PEARSON PLC
Form 20-F
May 05, 2006

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON May 5, 2006

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

Form 20-F

(Mark One)

o	**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
	or
þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	for the fiscal year ended December 31, 2005
	or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	for the transition period from to
o	**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	Date of event requiring this shell company report
	If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b2 of the Exchange Act). Yes o No o

Commission file number 1-16055
PEARSON PLC
(Exact name of Registrant as specified in its charter)
England and Wales
(Jurisdiction of incorporation or organization)
80 Strand
London, England WC2R 0RL
(Address of principal executive offices)
Securities registered or to be registered pursuant to Section 12(b) of the Act:

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

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

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

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

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

Ordinary Shares, 25p par value	804,020,000

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

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 þ Item 18 o

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

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

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

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

þ Large accelerated filer	oAccelerated filer	o Non-accelerated filer

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INTRODUCTION

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

We have prepared the financial information contained in this Annual Report in accordance with European Union (EU)-adopted International Financial Reporting Standards (IFRS), which differ in certain significant respects from generally accepted accounting principles in the United States, or US GAAP. We describe these differences in Item 5. Operating and Financial Review and Prospects Accounting Principles , and in note 35 to our consolidated financial statements included in Item 17. Financial Statements of this Annual Report. Unless we indicate otherwise, any reference in this Annual Report to our consolidated financial statements is to the consolidated financial statements and the related notes, included elsewhere in this Annual Report.

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

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

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

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

For convenience and except where we specify otherwise, we have translated some Sterling figures into US dollars at the rate of £1.00 = $1.72, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 30, 2005, the last business day of 2005. We do not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On April 28, 2006 the noon buying rate for sterling was £1.00 = $1.82.

FORWARD-LOOKING STATEMENTS

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

- operations and prospects,

- growth strategy,

- funding needs and financing resources,

- expected financial position,

- market risk,

- currency risk,

US federal and state spending patterns,

debt levels, and

general market and economic conditions.

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

PART I

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

Not applicable.

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

Not applicable.

ITEM 3. ***KEY INFORMATION***

Selected Consolidated Financial Data

The table below shows selected consolidated financial data for each of the years in the five-year period ended December 31, 2005. The selected consolidated profit and loss account data for the years ended December 31, 2005, 2004 and 2003 and the selected consolidated balance sheet data as at December 31, 2005, 2004 and 2003 have been derived from our audited consolidated financial statements included in Item 17. Financial Statements in this Annual Report and have been prepared in accordance with IFRS.

Our consolidated financial statements for the year ended December 31, 2005 have been prepared in accordance with IFRS, which differs from US GAAP in certain significant respects. See Item 5. Operating and Financial Review and Prospects Accounting Principles and note 35 to the consolidated financial statements. The consolidated financial statements contain a reconciliation to US GAAP of profit/loss for the financial year, shareholders funds and certain other financial data.

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

For convenience, we have translated the 2005 amounts into US dollars at the rate of £1.00 = $1.72, the noon buying rate in The City of New York on December 30, 2005.

Restatement

In accordance with EU regulations, the Company has prepared the financial statements as at December 31, 2005 in accordance with EU-adopted International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee interpretations (IFRIC). Consolidated financial statements of Pearson until December 31, 2004 had been prepared in accordance with UK GAAP. UK GAAP differs in certain respects from IFRS. When preparing the Group s 2005 consolidated financial statements, management has amended certain accounting, valuation and consolidation methods applied in the UK GAAP financial statements to comply with IFRS. The comparative figures in respect of 2004 and 2003 were restated to reflect these adjustments. See note 34 to our consolidated financial statements for an explanation of the effects of transition to IFRS.

	Year Ended December 31			
	2005	2005	2004	2003
	IFRS $	IFRS £	IFRS £	IFRS £
	(In millions, except for per share amounts)			
IFRS Information:				
Consolidated Profit and Loss Account Data				
Statutory Measures				
Total sales	**7,045**	**4,096**	3,696	3,850
Total operating profit/(loss)	**922**	**536**	404	406
Profit/(loss) after taxation from continuing operations	**588**	**342**	262	252
Profit/(loss) for the financial year	**1,108**	**644**	284	275
Basic earnings/(loss) per equity share(4)	**$ 1.35**	**78.2p**	32.9p	31.7p
Diluted earnings/(loss) per equity share(5)	**$ 1.34**	**78.1p**	32.9p	31.7p
Dividends per ordinary share	**$ 0.46**	**27.0p**	25.4p	24.2p
Consolidated Balance Sheet Data				
Total assets (Fixed assets plus Current assets)	**13,072**	**7,600**	6,578	6,736
Shareholders funds	**6,130**	**3,564**	2,800	2,969
Long-term obligations(6)	**(4,300)**	**(2,500)**	(2,403)	(1,982)
Capital stock(1)	**346**	**201**	201	201
Number of equity shares outstanding (millions of ordinary shares)	**804**	**804**	803	802

	Year Ended December 31					
	2005	2005	2004	2003	2002	2001
	$	£	£	£	£	£
	(In millions, except for per share amounts)					
US GAAP Information(7):						
Consolidated Profit and Loss Account Data						
Statutory Measures						
Total sales	**7,045**	**4,096**	3,696	3,879	4,320	4,225
Total operating profit/(loss)(2)	**746**	**434**	260	364	453	(389)
Profit/(loss) after taxation from continuing operations	**330**	**192**	203	198	219	(1,483)
Profit/(loss) for the financial year(8)	**707**	**411**	182	173	189	(1,500)
Profit/(loss) from continuing operations for the financial year(3)	**299**	**174**	166	160	221	(424)
(Loss)/profit from discontinued operations(3)	**(3)**	**(2)**	16	16	(10)	(91)
	411	**239**		(3)	(1)	(985)

Profit/(loss) on disposal of discontinued operations(3)						
Basic earnings/(loss) per equity share(4)	**$ 0.89**	**51.5p**	22.9p	21.8p	23.7p	(188.6)p
Diluted earnings/(loss) per equity share(5)	**$ 0.88**	**51.4p**	22.8p	21.8p	23.7p	(188.6)p
Basic earnings/(loss) from continuing operations per equity share(1)(4)	**$ 0.37**	**21.8p**	20.9p	20.1p	27.8p	(53.3)p
Diluted earnings/(loss) from continuing operations per equity shares(3)(5)	**$ 0.37**	**21.7p**	20.8p	20.1p	27.8p	(53.3)p
Basic (loss)/earnings per share from discontinued operations(3)(4)	**$ 0.51**	**29.7p**	2.0p	1.7p	(4.1)p	(135.3)p
Diluted (loss)/earnings per share from discontinued operations(3)(5)	**$ 0.51**	**29.7p**	2.0p	1.7p	(4.1)p	(135.3)p
Dividends per ordinary share	**$ 0.46**	**27.0p**	25.4p	24.2p	22.7p	21.9p
Consolidated Balance Sheet Data						
Total assets	**13,416**	**7,800**	7,040	7,101	6,767	8,280
Shareholders funds	**6,601**	**3,838**	3,218	3,333	4,155	4,155
Long-term obligations(6)	**(4,123)**	**(2,397)**	(2,392)	(1,951)	(2,026)	(2,829)

(1) Capital stock and the number of equity shares outstanding are the same under both IFRS and US GAAP.

(2) Total operating profit under US GAAP includes a profit of £nil in 2005 (a profit of £14 million in 2004 and a loss of £7 million in 2003) on the sale of fixed assets and investments. Additionally, the US GAAP operating profit includes the operating profit impact of the GAAP adjustments discussed in note 35 in Item 17. Financial Statements .

(3) Discontinued operations under both IFRS and US GAAP comprise the results of Recoletos Grupo de Comunicacion SA for all years presented and the results of RTL Group for 2002 and 2001. Discontinued operations under US GAAP also include the results of the Forum Corporation for 2003, 2002 and 2001.

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

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

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

(7) See note 35 to the consolidated financial statements included in this Annual Report entitled Summary of principal differences between International Financial Reporting Standards and United States of America generally accepted accounting principles .

(8) The loss of £1,500 million in 2001 is after charging goodwill amortization of £527 million. Since 2002, goodwill has no longer been subject to amortization under US GAAP. See note 35 in Item 17. Financial Statements .

Dividend Information

We pay dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. Our board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. Our board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders approval at our annual general meeting. At our annual general meeting on April 21, 2006 our shareholders approved a final dividend of 17.0p per ordinary share for the year ended December 31, 2005.

The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in the city of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2005 fiscal year will be paid on 5 May 2006.

Fiscal Year	Interim	Final	Total	Interim	Final	Total
	(Pence per ordinary share)			(Cents per ordinary share)		
2005	**10.0**	**17.0**	**27.0**	**17.2**	**29.2**	**46.4**
2004	9.7	15.7	25.4	18.6	30.2	48.8
2003	9.4	14.8	24.2	16.7	26.4	43.1
2002	9.1	14.3	23.4	14.7	23.0	37.7

2001	8.7	13.6	22.3	12.6	19.7	32.3

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

Exchange Rate Information

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in the city of New York on each day during a monthly period and on the last day of each month

during an annual period. On December 30, 2005, the noon buying rate for sterling was £1.00 = $1.72. On April 28, 2006 the noon buying rate for sterling was £1.00 = $1.82.

Month	High	Low
April 2006	$ 1.82	$ 1.74
March 2006	$ 1.76	$ 1.73
February 2006	$ 1.78	$ 1.73
January 2006	$ 1.79	$ 1.74
December 2005	$ 1.77	$ 1.72
November 2005	$ 1.78	$ 1.71

Year Ended December 31	Average Rate	
2005	$	1.81
2004	$	1.84
2003	$	1.63
2002	$	1.51
2001	$	1.45

Risk Factors

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

Our US educational textbook and testing businesses may be adversely affected by changes in state educational funding resulting from either general economic conditions, changes in government educational funding, programmes and legislation (both at the federal and state level), and/or changes in the state procurement process.

The results of our US educational textbook and testing business depends on the level of US and state educational funding and this funding is a significant influence on our ability to grow.

With the improvement in the US economy state educational expenditure has increased as state tax receipts have increased, reducing or eliminating state budget deficits, thereby minimizing the risk that state educational expenditure is cut or deferred. Federal legislative changes can also affect the funding available for educational expenditure, e.g. the No Child Left Behind Act. These might also include changes in the procurement process for textbooks, learning material and student tests, particularly in the adoptions market. For example, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year.

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

Our newspaper businesses may be adversely affected by reductions in advertising revenues and/or circulation either due to weak general economic conditions or competing news information distribution channels, particularly online and digital formats.

Our newspaper businesses are highly geared and remain dependent on advertising revenue; relatively small changes in revenue, positive or negative, have a disproportionate affect on profitability. We are beginning to see an increase in advertising revenues compared to prior years, however any downturn in corporate and financial advertising spend would negatively impact our results.

Changes in consumer purchasing habits, as readers look to alternative sources and/or providers of information, such as the internet and other digital formats, may change the way we distribute our content. We might see a decline in print circulation in our more mature markets as readership habits change and readers migrate online, although we see further opportunities for growth in our less mature markets outside Europe. If the migration of readers to new digital formats occurs more quickly than we expect, this is likely to affect print advertising spend by our customers, adversely affecting our profitability.

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

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

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

These unauthorized activities may be more easily facilitated by the internet. The lack of internet-specific legislation relating to trademark and copyright protection creates an additional challenge for us in protecting our proprietary rights relating to our online business processes and other digital technology rights. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance. In that regard, Penguin Group (USA) Inc. and Pearson Education have joined three other major US publishers in a suit brought under the auspices of the Association of American Publishers to challenge Google s plans to copy the full text of all books ever published without permission from the publishers or the authors. This lawsuit seeks to demarcate the extent to which search engines and other internet operators may rely on the fair-use doctrine to copy content without authorization from the copyright proprietors, and may give publishers more control over on-line users of their intellectual property. If the lawsuit is unsuccessful, publishers and authors may not be able to control copying of their content for purposes of on-line searching, which could have an adverse impact on our business and financial performance.

The contracting risks associated with our Professional division within Pearson Education are complex and could adversely affect our financial results and growth prospects.

Our Professional division provides services ranging from call center operations to complete outsourcing of administrative functions. Customers are government agencies and professional organizations, mainly in the USA and the UK, and commercial businesses. These services are provided under contracts with values that vary significantly, from a few million to several hundred million pounds over the term of the contract, which can run from one to ten years in length. The results of our Professional division can be significantly dependent on a small number of large contracts.

As in any long-term contracting business, there are inherent risks associated with the bidding process, operational performance, contract compliance (including penalty clauses), indemnification (if available) and contract re-bidding, which could adversely affect our financial performance and/or reputation. In addition, US government contracts are subject to audit and investigation by the applicable contracting government entity and may otherwise be investigated by the government, and this can result in payment delays and, in certain circumstances, reductions in the amounts received, penalties or other sanctions.

A control breakdown in our school testing businesses could result in financial loss and reputational damage.

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

We have recently experienced adverse publicity as a result of the rescoring of the October 2005 Scholastic Aptitude Test, or SAT, in the USA. We provide answer sheet scanning services for the College Board, which administers the SAT. We rescanned approximately 1.5 million tests taken in October 2005 through January 2006 and, as a result, the College Board reissued higher scores for about 4,400 out of

approximately 495,000 tests taken in October. We have also been named along with the College Board as a defendant in a class action lawsuit filed as a result of the revised scores.

Changes in the Penguin business may restrict our ability to grow and our profitability.

New distribution channels, e.g. digital format, the internet, used books, combined with the concentration of retailer power pose multiple threats to our traditional consumer publishing models. Penguin s financial performance can also be negatively affected if book return rates increase.

We operate in a highly competitive environment that is subject to rapid change and we must continue to invest and adapt to remain competitive.

Our education, business information and book publishing businesses operate in highly competitive markets. These markets constantly change in response to competition, technological innovations and other factors. To remain competitive we continue to invest in our authors, products and services. There is no guarantee that these investments will generate the anticipated returns or protect us from being placed at a competitive disadvantage with respect to scale, resources and our ability to develop and exploit opportunities. Specific competitive threats we face at present include:

Students seeking cheaper sources of content, e.g. on-line, used books or imported textbooks. To counter this trend we introduced our own on-line format (called SafariX) and are providing students with a greater choice and customization of our products.

Competition from major publishers and other educational material and service providers in our US educational textbook and testing businesses.

Penguin Authors advances in consumer publishing. We compete with other publishing businesses for the rights to author manuscripts. In certain instances author advances can be bid up to a level at which we cannot generate a sufficient return on our investment.

We operate in markets which are dependent on Information Technology systems and technological change.

All our businesses, to a greater or lesser extent, are dependent on technology. We either provide software and/or internet services or we use complex information technology systems and products to support our business activities, particularly in business information publishing, back-office processing and infrastructure.

We face several technological risks associated with software product development and service delivery in our educational businesses, information technology security (including virus and hacker attacks), e-commerce, enterprise resource planning system implementations and upgrades and business continuity in the event of a disaster at a key data center.

Our reported earnings may be adversely affected by changes in our pension costs and funding requirements due to poor investment returns and/or changes in pension regulations.

We operate 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 held independently of the Group. Regular valuations, conducted by independent qualified actuaries, are used to determine pension costs and funding requirements.

It is our policy to ensure that each pension scheme is adequately funded to meet its ongoing and future liabilities. Our earnings may be adversely affected by lower investment returns due to a general deterioration in equity or bond markets, requiring increased company funding of these schemes to eliminate any deficits over time. Similarly, changes in pension regulations, including accounting rules, may affect our pension costs and funding status.

Sarbanes-Oxley (SOX) 404 Compliance cost

Beginning with our 2006 fiscal year, we will be required to comply with section 404 of SOX relating to internal control over financial reporting. Our SOX 404 implementation project commenced in 2003 and we believe we are on track to be compliant. However, the cost of complying with SOX 404 may reduce our earnings.

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

As with any international business our earnings can be materially affected by exchange rate movements. We are particularly exposed to movements in the US dollar to sterling exchange rate as approximately 65% of our revenue is generated in US dollars. We estimate that if 2004 average rates had prevailed in 2005, sales for 2005 would have been £46 million or 1% lower. This is predominantly a currency translation risk (i.e., non-cash flow item), and not a trading risk (i.e., cash flow item) as our currency trading flows are relatively limited. We estimate that a five cent change in the average exchange rate between the US dollar and sterling in any year could affect our reported earnings per share by approximately 1 pence.

ITEM 4. *INFORMATION ON THE COMPANY*

Pearson

Pearson is a global publishing company with its principal operations in the education, business information and consumer publishing markets. We have significant operations in the United States, where we generate over 65% of our revenues, and in the United Kingdom and continental Europe. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names, to inform, educate and entertain. We deliver our content in a variety of forms and through a variety of channels, including books, newspapers and internet services. We increasingly offer services as well as content, from test processing to training.

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

Overview of Operating Divisions

Although our businesses increasingly share markets, brands, processes and facilities, they consist of three core operations:

Pearson Education is a global leader in educational publishing and services. We are a leading international publisher of textbooks, supplementary materials and electronic education programs for elementary and secondary school, higher education and business and professional markets worldwide. We also play a major role in the testing and certification of school students and professionals, mainly in the US but increasingly in the UK. Pearson Education consists of the following three operating segments:

School publisher, provider of testing and software services for primary and secondary schools

Higher Education publishes textbooks and related course materials for colleges and universities

Professional publishes texts, reference and interactive products for industry professionals. Provides various testing and service arrangements for government departments and professional bodies.

The FT Group consists of our international newspaper, print and online financial information, business magazine and professional publishing interests. Our flagship product is the *Financial Times,* published internationally and known for its premium editorial content and international scope both in newspaper and internet formats. The FT Group comprises the following operating segments:

FT Publishing publishes the *Financial Times*, other business newspapers, magazines and specialist information

Interactive Data (IDC) provides financial and business information to financial institutions and retail investors.

The Penguin Group is one of the premier English language publishers in the world, with brand imprints such as Penguin, Putnam, Berkley, Viking and Dorling Kindersley (DK). We publish the works of many authors in an extensive portfolio of fiction, non-fiction, reference and illustrated works.

Our Strategy

Since 1997, we have reshaped Pearson by divesting a range of non-core interests and investing over $7 billion in education, consumer publishing and business information companies. Each one of our businesses

aims to benefit from educating, informing and entertaining people in an increasingly knowledge-based economy. Our strategy is:

- to focus on businesses which provide education, in the broadest sense of the word, through intellectual property;
- to provide a combination of publishing, both in print and online, and related services that make our publishing more valuable and take us into new, faster-growing markets;
- to continue to invest in the growth of our businesses, including:
  - extending our lead in education publishing, investing in new programs for students in School and Higher Education and in testing and software services that help educators to personalize the learning process, both in the US and around the world;
  - developing our fast-growing contracting businesses, which provide testing and other services to corporations and government agencies;
  - building the international reach of the *Financial Times* both in print through its four editions worldwide and online through FT.com and enhancing the market positions of our network of national business newspapers around the world; and
  - growing our position in consumer publishing, balancing our investment across our stable of best-selling authors, new talent and our own home-grown content;
- to foster a collaborative culture which facilitates greater productivity and innovation by sharing processes, costs, technology, talent and assets across our business;
- to capitalize on the growth prospects in our markets and on our leaner operations to improve profits, cash flows and returns on invested capital.

Operating Divisions

Pearson Education

Pearson Education is one of the world s largest publishers of textbooks and online teaching materials based on published sales figures and independent estimates of sales. Pearson Education serves the growing demands of teachers, students, parents and professionals throughout the world for stimulating and effective education programs. With federal and state governments increasingly required to measure academic progress against clear objective standards, the market for educational testing services in the United States has grown significantly, as have markets around the world. Our integrated approach to education has helped us grow faster because of our breadth.

We report Pearson Education s performance by the three market segments it serves: School, Higher Education and Professional. In 2005, Pearson Education had sales of £2,663 million or 65% of Pearson s total sales (63% in 2004).

School

In the United States, our School business includes publishing, testing and software operations. Outside of the United States, we have a growing English Language Teaching business and we also publish school and college materials in local languages in a number of countries. In the United States, we publish for pre-kindergarten through 12th grade, with a comprehensive range of textbooks, supplementary materials and electronic education programs. Pearson Education s elementary school imprint, Pearson Scott Foresman, and secondary school imprint, Pearson Prentice Hall School, publish high quality programs covering subjects such as reading, literature, math, science and social studies. We also publish supplementary teaching aids for both elementary and secondary schools and teacher-written activity books. We are a leading publisher in online assessment and digital courseware through Pearson Digital Learning, whose offerings include SuccessMaker, NovaNet and the Waterford Early Reading Program. Through Pearson Achievement Solutions, we provide professional development for teachers in kindergarten through 12th grade with the use of the latest technologies and software tools to improve classroom teaching.

In the US, Pearson s assessments & testing operations are leading service providers in the markets for test development, processing and scoring and the provision of enterprise software solutions to schools. We score and process some 40 million student tests across the United States each year.

Pearson School Systems provides district-wide solutions that combine the power of assessment, student information, financial systems and actionable reporting to improve student performance. We are the market leader in student information with our solutions used by over 20% of schools nationwide and we are the provider of the newest technologies for benchmark testing and student progress analysis.

Over 90% of education spending for kindergarten through 12th grade in the United States is financed at the state or local level, with the remainder coming from federal funds. The School division s major customers are state education boards and local school districts. In the United States, 21 states, which account for over 50% of the total kindergarten through 12th grade US school population of some 53 million students, buy educational programs by means of periodic statewide adoptions . These adoptions cover programs in the core subject areas. Typically, a state committee selects a short-list of education programs from which the school districts then make individual choices. We actively seek to keep as many of our offerings as possible on the approved list in each state, and we sell directly to the school districts. In the states without adoptions, called open territories , local school districts choose education programs from the entire range available. We actively sell to school districts in open territories as well.

In 2004, Edexcel won a five year contract for the administration and marking of Key Stage testing for 11 and 14 year old students in the UK. Edexcel also began electronic scanning and marking of GCSE and A-level exams in 2004. 4 million scripts were marked electronically in 2005.

Higher Education

Pearson Education is the United States largest publisher, by sales, of textbooks and related course materials for colleges and universities. We publish across all of the main fields of study with imprints such as Pearson Prentice Hall, Pearson Addison Wesley, Pearson Allyn & Bacon and Pearson Benjamin Cummings. Our sales forces call on college educators, who choose the textbooks and online resources to be purchased by their students. In 2005, 1.8 million college students registered for our online offerings, which include homework and assessment products, online study guides and textbook companion websites. Many of our online offerings are integrated with course management systems that provide easy-to-use tools that enable professors to create online courses. In addition, our custom publishing business, Pearson Custom, works with professors to produce textbooks specifically adapted for their particular course.

Professional

We publish text, reference, and interactive products for IT industry professionals, graphics and design users of all types, and consumers interested in software applications and certification, professional business books, and strategy guides for those who use PC and console games. Publishing imprints in this area include Addison Wesley Professional, Prentice Hall PTR, and Cisco Press (IT professional imprints), Peachpit Press and New Riders Press (graphics and design imprints), Que/Sams (consumer and professional imprint) and Prentice Hall Financial Times (business imprint). We also generate revenues through our own website InformIT, and through Safari Books Online (a joint venture with O Reilly Media). We also provide services to professional markets, managing several commercial contracts to implement and execute qualification and assessment systems for individual professions, including IT professionals and nurses.

Our Government Solutions group manages and processes student loan applications on behalf of the US Department of Education. It also provides a number of non-education and other testing and service-related contracts with various government agencies both within and outside the US.

We also provide a range of data collection and management services, including scanners, to a wide range of customers. We also provide corporate training courses to professionals.

Contracts include a seven year contract to develop and deliver the Graduate Management Admissions Test (GMAT) worldwide, beginning in January 2006 and a nine year, non-exclusive contract to deliver the National Association of Security Dealers exams.

The FT Group

The FT Group, one of the world s leading business information sources, aims to provide a broad range of data, analysis and services to an audience of internationally-minded business people. In 2005, the FT Group had sales of £629 million, or 15% of Pearson s total sales (16% in 2004). The FT Group s business is global,

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producing a combination of news, data, comment, analysis and context. In addition to professional and business consumers, individuals worldwide are demanding such strategic business information.

FT Publishing

The *Financial Times* is a leading international daily business newspaper. Its average daily circulation of 439,563 copies in December 2005, as reported by the Audit Bureau of Circulation, gives the *Financial Times* the second largest circulation of any English language business daily in the world. The *Financial Times* derived approximately 67% of its revenue in 2005 from advertising and approximately 33% from print and online content sales. The geographic distribution of the *Financial Times* average daily circulation in 2005 was:

United Kingdom/ Republic of Ireland	32%
Continental Europe, Africa and Middle East	31%
Americas	29%
Asia	8%

The *Financial Times* is printed on contract in 23 cities around the world and our sales mix is increasingly international. The newspaper draws upon an extensive local network of correspondents to produce unique, informative and timely business information. For production and distribution, the *Financial Times* uses computer-driven communications and printing technology for timely delivery of the various editions of the newspaper to the appropriate geographic markets. The *Financial Times* is distributed through independent newsagents and direct delivery to homes and institutions.

The FT seeks to make its content available both in print and online, through FT.com, its internet service, and sales of electronic content to third parties. FT.com charges subscribers for detailed industry news, comment and analysis, while providing general news and market data to a wider audience. The business earns revenues by selling content directly, selling advertising and selling subscriptions. At the end of December 2005, FT.com had 84,000 paying subscribers and an average of 3.2 million unique monthly users.

Our other business publishing interests include France s leading business newspaper, *Les Echos* with an average daily 2005 circulation of 119,000 and lesechos.fr, its internet service.

FT Business produces specialist information on the retail, personal and institutional finance industries and publishes the UK s premier personal finance magazine, *Investors Chronicle,* together with *Money Management, Financial Advisor* and *The Banker* for professional advisers and financial sector professionals.

Interactive Data Corporation

Through our 62% interest in Interactive Data Corporation (Interactive Data), we are one of the world s leading global providers of financial market data, analytics and related services to financial institutions, active traders and individual investors. Interactive Data supplies time-sensitive pricing, dividend, corporate action, and descriptive information for more than 3.5 million securities traded around the world, including hard-to-value instruments. Customers subscribe to Interactive Data s services and use the company s analytical tools in support of their trading, analysis, portfolio management, and valuation activities.

Recoletos

On December 14, 2004, the Group announced that we had accepted an offer from Retos Catera S.A. to sell our 79% stake in Recoletos, a publicly quoted Spanish media group that we built with its Spanish founding shareholders over a number of years, for gross proceeds of 743 million. The consortium of investors behind Retos Cartera included members of the Recoletos management team, individual Spanish investors and the Banesto banking group. We decided to accept the offer as Recoletos strategy in sport, lifestyle and general publications had taken it further away from Pearson s core focus on financial and business news and information. The sale became unconditional in February, 2005 and net cash proceeds of £371 million were received on April 8, 2005 resulting in a profit on disposal of £306 million.

Joint Ventures and Associates

As at 2005 year end, the FT Group also had a number of other associates and joint ventures, including:

A 50% interest in *FT Deutschland,* launched in February 2000, in partnership with Gruner + Jahr. *FT Deutschland* is a German language newspaper with a fully integrated online business news, analysis and data service. Its circulation grew by 6% in 2005 to 102,000 copies.

A 50% interest in The Economist Group, which publishes the world s leading weekly business and current affairs magazine. Its circulation increased by 10% to 1,038,519 for the January to June 2005 period.

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

A 33% interest in *Vedomosti,* a leading Russian business newspaper and a partnership venture with Dow Jones and IMH Media Ltd.

A 50% interest in *Business Day* and *Financial Mail*, publishers of South Africa s leading financial newspaper and magazine.

A 14% interest in *Business Standard*, India s third largest daily financial newspaper.

The Penguin Group

Penguin is one of the premier English language book publishers in the world. We publish an extensive backlist and frontlist of titles, including some of the very best new fiction and non-fiction, literary prize winners and commercial bestsellers. Our titles range from history and science to essential reference. We are also one of the pre-eminent classics publishers and publish some of the most highly prized and enduring brands in children s publishing, featuring popular characters such as Spot, Peter Rabbit and Madeline, as well as the books of Roald Dahl. We rank in the top three consumer publishers, based upon sales, in all major English speaking and related markets the United States, the United Kingdom, Australia, New Zealand, Canada, India and South Africa.

Penguin publishes under many imprints including, in the adult market, Allen Lane, Avery, Berkley Books, Dorling Kindersley, Dutton, Hamish Hamilton, Michael Joseph, Plume, Putnam, Riverhead and Viking. Our leading children s imprints include Puffin, Ladybird, Warne and Grosset & Dunlap. In 2005, Penguin s US imprints placed 129 titles on *The New York Times* bestseller list. In the United Kingdom, 54 Penguin titles featured on the Nielsen Bookscan top ten bestseller list. Our illustrated reference business, Dorling Kindersley, or DK, is the leading global publisher of high quality illustrated reference books. DK has built a unique graphic style that is now recognized around the world. It produces books for children and adults covering a huge variety of subjects including childcare, health, gardening, food and wine, travel, business and sports. Not only does DK s lexigraphic design approach make its books easily translatable across cultures, but it has also formed the basis of a library of 2.5 million wholly-owned images which have many applications in print and online.

In 2005, Penguin had sales of £804 million, representing 20% of Pearson s total sales (21% in 2004). Revenues are balanced between frontlist and backlist titles. The Penguin Group earns over 95% of its revenues from the sale of hard cover and paperback books. The balance comes from audio books and from the sale and licensing of intellectual property rights, such as the Beatrix Potter series of fictional characters, and acting as a book distributor for a number of smaller publishing houses.

We sell directly to bookshops and through wholesalers. Retail bookshops normally maintain relationships with both publishers and wholesalers and use the channel that best serves the specific requirements of an order. We also sell online through third parties such as Amazon.com.

The Penguin Group s gateway internet site, Penguin.com, provides access to its focused websites in the United States, Canada, United Kingdom and Australia. Websites have also been developed to target certain niche audiences. For example, Penguinclassics.com has an entire online service for the classics, with anthologies, original essays, interviews and discussions and links to other classics sites.

Competition

All of Pearson s businesses operate in highly competitive environments.

Pearson Education competes with other publishers and creators of educational materials and services. These companies include some small niche players and some large international companies, such as McGraw-Hill, Reed Elsevier, Houghton Mifflin and Thomson. Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the school boards, educators and government officials making purchasing decisions.

The FT Group s newspapers and magazines compete with newspapers and other information sources, such as *The Wall Street Journal,* by offering timely and expert journalism. It competes for advertisers with

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other forms of media based on the ability to offer an effective means for advertisers to reach their target audience. The efficiency of its cost base is also a competitive factor.

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

Intellectual Property

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

Raw Materials

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

Government Regulation

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

Licenses, Patents and Contracts

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

Recent Developments

On January 9, 2006 Pearson announced the purchase of 1,130,739 shares in Interactive Data from an individual shareholder for $21.67 per share in cash. This purchase brings Pearson s total holding in Interactive Data to almost 62%.

On January 23, 2006 Pearson announced the acquisition of Promissor, a leading professional testing business from Houghton Mifflin Company for $42m in cash.

On April 25, 2006 Pearson announced the acquisition of National Evaluation Systems, Inc, a leading teacher certification testing company in the US.

On May 5, 2006 Pearson announced the acquisition of an 80% stake in Paravia Bruno Mondadori, one of Italy s leading educational publishing companies.

Organizational Structure

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries as at December 31, 2005, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

Name	Country of Incorporation/ Residence	Percentage Interest/ Voting Power
Pearson Education		
Pearson Education Inc	United States (Delaware)	100%
Pearson Education Ltd	England and Wales	100%
NCS Pearson Inc	United States (Minnesota)	100%
FT Group		
The Financial Times Limited	England and Wales	100%
Financial Times Business Ltd	England and Wales	100%
Interactive Data Corporation	United States (Delaware)	61%
Les Echos SA	France	100%
The Penguin Group		
Penguin Group (USA) Inc	United States (Delaware)	100%
The Penguin Publishing Co Ltd	England and Wales	100%
Dorling Kindersley Holdings Ltd	England and Wales	100%

Property, Plant and Equipment

Our headquarters is located at leasehold premises in London, England. We own or lease approximately 650 properties in more than 50 countries worldwide, the majority of which are located in the United Kingdom and the United States.

All of the properties owned and leased by us are suitable for their respective purposes and are in good operating condition.

We own the following principal properties:

General Use of Property	Location	Area in Square Feet
Warehouse	Pittstown, Pennsylvania, USA	510,000
Warehouse	Kirkwood, New York, USA	409,000
Offices	Iowa City, Iowa, USA	310,000
Offices	Old Tappan, New Jersey, USA	210,100
Warehouse/ office	Cedar Rapids, Iowa, USA	205,000
Offices	Reading, Massachusetts, USA	177,800
Offices	London, UK	155,000
Printing/ Processing	Owatonna, Minnesota, USA	128,000
Printing/ Processing	Columbia, Pennsylvania, USA	121,400
Offices	Eagan, Minnesota, USA	109,500
Offices	Mesa, Arizona, USA	96,000

We lease the following principal properties:

General Use of Property	Location	Area in Square Feet
Warehouses/ Offices	Lebanon, Indiana, USA	1,091,400
Warehouse/ Offices	Cranbury, New Jersey, USA	886,700
Warehouse	Indianapolis, Indiana, USA	737,850
Warehouse/ Offices	Newmarket, Ontario, Canada	518,128
Offices	Upper Saddle River, New Jersey, USA	474,801
Warehouse/ Offices	Rugby, UK	446,000
Offices	London, UK	375,000
Offices	Hudson St., New York, USA	302,000
Warehouse/ Offices	Austin, Texas, USA	226,100
Offices	Boston, Massachusetts, USA	225,299
Warehouse	Scoresby, Victoria, Australia	215,820
Offices	Boston, Massachusetts, USA	191,360
Offices	Glenview, Illinois, USA	187,500
Offices	Bloomington, Minnesota, USA	151,056
Offices	Parsippany, New Jersey, USA	143,800
Offices	Harlow, UK	137,900
Offices	Chester, Virginia, USA	123,200
Warehouse	San Antonio Zomeyucan, Mexico	113,638
Offices	London, UK	112,000
Offices	New York, New York, USA	107,939

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

There are no unresolved staff comments.

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

The following discussion and analysis is based on and should be read in conjunction with the consolidated financial statements, including the related notes, appearing elsewhere in this Annual Report. The financial statements have been prepared in accordance with IFRS, which differs in certain significant respects from US GAAP. Note 35 to our consolidated financial statements, included in Item 17. Financial Statements , provides a description of the significant differences between IFRS and US GAAP as they relate to our business and provides a reconciliation to US GAAP. These consolidated financial statements are the Group s first financial statements to be prepared in accordance with IFRS, as adopted by the EU. Consolidated financial statements of Pearson up to and including December 31, 2004 had been prepared in accordance with UK GAAP. UK GAAP differs in certain respects from IFRS. When preparing the Group s 2005 consolidated financial statements, management has amended certain accounting, valuation and consolidation methods applied in the UK GAAP financial statements to comply with IFRS. The comparative figures in respect of 2004 and 2003 were restated to reflect these adjustments. Note 34 included in Item 17. Financial Statements , describes how, in preparing the consolidated financial statements, the Group has applied accounting standards as adopted for use in the EU under the first-time adoption provisions as set out in IFRS 1.

General Overview

Introduction

Sales increased from £3,696 million in 2004 to £4,096 million in 2005, an increase of 11%. The increase reflected growth across all the businesses with a particularly strong performance at Pearson Education. The year on year growth

was impacted by exchange rates but less so than in previous years. The average US dollar exchange rate strengthened slightly in 2005, which had the effect of increasing reported sales in 2005 by £46 million when compared to the equivalent figure at constant 2004 rates. Reported operating profit increased by 33% from £404 million in 2004 to £536 million in 2005. Pearson Education benefited from strong sales growth and improved margins in the School and Higher Education businesses. FT Group benefited from improved profits largely as a result of increases in advertising revenues at FT Publishing and IDC s continued strong organic growth and synergies from the integration of recent acquisitions. Penguin profits benefited from

the effect of exchange rates but still improved from the prior year, with margins increasing despite only a small increase in sales. Included within operating profit in 2005 was the profit on the sale of MarketWatch of £40 million. Equivalent sales of businesses and investments in 2004 saw a profit of £9 million. Reported operating profit in 2005 was £12m higher than the equivalent figure reported at constant 2004 exchange rates.

Profit before taxation in 2005 of £466 million compares to a profit before taxation of £325 million in 2004. The increase of £141 million reflects the improved operating performance and a reduction in net finance costs. Net finance costs reduced from £79 million in 2004 to £70 million in 2005. Net interest payable benefited from the reduction in average net debt following receipt of the proceeds from the sale of Recoletos and MarketWatch and good cash generation from the businesses. Partially offsetting this effect was an increase in the group s average net interest rate payable driven principally by the strong rise in US dollar interest rates in the year. As at January 1, 2005 we adopted IAS 39 *Financial Instruments: Recognition and Measurement* in our financial statements. This has had the effect of introducing increased volatility into the net finance cost and in 2005 the adoption of IAS 39 reduced net finance costs by £14 million. There was no equivalent benefit in 2005 to the one-off credit of £9 million for interest on a repayment of tax that occurred in 2004.

In April 2005, Pearson sold its 79% interest in Recoletos Grupo de Comunicacion S.A. to Retos Cartera, a consortium of investors, as part of a tender offer for all of Recoletos. The transaction became unconditional on approval from the Spanish regulatory authorities in February 2005. The results of Recoletos have been consolidated for the period to February 28, 2005 and have been shown as discontinued operations in the consolidated income statement for 2005, 2004 and 2003.

Net cash generated from operating activities increased to £709 million in 2005 from £562 million in 2004 with very strong cash generation across all the businesses. Cash flow in 2004 benefited from collection of the $151 million receivable in respect of the Transportation Security Administration (TSA) contract, a contract to create a qualification, assessment, staffing and placement system for security screeners at airports in the US. The relative strength of the US dollar also increased the value of our cash flows in Sterling. Capital expenditure was down from 2004 following the up-front expenditure on professional testing contracts in that year but investment in pre-publication increased. On an average basis, the use of working capital continued to improve. The net cash inflow from disposals net of acquisitions was £175 million in 2005 compared to a net cash outflow of £4 million in 2004. Dividends paid of £222 million in 2005 (including £17 million paid to minority interests) compares to £197 million in 2004 and, after an adverse currency movement of £121 million, overall net borrowings fell 18% from £1,221 million at the end of 2004 to £996 million at the end of 2005.

Outlook

We expect 2006 to be another good year for Pearson as we anticipate increasing margins and growth ahead of our markets. We expect to achieve strong earnings growth, good cash generation and a further significant improvement in return on invested capital.

Pearson Education

We expect Pearson Education to achieve sales growth in the 3-5% range, with similar rates of growth in each of its three worldwide businesses (School, Higher Education and Professional). We expect margins to improve in School and Professional and remain stable in the Higher Education business. School testing is strengthened by 2005 contract wins with a lifetime value of $700 million (including Texas, Virginia, Michigan and Minnesota) and the US School new adoption market is expected to grow strongly over the period 2007 to 2009.

We expect our US Higher Education business to continue to benefit from its scale, the strength of its publishing and its lead in technology. 2006 is expected to be a strong year for first editions, with major new titles in statistics, algebra, psychology, economics, health and writing. We plan to launch online homework and assessment programs in new curriculum areas including economics, psychology and development writing and to extend our highly successful customized print publishing model to online curriculum and course management programs.

We expect our Professional business to deliver sustained growth on the basis of long-term contracts in Government Solutions and Professional Testing and to improve margins after the successful start-up of major new contracts in 2004 and 2005. We also expect to maintain our leading market share in professional

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publishing with a stronger schedule of releases in the professional and consumer technology market in 2006 and a strong list within the business publishing imprints.

FT Group

We expect further profit improvement at the FT Group. The *Financial Times* continues to show good momentum with circulation up 4% and advertising revenues continue to show double digit growth in the early part of 2006. IDC expects another good year, benefiting from similar business conditions to 2005, strong organic growth and the contribution of recent acquisitions.

The Penguin Group

Penguin is expected to grow at a similar rate in 2006 to 2005 with continued investment in new markets and international talent and with a strong list of new titles from best selling authors. Margins are expected to improve steadily as we benefit from efficiency gains.

Exchange rates

We generate around two-thirds of total sales in the US and a five cent change in the average exchange rate for the full year (which in 2005 was £1: $1.81) will have an impact of approximately 1p on earnings per share.

Sales Information by Operating Division

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

	Year Ended December 31		
	2005	**2004**	**2003**
	£m	**£m**	**£m**
Education:			
School	**1,295**	1,087	1,149
Higher Education	**779**	729	770
Professional	**589**	507	503
FT Group:			
FT Publishing	**332**	318	315
IDC	**297**	269	273
Penguin	**804**	786	840
Total	**4,096**	3,696	3,850

Sales Information by Geographic Market supplied

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

	Year Ended December 31		
	2005	**2004**	**2003**
	£m	**£m**	**£m**
European countries	**963**	835	768
North America	**2,717**	2,504	2,742
Asia Pacific	**300**	263	255
Other countries	**116**	94	85
Pearson Group	**4,096**	3,696	3,850

Exchange Rate Fluctuations

We earn a significant proportion of our sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was $1.81 in 2005, $1.83 in 2004 and $1.63 in 2003. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. The Group generates approximately 65% of its sales in US dollars and a five cent change in the average exchange rate for the full year has an impact of approximately 1 pence on earnings per share. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for more information.

Critical Accounting Policies

Our consolidated financial statements, included in Item 17. Financial Statements , are prepared based on the accounting policies described in note 1 to the consolidated financial statements which are in accordance with IFRS, which differs in certain significant respects from US GAAP.

The preparation of our consolidated financial statements in accordance with IFRS, and the reconciliation of these financial statements to US GAAP as described in note 35, requires management to make estimates and assumptions that affect the carrying value of assets and liabilities at the date of the consolidated financial statements and the reported amount of sales and expenses during the periods reported in these financial statements. Certain of our accounting policies require the application of management judgment in selecting assumptions when making significant estimates about matters that are inherently uncertain. Management bases its estimates on historical experience and other assumptions that it believes are reasonable.

We believe that the following are the more critical accounting policies used in the preparation of our consolidated financial statements that could have a significant impact on our future consolidated results of operations, financial position and cash flows. Actual results could differ from estimates.

Revenue Recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services net of value-added tax and other sales taxes, rebates and discounts, and after eliminating sales within the Group. Revenue is recognized as follows:

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

Circulation and advertising revenue is recognized when the newspaper or other publication is published. Subscription revenue is recognized 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 recognized for each element as if it were an individual contractual arrangement.

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

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

Pre-publication Costs

Pre-publication costs represent direct costs incurred in the development of educational programs and titles prior to their publication. These costs are carried forward in current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. These costs are amortized 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, usually with a higher proportion of the amortization taken in the earlier years. The investment in pre-publication has been disclosed as part of the investing activities in the cash flow statement. The assessment of useful life and the calculation of amortization involve a significant amount of estimation and management judgment based on historical trends and management estimation of their future potential sales. The overstatement of useful lives could result in excess amounts being carried forward in

intangible assets that would otherwise have been written off to the profit and loss account in an earlier period. Reviews are performed regularly to estimate recoverability of pre-publication costs.

Royalty Advances

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to bring the amount down to its net realizable value. The royalty advance is expensed at the contracted royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. This represents the operating cycle of consumer publishing titles. Royalty advances which will be consumed after one year are held in non-current assets. The realizable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realizable value of author contracts is overstated then this will have an adverse effect on operating profits as these excess amounts will be written off.

Defined Benefit Pension Obligations

The liability in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date minus the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high quality corporate bonds which have terms to maturity approximating the terms of the related liability.

Actuarial gains and losses arising from differences between actual and expected returns on plan assets, experience adjustments on liabilities and changes in actuarial assumptions are recognized immediately in the statement of recognized income and expense.

The service cost, representing benefits accruing over the year, is included as an operating cost and the unwinding of the discount rate on the scheme liabilities and the expected return on scheme assets as a financing charge or financing income.

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

The determination of the pension cost and defined benefit obligation of the Group s defined benefit pension schemes depends on the selection of certain assumptions (see note 24 in Item 17 Financial Statements) which include the discount rate, inflation rate, salary growth, longevity and expected return on scheme assets. Differences arising from actual experience or future changes in assumptions will be reflected in subsequent periods.

Income Taxes

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

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

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

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

Deferred tax is recognized in the income statement, except when the tax relates to items charged or credited directly to equity, in which case the tax is also recognized in equity.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group s share of the net identifiable assets of the acquired subsidiary or associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

IFRS and US GAAP

We prepare our financial statements in accordance with IFRS, which differs in certain significant respects from US GAAP. Profit attributable to equity holders of the Company and equity shareholders funds under IFRS and US GAAP were as follows for the respective period:

	December 31, 2005	**December 31, 2004**	**December 31, 2003**
	£m	**£m**	**£m**
Profit for the financial year			
IFRS	**624**	262	252
US GAAP	**411**	182	173
Equity shareholders funds			
IFRS	**3,564**	2,800	
US GAAP	**3,838**	3,218	

The main differences between IFRS and US GAAP relate to goodwill and intangible assets, acquisition and disposal adjustments, derivatives, pensions, stock based compensation and taxation. These differences are discussed in further detail under Accounting Principles and in note 35 to the consolidated financial statements.

Results of Operations

Year ended December 31, 2005 compared to year ended December 31, 2004

Consolidated Results of Operations

Sales

Our total sales increased by £400 million, or 11%, to £4,096 million in 2005, from £3,696 million in 2004. Sales growth was due to strong performance in our markets, helped in part by a favourable exchange rate impact. We estimate that had the 2004 average rates prevailed in 2005, sales would have been approximately £4,050 million.

Pearson Education had a strong year with an increase in sales of 15%. The School and Professional businesses were the biggest contributors to this growth with increases of 19% and 16% respectively. Higher Education growth was 5% in total and 6% in the US. Pearson s US Higher Education business has grown faster than the industry for seven straight years. The School publishing business benefited from a large share of the new adoption market in the US and testing sales were up more than 20% as the business made significant market share gains and benefited from mandatory state testing in the US under No Child Left Behind. In the Professional business, Professional testing and Government Solutions sales were both up by more than a third on last year with the successful start-up of major new contracts. Worldwide sales of technology-related books were again lower than the previous year although weakness in the professional markets was partly offset by growth in consumer technology publishing.

The FT Group sales were 7% ahead of last year. FT Publishing sales were up by 4% driven by higher advertising revenues at the *Financial Times* and IDC sales were up by 10% with organic growth at all its businesses aided by a full year contribution from FutureSource, acquired in September 2004, and the strength of the US dollar. Penguin s sales grew by 2% with successful format innovation helping to offset the weakness in the mass market category in the US, down a further 4% for the industry in 2005.

Pearson Education, our largest business sector, accounted for 65% of our sales in 2005, compared to 63% in 2004. North America continued to be the most significant source of our sales although sales there decreased, as a proportion of total sales, to 66% in 2005, compared to 68% in 2004.

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Cost of Sales and Operating Expenses

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

	Year Ended December 31	
	2005	**2004**
	£m	**£m**
Cost of goods sold	**2,022**	1,789
Distribution costs	**249**	201
Administrative and other expenses	**1,384**	1,365
Other operating income	**(41)**	(46)
Total operating expenses	**1,592**	1,520

Cost of Sales. Cost of sales consists of costs for raw materials, primarily paper, printing costs, amortization of pre-publication costs and royalty charges. Our cost of sales increased by £233 million, or 13%, to £2,022 million in 2005, from £1,789 million in 2004. The increase mainly reflected the increase in sales over the period although the overall gross margin declined slightly from 52% in 2004 to 51% in 2005.

Distribution Costs. Distribution costs consist primarily of shipping costs, postage and packing and are typically a fairly constant percentage of sales.

Administration and Other Expenses. Our administration and other expenses increased by £19 million, or 1%, to £1,384 million in 2005, from £1,365 million in 2004, although as a percentage of sales they decreased to 34% in 2005, from 37% in 2004. The increase in administration and other costs comes principally from additional employee benefit expense, but cost savings and more modest increases in other administration expenses has enabled overall operating margins to improve.

Other operating Income. Other operating income mainly consists of sub-rights and licensing income and distribution commissions. Other operating income decreased 11% to £41 million in 2005 from £46 million in 2004, with the decrease mainly representing the continued decline in commissions received for distribution of third party books.

Other Net Gains and Losses

Profits or losses on the sale of businesses, associates and investments that are included in our continuing operations are reported as other net gains and losses . In 2005 the only item in this category was the £40 million profit on the sale of our associate interest in MarketWatch. In 2004, other gains and losses amounted to £9 million, with the principal items being profits on the sale of stakes in Capella and Business.com.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased from £8 million in 2004 to £14 million in 2005. The increase was due to profit improvement at The Economist Group and a reduction in losses at FT Deutschland.

Operating Profit

The total operating profit increased by £132 million, or 32.7%, to £536 million in 2005 from £404 million in 2004. This £132 million or 33% increase was due to increases across all the businesses, the one-off gain from the sale of MarketWatch of £40 million and a beneficial impact of exchange. We estimate that had the 2004 average rates prevailed in 2005, operating profit would have been £12 million lower.

Operating profit attributable to Pearson Education increased by £56 million, or 20%, to £343 million in 2005, from £287 million in 2004. The increase was due to strong sales and improved margins in both the School and Higher Education businesses. Operating profit attributable to the FT Group increased by £63 million, or 90%, to £133 million

in 2005, from £70 million in 2004. £40 million of the increase was due to the profit from the sale of MarketWatch but there were also increases at IDC of £13 million and FT Publishing of £10 million. Operating profit attributable to the Penguin Group increased by £13 million, or 28%, to £60 million in 2005, from £47 million in 2004. The increase at Penguin was due in part to increased efficiencies and improved margins and also due to exchange gains and one-off items in 2004. Penguin s

operating profit in 2004 was reduced by costs associated with disruption in UK distribution following the move to a new warehouse and closure costs associated with Penguin TV.

Net Finance Costs

Net finance costs reduced from £79 million in 2004 to £70 million in 2005. Net interest payable in 2005 was £77 million, up from £74 million in 2004. The group s net interest rate payable rose by 0.9% to 5.9%. Although we were partly protected by our fixed rate policy, the strong rise in US dollar floating interest rates had an adverse effect. Year on year, average three month LIBOR (weighted for the Group s borrowings in US dollars, euro and sterling) rose by 1.9% to 3.4%. This was largely offset by the £260m fall in average net debt, reflecting in particular the proceeds from the disposal of Recoletos and good cash generation. In addition, in 2005 we did not benefit from a one-off credit of £9m for interest on a repayment of tax that occurred in 2004. As at January 1, 2005 we adopted IAS 39 *Financial Instruments: Recognition and Measurement* in our financial statements. This has had the effect of introducing increased volatility into the net finance cost and in 2005 the adoption of IAS 39 reduced net finance costs by £14 million. For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowing below and Item 11. Quantitative and Qualitative Disclosures About Market Risk .

Taxation

The total tax charge for the year was £124 million, representing a 27% rate on pre-tax profits of £466 million. This compares with a 2004 rate of 19% (or £63m on a pre-tax profit of £325m). In 2004, the tax charge reflected credits of £48m relating to previous years, a substantial element of which was non-recurring; adjustments relating to previous years in 2005 resulted in a credit of £18m. The 2005 rate benefited from the fact that the profit of £40m on the sale of Marketwatch.com was free of tax.

Minority Interests

Following the disposal of our 79% holding in Recoletos in April 2005 and the purchase of the 25% minority stake in Edexcel in February 2005, our minority interests now mainly comprise the 39% minority share in IDC.

Discontinued Operations

The results of Recoletos have been consolidated for the period up to February 28, 2005 and included in discontinued operations in 2005 and 2004. The results for 2005 include an operating loss for the two months to February 28, 2005 of £3 million compared to an operating profit in the full year to December 31, 2004 of £26 million. The profit on disposal of Recoletos reported in 2005 was £306 million.

Profit for the Financial Year

The total profit for the financial year in 2005 was £644 million compared to a profit in 2004 of £284 million. The overall increase of £360 million was mainly due to the profit on disposal of Recoletos and MarketWatch together with significant improvement in operating profits reported across all the Pearson businesses. These increases were only partially offset by the increase in the tax charge in 2005.

Earnings per Ordinary Share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 78.2 pence in 2005 compared to 32.9 pence in 2004 based on a weighted average number of shares in issue of 797.9 million in 2005 and 795.6 million in 2004. This increase in earnings per share was due to the additional profit for the financial year described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 78.1 pence in 2005 and 32.9 pence in 2004 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

Exchange Rate Fluctuations

The strengthening of the US dollar against sterling on an average basis had a positive impact on reported sales and profits in 2005 compared to 2004. We estimate that if the 2004 average rates had prevailed in 2005, sales would have been lower by £46 million and operating profit would have been lower by £12 million. See

Item 11. Quantitative and Qualitative Disclosures About Market Risk for a discussion regarding our management of exchange rate risks.

Sales and Operating Profit by Division

The following table summarizes our operating profit and results from operations for each of Pearson s divisions. Adjusted operating profit is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments, as reported under SFAS 131. Since 1998 we have reshaped the Pearson portfolio by divesting of non-core interests and investing in educational publishing and testing, consumer publishing and business information companies. During this period of transformation management has used adjusted operating profit to track underlying core business performance.

In our adjusted operating profit we have excluded amortization of acquired intangibles, other gains and losses and other net finance costs of associates. The amortization of acquired intangibles is not considered to be fully reflective of the underlying performance of the group. Other gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and investments that are included within continuing operations but which distort the performance for the year. Other net finance costs of associates are foreign exchange and other gains and losses that represent short-term fluctuations in market value and are subject to significant volatility. These gains and losses may not be realized in due course as it is normally the intention to hold these instruments to maturity. Increased volatility has been introduced as a result of adopting IAS 39 Financial Instruments: Recognition and Measurement as at January 1, 2005. Finance costs and income of joint ventures and associates are reported within the share of results of joint ventures and associates that is included within operating profit. Group finance costs and income are reported separately in the income statement below the operating profit line.

Adjusted operating profit enables management to more easily track the underlying operational performance of the group. A reconciliation of operating profit to adjusted operating profit is included in the table below:

	Year Ended December 31			
	2005		2004	
	£m	%	£m	%
Total operating profit				
Pearson Education:				
School	**142**	**27**	112	27
Higher Education	**156**	**29**	133	33
Professional	**45**	**8**	42	10
FT Group:				
FT Publishing	**58**	**11**	8	2
IDC	**75**	**14**	62	16
Penguin	**60**	**11**	47	12
Total	**536**	**100**	404	100
Add back:				
Amortization of acquired intangibles				
School	**5**			
Higher Education				
Professional				
Penguin				
FT Publishing	**1**			
IDC	**5**		5	
Total	**11**		5	
Other net gains and losses				
School			(4)	
Higher Education			(4)	
Professional			(2)	
Penguin			5	
FT Publishing	**(40)**		(4)	
IDC				
Total	**(40)**		(9)	
Other net finance costs of associates				
School				
Higher Education				
Professional				
Penguin				
FT Publishing	**2**			
IDC				

Total	**2**			
Adjusted operating profit				
Pearson Education:				
School	**147**	**29**	108	27
Higher Education	**156**	**31**	129	32
Professional	**45**	**9**	40	10
FT Group:				
FT Publishing	**21**	**4**	4	1
IDC	**80**	**15**	67	17
Penguin	**60**	**12**	52	13
Total	**509**	**100**	400	100

School

School business sales increased by £208 million, or 19%, to £1,295 million in 2005, from £1,087 million in 2004 and adjusted operating profit increased by £39 million, or 36%, to £147 million in 2005 from £108 million in 2004. The School results in 2005 benefit from the inclusion of AGS Publishing, acquired in July 2005 and the strengthening of the US dollar, which we estimate added £34 million to sales and £2 million to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates.

In the US school market, Pearson s school publishing business grew 12% ahead of the Association of American Publishers estimate of industry growth of 10.5%. New adoption market share was 33% in the adoptions where Pearson competed (and 24% of the total new adoption market). The School business now has leading positions in math, science, literature and foreign languages. School testing sales were up more than 20%, benefiting from significant market share gains and mandatory state testing under No Child Left Behind. School software also had a strong year with good sales and profit growth on curriculum and school administration services.

Outside the US, the School publishing sales increased in high single digits. The worldwide English Language Teaching business benefited from strong demand for English language learning and investments in new products, including *English Adventure* (with Disney) for the primary school market, *Sky* for secondary schools, *Total English* for adult learners and *Intelligent Business* (with *The Economist*) for the business markets. There was also strong growth in the international school testing markets. Four million UK GCSE, AS and A-Level scripts were marked onscreen and 2005 saw the first year of running the UK National Curriculum tests and a new contract for a national school testing pilot in Australia.

School margins were up by 1.5% points to 11.4% with efficiency gains in central costs, production, distribution and software development.

Higher Education

Sales in Higher Education increased by £50 million, or 7%, to £779 million in 2005, from £729 million in 2004. Adjusted operating profit increased by £27 million, or 21%, to £156 million in 2005 from £129 million in 2004. Both sales and adjusted operating profit benefited from the strengthening US dollar which we estimate added £14 million to sales and £3 million to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates.

In the US, the Higher Education sales were up by 6% ahead of the Association of American Publishers estimate of industry growth of 5%. 2005 is the seventh consecutive year that Pearson s US Higher Education business has grown faster than the industry. The US business benefited from continued growth from market-leading authors in key academic disciplines including biology (Campbell & Reece), chemistry (Brown & LeMay), sociology (Macionis), marketing (Kotler & Keller), math (Tobey & Slater), developmental math (Martin-Gay) and English composition (Faigley s *Penguin Handbook*). There was also expansion in the career and workforce education sector, with major publishing initiatives gaining market share in allied health, criminal justice, paralegal, homeland security and hospitality. The online learning and custom publishing businesses saw rapid growth. Approximately 3.6 million US college students are studying through one of our online programs, an increase of 20% on 2004; and custom publishing, which builds customized textbooks and online services around the courses of individual faculties or professors, had double digit sales growth.

International Higher Education publishing sales grew by 4%, benefiting from the local adaptation of global authors, including Campbell and Kotler, and the introduction of custom publishing and online learning capabilities into new markets in Asia and the Middle East.

Higher Education margins were up by 2.3% points to 20%. Good margin improvement in the US and in international publishing was helped by shared services and savings in central costs, technology, production and manufacturing.

Professional

Professional sales increased by £82 million, or 16%, to £589 million in 2005 from £507 million in 2004. Adjusted operating profit increased by £5 million, or 13%, to £45 million in 2005, from £40 million in 2004. Sales benefited from the strengthening US dollar, which we estimate added £8 million to sales when compared to the equivalent figures at constant 2004 exchange rates.

Professional testing sales were up more than 40% in 2005 benefiting from the successful start-up of major new contracts including the Driving Standards Agency, National Association of Securities Dealers and the Graduate Management Admissions Council. Government Solutions grew sales by 38%, helped by new contracts with the US Department of Education and the Social Security Administration worth over $800 million, together with strong growth from add-ons to existing programs, including those with the US Department of Health and Human Services.

Overall margins in the Professional business were a little lower in 2005 compared to 2004 mainly due to new contract start-up costs at Government Solutions. Margins in the Professional publishing businesses were maintained despite falling sales.

FT Publishing

Sales at FT Publishing (excluding discontinued businesses) increased by £14 million or 4%, from £318 million in 2004 to £332 million in 2005. Adjusted operating profit increased by £17 million, from £4 million in 2004 to £21 million in 2005. Much of the sales and profit increase was at the FT newspaper; sales at the other business newspapers were broadly level with 2004 with a small increase in adjusted operating profit compared to 2004.

FT newspaper sales were up 6% while adjusted operating profit increased £14 million to register a profit of £2 million in 2005 compared to a loss of £12 million in 2004. FT advertising revenues were up 9% for the year with sustained growth in luxury goods and worldwide display advertising. FT.com advertising sales were up 27% as some of the FT s biggest advertisers shifted to integrated print and online advertising. The FT s worldwide circulation was 2% lower for the year at 426,453 average copies per day although the second half of the year showed improvement to 430,635 average copies per day. FT.com s paying subscribers increased by 12% to 84,000 and the average unique monthly users was up 7% to 3.2 million.

Les Echos advertising and circulation revenues for 2005 were level with 2004 despite tough trading conditions. FT Business improved margins with growth in its international finance titles. Our share of the results of the FT s joint ventures and associates improved as *FT Deutschland* reduced its losses and increased its average circulation despite a weak advertising market in Germany and *The Economist* increased profits helped by an increase in circulation (10% to an average weekly circulation of 1,038,519 for the January-June ABC period).

Interactive Data

Interactive Data, grew its sales by 10% from £269 million in 2004 to £297 million in 2005. Adjusted operating profit grew by 19% from £67 million in 2004 to £80 million in 2005. Both sales and adjusted operating profit benefited from the strengthening US dollar, which we estimate added £2 million to sales and £1 million to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates.

FT Interactive Data, IDC s largest business (approximately two-thirds of IDC revenues) generated strong growth in North America and returned to growth in Europe. There was more modest growth at Comstock, IDC s business providing real-time data for global financial institutions, and at CMS BondEdge, its fixed income analytics business. Renewal rates for IDC s institutional businesses remain at around 95%. eSignal, IDC s active trader services business, increased sales by 27% with continued growth in the subscriber base and a full year contribution from FutureSource, acquired in September 2004.

The Penguin Group

The Penguin Group sales were up 2% to £804 million in 2005 from £786 million in 2004 and adjusted operating profit up 15% to £60 million in 2005 from £52 million in 2004. Both sales and adjusted operating profit benefited from the strengthening US dollar which we estimate added £9 million to sales and £6 million to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates. 2005 adjusted operating profit also benefited from reduced operating costs at our UK distribution center.

In the US, successful format innovation helped to address weakness in the mass market category that saw a further decline of 4% for the industry in 2005. The first seven Penguin Premium paperbacks were published in 2005, priced at $9.99, and all became bestsellers, with authors including Nora Roberts, Clive Cussler and Catherine Coulter.

Penguin authors received a number of awards during the year: A Pulitzer Prize (for Steve Coll s *Ghost Wars*), a National Book Award (William T. Vollman s *Europe Central*), the Whitbread Book of the Year (Hilary Spurling s *Matisse the Master*), the Whitbread Novel of the Year (Ali Smith s *The Accidental*) and the FT & Goldman Sachs Business Book of the Year Award (Thomas Friedman s *The World is Flat*). In 2005, there were 129 New York Times bestsellers and 54 top 10 bestsellers in the UK. Major bestselling authors include Patricia Cornwell, John Berendt, Sue Grafton, Jared Diamond, Jamie Oliver, Gillian McKeith, Jeremy Clarkson and Gloria Hunniford.

In 2005, there was also a strong contribution from new imprints and first-time authors. The new imprint strategy continued to gather pace and Penguin published more than 150 new authors in the US and approximately 250 worldwide its largest ever investment in new talent. Sue Monk Kidd s first novel, *The Secret Life of Bees,* has been a New York Times bestseller for almost two years; her second, *The Mermaid Chair,* reached number one in 2005. *The Kite Runner,* Khaled Hosseini s first book, stayed on the New York Times bestseller list for all of 2005, selling an additional two million copies (three million in total). In the UK, there was also strong performance from new fiction authors including Jilliane Hoffman, PJ Tracy, Karen Joy Fowler and Marina Lewycka.

Results of Operations

Year ended December 31, 2004 compared to year ended December 31, 2003

Consolidated Results of Operations

Sales

Our total sales decreased by £154 million to £3,696 million in 2004, from £3,850 million in 2003. This decrease of 4% was attributable to the effect of foreign currency exchange. The strength of sterling compared to the US dollar had a significant negative effect on sales, and we estimate that had the 2003 average rates prevailed in 2004, sales would have been higher by £301 million. In constant exchange rate terms Pearson Education had a strong year with an increase in sales of 5%. The Higher Education and Professional businesses were the main contributors to this growth with the Higher Education business growing faster than its market for the sixth straight year and Professional benefiting from new contracts and add-ons to existing contracts at Pearson Government Solutions. The School business was helped by a full year contribution from Edexcel, the UK testing business, but otherwise sales were flat as new adoption spending in the US fell by approximately $200 million. The FT Group sales were ahead of last year after another good year at Interactive Data and a return to sales growth for the Financial Times newspaper in a more stable business advertising environment. Penguin s results were disappointing with sales down 6% as reported, but flat on a constant currency basis after disruption to UK distribution and a weakness in the US consumer publishing market.

Pearson Education, our largest business sector, accounted for 63% of our sales in 2004 and in 2003. North America continued to be the most significant source of our sales although sales in the region decreased, as a proportion of total sales, to 68% in 2004, compared to 71% in 2003. This decrease in 2004, however, reflects the comparative strength of sterling and the euro compared to the US dollar.

Cost of Sales and Net Operating Expenses

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

	Year Ended December 31	
	2004	**2003**
	£m	**£m**
Cost of goods sold	**1,789**	1,846
Distribution costs	**201**	206
Administrative and other expenses	**1,365**	1,439
Other income	**(46)**	(51)

Total operating expenses	**1,520**	1,594

Cost of Sales. Cost of sales consists of costs for raw materials, primarily paper, printing costs, amortization of pre-publication costs and royalty charges. Our cost of sales decreased by £57 million, or 3%, to

£1,789 million in 2004, from £1,846 million in 2003. The decrease mainly reflected the decrease in sales over the period with overall gross margin remaining constant.

Distribution Costs. Distribution costs consist primarily of shipping costs, postage and packing.

Administration and Other Expenses. Our administration and other expenses decreased by £74 million, or 5%, to £1,365 million in 2004, from £1,439 million in 2003. Administration and other expenses as a percentage of sales remained constant at 37%. The decrease in administration and other expenses comes from both the effect of exchange and increased efficiencies, in particular from the cost actions taken at the Financial Times in recent years.

Other Operating Income. Other operating income mainly consists of sub-rights and licensing income and distribution commissions. Other operating income decreased 10% to £46 million in 2004 from £51 million in 2003 with the decrease mainly representing the continued decline in distribution commissions received for distribution of third party books.

Other Net Gains and Losses

Profits or losses on the sale of businesses, associates and investments that are included in our continuing operations are reported as other net gains and losses. In 2004, other gains and losses amounted to £9 million with the principal items being profits on the sale of stakes in Capella and Business.com. In 2003 there were small losses on a number of items totaling £6 million.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased from £2 million in 2003 to £8 million in 2004. The increase was largely due to a reduction in losses at FT Deutschland together with some improvement in profit at the Economist.

Operating Profit/Loss

The total operating profit in 2004 of £404 million compares to a profit of £406 million in 2003. This marginal decrease was due to the impact of exchange rates. We estimate that had the 2003 average rates prevailed in 2004, operating profit would have been £51 million greater. Operating profit attributable to Pearson Education remained constant at £287 million in both 2004 and 2003. There was an estimated reduction in profit of £29 million from exchange. After accounting for exchange rates, operating profit was ahead in each of the School, Higher Education and Professional businesses. Operating profit attributable to the FT Group increased by £33 million, or 89%, to £70 million in 2004, from £37 million in 2003. The increase was largely due to another strong performance from Interactive Data and significant cost savings at the Financial Times newspaper. Operating profit attributable to the Penguin Group decreased by £35 million, or 43%, to £47 million in 2004, from £82 million in 2003. The biggest single factor in the profit decline was exchange rates, which are estimated to have accounted for £14 million of the difference. There were also a number of other factors, including disruption in UK distribution following the move to a new warehouse and the weakness of the US consumer publishing market.

Net Finance Costs

Net finance costs decreased by £14 million to £79 million in 2004 from £93 million in 2003. Net interest payable decreased by £10 million, or 12%, to £74 million in 2004, from £84 million in 2003. The reduction is due to lower average net debt levels in 2004, which more than offset the effect of a general increase in floating interest rates, and a one-off credit of £9 million for interest on a repayment of tax in France which reduced the net interest cost in 2004. Year end indebtedness decreased to £1,221 million in 2004 compared to £1,376 million in 2003 due to funds generated from operations and foreign exchange movements. The weighted average three month London Interbank Offered (LIBOR) rate, reflecting our borrowings in US dollars, euros and sterling, rose by 40 basis points, or 0.4%. The company is partially protected from these increases by our treasury policy, which put £736 million of the year end debt on a fixed rate basis. As a result the net interest rate payable (excluding the £9 million credit referred to above) rose by only 25 basis points or 0.25% to 5% in 2004. For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowing and Item 11. Quantitative and Qualitative Disclosures About Market Risk .

Taxation

The overall taxation charge for 2004 was £63 million, compared to a charge of £61 million in 2003. In 2004 the Group recorded a total pre-tax profit of £325 million giving a tax rate of 19% compared to a similar rate of 19% on total pre-tax profits of £313 million in 2003. These low rates of tax were mainly a result credits of £56 million and £48 million respectively relating to prior year items; these reflect a combination of settlements with the Inland Revenue authorities and changes to deferred tax balances.

Minority Interests

Minority interests principally consist of the public s 39% interest in Interactive Data.

Discontinued Operations

Following the disposal of Recoletos in 2005, the results of Recoletos have been included in discontinued operations in 2004 and 2003. The results for 2004 include an operating profit of £26 million compared to an operating profit in 2003 of £43 million. The profit in 2003 includes a profit of £12 million on the sale of the Recoletos interest in El Mundo.

Profit for the Financial Year

The total profit for the financial year in 2004 was £284 million compared to a profit in 2003 of £275 million. The overall increase of £9 million was mainly due to the decrease in net finance costs in 2004 after adverse movements in exchange had eroded the underlying increase in operating profit.

Earnings per Ordinary Share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 32.9 pence in 2004 compared to 31.7 pence in 2003 based on a weighted average number of shares in issue of 795.6 million in 2004 and 794.4 million in 2003. This increase in earnings per share was due to the additional profit for the financial year described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 32.9 pence in 2004 and 31.7 pence in 2003 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

Exchange Rate Fluctuations

The weakening of the US dollar against sterling on an average basis had a negative impact on reported sales and profits in 2004 compared to 2003. We estimate that if the 2003 average rates had prevailed in 2004, sales would have been higher by £301 million and operating profit would have been higher by £51 million. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for a discussion regarding our management of exchange rate risks.

Sales and Operating Profit by Division

The following table summarizes our operating profit and results from operations for each of Pearson s divisions. Adjusted operating profit is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments, as reported under SFAS 131. Since 1998 we have reshaped the Pearson portfolio by divesting of non-core interests and investing in educational publishing and testing, consumer publishing and business information companies. During this period of transformation management has used adjusted operating profit to track underlying core business performance.

In our adjusted operating profit we have excluded amortization of acquired intangibles, other gains and losses and other net finance costs of associates. The amortization of acquired intangibles is not considered to be fully reflective of the underlying performance of the group. Other gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and investments that are included within continuing operations but which distort the performance for the year.

Adjusted operating profit enables management to more easily track the underlying operational performance of the group. A reconciliation of operating profit to adjusted operating profit is included in the table below:

	Year Ended December 31			
	2004		2003	
	£m	%	£m	%
Total operating profit				
Pearson Education:				
School	**112**	**27**	114	28
Higher Education	**133**	**33**	140	35
Professional	**42**	**10**	33	8
FT Group:				
FT Publishing	**8**	**2**	(29)	(7)
IDC	**62**	**16**	66	16
Penguin	**47**	**12**	82	20
Total	**404**	**100**	406	100
Add back:				
Amortization of acquired intangibles				
School				
Higher Education				
Professional				
Penguin				
FT Publishing				
IDC	**5**		4	
Total	**5**		4	
Other net gains and losses				
School	**(4)**		2	
Higher Education	**(4)**		2	
Professional	**(2)**		1	
Penguin	**5**		1	
FT Publishing	**(4)**			
IDC				
Total	**(9)**		6	
Other net finance costs of associates				
School				
Higher Education				
Professional				
Penguin				
FT Publishing				
IDC				

Total				
Adjusted operating profit				
Pearson Education:				
School	**108**	**27**	116	28
Higher Education	**129**	**32**	142	34
Professional	**40**	**10**	34	8
FT Group:				
FT Publishing	**4**	**1**	(29)	(7)
IDC	**67**	**17**	70	17
Penguin	**52**	**13**	83	20
Total	**400**	**100**	416	100

School

The School business sales decreased by £62 million, or 5%, to £1,087 million in 2004, from £1,149 million in 2003 and adjusted operating profit decreased by £8 million, or 7%, to £108 million in 2004 from £116 million in 2003. Both sales and adjusted operating profit were adversely affected by the weakening US dollar and we estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £93 million higher than reported and results from operations £8 million higher. The School results include a full year contribution from Edexcel, 75% of which was acquired in 2003. The extra Edexcel contribution increased sales growth in 2004 but reduced profit growth as the business is loss making in the first half.

In the US school market, adoption spending in 2004 fell by some $200 million to approximately $500 million. Our school businesses took the largest share (27%) of the new adoption opportunities. We benefited from strength across a wide range of subjects and grade levels, with a decline in elementary sales (after particularly strong market share growth in 2003) mitigated by a strong performance in the secondary market. We returned to growth in the open territories and in supplementary publishing, helped by restructuring actions taken in 2003 and by the sharp recovery in US state budgets. Our US school testing business benefited from growth in new and existing state contracts, including Texas, Ohio, Virginia and Washington. We continued to win new multi-year contracts including Tennessee, New Jersey and California ahead of implementation of the No Child Left Behind Act testing requirements, which become mandatory in the school year starting in September 2005. Our digital learning business showed a further profit improvement on slightly lower sales as we continued to integrate our content, testing and technology in a more focused way.

Outside the US, the School business sales increased with continued growth in English Language Teaching (ELT) helped by a very significant investment in ELT and in school testing we won $200 million of multi-year contracts.

Higher Education

Higher Education sales decreased by £41 million, to £729 million in 2004, from £770 million in 2003. Adjusted operating profit decreased by £13 million, or 9%, to £129 million in 2004 from £142 million in 2003. Both sales and adjusted operating profit were adversely affected by the weakening US dollar, and we estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £69 million higher than reported and results from operations £16 million higher than reported. In the US we grew faster than the market for the sixth consecutive year in US dollar terms, up 4% while the industry without Pearson was up 2% according to the Association of American Publishers.

In the US, our Higher Education business benefited from strength in two-year career colleges, a fast growing segment, with vocational programs in allied health, technology and graphic arts, and elsewhere in math and modern languages. Margins reduced a little as we achieved good growth outside the US and continued to invest to make our technology central to the teaching and learning process. Our custom publishing business, which creates specific programs built around the curricula of individual faculties or professors, grew strongly. Pearson Custom has now increased its sales in dollar terms eight-fold over the past six years and we have introduced our first customized online resources for individual college courses.

Professional

Sales and profit from operations in our Professional business improved in spite of the weakening dollar. Sales increased by £4 million, or 1%, to £507 million in 2004 from £503 million in 2003. Adjusted operating profit increased by £6 million, or 18%, to £40 million in 2004, from £34 million in 2003. We estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £60 million higher than reported and results from operations £5 million higher than reported.

After taking out the effect of exchange rates, Pearson Government Solutions grew sales by 25%, with strong growth from add-ons to existing programs. We also won some important new contracts, including multi-year contracts worth $500 million from customers such as the US Department of Health and Human Services and the London Borough of Southwark. Our professional testing business grew sales (before exchange impacts) by 31% as we benefited from the start-up of major new contracts, although we continued to operate at a small loss as we invested in building up the infrastructure for our 150-strong UK test center

network. Markets remained tough for our technology publishing titles, where although sales were lower, profits were broadly level as a result of further cost actions.

FT Publishing

Sales at the FT Publishing (excluding discontinued businesses) increased by £3 million, from £315 million in 2003 to £318 million in 2004 and adjusted operating profit increased by £33 million from a loss of £29 million in 2003 to a profit of £4 million in 2004. Sales were boosted by a return to growth at the *Financial Times* newspaper (FT) for the first year since 2000. The FT returned to profit in the seasonally strong fourth quarter of 2004 with both advertising and circulation revenues ahead for the full year.

Advertising performance across all categories and regions at the FT were mixed throughout the year. While the recruitment and luxury goods categories increased by more than 20%, the business-to-business and technology sectors showed few signs of recovery. In terms of geography, good growth in Europe and Asia offset a very weak US corporate advertising market. Average circulation for 2004 was 3% lower than in 2003, whilst FT.com now has 76,000 paying subscribers and 3.0 million average unique monthly users. Adjusted operating profit at the FT improved by £24 million over 2003 as we continued to reduce the FT s cost base, which is now £110 million lower than it was in 2000.

Les Echos achieved euro sales growth of 4% and profits grew strongly despite a volatile advertising market. Average circulation grew 3% to 119,800, while competitors saw falling sales. FT Business posted significant sales growth of 8%, with progress in all its main markets. Profits improved 25% following a continued emphasis on cost management. Adjusted operating profit at the FT s associates and joint ventures showed a profit of £6 million compared to £2 million in 2003. Losses narrowed at FT Deutschland as circulation and advertising revenue grew strongly. FT Deutschland reached the 100,000 copy sales mark in December and circulation averaged 96,600, up 6% on the previous year. The Economist Group again increased adjusted operating profit with The Economist s circulation passing the 1 million mark with an average weekly circulation of 1,009,759 (January-June Audit Bureau of Circulations period).

Interactive Data

Interactive Data, our 61%-owned financial information business saw a decrease in sales of £4 million, from £273 million in 2003 to £269 million in 2004 and adjusted operating profit decreased by £3 million from £70 million in 2003 to £67 million in 2004. We estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £22 million higher than reported and results from operations £7 million higher than reported.

FT Interactive Data and e-Signal (Interactive Data s real-time financial market information and decision support tool business) performed well particularly in the US in 2004 where there were some signs of improvement in market conditions. Worldwide renewal rates among institutional clients remained at or above 95%. Demand for Interactive Data s value-added services remained strong, with the signing of our 100th customer for our Fair Value Information Service product in December 2004. IDC had a first full year contribution from acquisitions made in 2003, ComStock and Hyperfeed Technologies, and acquired FutureSource in September 2004 to expand and compliment e-Signal.

The Penguin Group

The Penguin Group had a difficult 2004 with sales down 6% to £786 million from £840 million in 2003 and adjusted operating profit down 37% to £52 million in 2004 from £83 million in 2003. Both sales and adjusted operating profit were adversely affected by the weakening US dollar, and we estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £57 million higher than reported and results from operations £14 million higher than reported. In addition to exchange, the decline in results from operations was caused by a number of factors including disruption at the new UK warehouse and a weakening in the US consumer publishing market.

In the UK, our move to a new warehouse, to be shared with Pearson Education, disrupted supply of our books and had a particular impact on backlist titles. Although we traded well in the second half of 2004, and shipped more books to our UK customers than in the previous year, we incurred some £9 million of additional costs as we took special measures to deliver books, including the costs of running two warehouses, shipping

books direct and additional marketing support. By the end of the year we had eliminated the order backlog in the warehouse and the new management team has continued to make good progress in the early part of 2005.

After a good start to the year, the US consumer publishing market deteriorated sharply in the second half and full year industry sales were 1% lower than in 2003, according to the Association of American Publishers. The adult mass market segment, which accounts for approximately one-third of Penguin s US sales, was down 9% for the industry for the full year, and 13% in the second half.

Despite the problems outlined above, Penguin had another great publishing year in 2004. We benefited from our new imprint strategy, with a further four imprints published for the first time. Non-fiction performed particularly well, with a 40% increase in our titles on the New York Times bestseller list, including Lynne Truss s *Eats, Shoots & Leaves* (now with over one million copies in print), Ron Chernow s *Alexander Hamilton* and Maureen Dowd s *Bushworld.* Best selling UK titles included Jamie Oliver s *Jamie s Dinners,* Sue Townsend s *Adrian Mole and the Weapons of Mass Destruction* and Gillian McKeith s *You Are What You Eat.*

Liquidity and Capital Resources

Cash Flows and Financing

Net cash inflow from operating activities increased by £170 million, or 24%, to £875 million in 2005, from £705 million in 2004, even though the 2004 cash inflow included collection of the $151 million receivable in respect of the TSA contract. Cash flows within the education businesses and IDC in particular continued to grow strongly and cash flows at Penguin recovered significantly from their lower levels in 2004 and 2003. Underlying working capital efficiency improved considerably. On an average basis (excluding the impact of the TSA receivable), the working capital to sales ratio for our book publishing businesses improved from 29.4% to 27.4%. Compared to 2003, the net cash inflow from operating activities in 2004 increased by £174 million, or 33%, to £705 million from £531 million. Although the 2004 performance was helped by the receipt of the $151 million receivable in respect of the TSA contract, growth within the education businesses and IDC underpinned the underlying improvement.

Net interest paid was £72 million in 2005 compared to £85 million in 2004 and £76 million in 2003. The 7% decrease in 2005 over 2004 reflected the reduction in debt following receipt of the proceeds from the disposals of Recoletos and MarketWatch (offset in part by the impact of the year on year increases in interest rates), while the 2004 increase compared to 2003 was entirely due to the year on year increases in interest rates.

Capital expenditure on property, plant and equipment was £76 million in 2005 compared to £101 million in 2004 and £79 million in 2003. The higher spending in 2004, compared to both 2005 and 2003, reflected up-front expenditure on our Professional testing contracts.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £253 million in 2005 against £51 million in 2004 and £65 million in 2003. The principal acquisitions in 2005 were of AGS for £161 million within the School business and IS. Teledata for £29 million by Interactive Data. The principal acquisitions in 2004 were of KAT and Dominie Press for £10 million within our education businesses and FutureSource by Interactive Data for £9 million. The principal acquisition in 2003 was of ComStock by Interactive Data for net cash of £68 million. The sale of subsidiaries and associates produced a cash inflow of £430 million in 2005 against £31 million in 2004 and £56 million in 2002. The principal disposals in 2005 were of Recoletos for net cash proceeds of £371 million and MarketWatch for net cash proceeds of £54 million. The proceeds in 2004 relate primarily to the sale of Argentaria Cartera by Recoletos. The principal disposal in 2003 was the sale of Unedisa by Recoletos.

The cash outflow from financing of £321 million in 2005 reflects the improved group dividend and the repayment of bank borrowings following the sale of Recoletos. The cash outflow from financing of £261 million in 2004 reflects the payment of the group dividend and the repayment of one 550 million bond offset by the proceeds from the issue of new $350 million and $400 million bonds. The cash outflow from financing of £142 million in 2003 again reflects the group dividend and the issue in the year of a $300 million bond as we took advantage of favorable market conditions, offset by the repayment of a 250 million bond. Bonds are issued as part of our overall financing program to support general corporate expenditure.

Capital Resources

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

At December 31, 2005, our net debt was £996 million compared to net debt of £1,221 million at December 31, 2004. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash and liquid resources. Liquid resources comprise short-term deposits of 90 days and investments that are readily realizable and held on a short-term basis. Short-term, medium-term and long-term borrowing amounted to £1,959 million at December 31, 2005, compared to £1,823 million at December 31, 2004. At December 31, 2005, cash and liquid resources were £902 million, compared to £461 million at December 31, 2004.

Contractual Obligations

The following table summarizes the maturity of our borrowings and our obligations under non-cancelable operating leases.

	At December 31, 2005				
	Total	**Less Than One Year**	**One to Two Years**	**Two to Five Years**	**After Five Years**
	£m	**£m**	**£m**	**£m**	**£m**
Gross borrowings:					
Bank loans, overdrafts and commercial paper	102	102			
Variable rate loan notes					
Bonds	1,854	152	436	310	956
Lease obligations	1,395	129	115	288	863
Total	**3,351**	**383**	**551**	**598**	**1,819**

The group had capital commitments for fixed assets, including finance leases already under contract, of £1 million. There are contingent liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities in respect of legal claims. None of these claims or guarantees is expected to result in a material gain or loss.

The group is committed to a quarterly fee of 0.125% on the unused amount of the group s bank facility.

Off-Balance Sheet arrangements

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

Borrowings

We have in place a $1.35 billion term revolving credit facility, which matures in July 2009. At December 31, 2005, approximately $1.35 billion was available under this facility. This included allocations to

refinance short-term borrowings not directly drawn under the facility. The credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

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

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

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

Treasury Policy

We hold financial instruments for two principal purposes: to finance our operations and to manage the interest rate and currency risks arising from our operations and from our sources of financing.

We finance our operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. We borrow principally in US dollars, sterling and euro at both floating and fixed rates of interest, using derivatives, where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally interest rate swaps, interest rate caps and collars, currency swaps and forward foreign exchange contracts. For a more detailed discussion of our borrowing and use of derivatives, see Item 11. Quantitative and Qualitative Disclosures About Market Risk .

Related Parties

There were no significant or unusual related party transactions in 2005, 2004 or 2003. Refer to note 32 in Item 17. Financial Statements .

Accounting Principles

The following summarizes the principal differences between IFRS and US GAAP in respect of our financial statements. For further details refer to note 35 in Item 17. Financial Statements .

Before the adoption of IFRS 3 on 1 January 2003 and before the adoption of FAS 142 on 1 January 2002, goodwill was recognized as an asset and amortization expense was recorded over useful lives ranging between 3 and 20 years. Under IFRS 3 and FAS 142 goodwill is no longer amortized but tested annually for impairment. Before the adoption of IFRS, the Group s intangible assets were not recognized as they did not meet the requirements under UK GAAP. Under IFRS and US GAAP, intangible assets are recognized separately from goodwill when they arise from separate contractual or legal rights or can be separately identified and be sold, transferred, licensed, rented or exchanged regardless of intent. Therefore, intangible assets such as publishing rights, non-compete agreements, software, databases, patents and non-contractual customer relationships such as advertising relationships have been recognized and are being amortized over a range of useful lives between 2 and 25 years. A difference between US GAAP and IFRS arises in goodwill and intangible assets due to the different adoption dates of IFRS 3 and FAS 142 as well as the impact of foreign exchange on the translation of those underlying assets that are denominated in a foreign currency. This difference also creates a difference in the gain or loss recognized on the disposal of a business.

Under IFRS, the Group reviews the recoverability of goodwill annually. These reviews are based on comparing the fair value of the Group s cash-generating units determined by discounting future cash flows to their carrying value. Under US GAAP, a two stage impairment test is required at least annually under FAS 142. The Group performed the transitional impairment test under FAS 142 by comparing the carrying value of each reporting unit with its fair value as determined by discounted future cash flows. The Group also completed the annual impairment tests required by FAS 142 in 2005, 2004 and 2003. The Group has determined that its reporting units under FAS 142 are consistent with its cash-generating units under IAS.

IAS 12 *Income Taxes* requires a full provision to be made for deferred taxes. Deferred taxes are to be accounted for on all temporary differences, with deferred tax assets recognized to the extent that they are more likely than not recoverable against future taxable profits. Under US GAAP, deferred tax assets not considered recoverable are adjusted through a separate valuation allowance in the balance sheet. There are no separate valuation allowances under IFRS. Under US GAAP, deferred taxes are accounted for in accordance with FAS 109, *Accounting for Income Taxes,* with a full provision also made for deferred taxes on all temporary

differences and a valuation allowance is established when it is more likely than not that they will not be realised. This is similar to the treatment required under IAS 12.

Using the transitional exceptions of IAS 39, derivatives were accounted for in accordance with UK GAAP for the years ended 31 December 2003 and 2004. Under UK GAAP, there are no specific criteria, which must be fulfilled in order to record derivative contracts such as interest rate swaps, currency swaps and forward currency contracts as a hedging instrument. Accordingly, based upon our intention and stated policy with respect to entering into derivative transactions, they have been recorded as hedging instruments for UK GAAP. This means that unrealized gains and losses on these instruments are typically deferred and recognized when realized. From 1 January 2005, the Group has adopted IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Disclosure and Presentation* . Under US GAAP, we have adopted FAS 133, *Accounting for Derivative Instruments and Hedging Activities* and its related guidance. In 2003, our derivative contracts did not meet the prescribed criteria for hedge accounting, and have been recorded at market value at each period end, with changes in their fair value being recorded in the profit and loss account. In 2004 the Group met the prescribed designation requirements and hedge effectiveness tests under US GAAP for certain of its derivative contracts. As a result, the movements in the fair value of the effective portion of fair value hedges and net investment hedges have been offset in earnings and other comprehensive income respectively by the corresponding movement in the fair value of the underlying bond or asset.

Finance lease rentals are capitalized at the net present value of the total amount of rentals payable under the leasing agreement (excluding finance charges) and depreciated over the period of the lease (if in respect of property) or the useful economic life of the asset (if in respect of plant and equipment). 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 charged to the profit and loss on a straight-line basis over the duration of each lease term.

Under IFRS and US GAAP, the annual pension is determined in accordance with IAS 19 Employee Benefits and FAS 87 Employers Accounting for Pensions . Actuarial assumptions are adjusted annually to reflect current market and economic conditions. Under IFRS the difference between the fair value of the assets and the defined benefit obligation is recognized as a prepayment/ liability. Actuarial gains and losses are recognized in the statement of recognized income and expenses. Under US GAAP, if the fair value of a pension plan s assets is below the plan s accumulated benefit obligation, a minimum pension liability is required to be recognized in the balance sheet. Unrecognized gains or losses outside the 10% corridor are spread over the employees remaining service lifetimes.

Under IFRS and US GAAP, we account for options and restricted shares granted to employees using their fair value. Compensation expense is determined based upon the fair value at the grant date, and has been estimated using the Black Scholes, Binomial or Monte Carlo model as appropriate. Compensation cost is recognized over the service life of the awards, which is normally equal to the vesting period. Differences between the US GAAP and IFRS charges are mainly due to the different treatment of options with graded vesting features. Under IFRS, the charge is recognized as the options gradually vest. Under US GAAP, the charge is recognized on a straight line basis over the vesting period. Other noteable differences include the treatment of forfeitures.

For a further explanation of the differences between IFRS and US GAAP see note 35 to the consolidated financial statements.

Recent U.S. Accounting Pronouncements

In November 2004, the FASB issued FASB Statement No. 151 *Inventory Costs An Amendment of ARB No. 43, Chapter 4* (FAS 151). FAS 151 amends the guidance in ARB No. 43, Chapter 4 Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion of so abnormal as stated in ARB No. 43. Additionally, FAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. FAS 151 is effective for fiscal years beginning after June 15, 2005.

The Group will adopt FAS 151 in 2006 but does not expect the adoption of the new standard to have a material impact.

In December 2004, the FASB issued FASB Statement No. 153 *Exchanges of Nonmonetary Assets An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions* (FAS 153). FAS 153 eliminates the exception from fair value measurement for non monetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, Accounting for Nonmonetary Transactions, and replaces it with an exception for exchanges that do not have commercial substance. FAS 153 specifies that a non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS 153 is effective for the fiscal periods beginning after June 15, 2005. The Group will adopt FAS 153 in 2006 but does not expect the adoption of the new standard to have a material impact.

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004) *Share-Based Payment* (FAS 123(R)), which replaces FAS No. 123 *Accounting for Stock-Based Compensation* (FAS 123) and supersedes APB Opinion No. 25 *Accounting for Stock Issued to Employees.* FAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under FAS 123 no longer will be an alternative to financial statement recognition. The Group will adopt FAS 123(R) in 2006 but does not expect the adoption of the new standard to have a material impact as it already recognizes share-based payment cost in its income statement in accordance with FAS 123.

In March 2005, the FASB issued FASB Interpretation No. 47 *Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143* (FIN 47). FIN 47 clarifies the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and/or settlement are conditional on a future event. FIN 47 is effective for the fiscal periods ending after December 15, 2005. The adoption of FIN 47 did not have a material impact on the Group.

In May 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections A replacement of APB Opinion No. 20 and FASB Statement No. 3* (FAS 154). This statement requires retrospective application to prior periods financial statements of changes in accounting principles unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement applies to all voluntary changes in accounting principles and changes required by an accounting pronouncement that does not include specific transition provisions. FAS 154 is required to be adopted in fiscal years beginning after December 15, 2005. FAS 154 would not have had a material effect on the financial position, results of operations or cash flows of the Group under US GAAP as at December 31, 2005.

In October 2005, the FASB issued FASB Staff Position (FSP) 13-1 *Accounting for Rental Costs Incurred during a Construction Period* (FSP 13-1). FSP 13-1 requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense and included in income from continuing operations. FSP 13-1 is effective for the fiscal periods beginning after December 15, 2005. The Group will adopt FSP 13-1 in 2006 but does not expect the adoption of the new standard to have a material impact.

In January 2006 the FASB issued FASB Statement No. 155 *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* (FAS 155). FAS 155 provides entities with relief from having to separately determine the fair value of an embedded derivative that would otherwise be required to be bifurcated from its host contract. FAS 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event occurring after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Group is currently evaluating the impact the adoption of FAS 155 will have, but does not expect it to have a material impact.

Recent International Accounting Pronouncements

IFRS 7 Financial Instruments: Disclosures . IFRS 7 introduces new disclosures of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. IFRS 7 is effective for accounting

periods beginning on or after 1 January 2007. The Group is currently assessing the impact of IFRS 7 on the Group s financial statements, but does not expect it to be significant.

A complementary amendment of IAS 1 *Presentation of Financial Statements Capital Disclosures* . The amendment to IAS 1 introduces disclosures about the level of an entity s capital and how it manages capital. The amendment to IAS 1 is effective for accounting periods beginning on or after 1 January 2007. The Group is currently assessing the impact of the amendment to IAS 1, but does not expect it to be significant.

IFRIC 4 *Determining whether an Arrangement contains a Lease* . IFRIC 4 requires the determination if whether an arrangement is or contains a lease to be based on the substance of the arrangement. IFRIC 4 is effective for accounting periods beginning on or after 1 January 2006. The Group will implement IFRIC 4 from 1 January 2006 but does not expect it to have a significant impact on the Group s operations.

IAS 21 (Amendment) *Net investment in a foreign operation* . This amendment deals with the requirement for a monetary item that forms part of a reporting entity s net investment in a foreign operation to be denominated in the functional currency of either the reporting entity or the foreign operation. The amendment also clarifies the accounting treatment of exchange differences arising on a loan made between two sister companies within a group. The exchange differences would be taken to equity in the parent s consolidated financial statements, irrespective of the currency in which the loan is made, provided that the nature of the loan is similar to an equity investment, that is, settlement of the loan is neither planned nor expected to occur in the foreseeable future.

IFRIC 8 *Scope of IFRS 2* . IFRIC 8 clarifies that transactions within the scope of IFRS 2 Share-based payment , include those in which the entity cannot specifically identify some or all of the goods or services received. If the identifiable consideration given appears to be less than the fair value of the equity instruments granted or liability incurred, this situation generally indicates that other consideration has been or will be received.

ITEM 6. *DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES*

Directors and Senior Management

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

The following table sets forth information concerning senior management, as of April 2006.

Name	Age	Position
Glen Moreno	62	Chairman
Marjorie Scardino	59	Chief Executive
David Bell	59	Director for People and Chairman of the FT Group
Terry Burns	62	Non-executive Director
Patrick Cescau	57	Non-executive Director
Rona Fairhead	44	Chief Financial Officer
Susan Fuhrman	62	Non-executive Director
John Makinson	51	Chairman and Chief Executive Officer, Penguin Group
Reuben Mark	67	Non-executive Director
Vernon Sankey	56	Non-executive Director
Rana Talwar	58	Non-executive Director
David Arculus	59	Non-executive Director
Ken Hydon	61	Non-executive Director

Glen Moreno was appointed chairman on 1 October 2005. He is the senior independent non-executive director of Man Group plc and also a director of Fidelity International Limited and a trustee of The Prince of Liechtenstein Foundation and of The Liechtenstein Global Trust.

Marjorie Scardino joined the board and became chief executive in January 1997. She is a member of Pearson s nomination committee. She was chief executive of The Economist Group from 1993 until joining Pearson. She is also a non-executive director of Nokia Corporation.

David Bell became a director in March 1996. He is chairman of the FT 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.

Terry Burns became a non-executive director in May 1999 and the senior independent director in February 2004. He currently serves on the nomination and personnel committees. He was the UK government s chief economic advisor 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 Banco Santander Central Hispano. On 1 October 2005, he was appointed deputy chairman of Marks and Spencer Group plc.

Patrick Cescau became a non-executive director in April 2002. He joined the audit committee in January 2005, and is also a member of the nomination committee. He joined Unilever in 1973, latterly serving as Finance Director until January 2001, at which time he was appointed Director of Unilever s Foods Division. He is currently group chief executive of Unilever.

Rona Fairhead became a director and chief financial officer in June 2002. She had served as deputy finance director from October 2001. From 1996 until 2001, she worked at ICI plc, where she served as executive vice president, group control and strategy, and as a member of the executive committee from 1998. 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.

Susan Fuhrman became a non-executive director in July 2004. She is a member of the audit and nomination committees. She is dean of the Graduate school of Education at the University of Pennsylvania. She is a member of the Board of Trustees of the Carnegie Foundation for the Advancement of Teaching and a member of the Council for Corporate and School Partnerships of the Coca-Cola Foundation.

John Makinson became chairman of the Penguin Group in May 2001 and its chief executive officer in June 2002. He was appointed chairman of Interactive Data in December 2002. He served as Pearson Finance Director from March 1996 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 is also a non-executive director of George Weston Limited in Canada.

Reuben Mark became a non-executive director in 1988 and served on the audit and nomination committees and as chairman of the personnel committee. He became chief executive of the Colgate Palmolive Company in 1984, and chairman in 1986. He has held these positions since then. He is also a director of Time Warner Inc. He retired from the board at the 2006 AGM.

Vernon Sankey became a non-executive director in 1993 and served as chairman of the audit committee and as a member of the treasury and nomination committees. He was previously chief executive of Reckitt & Colman plc and is chairman of Photo-Me International plc. He is also a non-executive director of Taylor Woodrow plc and Zurich Financial Services AG. He retired from the board at the 2006 AGM.

Rana Talwar became a non-executive director in March 2000 and currently serves on the personnel, nomination and treasury committees. He is currently chairman of Sabre Capital Worldwide and Centurion Bank and a non-executive director of Schlumberger Limited and Fortis Bank. He served as group chief executive of Standard Chartered plc from 1998 until 2001, and was at Citicorp from 1969 to 1997, where he held a number of senior international management roles.

David Arculus became a non-executive director in February 2006 and currently serves on the audit and nomination committees and as chairman of the personnel committee. He is a non-executive director of Telefonica SA, and was chairman of O2 plc from 2004 until it was acquired by Telefonica in early 2006. His previous roles include chairman of Severn Trent plc, chairman of IPC Group, chief operating officer of United Business Media plc, group managing director of EMAP plc and non-executive director of Barclays Bank plc.

Ken Hydon became a non-executive director in February 2006 and currently serves on the nomination committee and as chairman of the audit committee. He is a non-executive director of Tesco plc and Reckitt Benckiser plc. He was previously finance director of Vodafone Group plc and of subsidiaries of Racal Electronics.

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Compensation of Senior Management

It is the role of the personnel committee to approve the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee, as well as to ensure senior management receives the development they need and that succession plans are being made. The committee also takes note of the remuneration for those executives with base pay over a certain level, representing approximately the top 50 executives of the company.

Remuneration Policy

Pearson seeks to generate a performance culture by operating incentive programmes that support its business goals and reward their achievement. It is the company s policy that total remuneration (base compensation plus short- 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 directly to Pearson s financial performance.

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives. Base salary and other fixed remuneration (such as benefits and pension) reflect competitive market level, role and individual contribution. Annual incentives motivate achievement of annual strategic and operational goals. Long-term incentives focus on long-term earnings and share price growth, improvement in returns and value creation and align with shareholders interests through ownership and retention of shares.

Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual incentive, bonus share matching and long-term incentives.

Our policy is that the remuneration of the executive directors should be competitive with those of directors and executives in similar positions in comparable companies. We use a range of UK and US companies in different sectors including the media sector. Some are of a similar size to Pearson, some smaller, others are larger, but the method which the committee s independent advisers use to make comparisons on remuneration takes this into account. In addition, all have very substantial overseas operations. We also use selected media companies in North America as well as the UK because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

Base Salary

Our policy is to review salaries annually, considering levels of pay and pay increases throughout the company.

Other Emoluments

Other emoluments may include benefits such as company car, healthcare, and, where relevant, amounts paid in respect of housing or other costs.

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 require executives to operate worldwide and recognize that recruitment also operates worldwide.

Annual Bonus

The committee establishes the annual incentive plans for the executive directors and the chief executives of the company s principal operating companies, including performance measures and targets. The committee also establishes the target and maximum levels of individual incentive opportunity based on an assessment by the committee s independent advisers of market practice for comparable companies and jobs. The perform-

ance measures relate to the company s main drivers of business performance at both the corporate and operating company level. With the exception of the CEO, 10% of the total annual incentive opportunity for the executive directors and other members of the Pearson Management Committee is based on performance against personal objectives. For the CEO, all measures are financial.

For 2006, the financial performance measures for Pearson plc are sales, growth in underlying adjusted earnings per share for continuing operations at constant exchange rates, average working capital as a ratio to sales and operating cash flow.

There have been no changes to the executive directors individual incentive opportunities. For the CEO, the target annual incentive opportunity is 100% of base salary and the maximum is 150%. For the other executive directors and other members of the Pearson Management Committee, the target is up to a maximum of 75% of salary and the maximum is twice target.

The committee may award individual discretionary payments or exercise discretion in the payment of bonuses under the plan.

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

Annual incentive payments do not form part of pensionable earnings.

Bonus Share Matching

The company encourages executive directors and other senior executives to acquire and 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. For awards to be made in 2006 and thereafter, if these shares are held and the company s adjusted earnings per share increase in real terms by at least 3% per annum compound, the company will match them on a gross basis of one share for every two held after three years, and another one for two held (i.e. a total of one-for-one) after five years.

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

The Long-Term Incentive Plan

Shareholders at the AGM approved the renewal of the long-term incentive plan first introduced in 2001. The committee has reviewed the operation of this plan in the light of the company s strategic goals and concluded that it is operating satisfactorily and achieving its objectives. We have therefore sought and received approval of its renewal on broadly its original terms.

Executive directors, senior executives and other managers will be eligible to participate in the plan, which can deliver restricted stock and/or stock options. The aim as before 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.

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

It is not the committee s intention to grant stock options in 2006. Should the committee decide to grant them in future, options granted to executive directors would come with a minimum three-year vesting period and would vest on a sliding scale based on stretching performance over the three-year period with no retesting.

The committee s independent advisers calculate the expected value of both restricted stock and stock options 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. Taking into account the independent advisors values and assessments of market practice for comparable companies, the committee establishes guidelines each year for the maximum expected value of individual awards.

In any rolling 10-year period, no more than 10% of Pearson equity will be issued, or available for issue, under all Pearson s share plans, and no more than 5% of Pearson equity will be issued, or available for issue, under executive or

discretionary plans.

Shareholding Policy

As previously noted, in line with the policy of encouraging employee ownership, the company encourages executive directors to build up a substantial shareholding in the company. Given the share retention features of the annual bonus share matching and long-term incentive plans and the volatility of the stock market, we do not think it is necessary to specify a particular relationship of shareholding to salary.

Service Agreements

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

These service agreements provide that the company may terminate these agreements by giving 12 months notice, and they 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 compensation for loss of office and in line with the market. The compensation payable in these circumstances is typically 100% of annual salary, 100% of other benefits, and a proportion of potential bonus.

Peter Jovanovich stood down as a director of the company for health reasons on 31 January 2005, but remained entitled to contractual short- and long-term disability and other benefits. These arrangements are set out in an agreement dated 28 January 2005. Dennis Stevenson retired as chairman and director on 1 October 2005. Glen Moreno was appointed chairman and director on 1 October 2005.

Retirement Benefits

Following are the retirement benefits for each of the executive directors.

Executive directors participate in the approved pension arrangements set up for Pearson employees. Marjorie Scardino, John Makinson, Rona Fairhead and Peter Jovanovich will also receive benefits under unapproved arrangements because of the cap on the amount of benefits that can be provided from the approved arrangements in the US and the UK.

The pension arrangements for all the executive directors include life insurance cover while in employment and entitlement to a pension in the event of ill-health or disability. A pension for their spouse and/or dependants is also available on death.

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

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

In the UK, the approved plan is the Pearson Group Pension Plan and some executive directors participate in the Final Pay section. Normal retirement age is 62 but, subject to company consent, retirement is possible after age 50. The accrued pension is reduced on retirement prior to age 60. Pensions in payment are guaranteed to increase each year at 5% or the increase in the Index of Retail Prices, if lower. Pensions for a member s spouse, dependent children and/or nominated financial dependant are payable in the event of death.

In response to the UK Government s plans for pensions simplification and so-called A-Day effective from April 2006, UK executive directors and other members of the Pearson Group Pension Plan who are, or become, affected by the lifetime allowance will be offered a cash supplement as an alternative to further accrual of pension benefits on a basis that is broadly cost neutral to the company. Further details will be set out in the report on directors remuneration for 2006.

Marjorie Scardino

Marjorie Scardino participates in the Pearson Inc. Pension Plan and the approved 401(k) plan. Additional pension benefits will be provided through an unfunded unapproved defined contribution plan and a

funded defined contribution plan approved by HM Revenue and Customs as a corresponding plan to replace 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 that increases annually by a specified notional interest rate. This plan provides the opportunity to convert a proportion of this notional cash account into a notional share account reflecting the value of a number of Pearson ordinary shares. The number of shares in the notional share account is determined by reference to the market value of Pearson shares at the date of conversion.

David Bell

David Bell is a member of the Pearson Group Pension Plan. He is eligible for a pension of two-thirds of his final base salary at age 62 due to his long service. Early retirement with a reduced pension before that date is possible, subject to company consent.

Rona Fairhead

Rona Fairhead is a member of the Pearson Group Pension Plan. Her pension accrual rate is 1/30th of pensionable salary per annum, restricted to the earnings cap introduced by the Finance Act 1989. The company also contributes to a Funded Unapproved Retirement Benefits Scheme (FURBS) on her behalf. In the event of death before retirement, the proceeds of the FURBS account will be used to provide benefits for her dependants.

Peter Jovanovich

Peter Jovanovich is a member of the Pearson Inc. Pension Plan and the approved 401(k) plan. He also participates in an unfunded, unapproved Supplemental Executive Retirement Plan (SERP) that provides an annual accrual of 2% of final average earnings, less benefits accrued in the Pearson Inc. Pension Plan and US Social Security. He ceased to build up further benefits in the SERP at 31 December 2002. Additional defined contribution benefits are provided through a funded, unapproved 401(k) excess plan and an unfunded, unapproved arrangement. In the event of death while in receipt of disability benefits, the account balances in the defined contribution arrangements will be used to provide benefits for dependants. The SERP arrangement provides a spouse s pension on death while in receipt of disability benefits and the option of a death in retirement pension by reducing the member s pension.

John Makinson

John Makinson is a member of the Pearson Group Pension Plan under which his pensionable salary is restricted to the earnings cap. The company ceased contributions on 31 December 2001 to his FURBS arrangement. During 2002 it set up an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for him. The UURBS tops up the pensions payable from the Pearson Group Pension Plan and the closed FURBS to target a pension of two-thirds of a revalued base salary on retirement at age 62. The revalued base salary is defined as £450,000 effective at 1 June 2002, increased at 1 January each year by reference to the increase in the Index of Retail Prices. In the event of his death a pension from the Pearson Group Pension Plan, the FURBS and the UURBS will be paid to his spouse or nominated financial dependant. Early retirement is possible from age 50, with company consent. The pension is reduced to reflect the shorter service, and before age 60, further reduced for early payment.

Chairman s Remuneration

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

The committee s view is that, taking into account the remuneration of chairmen in comparable positions, the appropriate total pay level is £425,000 per year.

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.

For 2005, the chairman and the executive directors of the board reviewed the level and structure of non-executive directors fees, which had not been changed since January 2000. After reviewing external benchmarks, they agreed an increase in the basic fee to £45,000, an increase in the fee for the audit and personnel committee chairmen to £10,000, the introduction of separate fees of £5,000 for audit and personnel committee membership and of £10,000 for the senior independent director and the replacement of the fee for non-UK based directors with a fee of £2,500 for overseas meetings.

One-third of the basic fee, or the entire fee in the case of Rana Talwar, is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

In the case of Patrick Cescau, his fee was paid over to his employer.

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

Remuneration of Senior Management

Excluding contributions to pension funds and related benefits, senior management remuneration for 2005 was as follows:

	Salaries/Fees	Bonus(1)	Other(2)	Total
	£ 000	**£ 000**	**£ 000**	**£ 000**
Chairman				
Dennis Stevenson (retired 1 October 2005)	281			281
Glen Moreno (appointed 1 October 2005)	106			106
Executive directors				
Marjorie Scardino	710	1,038	62	1,810
David Bell	395	560	17	972
Rona Fairhead	420	608	16	1,044
Peter Jovanovich	41		373	414
John Makinson	475	564	211	1,250
Senior management as a group	**2,428**	**2,770**	**679**	**5,877**

(1) For Marjorie Scardino, David Bell and Rona Fairhead, annual incentives were based on the financial performance of Pearson plc. In the case of John Makinson, 70% of his annual incentive was based on the performance of Penguin Group and 20% on the financial performance of Pearson plc. In the case of David Bell, Rona Fairhead and John Makinson, 10% of their annual incentives was based on performance against personal objectives.

For Pearson plc, the performance measures were earnings per share growth, operating cash flow, sales and average working capital as a ratio to sales. Actual underlying growth in adjusted earnings per share at constant exchange rates consistent with the reported adjusted earnings per share (pre-intangibles) of 34.1p, operating cash flow of £570m and average working capital as a ratio to sales were each better than the level of performance required for maximum payout. Actual sales at £4,096m were above target but below maximum.

For Penguin Group, the performance measures were operating profit, operating cash flow and average working capital as a ratio to sales. For operating cash flow and working capital as a ratio to sales actual performance was better than that required for maximum payout and for operating profit was above target but below maximum.

(2) Other emoluments include company car and healthcare benefits. In the case of Marjorie Scardino, these include £39,245 in respect of housing costs and a cash US payroll supplement of £8,372. 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 £186,279 in cash for 2005. Marjorie Scardino, Rona Fairhead, David Bell and John Makinson have the

use of a chauffeur. In accordance with the agreement dated 28 January 2005 referred to on page 26 of this report, Peter Jovanovich received short-and long-term disability payments in cash for the period 1 February 2005 to 31 December 2005.

Share Options of Senior Management

This table sets forth for each director the number of share options held as of December 31, 2005 as well as the exercise price, rounded to the nearest whole penny/cent, and the range of expiration dates of these options.

Director	Number of Options	(1)	Exercise Price	Earliest Exercise Date	Expiry Date
Dennis Stevenson	3,556	b	494.8p	01/08/11	01/02/12
Total	**3,556**				
Marjorie Scardino	176,556	a*	973.3p	14/09/01	14/09/08
	5,660	a*	1090.0p	14/09/01	14/09/08
	2,224	b	424.8p	01/08/06	01/02/07
	37,583	c*	1372.4p	08/06/02	08/06/09
	37,583	c*	1647.5p	08/06/02	08/06/09
	37,583	c	1921.6p	08/06/02	08/06/09
	36,983	c	3224.3p	03/05/03	03/05/10
	41,550	d*	1421.0p	09/05/02	09/05/11
	41,550	d*	1421.0p	09/05/03	09/05/11
	41,550	d*	1421.0p	09/05/04	09/05/11
	41,550	d*	1421.0p	09/05/05	09/05/11
Total	**500,372**				
David Bell	20,496	a*	973.3p	14/09/01	14/09/08
	272	b	696.0p	01/08/05	01/02/06
	444	b	424.8p	01/08/06	01/02/07
	1,142	b	494.8p	01/08/07	01/02/08
	373	b	507.6p	01/08/08	01/02/09
	18,705	c*	1372.4p	08/06/02	08/06/09
	18,705	c*	1647.5p	08/06/02	08/06/09
	18,705	c	1921.6p	08/06/02	08/06/09
	18,686	c	3224.3p	03/05/03	03/05/10
	16,350	d*	1421.0p	09/05/02	09/05/11
	16,350	d*	1421.0p	09/05/03	09/05/11
	16,350	d*	1421.0p	09/05/04	09/05/11
	16,350	d*	1421.0p	09/05/05	09/05/11
Total	**162,928**				
Rona Fairhead	1,904	b	494.8p	01/08/07	01/02/08
	20,000	d*	822.0p	01/11/02	01/11/11
	20,000	d*	822.0p	01/11/03	01/11/11
	20,000	d*	822.0p	01/11/04	01/11/11
Total	**61,904**				

Director	Number of Options	(1)	Exercise Price	Earliest Exercise Date	Expiry Date
Peter Jovanovich	8,250	a*	757.5p	12/09/00	12/09/07
	102,520	a*	676.4p	12/09/00	12/09/07
	32,406	c*	1372.4p	08/06/02	08/06/09
	32,406	c*	1647.5p	08/06/02	08/06/09
	32,406	c	1921.6p	08/06/02	08/06/09
	33,528	c	3224.3p	03/05/03	03/05/10
	31,170	d*	$ 21.00	09/05/02	09/05/11
	31,170	d*	$ 21.00	09/05/03	09/05/11
	31,170	d*	$ 21.00	09/05/04	09/05/11
	31,170	d*	$ 21.00	09/05/05	09/05/11
	20,000	d*	$ 11.97	01/11/02	01/11/11
	20,000	d*	$ 11.97	01/11/03	01/11/11
	20,000	d*	$ 11.97	01/11/04	01/11/11
Total	**426,196**				
John Makinson	36,736	a*	584.0p	08/08/99	08/08/06
	73,920	a*	676.4p	12/09/00	12/09/07
	30,576	a*	973.3p	14/09/01	14/09/08
	4,178	b	424.8p	01/08/10	01/02/11
	21,477	c*	1372.4p	08/06/02	08/06/09
	21,477	c*	1647.5p	08/06/02	08/06/09
	21,477	c	1921.6p	08/06/02	08/06/09
	21,356	c	3224.3p	03/05/03	03/05/10
	19,785	d*	1421.0p	09/05/02	09/05/11
	19,785	d*	1421.0p	09/05/03	09/05/11
	19,785	d*	1421.0p	09/05/04	09/05/11
	19,785	d*	1421.0p	09/05/05	09/05/11
Total	**310,337**				

(1) 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

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.

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.

c Premium priced

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. 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.

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 May 9, 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 November 1, 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.

(2) In addition to the above listed options both Marjorie Scardino and Peter Jovanovich participate in the Pearson US Employee Stock Purchase Plan saving the maximum amount of US$12,000 per annum.

Share Ownership of Senior Management

The table below sets forth the number of ordinary shares and restricted shares held by each of our directors as at March 31, 2006. Additional information with respect to share options held by, and bonus awards for, these persons is set out above in Remuneration of Senior Management and Share Options for Senior Management . The total number of ordinary shares held by senior management as of March 31, 2006 was 626,152 representing less than 1% of the issued share capital on March 31, 2006.

As at March 31, 2006	Ordinary Shares(1)	Restricted Shares(2)
Glen Moreno	100,000	
Marjorie Scardino	184,889	1,336,015
David Bell	103,158	587,829
Terry Burns	5,717	
Patrick Cescau		
Rona Fairhead	43,209	637,936
Susan Fuhrman	2,681	
John Makinson	149,466	642,756
Reuben Mark	16,908	
Vernon Sankey	5,563	
Rana Talwar	14,561	

(1) Amounts include shares acquired by individuals under the annual bonus share matching plan and amounts purchased in the market by individuals.

(2) Restricted shares comprise awards made under the reward, annual bonus share matching and long-term incentive plans. The number of shares shown represents the maximum number of shares which may vest, subject to the performance conditions being fulfilled.

Employee Share Ownership Plans

Worldwide Save for Shares & US Employee Share Purchase Plans

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

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

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

Board Practices

Our board currently comprises the chairman, who is a part-time non-executive, four executive directors and six non-executive directors. Our articles of association provide that at every annual general meeting, one-third of the board of directors, or the number nearest to one-third, shall retire from office. The directors to

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

Details of our approach to corporate governance and an account of how we comply with NYSE requirements can be found on our website (www.pearson.com/investor/ corpgov.htm).

The board of directors has established the following committees, all of which have written terms of reference setting out their authority and duties:

Audit Committee

This committee provides the board with a vehicle to appraise our financial management and reporting and to assess the integrity of our accounting procedures and financial controls. Until April 21, 2006, Vernon Sankey chaired this committee and Terry Burns, Patrick Cescau and Reuben Mark were members. Vernon Sankey was also the designated audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission. Vernon Sankey and Reuben Mark retired from the committee on April 21, 2006 and Terry Burns stepped down from the committee on April 27, 2006. Ken Hydon, David Arculus and Susan Fuhrman have now joined the committee, with Ken Hydon as both the chairman and designated audit committee financial expert. Our internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee. The committee reports to the full board of directors.

Personnel Committee

This committee meets regularly to decide the remuneration and benefits of the executive directors and the chief executives of our three operating divisions. The committee also recommends the chairman s remuneration to the board of directors for its decision and reviews management development and succession plans. Until April 21, 2006, Reuben Mark chaired this committee and Terry Burns and Rana Talwar were members. Reuben Mark retired from the committee on April 21, 2006. David Arculus has now joined the committee as chairman. All the three members are non-executive directors.

Nomination Committee

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

Treasury Committee

This committee sets the policies for our treasury department and reviews its procedures on a regular basis. Dennis Stevenson was chairman of the committee until his retirement on October 1, 2005 and Rona Fairhead, Vernon Sankey and Rana Talwar were members. Vernon Sankey retired from the committee on April 21, 2006. The constitution of the committee will be reviewed later in the year.

Employees

The average numbers of persons employed by us during each of the three fiscal years ended 2005 were as follows:

32,203 in fiscal 2005

33,086 in fiscal 2004, and

30,584 in fiscal 2003.

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

The table set forth below shows for 2005, 2004 and 2003 the average number of persons employed in each of our operating divisions.

Average number employed	2005	2004	2003
School	10,133	10,403	9,348
Higher Education	4,196	4,087	3,912
Professional	8,342	7,491	6,434
Penguin	4,051	4,085	4,318
FT Publishing	1,952	1,989	2,283
IDC	1,956	1,826	1,628
Other	1,573	1,365	928
Continuing operations	**32,203**	**31,246**	**28,851**
Discontinued operations		1,840	1,733
Total	**32,203**	**33,086**	**30,584**

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

To our knowledge, as of February 26, 2006, the only beneficial owners of 3% or more of our issued and outstanding ordinary share capital were Franklin Resources Inc. which owned 104,485,808 ordinary shares representing 13.0% of our outstanding ordinary shares and The Capital Group Companies Inc. which owned 55,653,209 ordinary shares representing 6.9% of our outstanding ordinary shares. On February 26, 2006, record holders with registered addresses in the United States held 34,992,603 ADRs, which represented 4.4% of our outstanding ordinary shares. Because some of these ADRs are held by nominees, these numbers may not accurately represent the number of beneficial owners in the United States.

Loans and equity advanced to joint ventures and associates during the year and as at December 31, 2005 are shown in note 13 in Item 17. Financial Statements. Amounts due from joint ventures and associates are set out in note 17 and dividends receivable from joint ventures and associates are set out in note 13 in Item 17. Financial Statements . There were no other related party transactions in 2005.

ITEM 8. ***FINANCIAL INFORMATION***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-80 hereof.

Other than those events described in note 33 in Item 17. Financial Statements of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to our financial condition or results of operations since December 31, 2005. Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements of the educational book business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December.

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

Legal Proceedings

We and our subsidiaries are defendants in a number of legal proceedings including, from time to time, government and arbitration proceedings, which are incidental to our and their operations. We do not expect that the outcome of pending proceedings, either individually or in the aggregate, will have a significant effect on our financial position or profitability nor have any such proceedings had any such effect in the recent past. To our knowledge, there are no material proceedings in which any member of senior management or any of our affiliates is a party adverse to us or any of our subsidiaries or in respect of which any of those persons has a material interest adverse to us or any of our

subsidiaries.

ITEM 9. ***THE OFFER AND LISTING***

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

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

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

on an annual basis for our five most recent fiscal years,

on a quarterly basis for our most recent quarter and two most recent fiscal years, and

on a monthly basis for the six most recent months.

Reference Period	Ordinary Shares High	Ordinary Shares Low	Average Daily Trading Volume
	(In pence)		(Ordinary shares)
Five Most Recent Fiscal Years			
2005	695	608	5,296,700
2004	682	579	6,219,200
2003	680	430	6,631,800
2002	922	505	6,164,500
2001	1,726	645	5,245,000
Most Recent Quarter and Two Most Recent Fiscal Years			
2006 First quarter	811	671	6,395,400
2005 Fourth quarter	692	616	4,947,900
Third quarter	695	652	4,860,700
Second quarter	668	628	5,823,300
First quarter	662	608	5,626,100
2004 Fourth quarter	640	590	5,020,800
Third quarter	657	579	5,864,300
Second quarter	682	623	6,993,900
First quarter	657	584	7,039,600
Most Recent Six Months			
April 2006	798	756	7,614,100
March 2006	811	720	7,055,300
February 2006	737	706	4,336,400
January 2006	734	671	7,577,400
December 2005	692	674	3,912,900
November 2005	673	636	6,524,000

ITEM 10. *ADDITIONAL INFORMATION*

Memorandum and Articles of Association

We summarize below the material provisions of our memorandum and articles of association, as amended, which have been filed as an exhibit to our annual report on Form 20-F for the year ended December 31, 2003. The summary below is qualified entirely by reference to the Memorandum and Articles of Association. We have multiple business objectives and purposes and are authorized to do such things as the board may consider to further our interests or

incidental or conducive to the attainment of our objectives and purposes.

Directors Powers

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

Interested Directors

A director shall not be disqualified from contracting with us by virtue of his or her office or from having any other interest, whether direct or indirect, in any contract or arrangement entered into by or on behalf of us. An interested director must declare the nature of his or her interest in any contract or arrangement entered into by or on behalf of us in accordance with the Companies Act 1985. Provided that the director has declared

his interest and acted in accordance with law, no such contract or arrangement shall be avoided and no director so contracting or being interested shall be liable to account to us for any profit realized by him from the contract or arrangement by reason of the director holding his office or the fiduciary relationship thereby established. A director may not vote on any contract or arrangement or any other proposal in which he or she has, together with any interest of any person connected with him or her, an interest which is, to his or her knowledge, a material interest, otherwise than by virtue of his or her interests in shares, debentures or other securities of or otherwise in or through us. If a question arises as to the materiality of a director s interest or his or her entitlement to vote and the director does not voluntarily agree to abstain from voting, that question will be referred to the chairman of the board or, if the chairman also is interested, to a person appointed by the other directors who is not interested. The ruling of the chairman or that other person, as the case may be, will be final and conclusive. A director will not be counted in the quorum at a meeting in relation to any resolution on which he or she is prohibited from voting.

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

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

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

- any proposal relating to us or any of our subsidiaries where we are offering securities in which a director is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which a director is to participate;

- any proposal relating to an arrangement for the benefit of our employees or any of our subsidiaries that does not award him or her any privilege or benefit not generally awarded to the employees to whom such arrangement relates; and

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

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

Borrowing Powers

The board of directors may exercise all powers to borrow money and to mortgage or charge our undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as collateral security for any of our or any third party s debts, liabilities or obligations. The board of directors must restrict the borrowings in order to secure that the aggregate amount of undischarged monies borrowed by us (and any of our subsidiaries), but excluding any intra-group debts, shall not at any time exceed a sum equal to twice the aggregate of the adjusted capital and reserves, unless the shareholders in general meeting sanction an excession of this limitation.

Other Provisions Relating to Directors

Under the articles of association, directors are paid out of our funds for their services as we may from time to time determine by ordinary resolution and, in the case of non-executive directors, up to an aggregate of £500,000 or such other amounts as resolved by the shareholders at a general meeting. Directors currently are not required to be qualified by owning our shares. While the Companies Act 1985 states that no director may be appointed after he reaches the age of 70, our articles of association provide for the reappointment, after retirement, of directors attaining the age of 70.

This is permissible under the Companies Act 1985.

Annual General Meetings and Extraordinary General Meetings

Shareholders meetings may be either annual general meetings or extraordinary general meetings. However, the following matters are ordinarily transacted at an annual general meeting:

- sanctioning or declaring dividends;
- consideration of the accounts and balance sheet;
- ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;
- as holders of ordinary shares vote for the election of one-third of the members of the board of directors at every annual general meeting, the appointment or election of directors in the place of those retiring by rotation or otherwise;
- appointment or reappointment of, and determination of the remuneration of, the auditors; and
- the renewal, limitation, extension, variation or grant of any authority of or to the board, pursuant to the Companies Act 1985, to allot securities.

Business transacted at an extraordinary general meeting may also be transacted at an annual general meeting.

We hold a general meeting as our annual general meeting within fifteen months after the date of the preceding annual general meeting, at a place and time determined by the board. The board may call an extraordinary general meeting at any time and for any reason. The board must convene an extraordinary general meeting if requested to do so by shareholders holding not less than one-tenth of our issued share capital.

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

Ordinary Shares

Certificates representing ordinary shares are issued in registered form and, subject to the terms of issue of those shares, are issued following allotment or receipt of the form of transfer bearing the appropriate stamp duty by our registrar, Lloyds Bank Registrars, the Causeway, Worthing, West Sussex BN99 6DA, United Kingdom, telephone number +44-1903-502-541.

Share Capital

Any share may be issued with such preferred, deferred or other special rights or other restrictions as we may determine by way of a shareholders vote in general meeting. Subject to the Companies Act 1985, any shares may be issued on terms that they are, or at our or the shareholders option are, liable to be redeemed on such terms and in such manner as we, before the issue of the shares, may by special resolution of the shareholders, determine.

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

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

unpaid upon any shares held by him.

Changes in Capital

We may from time to time, by ordinary resolution:

- consolidate and divide our share capital into shares of a larger amount than its existing shares; or
- sub-divide all of or any of our existing shares into shares of smaller amounts than is fixed by the Memorandum of Association, subject to the Companies Act 1985; or
- cancel any shares which, at the date of passing of the resolution, have not been taken, or agreed to be taken, by any person and diminish the amount of our share capital by the amount of the shares so cancelled.

We may, from time to time, by ordinary resolution increase our share capital and, by special resolution, decrease our share capital, capital redemption reserve fund and any share premium account in any way.

Voting Rights

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

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

Dividends

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

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

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

Liquidation Rights

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

Other Provisions of the Articles of Association

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

In the event that a shareholder or other person appearing to the board of directors to be interested in ordinary shares fails to comply with a notice requiring him or her to provide information with respect to their interest in voting shares pursuant to section 212 of the Companies Act 1985, we may serve that shareholder with a notice of default. After service of a default notice, that shareholder shall not be entitled to attend or vote

at any general meeting or at a separate meeting of holders of a class of shares or on a poll until he or she has complied in full with our information request.

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

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

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

No provision of our articles of association expressly governs the ordinary share ownership threshold above which shareholder ownership must be disclosed. Under the Companies Act 1985, any person who acquires, either alone or, in specified circumstances, with others:

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

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

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

Limitations Affecting Holders of Ordinary Shares or ADSs

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

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

Material Contracts

The following summaries are not intended to be complete and reference is made to the contracts themselves, which are included, or incorporated by reference, as exhibits to this annual report. We have entered into the following contracts outside the ordinary course of business during the two year period immediately preceding the date of this annual report:

Issuance of $350,000,000 4.70% Guaranteed Senior Notes due 2009 and $400,000,000 5.70% Guaranteed Senior Notes due 2014

Our wholly-owned subsidiary, Pearson Dollar Finance plc, issued $350 million principal amount of 4.70% senior notes due 2009 and $400 million principal amount of 5.70% senior notes due 2014, in each case fully and unconditionally guaranteed by Pearson plc, under an indenture dated May 25, 2004 between Pearson Dollar Finance plc, Pearson plc and The Bank of New York, as trustee. The first semi-annual interest payment was made on December 1, 2004. Pearson Dollar Finance may redeem the notes at any time, in whole or in part, at its option.

The indenture describes the circumstances that would be considered events of default. If an event of default occurs, other than an insolvency or bankruptcy of Pearson Dollar Finance plc, Pearson plc or a principal subsidiary of Pearson plc (as defined in the indenture), the holders of at least 25% of the principal amount of the then outstanding notes may declare the notes, along with accrued but unpaid interest and other amounts described in the indenture, as immediately due and payable. In the event of an insolvency or bankruptcy of Pearson Dollar Finance plc, Pearson plc or a principal subsidiary of Pearson plc (as defined in the indenture), the principal of all outstanding notes shall become due and payable immediately.

The indenture limits our ability to create liens to secure certain types of debt intended to be listed or traded on an exchange.

Issuance of $300,000,000 4.625% Senior Notes due 2018

We issued $300 million principal amount of 4.625% senior notes due 2018 under an indenture dated June 23, 2003 between us and The Bank of New York, as trustee. The first semi-annual interest payment was made on December 15, 2003. We may redeem the notes at any time, in whole or in part, at our option.

The indenture describes the circumstances that would be considered events of default. If an event of default occurs, other than the insolvency or bankruptcy of us or a principal subsidiary (as defined in the indenture), the holders of at least 25% of the principal amount of the then outstanding notes may declare the notes, along with accrued, but unpaid, interest and other amounts described in the indenture, as immediately due and payable.

The indenture limits our ability to create liens to secure certain types of debt intended to be listed or traded on an exchange.

Executive Employment Contracts

We have entered into agreements with each of our executive directors pursuant to which such executive director is employed by us. These agreements describe the duties of such executive director and the compensation to be paid by us. See Item 6. Directors, Senior Management & Employees Compensation of Senior Management . Each agreement may be terminated by us on 12 months notice or by the executive director on six months notice. In the event we terminate any executive director without giving the full 12 months advance notice, the executive director is entitled to receive liquidated damages equal to 12 months base salary and benefits together with a proportion of potential bonus.

Agreement with Peter Jovanovich

On January 28, 2005, we entered into a letter agreement with Peter Jovanovich with respect to his employment with Pearson Education and its affiliates. Due to poor health, Mr. Jovanovich terminated his employment with us. The letter agreement sets forth the terms of his disability leave and confirms his existing disability benefits, including benefits under our short term disability plan, long-term disability plan, and supplemental long-term disability plan. Under the terms of the agreement, Mr. Jovanovich will receive standard benefits (except awards under Pearson plc stock plans), and thereafter, will receive coverage under our medical, dental and vision plans and our life insurance plan, plus a payment for unused vacation days. We have agreed to continue to credit Mr. Jovanovich s individual defined contribution arrangement. We also agreed to pay him his 2004 annual bonus. The value of Mr. Jovanovich s disability package, and his total remuneration for our 2004 financial year, is included in Item 6. Directors and Senior Management .

Exchange Controls

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

Tax Considerations

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

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

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

- dealers or traders in securities or currencies,
- financial institutions or other US holders that treat income in respect of the ordinary shares or ADSs as financial services income,

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

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

The discussion below is based upon current UK law and the provisions of the US Internal Revenue Code of 1986, or the Code, and regulations, rulings and judicial decisions as of the date of this Annual Report; any such authority may be repealed, revoked or modified, perhaps with retroactive effect, so as to result in tax consequences different from those discussed below. This discussion is also based on the Income Tax Treaty between the United Kingdom and the United States, which came into force in March 2003 (the Income Tax Treaty). The discussions below regarding US residents are based on the articles of the New Income Tax Treaty.

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

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

UK Income Taxation of Distributions

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

US Income Taxation of Distributions

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

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

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

from the distribution are translated into US dollars at the average rate for the taxable year.

A distribution by the Company to noncorporate shareholders before 2009 will be taxed as net capital gain at a maximum rate of 15%, provided certain holding periods are met, to the extent such distribution is treated as a dividend under U.S. federal income tax principles.

UK Income Taxation of Capital Gains

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

US Income Taxation of Capital Gains

Upon a sale or exchange of ordinary shares or ADSs to a person other than Pearson, a US holder will recognize gain or loss in an amount equal to the difference between the amount realized on the sale or exchange and the US holder s adjusted tax basis in the ordinary shares or ADSs. Any gain or loss recognized will be capital gain or loss and will be long-term capital gain or loss if the US holder has held the ordinary shares or ADSs for more than one year. Long-term capital gain of a noncorporate US holder is generally taxed at a maximum rate of 15%. This long-term capital gain rate is scheduled to expire in 2009.

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

Estate and Gift Tax

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

Stamp Duty

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

A transfer for value of the underlying ordinary shares will generally be subject to either stamp duty or SDRT, normally at the rate of 0.5% of the amount or value of the consideration. A transfer of ordinary shares from a nominee to its beneficial owner, including the transfer of underlying ordinary shares from the Depositary to an ADS holder, under which no beneficial interest passes is subject to stamp duty at the fixed rate of £5.00 per instrument of transfer.

Close Company Status

We believe that the close company provisions of the UK Income and Corporation Taxes Act 1988 do not apply to us.

Documents on Display

Copies of our Memorandum and Articles of Association, the material contracts described above and filed as exhibits to this Annual Report and certain other documents referred to in this Annual Report are available for inspection at our registered office at 80 Strand, London WC2R 0RL (c/o the Company Secretary), or, in

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the United States, at the registered office of Pearson Inc. at 1330 Avenue of the Americas, 7th Floor, New York, New York, during usual business hours upon reasonable prior request.

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

Introduction

Our principal market risks are changes in interest rates and currency exchange rates. Following evaluation of these positions, we selectively enter into derivative financial instruments to manage our risk exposure. For this purpose, we primarily use interest rate swaps, interest rate caps and collars, forward rate agreements, currency swaps and forward foreign exchange contracts. Managing market risks is the responsibility of the Chief Financial Officer, who acts pursuant to policies approved by a Treasury Committee of our board of directors. This receives regular reports on our treasury activities, which outside advisers also review periodically.

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

We have formulated our policies for hedging exposures to interest rate and foreign exchange risk, and have used derivatives to ensure compliance with these policies. Although the majority of our derivative contracts were transacted without regard to existing US GAAP requirements on hedge accounting, during 2005 and 2004 (but not 2003) we qualified for hedge accounting under US GAAP on a limited number of our key derivative contracts.

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

Adoption of International Financial Reporting Standards

From 1 January 2005 the Group adopted IAS 39 Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Disclosure and Presentation . The market values of the Group s derivatives were recognized in the balance sheet at the date of adoption. Subsequent changes in their market value will change the carrying values on the balance sheet and create movements in the finance cost section of the income statement, unless they have been designated (and passed the prescribed tests) for hedge accounting treatment. In addition, IAS 39 requires to value the Group s derivatives at 1 January 2005 as if the standard had been in place at the start date of each individual contract. This has given rise to transition adjustments, which in some cases are being amortised over the remaining life of the relevant transaction. Also, where the Group qualifies for hedge accounting on a derivative, the carrying value of the relevant bond is adjusted to reflect this (in addition to the requirement under IFRS that accrued interest should be included in the carrying value of the bond or derivative).

As the Group elected to adopt IAS 39 from 1 January 2005 as permitted by the transitional provisions in IFRS 1, the effects described above are not reflected in the 2004 and 2003 comparatives. A detailed description on the effects of the adoption of IAS 39 is included in note 1 and note 34 in Item 17. Financial Statements .

Interest Rates

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

The Group s objectives are applied to core net debt, which is year-end borrowings net of year-end cash and liquid funds. Since September 2005 the objective has been to maintain a proportion of forecast core net debt in fixed or capped form for the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% each year. Within this target range the proportion that is hedged is triggered by a formula based on historical interest rate frequencies. Previously the minimum was 40%.

The principal method to hedge interest rate risk is to enter into an agreement to pay a fixed-rate and receive a variable rate, known as a swap. Under interest rate swaps, the Group agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and variable-rate amounts calculated by reference to an agreed notional principal amount. The majority of these contracts are US dollar denominated,

and some of them have deferred start dates, in order to maintain the desired risk profile as other contracts mature. The variable rates received are normally based on three-month and six-month LIBOR, and the dates on which these rates are set do not necessarily exactly match those of the hedged borrowings. Management believes that our portfolio of these types of swaps is an efficient hedge of our portfolio of variable rate borrowings.

In addition, from time to time the Group issues bonds or other capital market instruments to refinance existing debt. To avoid the rate on a single transaction unduly influencing our overall net interest expense, it is practice to enter into a related derivative contract effectively converting the interest rate profile of the bond transaction to that of the debt which it is refinancing. Most often this is a variable interest rate denominated in US dollars. In several cases, the bond issue was denominated in a different currency than the debt being refinanced and the Group has entered into a related interest rate and currency swap in order to maintain an unchanged borrowing risk profile.

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

Currency Exchange Rates

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

The Group s policy is to align approximately the currency composition of its core net borrowings with its forecast operating profit. This policy aims to dampen the impact of changes in foreign exchange rates on consolidated interest cover and earnings. In September 2005 this policy was modified to apply only to currencies that accounted for more than 15% of group operating profit, which is currently only the US dollar. Previously, the policy applied specifically to US dollars, Euro and Sterling. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. In addition, the Group currently expects to hold its legacy borrowings in Euros and Sterling to their maturity dates: the Group s policy does not require existing currency debt to be terminated to match declines in that currency s share of group operating profit. At December 31, 2005 the Group s net borrowings/ (cash) in the three currencies above (taking into account currency rate swaps) were: US dollar £1114 million, euro £78 million and sterling £(93) million

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

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

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

Forward Foreign Exchange Contracts

The Group uses forward foreign exchange contracts where a specific major project or forecasted cash flow, including acquisitions and disposals, arises from a business decision that has used a specific foreign

exchange rate. The Group s policy is to effect transactional conversions between currencies, for example to collect receivables or settle payables, at the relevant spot exchange rate.

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

Although the Group prepares its consolidated financial statements in Sterling, significant sums have been invested in overseas assets, particularly in the United States. Therefore, fluctuations in currency exchange rates, particularly between the US dollar and Sterling, and also between the Euro and Sterling, are likely to affect shareholders funds and other accounting values.

Derivatives

Under both IFRS and US GAAP, the Group is required to record all derivative instruments on the balance sheet at fair value. Derivatives not classified as hedges are adjusted to fair value through earnings. Changes in fair value of the derivatives that the Group has designated and that qualify as effective hedges are recorded in either other comprehensive income or earnings. Any ineffective portion of derivatives that are classified as hedges is immediately recognized in earnings.

Using the transitional exceptions of IAS 39, derivatives were accounted for in accordance with UK GAAP for the years ended December 31, 2003 and 2004. Under UK GAAP, there are no specific criteria, which must be fulfilled in order to record derivative contracts such as interest rate swaps, currency swaps and forward currency contracts as a hedging instrument. Accordingly, based upon our intention and stated policy with respect to entering into derivative transactions, they have been recorded as hedging instruments for UK GAAP. This means that unrealized gains and losses on these instruments are typically deferred and recognized when realized. From January 1, 2005, the Group has adopted IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Disclosure and Presentation* , which resulted in a transitional adjustment in reserves of £12 million.

Under US GAAP, in 2003 our derivative contracts did not meet the prescribed criteria for hedge accounting, and have been recorded at market value at each period end, with changes in their fair value being recorded in the profit and loss account. In 2005 and 2004 the Group met the prescribed designation requirements and hedge effectiveness tests under US GAAP for certain of its derivative contracts. As a result, the movements in the fair value of the effective portion of fair value hedges and net investment hedges have been offset in earnings and other comprehensive income respectively by the corresponding movement in the fair value of the underlying bond or asset.

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

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

Not applicable.

PART II

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

None.

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

Not applicable.

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

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2005 was carried out by us under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation the Chief Executive Officer and Chief Financial Officer concluded that Pearson s disclosure controls and procedures have been designed to provide, and are effective in providing, reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and

Exchange Commission s rules and forms. A controls system, no matter how well designed and operated cannot provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. During the period covered by this Annual Report on Form 20-F, Pearson has made no changes to its internal control over financial reporting that have materially affected or are reasonably likely to materially affect Pearson s internal control over financial reporting.

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

The members of the Board of Directors of Pearson plc have determined that Vernon Sankey was an audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission for the period until April 21, 2006. The members of the Board of Directors of Pearson plc have determined that Ken Hydon is an audit committee financial expert, for subsequent periods.

ITEM 16B. ***CODE OF ETHICS***

Pearson has adopted a code of ethics (the Pearson code of business conduct) which applies to all employees including the Chief Executive Officer and Chief Financial Officer and other senior financial management. This code of ethics is available on our website (www.pearson.com/investor/ corpgov.htm). The information on our website is not incorporated by reference into this report.

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

In 2003, the audit committee adopted a revised policy for external auditor services. The policy requires all audit engagements undertaken by our external auditors, PricewaterhouseCoopers LLP, to be approved by the audit committee. The policy permits the auditors to be engaged for other services provided the engagement is specifically approved in advance by the committee or alternatively meets the detailed criteria of specific pre-approved services and is notified to the committee.

The Group Chief Financial Officer or Deputy Chief Financial Officer can procure pre-approved services, as defined in the audit committee s policy for auditor services, of up to an amount of £100,000 per engagement, subject to a cumulative limit of £500,000 per year. The limit of £100,000 will be subject to annual review by the audit committee. Where pre-approval has not been granted for a service or where the amount is above these limits, specific case by case approval must be obtained from the audit committee prior to the engagement of our auditor.

Auditors Remuneration	**2005**	**2004**	**2003**
	£m	**£m**	**£m**
Statutory audit	4	3	3
Audit-related regulatory reporting services	1	1	
Non-audit services	2	2	2
Non-audit services are analysed as follows:			
Tax compliance services	1	1	1
Tax advisory services		1	1
Other non-audit services	1		

Note Included in statutory audit fees are amounts relating to the parent company of £30,000 (2004: £20,000; 2003: £20,000). Audit-related regulatory reporting fees are £225,000 (2004: £225,000; 2003: £200,000). Non-audit fees in the UK in 2005 are £1,000,000 (2004: £1,000,000; 2003: £341,000) and are in respect of tax advisory and tax compliance services and other advisory services. The remainder of the non-audit fees relate to overseas subsidiaries.

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

Not applicable.

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

Period	Total number of shares purchased	Average price paid per share	Total number of units purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
September 1, 2005 - September 30, 2005	625,000	£6.63	N/A	N/A

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

PART III

ITEM 17. ***FINANCIAL STATEMENTS***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-79 hereof.

ITEM 18. ***FINANCIAL STATEMENTS***

We have elected to respond to Item 17.

ITEM 19. ***EXHIBITS***

1.1 Memorandum and Articles of Association of Pearson plc.
2.1 Indenture dated June 23, 2003 between Pearson plc and The Bank of New York, as trustee.
2.2 Indenture dated May 25, 2004 among Pearson Dollar Finance plc, as Issuer, Pearson plc, Guarantor, and the Bank of New York, as Trustee, Paying Agent and Calculation Agent.#
4.1 Letter Agreement dated January 28, 2005 between Pearson plc and Peter Jovanovich.#
4.2 Irrevocable undertakings in respect of an offer by Retos Cartera, for the shares of Recoletos Grupo de Communicación, dated December 14, 2004 between Pearson plc and Retos Cartera.#
8.1 List of Significant Subsidiaries.
12.1 Certification of Chief Executive Officer.
12.2 Certification of Chief Financial Officer.
13.1 Certification of Chief Executive Officer.
13.2 Certification of Chief Financial Officer.
15 Consent of PricewaterhouseCoopers LLP.

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

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Pearson plc:

In our opinion, the accompanying consolidated balance sheets and the related consolidated income statements, consolidated statements of recognised income and expense, and consolidated cash flow statements present fairly, in all material respects, the financial position of Pearson plc and its subsidiaries at 31 December 2005, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended 31 December 2005, in conformity with EU-adopted International Financial Reporting Standards. These financial statements are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the Company adopted International Accounting Standards (IAS) 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement in accordance with International Financial Reporting Standards as adopted by the European Union. The change has been accounted for prospectively from 1 January 2005.

EU-adopted International Financial Reporting Standards vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 35 to the consolidated financial statements.

PricewaterhouseCoopers LLP
London, England
May 5, 2006

CONSOLIDATED INCOME STATEMENT
YEAR ENDED 31 DECEMBER 2005
(All figures in £ millions)

	Notes	2005	2004	2003
Continuing operations				
Sales	2	**4,096**	3,696	3,850
Cost of goods sold		**(2,022)**	(1,789)	(1,846)
Gross profit		**2,074**	1,907	2,004
Operating expenses	5	**(1,592)**	(1,520)	(1,594)
Other net gains and losses	4	**40**	9	(6)
Share of results of joint ventures and associates		**14**	8	2
Operating profit	2	**536**	404	406
Finance costs	7	**(132)**	(96)	(100)
Finance income	7	**62**	17	7
Profit before tax		**466**	325	313
Income tax	8	**(124)**	(63)	(61)
Profit for the year from continuing operations		**342**	262	252
Profit for the year from discontinued operations	3	**302**	22	23
Profit for the year		**644**	284	275
Attributable to:				
Equity holders of the Company		**624**	262	252
Minority interest		**20**	22	23
Earnings per share for profit from continuing and discontinued operations attributable to the equity holders of the Company during the year (expressed in pence per share)				
basic	9	**78.2p**	32.9p	31.7p
diluted	9	**78.1p**	32.9p	31.7p
Earnings per share for profit from continuing operations attributable to the equity holders of the Company during the year (expressed in pence per share)				
basic	9	**40.4p**	30.8p	29.4p
diluted	9	**40.3p**	30.8p	29.4p

CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE
YEAR ENDED 3 DECEMBER 2005
(All figures in £ millions)

	Notes	2005	2004	2003
Net exchange differences on translation of foreign operations	26	**327**	(203)	(288)
Actuarial gains/(losses)on defined benefit pension and post-retirement medical schemes	24	**26**	(61)	(28)
Taxation on items taken directly to equity	8	**12**	9	
Net income/(expense) recognised directly in equity		**365**	(255)	(316)
Profit for the year		**644**	284	275
Total recognised income and expense for the year		**1,009**	29	(41)
Attributable to:				
Equity holders of the Company		**989**	7	(64)
Minority interest		**20**	22	23
Effect of transition adjustment on adoption of IAS 39				
Attributable to:				
Equity holders of the Company	34	**(12)**		

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CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2005
(All figures in £ millions)

	Notes	2005	2004	2003
Assets				
Non-current assets				
Property, plant and equipment	11	**384**	355	402
Intangible assets	12	**3,854**	3,278	3,550
Investments in joint ventures and associates	13	**36**	47	64
Deferred income tax assets	14	**385**	359	342
Financial assets Derivative financial instruments	16	**79**		
Other financial assets	15	**18**	15	21
Other receivables	19	**108**	102	100
		4,864	4,156	4,479
Current assets				
Intangible assets pre-publication	17	**426**	356	362
Inventories	18	**373**	314	319
Trade and other receivables	19	**1,031**	933	1,025
Financial assets Derivative financial instruments	16	**4**		
Cash and cash equivalents (excluding overdrafts)	20	**902**	461	551
		2,736	2,064	2,257
Non-current assets classified as held for sale			358	
		2,736	2,422	2,257
Total assets		**7,600**	6,578	6,736

CONSOLIDATED BALANCE SHEET (CONTINUED)
AS AT 31 DECEMBER 2005
(All figures in £ millions)

	Notes	2005	2004	2003
Liabilities				
Non-current liabilities				
Financial liabilities Borrowings	21	**(1,703)**	(1,714)	(1,349)
Financial liabilities Derivative financial instruments	16	**(22)**		
Deferred income tax liabilities	14	**(204)**	(139)	(140)
Retirement benefit obligations	24	**(389)**	(408)	(364)
Provisions for other liabilities and charges	22	**(31)**	(43)	(59)
Other liabilities	23	**(151)**	(99)	(70)
		(2,500)	(2,403)	(1,982)
Current liabilities				
Trade and other liabilities	23	**(974)**	(868)	(943)
Financial liabilities Borrowings	21	**(256)**	(109)	(578)
Current income tax liabilities		**(104)**	(89)	(54)
Provisions for other liabilities and charges	22	**(33)**	(14)	(18)
		(1,367)	(1,080)	(1,593)
Liabilities directly associated with non-current assets classified as held for sale			(81)	
Total liabilities		**(3,867)**	(3,564)	(3,575)
Net assets		**3,733**	3,014	3,161
Equity				
Share capital	25	**201**	201	201
Share premium	25	**2,477**	2,473	2,469
Other reserves	26	**(328)**	(623)	(410)
Retained earnings	26	**1,214**	749	709
Total equity attributable to equity holders of the Company		**3,564**	2,800	2,969
Minority interest		**169**	214	192
Total equity		**3,733**	3,014	3,161

These financial statements have been approved for issue by the board of directors on 26 February 2006 and signed on its behalf by
Rona Fairhead, Chief financial officer

CONSOLIDATED CASH FLOW STATEMENT
YEAR ENDED 31 DECEMBER 2005
(All figures in £ millions)

	Notes	2005	2004	2003
Cash flows from operating activities				
Cash generated from operations	29	**875**	705	531
Interest paid		**(101)**	(98)	(87)
Tax paid		**(65)**	(45)	(44)
Net cash generated from operating activities		**709**	562	400
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	27	**(246)**	(41)	(60)
Acquisition of joint ventures and associates		**(7)**	(10)	(5)
Purchase of property, plant and equipment (PPE)		**(76)**	(101)	(79)
Proceeds from sale of PPE	29	**3**	4	8
Purchase of intangible assets		**(24)**	(24)	(26)
Investment in pre-publication		**(222)**	(181)	(173)
Purchase of other financial assets		**(2)**	(1)	(3)
Disposal of subsidiaries, net of cash disposed	28	**376**	7	(3)
Disposal of joint ventures and associates		**54**	24	57
Disposal of other financial assets			17	
Interest received		**29**	13	11
Dividends received from joint ventures and associates		**14**	12	10
Net cash used in investing activities		**(101)**	(281)	(263)
Cash flows from financing activities				
Proceeds from issue of ordinary shares	25	**4**	4	5
Purchase of treasury shares		**(21)**	(10)	(1)
Proceeds from borrowings			414	235
Short-term investments (acquired)/repaid			(5)	1
Other borrowings			59	(13)
Repayments of borrowings		**(79)**	(524)	(159)
Finance lease principal payments		**(3)**	(2)	(3)
Dividends paid to Company s shareholders	10	**(205)**	(195)	(188)
Dividends paid to minority interests		**(17)**	(2)	(19)
Net cash used in financing activities		**(321)**	(261)	(142)
Effects of exchange rate changes on cash and cash equivalents		**13**	(4)	45
Net increase in cash and cash equivalents		**300**	16	40
Cash and cash equivalents at beginning of year		**544**	528	488
Cash and cash equivalents at end of year	20	**844**	544	528

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

General information

Pearson plc (the Company) and its subsidiaries (together the Group) are involved in the provision of information for the educational sector, consumer publishing and business information.

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

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

These consolidated financial statements were approved for issue by the Board of Directors on 26 February 2006.

1 Accounting policies

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

a. Basis of preparation

These consolidated financial statements have been prepared in accordance with EU-adopted International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied in preparing these financial statements. These consolidated financial statements are the Group s first financial statements to be prepared in accordance with IFRS as adopted by the EU.

The policies set out below have been consistently applied to all the years presented, with the exception of IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement which have been applied with effect from 1 January 2005.

Consolidated financial statements of Pearson plc until 31 December 2004 had been prepared in accordance with UK GAAP. UK GAAP differs in certain respects from IFRS.

When preparing the Group s 2005 consolidated financial statements, management has amended certain accounting, valuation and consolidation methods applied in the UK GAAP financial statements to comply with IFRS. The comparative figures in respect of 2004 and 2003 were restated to reflect these adjustments.

Note 34 describes how, in preparing these consolidated financial statements, the Directors have applied accounting standards as adopted for use in the EU under the first-time adoption provisions as set out in IFRS 1.

These consolidated financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group s accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed below in Critical accounting assumptions and judgements .

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Interpretations and amendments to published standards effective in 2005

The following amendments and interpretations to standards are mandatory for the Group s accounting periods beginning on or after 1 January 2005:

IFRIC 2 Members Shares in Co-operative Entities and Similar Instruments ;

SIC 12 (Amendment) Consolidation Special Purpose Entities ; and

IAS 39 (Amendment) Transition and Recognition of Financial Assets and Financial Liabilities .

Management assessed the relevance of these amendments and interpretations with respect to the Group s operations and concluded that they are not relevant to the Group.

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

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group s accounting periods beginning on or after 1 January 2006 or later periods but which the Group has not early adopted. These are as follows:

IFRS 7 Financial Instruments: Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk.

A complementary amendment to IAS 1 Presentation of Financial Statements Capital Disclosures (effective from 1 January 2007). The amendment to IAS 1 introduces disclosures about the level of an entity s capital and how it manages capital. Management is currently assessing the impact of IFRS 7 and the complementary amendment to IAS 1 on the Group s financial statements; and

IFRIC 4 Determining whether an Arrangement contains a Lease (effective from 1 January 2006). IFRIC 4 requires the determination whether an arrangement is or contains a lease to be based on the substance of the arrangement. Management is currently assessing the impact of IFRIC 4 on the Group s operations, but does not expect it to be significant.

In addition, management assessed the relevance of the following amendments and interpretations with respect to the Group s operations and concluded that they are not relevant to the Group:

IAS 39 (Amendment) Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006);

IAS 39 (Amendment) The Fair Value Option (effective from 1 January 2006);

IAS 39 (Amendment) and IFRS 4 (Amendment) Financial Guarantee Contracts (effective from 1 January 2006);

IFRS 1 (Amendment) First-time Adoption of International Financial Reporting Standards (effective from 1 January 2006);

IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006);

IFRIC 5 Rights of Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006); and

IFRIC 6 Liabilities arising from Participating in a Specific Market Waste Electrical and Electronic Equipment (effective from 1 December 2005).

b. Consolidation

(1) Subsidiaries Subsidiaries are entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. Acquisitions made prior to the date of transition to IFRS were accounted for in accordance with UK GAAP (see note 34). The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets and contingent assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the Group s share of the identifiable net assets acquired, after the identification of purchased intangible assets, is recorded as goodwill. See note 1e*(1)* for the accounting policy on goodwill.

(2) Joint ventures and associates Joint ventures are entities in which the Group holds an interest on a long-term basis and which are jointly controlled, with one or more other ventures, under a contractual arrangement. Associates are entities over which the Group has significant influence but not the power to control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group s investment in associates includes related goodwill.

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

c. Foreign currency translation

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

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

Translation differences on other non-monetary items such as equities held at fair value are reported as part of the fair value gain or loss through the income statement. Fair value adjustments on non-monetary items such as equities classified as available for sale financial assets, are included in the fair value reserve in equity as from 1 January 2005.

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

At the date of transition to IFRS the cumulative translation differences for foreign operations have been deemed to be zero. Any gains and losses on disposals of foreign operations will exclude translation differences arising prior to the transition date.

The principal overseas currency for the Group is the US Dollar. The average rate for the year against Sterling was $1.81 (2004: $1.83; 2003: $1.63) and the year end rate was $1.72 (2004: $1.92; 2003: $1.79).

d. Property, plant and equipment

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

Buildings (freehold) 20 50 years

Buildings (leasehold) 50 years (or over the period of the lease if shorter)

Plant and equipment 3 20 years

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

e. Intangible assets

(1) Goodwill Goodwill represents the excess of the cost of an acquisition over the fair value of the Group s share of the net identifiable assets of the acquired subsidiary or associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. IFRS 3 Business Combinations has not been applied retrospectively to business combinations before the date of transition to IFRS. Subject to the transition adjustments to IFRS required by IFRS 1, the accounting for business combinations before the date of transition has been grandfathered.

(2) Software development costs Costs directly associated with the production of identifiable and unique software products, where it is probable that they will generate economic benefits exceeding costs, are recognised as intangible assets and are amortised over their estimated useful lives not exceeding ten years from when the software is available for use.

(3) Acquired intangible assets Acquired intangible assets comprise publishing rights, customer lists and relationships, technology, trade names and trademarks. These assets are capitalised on acquisition and included in intangible assets and amortised over their estimated useful lives between two and 30 years.

(4) Pre-publication costs Pre-publication costs represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are carried forward in current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. These costs are amortized upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating life cycle of the title, with a higher proportion of the amortization taken in the earlier years. The investment in pre-publication has been disclosed as part of the investing activities in the cash flow statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

f. Other financial assets

Up to 31 December 2004 Other financial assets include investments in companies other than subsidiaries and associates and other securities. Financial fixed assets are recorded at historical cost less provisions for diminution in value.

From 1 January 2005 Other financial assets, designated as available for sale investments, are non-derivative financial assets measured at estimated fair value. Changes in the fair value are recorded in equity in the fair value reserve. On the subsequent disposal of the asset, the net fair value gains or losses are taken through the income statement.

g. Inventories

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

h. Royalty advances

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to bring the amount down to its net realisable value. The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. This represents the operating cycle of consumer publishing titles. Royalty advances which will be consumed after one year are held in non-current assets.

i. Newspaper development costs

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

j. Cash and cash equivalents

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

k. Share capital

Ordinary shares are classified as equity.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

l. Borrowings

Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. From 1 January 2005, accrued interest is also included as part of the borrowing. Where a debt instrument is in a fair value hedging relationship, an adjustment is made to the bond carrying value to reflect the hedged risk.

m. Derivative financial instruments

Upto 31 December 2004 Amounts payable or receivable in respect of interest rate derivatives are accrued within 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 income statement. Foreign currency borrowings together with their related cross currency 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 income statement in line with the transactions which they are hedging.

From 1 January 2005 Derivatives are initially recognised at fair value at the date of transition to IAS 39 or, if later, on the date a derivative is entered into. Derivatives are subsequently remeasured at their fair value. The fair value of derivatives has been determined by using market data and the use of established estimation techniques such as discounted cashflow and option valuation models. The Group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of its bonds (fair value hedges) or hedges of net investments in foreign operations (net investment hedges).

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

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

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

n. Taxation

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

o. Employee benefits

(1) Retirement benefit obligations The Group has elected to early adopt the amendment to IAS 19 Employee Benefits with effect from the date of transition to IFRS. The liability in respect of defined benefit pension plans is the present value of the defined benefit obligations at the balance sheet date minus the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high quality corporate bonds which have terms to maturity approximating the terms of the related liability.

Actuarial gains and losses arising from differences between actual and expected returns on plan assets, experience adjustments on liabilities and changes in actuarial assumptions are recognised immediately in the statement of recognised income and expense.

The service cost, representing benefits accruing over the year, is included as an operating cost and the unwinding of the discount rate on the scheme liabilities and the expected return on scheme assets as a financing charge or financing income.

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

(2) Other post-retirement obligations The Group provides certain healthcare and life assurance benefits. The principal plans are unfunded. The expected costs of these benefits are accrued over the period of employment, using an accounting methodology which is the same as that for defined benefit pension plans. The liabilities and costs relating to other post-retirement obligations are assessed annually by independent qualified actuaries.

(3) Share-based compensation The Group has a number of employee option and performance share schemes. The fair value of options granted is recognised as an employee expense after taking into account the Company s best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the instrument. The fair value of the options granted is measured using whichever of the Black-Scholes, Binomial and Monte Carlo model is most appropriate to the award. Any proceeds received are credited to share capital and share premium when the options are exercised. The Group has applied IFRS 2 Share-based Payment retrospectively to all options granted but not fully vested at the date of transition to IFRS.

p. Provisions

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

The Group recognises a provision for deferred consideration in the period that an acquisition is made and the Group becomes legally committed to making the payment.

The Group recognises a provision for integration and reorganisation costs in the period in which the Group becomes legally or constructively committed to making the payment.

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. The provision is based on the present value of future payments for surplus leased properties under non-cancellable operating leases, net of estimated sub-leasing revenue.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

q. Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services net of value-added tax and other sales taxes, rebates and discounts, and after eliminating sales within the Group. Revenue is recognized as follows:

Revenue from the sale of books is recognized when title passes. Anticipated returns are estimated 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 multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

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

r. Leases

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

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

s. Dividends

Dividends are recorded in the Group s financial statements in the period in which they are approved by the Company s shareholders. Interim dividends are recorded in the period in which they are approved and paid.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

t. Non-current assets held for sale and discontinued operations

Non-current assets are classified as assets held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is intended to recover their carrying amount principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale.

u. Trade receivables

Trade receivables are recognised at fair value less provision for bad and doubtful debts and anticipated future sales returns (see also note 1q).

Critical accounting assumptions and judgements

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

Critical accounting estimates and assumptions

(1) Revenue recognition Revenue from the sale of books is recognized when title passes. A provision for anticipated returns is made based primarily on historical return rates. If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period. The provision for sales returns is set out in note 19.

(2) Pre-publication costs The assessment of the useful life of pre-publication costs and the calculation of amortisation involve a significant amount of judgement based on historical trends and management estimation of their future potential sales, in accordance with the accounting policy stated in note 1e*(4).* The overstatement of useful lives could result in excess amounts being carried forward as intangible assets that would otherwise have been written off to the income statement in an earlier period. Reviews are performed regularly to estimate recoverability of pre-publication costs. The carrying amount of pre-publication costs is set out in note 17.

(3) Royalty advances The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts, in accordance with the accounting policy stated in note 1h. If the estimated realisable value of author contracts is overstated then this will have an adverse effect on operating profits as these excess amounts will be written off. The carrying amount of royalty advances is set out in note 19.

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

(5) Goodwill The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 1e*(1).* The recoverable amounts of cash generating units have been determined based on value in use calculations. These calculations require the use of estimates (see note 12).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Critical judgements in applying the Group s accounting policies

(1) Revenue recognition Revenue from multi-year contractual arrangements is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related expenses reported.

(2) Retirement benefit obligations The determination of the pension cost and defined benefit obligation of the Group s defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth, longevity and expected return on scheme assets. Differences arising from actual experience or future changes in assumptions will be reflected in subsequent periods.

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

Financial risk management

The Group s treasury policy governs the management of financial risks within the Group. The policy, which is approved by the treasury committee, covers interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. In accordance with the treasury policy, the Group actively monitors and manages its financial risk exposures. The policy permits the use of financial instruments such as derivatives, where appropriate. The policy only permits transactions related to underlying positions and speculative transactions are not permitted.

Interest rate risk A change in market interest rates can cause fluctuations in the Group s net income or financial position. The Group is predominantly funded through bonds issued at fixed rates and nearly all of these bonds have been swapped to a floating rate for the term of the debt. The Group s policy (as updated in September 2005) requires that interest rates on its net debt position are fixed for the next four years such that the fixed rate portion is within a range of 65% to 40% in the first year, with the lower end of the range declining by 10% each year such that the fixed rate portion falls within a range of 65% to 10% in year four. The Group also uses derivatives to change the currency profile of its debt and to alter the timing of floating interest rate resets in order to comply with its policy. The Group manages the derivatives and debt to achieve policy objectives on a portfolio basis. The Group designates derivatives as hedges under IAS 39 where hedge accounting is possible, so long as a designation will not have an adverse effect on the balancing of the portfolio.

Liquidity and refinancing risk The Group s funding objective is to ensure that committed funding is available to the Group at a reasonable cost, with an extended maturity profile and that funding is available from diverse sources. To assist with the diversity of funding objective, the Group has ratings with Moody s and Standard & Poor s, which provides greater access to international capital markets.

Counterparty risk The Group s risk of loss on deposits or derivative contracts with individual banks is managed in part through the use of counterparty limits reflecting published credit ratings. Exposures to individual counterparties are monitored on a regular basis. Where appropriate, ISDA Master Agreements permitting the netting of transactions in the event of counterparty failure are entered into with derivative counterparties.

Foreign currency risk The Group has operations overseas and is therefore exposed to movements in foreign currencies, particularly the US dollar. For transactional foreign exchange exposure, the policy allows the use of derivatives where appropriate. The Group mainly converts foreign currencies at spot rate and had no cash flow hedges in place at the balance sheet date. Translational foreign exchange exposure is of more significance to the Group. It seeks to offset this exposure through its policy of aligning approximately the currency composition of its core net borrowings with its forecast operating profit. This policy only applies where a currency accounts for more than 15% of Group operating profit and currently is only applicable to the

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

US dollar. The Group uses its dollar denominated debt and the foreign exchange portion of certain cross currency rate derivatives as net investment hedges of foreign operations. Unremitted profits are not hedged with foreign exchange contracts, as the Company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments.

2 Segment information

Due to the differing risks and rewards associated with each business segment and the different customer focus of each segment, business is the Group s primary reporting segment. At 31 December 2005 the Group is organised into five primary business segments, School, Higher Education, Penguin, FT Publishing and Interactive Data Corporation (IDC).The remaining business group, Professional, brings together a number of education publishing, testing and services businesses and does not meet the criteria for classification as a segment under IFRS.

Primary reporting format business segments

	School	Higher Education	Professional	Penguin	FT Publishing	IDC	Corporate	2005 Group
					(All figures in £ millions)			
Continuing operations								
Sales (external)	**1,295**	**779**	**589**	**804**	**332**	**297**		**4,096**
Sales (inter-segment)				**16**				**16**
Operating profit before joint ventures and associates	**138**	**156**	**44**	**60**	**49**	**75**		**522**
Share of results of joint ventures and associates	**4**		**1**		**9**			**14**
Operating profit	**142**	**156**	**45**	**60**	**58**	**75**		**536**
Finance costs								**(132)**
Finance income								**62**
Profit before tax								**466**
Income tax								**(124)**
Profit for the year from continuing operations								**342**
Reconciliation to adjusted operating profit								
Operating profit	**142**	**156**	**45**	**60**	**58**	**75**		**536**
Amortisation of acquired intangibles	**5**				**1**	**5**		**11**
Other net gains and losses					**(40)**			**(40)**
Other net finance costs of associates					**2**			**2**
	147	**156**	**45**	**60**	**21**	**80**		**509**

Adjusted operating profit continuing operations								
Segment assets	**2,067**	**1,402**	**1,705**	**960**	**154**	**291**	**985**	**7,564**
Joint ventures	**6**			**2**	**4**			**12**
Associates	**6**				**18**			**24**
Total assets	**2,079**	**1,402**	**1,705**	**962**	**176**	**291**	**985**	**7,600**
Total liabilities	**(557)**	**(341)**	**(263)**	**(280)**	**(336)**	**(109)**	**(1,981)**	**(3,867)**
Other segment items								
Capital expenditure (notes 11, 12 and 17)	**114**	**96**	**43**	**34**	**14**	**19**		**320**
Depreciation (note 11)	**26**	**8**	**17**	**7**	**11**	**11**		**80**
Amortisation (notes 12 and 17)	**91**	**78**	**20**	**24**	**3**	**5**		