(1)	(2)
Net cash flow	(114)	23	(91)	85	119	(182)	3	(66)
At 31 December 2003	309	(23)	286	252	(552)	(1,347)	(5)	(1,366)
At 31 December 2001	300	(60)	240	93	(105)	(2,607)	(14)	(2,393)
Exchange differences	(15)	4	(11)	(2)	(6)	150	1	132
Acquired with subsidiary	–	–	–	24	–	–	–	24
Other non-cash items	–	–	–	–	(148)	146	1	(1)
Net cash flow	132	(21)	111	43	87	577	5	823
At 31 December 2002	417	(77)	340	158	(172)	(1,734)	(7)	(1,415)

Note Finance leases are included within other creditors in the balance sheet (see note 20).

All figures in £ millions	2003	2002
c. Reconciliation of net cash flow to movement in net debt		
(Decrease)/increase in cash in the year	(91)	111
Decrease in net debt from management of liquid resources	85	43
Decrease in net debt from other borrowings	(63)	664
Decrease in finance leases	3	5
Acquired with subsidiary	–	24
Other non-cash items	(2)	(1)
Exchange differences	117	132
Movement in net debt in the year	49	978
Net debt at beginning of the year	(1,415)	(2,393)
Net debt at end of the year	(1,366)	(1,415)

28 Contingent liabilities

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

29 Commitments under leases

At 31 December 2003 the Group had commitments under leases, other than finance leases, to make payments in 2004 as follows:

All figures in £ millions	Land and buildings	Other
For leases expiring		
In 2004	7	2
Between 2005 and 2008	28	14
Thereafter	64	1
	99	17

Notes to the accounts continued

30 Related parties

Joint ventures and associates – Loans and equity advanced to joint ventures and associates during the year and at the balance sheet date are shown in notes 13 and 14. Amounts falling due from joint ventures and associates are set out in note 17. Dividends receivable from joint ventures and associates are set out in notes 13 and 14.

There were no other related party transactions in 2003.

31 Post balance sheet events

There were no significant post balance sheet events.

32 Company balance sheet as at 31 December 2003

All figures in £ millions	Note	2003	2002
Fixed assets			
Tangible fixed assets	33	–	–
Investments: subsidiaries	33	6,343	6,422
Investments: own shares held	33	33	39
		6,376	6,461
Current assets			
Debtors:			
Amounts due from subsidiaries – due within one year		1,394	971
Amounts due from subsidiaries – due after more than one year		944	1,453
Taxation		3	10
Other debtors		–	1
Cash at bank and in hand	18	75	8
		2,416	2,443
Creditors – amounts falling due within one year			
Short-term borrowing	19	(610)	(323)
Amounts due to subsidiaries		(2,860)	(2,641)
Other creditors		(1)	(1)
Accruals and deferred income		(16)	(13)
Dividends	8	(119)	(115)
		(3,606)	(3,093)
Net current liabilities		(1,190)	(650)
Total assets less current liabilities		5,186	5,811
Creditors – amounts falling due after more than one year			
Medium and long-term borrowing	19	(1,123)	(1,369)
Amounts due to subsidiaries		(234)	(393)
Provisions for liabilities and charges		(2)	(2)
		(1,359)	(1,764)
Net assets		3,827	4,047
Capital and reserves			
Called up share capital	23	201	200
Share premium account	33	2,469	2,465
Special reserve	33	397	397
Other reserves	33	50	50
Profit and loss account	33	710	935
Equity shareholders' funds		3,827	4,047

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

33 Notes to the company balance sheet

All figures in £ millions	2003	2002
Tangible fixed assets (leasehold property)		
Cost	1	1
Depreciation	(1)	(1)
Net book value	–	–

Note The company had no capital commitments for fixed assets at the end of 2003.

All figures in £ millions	
Investment in subsidiaries	
At 31 December 2002	6,422
External acquisition	15
Disposal to subsidiary	(22)
Provision for diminution in value	(33)
Revaluations	(39)
At 31 December 2003	6,343

Note Shares are stated at cost less provisions for diminution in value or directors' valuations.

Own shares held – Amounts included within own shares held relate to Pearson plc ordinary shares held in respect of the Pearson plc Employee Share Ownership Trusts (see note 15).

All figures in £ millions	Share premium account	Special reserve	Other reserves	Profit and loss account	Total
Reserves					
Summary of movements					
At 31 December 2002	2,465	397	50	935	3,847
Exchange differences	–	–	–	(23)	(23)
Premium on issue of equity shares	4	–	–	–	4
Loss for the financial year	–	–	–	(10)	(10)
Dividends on equity shares	–	–	–	(192)	(192)
At 31 December 2003	2,469	397	50	710	3,626

Note The special reserve represents the cumulative effect of cancellation of the company's share premium account. As permitted by section 230(4) of the Companies Act 1985, only the Group's profit and loss account has been presented.

Notes to the accounts continued

34 Principal subsidiaries and associates

	Country of incorporation or registration
Subsidiaries	
The principal operating subsidiaries are listed below. They operate mainly in the countries of incorporation or registration, the investments are in equity share capital and they are all 100% owned unless stated otherwise.	
Pearson Education	
Pearson Education Inc.	US
Pearson Education Ltd	England
NCS Pearson Inc.	US
FT Group	
The Financial Times Ltd	England
Financial Times Business Ltd	England
Interactive Data Corporation (61%)	US
Les Echos SA	France
Recoletos Grupo de Comunicación SA (79%)	Spain
The Penguin Group	
Penguin Group (USA) Inc.	US
The Penguin Publishing Co Ltd	England
Dorling Kindersley Holdings Ltd*	England

* Direct investment of Pearson plc.

	Country of incorporation or registration	Class of share	Beneficial interest %	Accounting year end
Associates				
FT Group				
The Economist Newspaper Ltd	England	Ord 5p	50	March
		'B' 5p	100	
		'A' 5p	Nil	
		Trust 5p	Nil	
FT-SE International Ltd	England	Ord £1	50	December

Five year summary

All figures in £ millions	1999	2000	2001	2002	2003
Sales					
Continuing operations	2,977	3,689	4,225	4,320	4,048
Discontinued operations	355	185	–	–	–
	3,332	3,874	4,225	4,320	4,048
Sales – underlying movement %	8	11	0	6	(4)
Sales – constant exchange rate movement %	–	–	–	–	(2)
Operating profit*					
Pearson Education	254	237	274	326	313
FT Group	114	98	72	80	86
The Penguin Group	65	79	80	87	91
Continuing operations	433	414	426	493	490
Operating profit – underlying movement %	–	–	(2)	18	0
Operating profit – constant exchange rate movement %	–	–	–	–	5
Adjusted eps*	39.5p	30.6p	21.4p	30.3p	32.0p
Dividends per share*	20.1p	21.4p	22.3p	23.4p	24.2p
Net assets	1,527	4,398	3,973	3,530	3,147
Deferred taxation	(266)	(295)	(272)	(174)	(145)
Provisions for liabilities and charges	206	257	239	165	152
Net debt (excluding finance leases)	1,995	2,301	2,379	1,408	1,361
Capital employed	3,462	6,661	6,319	4,929	4,515
Operating free cash flow per share*	43.4p	23.0p	29.6p	38.3p	26.4p
Total free cash flow per share*	13.8p	2.5p	17.6p	27.0p	24.2p
Return on Investment Capital %*	8.1	4.9	4.6	6.0	6.3

* Before goodwill charge, integration costs and non operating items, and restated to reflect the rights issue of equity shares during 2000.

Corporate and operating measures

Sales – underlying and constant exchange rate movement

Sales movement excluding the impact of acquisitions and disposals and movements in exchange rates.

All figures in £ millions	2003
Underlying decrease	(180)
Portfolio changes	89
Exchange differences	(181)
Total sales decrease	(272)
Underlying decrease	(4%)
Constant exchange rate decrease	(2%)

Operating profit*– underlying and constant exchange rate movement

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

All figures in £ millions	2003
Underlying decrease	0
Portfolio changes	24
Exchange differences	(27)
Total operating profit decrease	(3)
Underlying decrease	0%
Constant exchange rate increase	5%

Free cash flow per share

Operating cash flow less tax, interest and integration costs paid, divided by the weighted average number of shares in issue.

All figures in £ millions	2003
Operating profit*	490
Cash conversion	65%
Operating cash flow	320
Tax paid on operating profits	(34)
Interest paid	(76)
Operating free cash flow	210
Non operating tax paid	(10)
Integration costs	(8)
Total free cash flow	192
Weighted average number of shares in issue (millions)	794.4
Operating free cash flow per share	26.4p
Total free cash flow per share	24.2p

Return on invested capital*

Operating profit less cash tax expressed as a percentage of gross invested capital.

All figures in £ millions	2003
Operating profit	490
Cash tax (15%)	(73)
Return	417
Gross goodwill	5,295
Net operating assets	1,304
Invested capital	6,599
Return on invested capital	6.3%

* Before goodwill charge, integration costs and non operating items.

Shareholder information

Payment of dividends to mandated accounts

Where shareholders have given instruction for payment to be made direct into a bank or building society, this is done through the Bankers Automated Clearing System (BACS), with the associated tax voucher showing the tax credit attributable to the dividend payment sent direct to the shareholder at the address shown on our register. If you wish the tax voucher to be sent to your bank or building society, please inform our registrar, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 0870 600 3986 or, for those shareholders with hearing difficulties, textphone number 0870 600 3950.

Dividend reinvestment plan (DRIP)

The plan provides the benefit of giving shareholders the right to buy the company's shares on the London stock market with the cash dividend. If you would like further information about the DRIP, please contact Lloyds TSB Registrars. Telephone 0870 241 3018.

Personal Equity Plans (PEPs) and Individual Savings Accounts (ISAs)

The government no longer permits investment to be made in PEPs, although existing PEPs may be continued. Existing Corporate PEP and Single Company PEP holders who require further information about their PEPs should ring the HBOS helpline on 0870 606 6417. Lloyds TSB Registrars offer ISAs in Pearson shares. They can be contacted for information on 0870 242 4244.

Low cost share dealing facilities

A telephone and internet dealing service has been arranged through Lloyds TSB Registrars which provides a simple way of selling Pearson shares. Commission is 0.5% with a minimum charge of £20 for telephone dealing and £17.50 for internet dealing. For telephone sales call 0870 850 0852 between 8.30 am and 4.30 pm, Monday to Friday, and for internet sales log on to www.shareview.co.uk/dealing. You will need your shareholder reference number shown on your share certificate.

A postal facility, which provides a simple, low cost way of buying and selling Pearson shares, is available through the company's stockbroker, Cazenove & Co. Limited, 12 Tokenhouse Yard, London EC2R 7AN. Telephone 020 7588 2828. An alternative weekly postal dealing service is available through our registrars, telephone 0870 242 4244 for details.

ShareGift

The Orr Mackintosh Foundation operates a charity share donation scheme for shareholders with small holdings of shares, whose value makes them uneconomic to sell. Details can be obtained from the ShareGift website at www.sharegift.org or by telephoning 020 7337 0501.

Shareholder information on-line

Lloyds TSB Registrars provide a range of shareholder information on-line. You can check your holding and find practical help on transferring shares or updating your details at www.shareview.co.uk. Lloyds TSB Registrars can be contacted for information on 0870 600 3970.

Information about the Pearson share price

The current price of Pearson ordinary shares can be obtained from the company's website, www.pearson.com, from FT.com or from Financial Times CityLine (telephone 0906 843 3620).

American Depositary Receipts (ADRs)

Pearson's ordinary shares are listed on the New York Stock Exchange in the form of ADRs and traded under the symbol PSO. Each ADR represents one ordinary share. All enquiries regarding registered ADR holder accounts and payment of dividends should be directed to The Bank of New York, the authorised depositary bank for Pearson's ADR programme, at The Bank of New York, Investor Services, P.O. Box 11258, Church Street Station, New York, NY 10286-1258, telephone 1-888 BNY ADRs (toll free within the US) or (1) 610 382 7836 (outside the US), or email shareowners@bankofny.com, or sign-in at www.stockbny.com. Voting rights for registered ADR holders can be exercised through The Bank of New York, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a report on Form 20-F that will contain a US GAAP reconciliation.

Advisers

Auditors PricewaterhouseCoopers LLP

Bankers HSBC Bank Plc

Brokers Cazenove & Co. Limited, Citigroup

Financial advisers Lazard Brothers & Co. Limited, J. Henry Schroder & Co. Limited

Solicitors Freshfields Bruckhaus Deringer, Herbert Smith and Morgan, Lewis & Bockius

Financial calendar for 2004	
Ex-dividend date	7 April
Record date	13 April
Last date for dividend reinvestment election	22 April
Annual general meeting	30 April
Payment date for dividend and share purchase date for dividend reinvestment	7 May
Interim results	26 July
Interim dividend	24 September