Pearson

Learning for life

Pearson Annual report and accounts 2018

Enabling employability, connecting the education ecosystem and supporting lifelong learning.

In this report

Strategy and performance reporting
The strategic report up to and including p76 is formed of three sections: 'Overview', 'Our strategy in action' and 'Our performance', and was approved for issue by the Board on 11 March 2019 and signed on its behalf by:

Coram Williams Chief Financial Officer

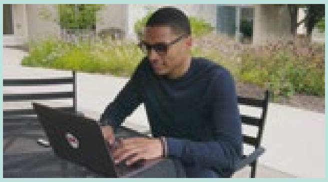
Education has never been more important. In an ever-changing and increasingly connected world, many people pursue an education to get a better job and to build a more prosperous life for themselves and their families.

To keep up with the pace of change, we are all going to need to be lifelong learners, continuously acquiring new knowledge and skills to stay on top of new technologies and a rapidly changing world of work.

For every individual, at every stage of their life, education is the path to opportunity and fulfilment. We are here to help keep the whole world learning – because wherever learning flourishes, so do people.

Our strategy see p18

Connections Academy offers flexible education for its students see p15



Studying an online degree powered by Pearson, at Maryville University see p6

BTECs provide students with real-world experience see p52

Glossary of major products and services see p226

Overview
Our strategy in action
Our performance
Governance
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Key performance indicators

Financial measures

Sales £million, underlying change (R)

£4,129m -1%

Year	Value
18	4,129
17	4,513
16	4,552
15	4,468
14	4,540

Adjusted operating profit[1] £million, underlying change (R)

£546m +8%

Year	Value
18	546
17	576
16	635
15	723
14	722

Adjusted earnings per share[1] pence, headline change (R)

70.3p +30%

Year	Value
18	70.3
17	54.1
16	58.8
15	70.3
14	66.7

Net debt £million, headline change

£143m -67%

Year	Value
18	143
17	432
16	1,092
15	654
14	1,639

Operating profit/loss[2] £million, headline change

£553m +23%

Year	Value
18	553
17	451
16	-2,497
15	-404
14	348

Basic earnings per share[2] pence, headline change

75.6p +52%

Year	Value
18	75.6
17	49.9
16	-286.8
15	101.2
14	58.1

Operating cash flow and cash conversion[1] £million, headline change (R)

£513m -23%

Year	Value
18	513 (94%)
17	669 (116%)
16	663 (104%)
15	435 (60%)
14	649 (90%)

Net cash generated from operations[2] £million, headline change

£547m +18%

Year	Value
18	547
17	462
16	522
15	518
14	704

Dividend per share pence, headline change

18.5p +9%

Year	Value
18	18.5
17	17
16	52
15	52
14	51

Return on invested capital (gross basis) %, headline change (R)

4.7% +9%

Year	Value
18	4.7
17	4.3
16	5.0
15	5.8
14	5.6

Return on invested capital (net basis) %, headline change

6.7% +8%

Year	Value
18	6.7
17	6.2
16	7.2
15	6.3
14	5.7

Total shareholder returns[3] (R)

+30.4% 1 year TSR

+47.1% 3 year TSR

-12.1% 5 year TSR

1 See p46–47 for an explanation of these alternative performance measures.
2 Equivalent statutory measure.
3 Source: Datastream.

Note: Underlying growth rates exclude currency movements, portfolio changes and accounting changes. See p222–225 for full reconciliation of the alternative performance measures to the equivalent statutory measure and definitions of headline and underlying variances.

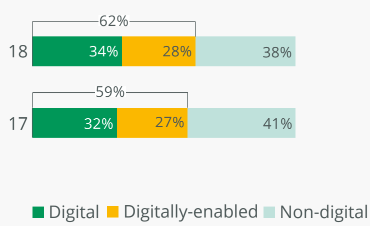
(R) See how we link strategy to management reward on p110.

Business measures

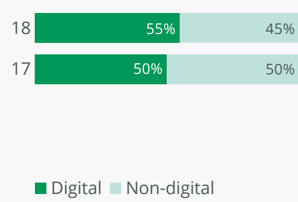
1 Grow market share through digital transformation of our courseware and assessment businesses ®

p20

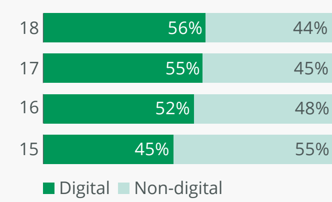
Digital revenue[4] %



US Higher Education Courseware



Shift from physical to digital test papers marked for US Assessment %



4 Excludes WSE, US K12 Courseware and GEDU. WSE was sold in 2018; US K12 Courseware was held for sale in 2018 and we announced the agreement to sell this business in 2019; and GEDU was sold in 2017

2 Invest in structural growth markets

p22

Virtual Schools (Connections Academy)	Growth
Underlying revenue	+8%
FTE students in continuing partner schools	+11%

Professional Certification (Pearson VUE)	Growth
Underlying revenue	+4%
Test volume	+4%

Global Online Program Management	Growth
Underlying revenue	+10%
Enrolments	+14%

English	Growth
English Courseware underlying revenue	+3%
PTE Academic test volume	+30%

3 Become a simpler, more efficient and more sustainable business ®

This strategic priority is captured in more detail in the strategy section on p24.

p24

Non-financial measures

Talent and employee engagement	
Employees who took part in our 2018 organisational health survey	57%
Participating employees who agreed with our organisational health approach	59%

p37

Reduce our carbon footprint		
Global greenhouse gas emissions (Metric Tonnes of CO_2e)	84,649	-19%

p39

Deliver gender diversity	2018	2017
Female Board members	30%	30%
Female senior managers[5]	31%	30%
Female employees	62%	61%
UK median gender pay gap	14%	15%

5 Two reporting lines from the Chief Executive.

p38

Note: Underlying growth rates exclude currency movements, portfolio changes and accounting changes.

About Pearson

We are the world's learning company operating in 70 countries around the world with more than 24,000 employees, providing a range of products and services that help people make progress in their lives through learning.

Where we operate

We operate in 70 markets worldwide, with a focus on those below. We report by geography because this is how we deliver learning: providing a range of educational products and services to institutions, governments, professional bodies and individual learners in our key markets around the world to help people everywhere aim higher and fulfil their true potential.

Sales by geography

North America

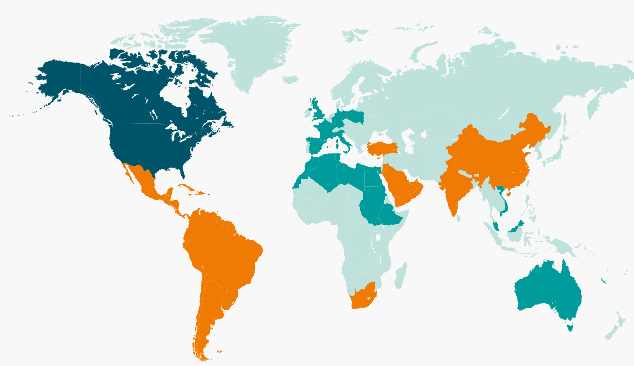
Our largest market including all 50 US states and Canada.

Core markets

Our international business in established and mature education markets including the UK, Europe, APAC and North Africa.

Growth markets

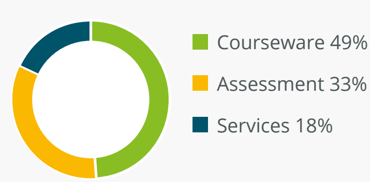
Our growth markets are emerging and developing economies with investment priorities in Brazil, India, South Africa, Hispano-America, Hong Kong & China and the Middle East.



What we offer

We provide content, assessment and digital services to schools, colleges and universities, as well as professional and vocational education to learners to help increase their skills and employability prospects. Increasingly, we do this through partnership models where we bring investment, expertise and scale to help deliver better learning outcomes.

Sales by products and services



Our major businesses are focused on two key strategic priorities:

See our strategic priorities, p20

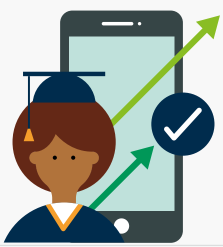
1 Grow market share through digital transformation

Digitisation enables us to drive improvements in learning outcomes. It allows us to build a more sustainable and profitable business with a more visible and predictable revenue profile, based around access not ownership models.

Higher Education Courseware

Our course content and digital resources help educators gain better insights on their students and unlock learners' potential. We increasingly sell directly to consumers and to educational institutions enabling our business to become more predictable. The shift to digital means students can come to class better prepared from day one. This helps drive better learning experiences and outcomes.

See case study, p55



US Assessment

We partner with US educators and states to develop new, personalised ways of learning through effective, scalable assessments that measure 21st century skills and inform instruction for all learners.

UK Assessment & Qualifications

In the UK, Pearson is a market leading organisation offering academic and vocational qualifications including GCSEs, A Levels and BTECs. We are driving the adoption of AI in assessment to support better learning.

See case study, p52

2 Invest in structural growth markets

Fast growing areas that will be the long-term growth drivers of Pearson – such as Online Program Management (OPM), Virtual Schools, Professional Certification and English Language Learning.

Online Program Management

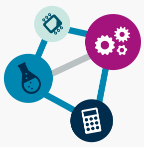
Pearson helps higher education institutions launch or expand online degrees, enabling them to increase enrolments, support online learning, boost graduation rates and deliver on employability.

See case study, p6

Virtual Schools

Pearson delivers K12 online education to schools and students across the US and world. Solutions include the accredited Connections Academy, an online school programme which is delivered via full time, online public schools. This is an option for families seeking personalised learning and a high-quality alternative to the traditional classroom. A global online private school, International Connections Academy, is also available.

See case study, p15



Professional Certification

We help organisations measure and make improvements to ensure the success of employees and learners, helping support lifelong learning. Test owners and test takers across the world choose us to help develop, manage, deliver and grow their computer-based testing programmes. With some of the industry's most secure testing environments, we are a leader in computer-based testing.

English

Pearson English language teaching develops courses, qualifications and learning tools to make teaching English easier. Our fast-growing test, Pearson Test of English Academic, is a leading computer-based test of English for study abroad and immigration.

See case study, p42

I can work full time as a 19 year old. I can get my experience way before a lot of my generation so that's been a great opportunity for me.

JORDAN DAVIS
MARYVILLE UNIVERSITY

Jordan Davis is a sophomore at Maryville University studying cybersecurity. Like most of his college-age peers, he also has a job. It can be hard to balance schoolwork with the demands of a job.

Since OPM courses are delivered online, learners have the freedom and flexibility to learn when and where they need to, and faculty members are able to engage students in courses designed with rich content and robust learning activities.

Pearson helps institutions expand their educational reach through effective online program management solutions. By delivering online degree programs or extending the reach of existing online programs, students like Jordan have the opportunity to excel at school and at work.

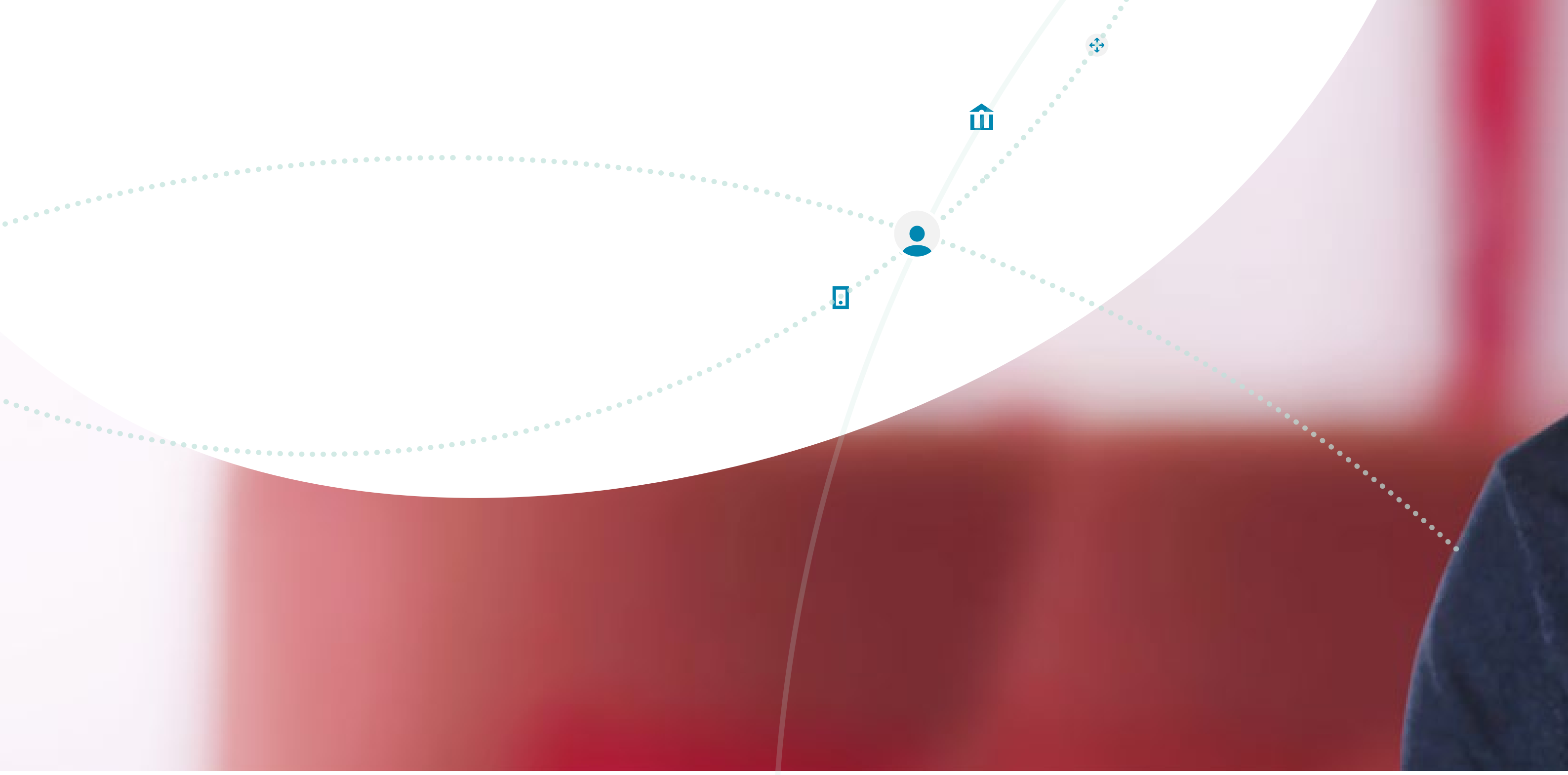
Pearson currently supports more than 40 academic partners and runs nearly 350 global programs with 400,000+ course registrations in 2018, to give learners more control over their education and help them get a better job and a better life.

Global Online Program Management

£234m
Revenue

+10%
Underlying revenue growth

2 Aligned to strategic priority, p22



Chair's introduction

2018 has been a pivotal year for Pearson as we returned to underlying profit growth and laid a firm foundation for further progress in 2019.

Sidney Taurel
Chair

Dear Shareholders,

2018 has been a pivotal year for Pearson. The pace of our strategic delivery over the past year has been strong, improving both our operational and financial performance as we returned to underlying adjusted operating profit growth for the first time since 2014. This marks an important milestone for us, with the business meeting strategic expectations and hitting its financial targets.

While we are still in the midst of a transformation and the environment in a key business, US Higher Education Courseware, remains challenging, a strong performance in our structural growth opportunities in 2018 largely offset the declines we saw in this market. Furthermore, we continued to make good progress with our digital transformation increasing digital and digitally-enabled sales to 62%[1].

I do not underestimate the scale of the transformation we are undertaking but believe we delivered real and sustainable momentum in 2018. Management continues to faithfully execute on our strategy, further simplifying the company, growing our digital capabilities and investing in structurally growing businesses. Our near-term prospects look increasingly bright and the long-term opportunities remain significant.

Making progress implementing our short-to-medium-term strategy

As a Board, in 2018 we spent considerable time monitoring our progress on implementation against Pearson's three immediate strategic goals – growing market share through our digital transformation, investing in structural growth markets, and becoming a simpler, more efficient and more sustainable business.

A key tenet of our strategy has been the steady investment in the business to support our digital transformation. This is an area the Board has fully supported and, in 2018, the business made good progress as it lays plans to develop a digital first approach built around artificial intelligence and data analytics – a digitally-enabled offering that will deliver value to customers faster, while at the same time ensuring better outcomes. This will be crucial to our future competitiveness as well as our ability to retain and attract the best and brightest talent to support our transition to a digital led model.

We are continuing to invest in structural growth markets that promote lifelong learning, delivering good growth across each of these four businesses – Professional Certification, Virtual Schools, Online Program Management (OPM) and English language learning and assessment.

Our simplification programme, which we embarked upon in 2017, is performing ahead of plan as we strive to make Pearson an efficient and more focused business. During 2018, we increased and accelerated our cost savings and now expect to deliver total annualised cost savings in excess of £330m by the end of 2019. This is ahead of our original plan of £300m of savings.

We also continued the process of simplifying the portfolio in 2018, to enable us to focus on the biggest opportunities in education. We completed the disposal of Wall Street English and our stake in Mexican joint venture, UTEL, in the first half of the year. The proceeds of these sales helped strengthen our balance sheet further and improve our cash position. We have recently announced the disposal of our US K12 Courseware business, which is a further milestone in our simplification journey.

You can read more about these accomplishments in the Chief Executive's overview that follows.

Focusing on Pearson's longer-term future

As the Board has become more confident in progress on implementation against Pearson's three immediate strategic goals, it has focused even more on the company's longer-term future, evaluating and planning our long-term strategy, to ensure we continue to evolve and meet our strategic vision of delivering lifelong learning to customers, leading to increased employability and work-related skills, as part of a wider ecosystem of delivery partners and stakeholders.

As we now look ahead, we expect to build on our performance in 2018 and deliver further profit growth in 2019 and for revenue to stabilise. We remain confident about Pearson's longer-term prospects and on building shareholder value through the delivery of profitable growth and strong cash generation, while continuing to invest for the future.

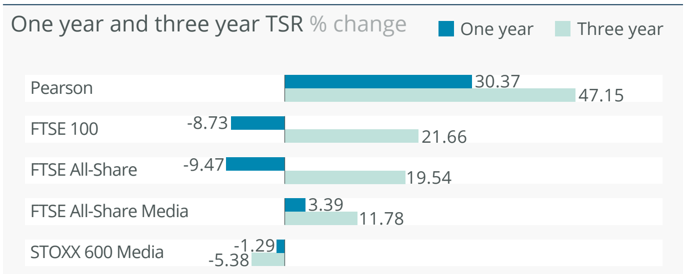
Focused on shareholder returns

As Chair it is my job to protect and grow shareholder value through the prudent allocation of capital.

Pearson's capital allocation policy remains unchanged: to maintain a strong balance sheet and a solid investment grade rating, to continue to invest in the business, to have a sustainable and progressive dividend policy, and to return surplus cash to our shareholders where appropriate.

In recent years, we have navigated through a period of significant change – both within Pearson and across the industry as a whole. Tight financial and cash management and oversight of the business means that, while there is still much to be done, we are now in a significantly stronger financial position than we have been for several years. This financial strength underpins our business transformation and continuing investment in the company.

1 Excluding WSE and US K12 Courseware.
Underlying growth rates exclude currency movement portfolio changes and accounting changes.



Progress over the last three years

	2016	2017	2018
Adjusted earnings per share[1]	58.8p	54.1p	70.3p
Dividend per share	52p	17p	18.5p
Net debt	£1,092m	£432m	£143m

In terms of the dividend, when we made the hard decision to cut the dividend in 2017, we said that we would reset it to be sustainable and progressive going forward. We have proposed a final 2018 dividend of 13p, an increase of 8%, equating to a full year dividend of 18.5p per share. This reflects the Board's continued confidence in the future growth of the business.

We also completed a £300m share buyback in February 2018, following our disposal of a 22% stake in Penguin Random House in October 2017.

I am pleased to report that our UK pension Plan is in surplus, with a well-run Plan for the benefit of all its members. In early 2019, the Plan purchased a further insurance buy-in policy with Legal & General, amounting to c.£500m, putting the Plan in an even stronger position and further reducing our future pension funding risk, at no additional cost to Pearson.

The continued stabilisation of the business, combined with disciplined capital management, helped Pearson to become one of the top five FTSE 100 companies in 2018 for shareholder returns.

Ongoing focus on corporate governance

Corporate governance remains an important area of focus for the Board and I enjoyed spending time throughout the year with many of our shareholders to ensure we maintained an open, transparent dialogue on our strategy and progress. More broadly, our Board members have been engaging with employees, educators, learners, community and thought leaders, and other stakeholders in a variety of ways throughout the year.

During the year my fellow Board members and I visited some of our offices across the Pearson network including in Milan, Italy and Cape Town, South Africa, to meet and engage with employees and other stakeholders, and hold meetings to share learnings around some of the exciting opportunities coming out of our Core and Growth markets – for example fast growing products such as the Pearson Test of English Academic.

This continues to be a focus for us in the year ahead.

Talent

I would like to thank all colleagues in the business for their efforts in achieving a successful 2018. Our people are key to the future of Pearson and as a Board we are increasingly focused on ensuring we have a corporate culture that is inclusive, innovative and meritocratic.

My fellow Board members and I are delighted to be able to help support our talent pipeline through the introduction of a new mentoring programme. You can read more about our employee engagement and talent initiatives in the Governance section which begins on p77.

Board composition

Our Board benefits from having a wide range of experience, skills and backgrounds spanning business strategy, innovation, education, digital & technology, sustainability, international, regulatory affairs and more.

We saw two changes to the Board over the course of 2018. In February 2018 Michael Lynton joined us as a Non-Executive Director. Meanwhile we said goodbye to Harish Manwani, a Non-Executive Director of Pearson since 2013, who retired from the Board at the AGM in May. I thank Harish for his commitment and contribution to Pearson.

Looking ahead

We will continue to transform the business through moving our US Higher Education Courseware business into a more digital and direct to consumer business, and continue to invest in and develop our long-term structural growth opportunities. Through our simplification programme we will emerge a simpler, more efficient and agile company with a cost base that is considered optimal for the size and scale of the business.

Pearson has proved resilient, we have laid solid foundations for growth and the Board is confident that the management team continues to execute faithfully on the strategy as we look to deliver another good performance in the year ahead.

We remain confident about Pearson's longer-term prospects and on building shareholder value through the delivery of profitable growth and strong cash generation, while continuing to invest for the future.

I look forward to seeing you in the coming year and thank you for your ongoing support.

Sidney Taurel
Chair

Governance at Pearson

For more information on corporate governance visit www.pearson.com/governance see p77

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CEO's strategic overview

Technology is radically changing the way we live, work, and learn, and we are only in the early stages of what is possible.

John Fallon
Chief Executive

Dear Shareholders,

A year of progress

We are making good progress, financially, operationally and strategically. Underlying adjusted operating profit increased by 8% last year, with a healthy 94% of that profit converted into cash. We outperformed on our cost savings plan and are now on track to achieve more than £330m in annualised cost savings by the end of this year. We strengthened our balance sheet even further, allowing us to invest more than ever in the digital transformation of our company. The demand for dynamic, evidence-based, outcome led, digital first education products and services is growing all the time. So we are investing in the digital platforms, products and services that help people make progress in their lives through learning – and it is starting to pay off. Our digital and digitally-enabled revenues now account for 62%[1] of our sales and we expect them to grow steadily over time.

A strategy for future, sustainable growth

There is, however, a lot still to do. On the measure that is the best indicator of our company's long-term success – sustainable and profitable growth in like for like sales – we are not yet where we need to be. Underlying sales were down by a further one percent last year. What is encouraging, though, is that we expect revenues to stabilise this year – an important step in the Pearson recovery – before starting to grow again in 2020 and future years.

That growth will be driven by our compelling vision of Pearson's future, a clear understanding of the capabilities – the competitive edge – that will get us there, and what we need to be focusing on today to secure that future.

Pearson is the world's learning company. Our purpose is to empower people to progress in their lives through learning, enabling them to acquire the knowledge and skills to thrive in an ever-changing and increasingly connected world. As the link between education and employment becomes both more important and explicit, we aim to be at the heart of a wider ecosystem of partners, shaping the future of learning.

We will be able to play that role because of the world-class capabilities we bring to bear, and the ways in which we combine them to achieve better learning outcomes. We will get there by focusing on the three things that are starting to change the growth dynamic of Pearson:

- One, we are leading the digital transformation of our courseware and assessment businesses. These businesses make up 65% of our sales today. Their collective sales fell by 4% underlying last year as we are at a point in the technological disruption of these businesses where the impact of the decline in analogue sales (from textbooks and paper and pen testing) is still greater than the benefit of growing digital uptake. We are now close to a tipping point in these businesses, however, where the momentum shifts. As these businesses become increasingly digital first, the rate of decline will gradually lessen before revenues stabilise and, in time, grow again.
- Two, we are investing more in our businesses in structurally growing markets. These businesses, all fully digital or digitally-enabled, make up 35% of our sales today and grew 7% underlying last year. As we invest more, these businesses will grow more quickly and, as they become a bigger part of Pearson, they help the company as a whole to start to grow again.
- And three, making Pearson simpler and more efficient. This does not just cut costs. It also provides an important platform for future growth because it enables us to reallocate investment to our growth areas more quickly, innovate at scale, and build a more direct, longer-term relationship with the tens of millions of learners who use Pearson products each year.

A digital first approach

The increasingly digital nature of our courseware and assessment businesses can be seen in the work we do with American schools and universities. Digital now accounts for 56% of all tests we administer in US schools and 55% of our US Higher Education Courseware revenue.

This digital first approach is driving our product innovation and investment. Our Global Learning Platform (GLP) will accelerate our ability to develop, test, and deliver highly personalised experiences across all of our products and services, eventually becoming a platform for growth for the whole company.

Revel, our first fully integrated digital courseware product, increased subscribers by over 40% last year. New Revel titles, with enhanced assignment options and sophisticated data analytics, will be the first products to launch commercially later this year on the GLP.

We will also launch our first Artificial Intelligence (AI) powered maths tutor, as a mobile app marketed directly to Calculus students around the world, providing step by step feedback instantaneously on hand written attempts to solve a problem.

1 Excluding WSE and US K12 Courseware.
Underlying growth rates exclude currency movement portfolio changes and accounting changes.

We will partner with universities on our first AI powered essay marker, that will adapt to the personal style of any professor. And we expect to bring a new adaptive maths product, which we are currently piloting, to commercial launch early next year.

This growing, innovative product pipeline signals we are now ready to shift our higher education product portfolio to a digital first model, with frequent releases of content, features and updates no longer tied to an edition cycle.

Print resources will be available, but as rental or an "add on" service. This means better customer choice with simple, affordable and convenient access to the courseware that enables students to be successful – and all giving better insights for instructors to enable better outcomes. A digital first, subscription-based business is also, of course, a much more stable one.

Increased investment in our structural growth opportunities is also paying off. Online Program Management, (OPM) our business helping universities scale online, increased underlying sales 10% last year, with global course registrations growing 14%. We signed a new OPM contract with leading European business school ESSEC in France – the fourth global market we have entered in OPM – allowing students to study AI and big data in an online masters format.

Our virtual schools business, Connections Academy, grew underlying revenue by 8%. Professional Certification grew underlying revenue by 4% with over 70 new contracts signed during the year.

The Pearson Test of English Academic, our homegrown test of English aptitude, increased test volumes by 30% in part driven by the extension of the Australian immigration office contract for a further two years. This has opened up additional opportunities with governments and educational institutions that we are currently exploring. The Pearson Test of English is also a good example of how, as we become a simpler and more efficient company, we are also able to operate much more globally, sharing innovation more quickly with customers all over the world.

Key achievements in 2018

Adjusted operating profit[1]

£546m

Achieved 2018 adjusted operating profit in the upper half of our guidance range.

1 See p46–47 for an explanation of this alternative performance measure and p222–225 for full reconciliation of the numbers to the equivalent statutory measure.

Strong balance sheet, low net debt

£143m

Net debt down from £432m in 2017 as we continue to strengthen our balance sheet, enabling us to navigate a large transformation.

Continuing organic investment

£700m+

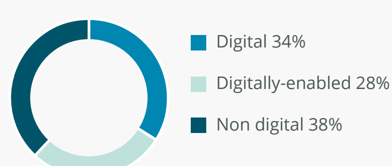
Continued investment in fastest growing businesses in order to build a pipeline to grow revenue over the next few years.

Simplification programme ahead of plan

£130m

In year cost savings for 2018 running ahead of our plan enabling further investment back into the business. Total annualised cost savings now expected to be £330m+.

Pearson's digital revenue 2018 Percent of sales[2]



2 Excludes WSE and US K12 Courseware.

CEO's strategic overview

A wider trend in lifelong learning is the growing demand for employer certified and applied, career relevant education. Our leadership in BTEC and apprenticeship programmes is an interesting opportunity to grow internationally – and we are working on some promising initiatives in Thailand, Vietnam and China.

It is by focusing on these three priorities – leading the digital transformation of our courseware and assessment businesses; investing more in our structurally growing businesses; and making Pearson simpler and more efficient – that we will set Pearson growing again. As we accelerate our move to digital, Pearson also becomes more sustainably profitable and scalable, with a more reliable and predictable revenue and cash profile.

Our commitment to efficacy and impact

Underpinning all of this work is our commitment to efficacy, to achieving the very best learning outcomes. Last year, we became the first education company in the world to publish externally audited and independently reviewed reports about the efficacy of our products. This year, we are releasing our second series of reports. These reports give us confidence that our existing products can be used to impact on outcomes that matter to our customers and learners. Our public commitment to efficacy is also influencing others in the sector to now take up similar work. What is most exciting, though, is how we are applying what we are learning to the next generation of digital first products and services that we are launching this year. We are able to explicitly connect the outcomes that matter most to our customers: evidence-based content, assessment, and technology, all designed to be implemented in ways that maximise the impact on learning. This enables us to shape the future of learning so educators, learners, employers – and shareholders – all get the best possible return for the investments we make.

Promoting talent and diversity through a time of great change

Making an impact matters to the highly motivated and talented colleagues who, inspired by our mission and purpose, are committed to driving the company through what is, by any definition, a major transformation. Many new and talented employees are joining Pearson, but we also continue to say goodbye to some long-standing friends and colleagues. As we align our cost base, and bring everything we do in line with the future direction of the company, the scale and pace of change can be disruptive and difficult for many colleagues. This makes it all the more important that we are very focused on the overall health of the organisation, and in fostering a culture that enables people to learn, to grow, and to be able to innovate, through these times of change.

To do that, we are focusing on developing talent at all levels, and we remain firmly committed to improving diversity and inclusion across the company. For example, as required by UK legislation, we now publish an annual gender pay report covering our UK employees, which reveals a median pay gap, in favour of men, of 14%. The only way to close this gap is to have more women in more senior positions in the company, and we are taking concerted actions that we believe will help us to achieve this over time. As a global company, we think it is important to hold ourselves to account on that basis, so we are planning to publish a company-wide gender pay report next year.

We continue to make progress. We are proud to be recognised on Forbes Best Employers for Diversity in 2019 and Bloomberg's Gender Equality Index. We are also proud of the progress and the external recognition of our sustainability work. In January 2019, we were named as one of the Global 100 Most Sustainable Corporations in the World, which ranks large companies on their performance of reducing carbon and waste, their gender diversity among leadership, revenues derived from clean products and overall sustainability.

A simpler portfolio

We have now reached an agreement to sell our US K12 Courseware business to Nexus Capital Management. School publishing in America has been an important part of Pearson for many years, and what it does matters to teachers and students across the country. We are pleased to have found new owners who are committed to its future, and we wish it every success. The sale frees us up to focus on the digital first strategy that will drive our future growth. Through our assessment, virtual schools, advanced placement and career education businesses, we will still serve schools across America and we will now be better placed to focus on the areas in which we can help students to be successful in their studies and future careers.

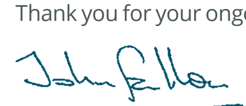
Looking ahead

Last year, Viscount Blakenham, Pearson's former Chairman and CEO, and the last member of the Pearson family to lead the company, sadly passed away. Michael was widely regarded for his staunch defence of editorial independence and freedom of speech, his commitment to international growth and expansion, and his personal embodiment of Pearson's values.

In terms of its focus and operations, Pearson is now quite different from the company he stepped down from 23 years ago. What has not changed is our commitment to taking a long-term view, and creating sustainable value for our shareholders by providing important services to our customers in entrepreneurial and innovative ways.

Accelerating the move to more accessible, more affordable and better learning is as important as anything that this company has taken on in its 175 year history. We are confident that our strategy will deliver long-term sustainable growth, and we expect to make further progress in 2019.

Thank you for your ongoing support.



John Fallon
Chief Executive

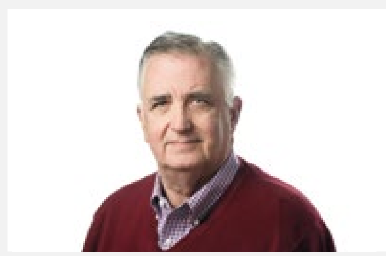
Executive team

John Fallon Chief Executive

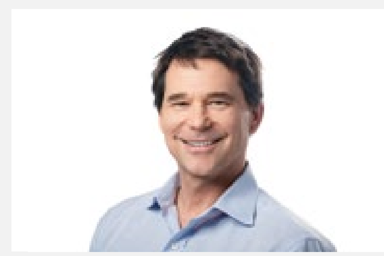
Coram Williams Chief Financial Officer

Albert Hitchcock Chief Technology & Operations Officer

Anna Vikström Persson Chief Human Resources Officer

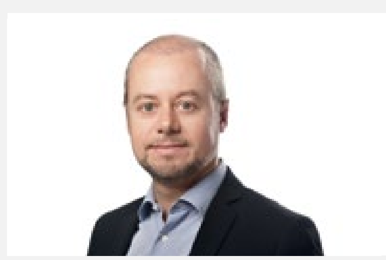


Bob Whelan President Pearson Assessments



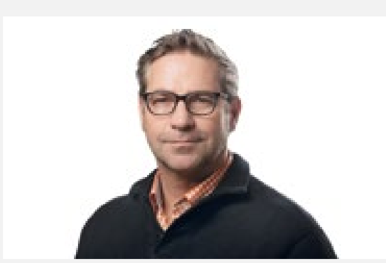
Bjarne Tellmann General Counsel & Chief Legal Officer

Deirdre Latour Chief Corporate Affairs Officer



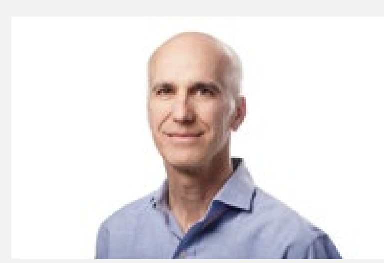
Giovanni Giovannelli President Growth Markets

Jonathan Chocqueel-Mangan Chief Strategy Officer



Kevin Capitani President North America

Rod Bristow President UK & Core Markets



Tim Bozik President Global Product


LEKI

Online learning is the only way for me to keep up with school because I can set the pace for my coursework.

ARUWIN SALEHHUDDIN
STUDENT ATHLETE

Aruwin chose Colorado Connections Academy, a virtual school, because it offered her the flexibility to pursue her dream of becoming a professional alpine skier.

In between practice sessions and competitions, Aruwin spends time planning for her future. After high school, she hopes to attend Cornell University, with the goal of becoming an architect or industrial designer after her skiing career.

Connections Academy allows students like Aruwin to pursue their dreams today, while also preparing them for the careers they want later. Connections Academy schools are tuition-free, online public schools for students in grades K through 12.

At Connections, students can work at their own pace and are supported by certified teachers who create personalised learning plans.
Over 70,000 students in the US take advantage of this virtual option, while international students can enroll in our online private school. This way of providing education to even more learners has been hugely successful – 93% of parents with enrolled students say they would recommend the programme to others.

Virtual schools

£288m
Revenue

+8%
Underlying revenue growth

2 Aligned to strategic priority, p22

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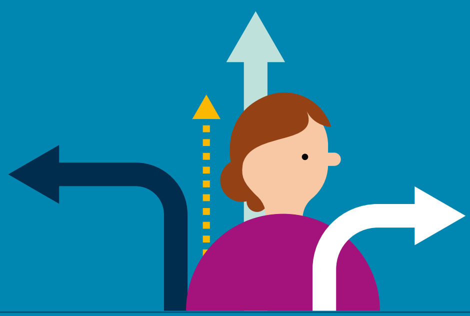
Market trends

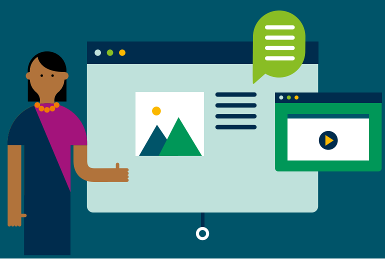
Technology is changing expectations and increasing possibilities in education.

The rise of choice



Technology and access means young people today have more choices than ever – and expect it everywhere, even in how they learn. While institutions continue to influence and drive learning, students are playing a bigger role in their own learning, whether it is choosing what they need to pass a course or where they obtain their learning or credentials from.

Gen-Z needs tech + teachers



Young people believe in the value of education and expect their learning experiences to mimic other experiences in their lives that have been enabled by technology – making everything more seamless, efficient, accessible and intuitive. Teachers have a vital role to play and now technology is enabling teachers to teach and reach students more effectively.

The career-driven learner

Everything will be affected by the changing nature of work in the decades to come. How learners react to that, however, is going to vary based on context, personality, and background.

While traditional learners may continue to gravitate towards formal educational settings, there will be a new crop of multi-generational, driven, "Career-Learners" who will seek out flexible learning for continued success in life.

Non-traditional paths to success

A traditional education is not always in reach for an increasingly diverse student population, despite the inherent belief that one needs an education to be successful.

Many young students struggle in school or have other barriers to attending higher education, and believe that traditional university is not for them.

As the future of learning evolves, educators are preparing students for a world of work whether or not they go to university.

We can take advantage of AI techniques to create more engaging teaching and learning experiences.

MILENA MARINOVA
SVP, ARTIFICIAL INTELLIGENCE (AI) PRODUCT & SOLUTIONS, SAN FRANCISCO, CA

AI and education

I joined Pearson in 2018 as the SVP of Artificial Intelligence (AI) Products and Solutions. In this role, I make sure we are taking advantage of advancements in Machine Learning – or AI broadly – to create more engaging teaching and learning experiences.

Pearson's digital transformation is helping more people develop the skills they need to prosper, and we are well positioned to engage with millions of learners across the world because of our reach and expertise.

Education has the potential to benefit hugely from digital disruption and advancements in AI. The opportunity to utilise AI to improve the learning experience, and ultimately to better prepare people for their career in the future, is an incredibly exciting prospect.

AI as the solution

Currently, I am working on developing human-centric solutions – this means making learning experiences better for students and teachers; enabling lifelong learning through more accessible and affordable products; and, building better products and solutions using new technologies.

Many companies don't have a deep enough understanding of how to use AI to solve the biggest problems they have. It is important to be really clear on the problem in order to identify the right approach. In addition, the problem must determine which AI algorithms are used, not the other way around.

At Pearson the problem we are trying to solve is clear: how to make learning experiences better through products and services that deliver increased engagement and improved outcomes for more learners around the globe.

Our strategy

Pearson

Our mission is to help people make progress in their lives through learning.

Our Vision

is to have a direct relationship with millions of lifelong learners and to link education to the way people aspire to live and work every day. To do that, we will collaborate with a wide group of partners to help shape the future of learning.

Our Capabilities

include combining world-class educational content and assessment, powered by services and technology, to enable more effective teaching and personalised learning at scale. Our capabilities are based on our deep expertise in how people learn, and we apply them to our three strategic priorities:

Our strategic priorities

1 Grow market share through the digital transformation of our courseware and assessment businesses

- Shift from selling ownership of our content to selling print or digital services
- Global Learning Platform: A cloud-based, scalable product platform

2 Invest in structural growth opportunities

- Online Program Management
- Virtual Schools
- English Language Learning & Assessment
- Professional Certifications & Licensure

3 Become a simpler, more efficient and more sustainable business

- Eliminate duplication and speed up innovation
- Increase standardisation to reduce costs and improve scalability
- Provide world-class customer experiences that improve efficacy and outcomes
- Ensure access to quality education for all

Our values are **brave**, **imaginative**, **decent** and **accountable**

We are the world's learning company

Strategic advantages

Insights and capabilities

We partner with world-class authors to develop our content and we take a data-driven approach to product design, based on proven learning science and pedagogy. This enables huge advancements in rich content, personalised learning and effective analytics.

Investing back into our business

Pearson's strong balance sheet underpins the continuing investment in our digital transformation and structural growth markets. We are investing record levels to become the winners in digital education.

Global reach and scale

We have a truly global scale and focus. We operate in 70 markets worldwide. Our products and services benefit from being centrally developed, globally deployed with local expertise and capabilities ensuring success.

Capital allocation

- Maintain a strong balance sheet
- Maintain an investment grade credit rating
- Invest in our business – we are investing over £700m in our digital future
- Return capital via a sustainable and progressive dividend
- Return any excess capital via special returns where appropriate

Delivering long-term value for all stakeholders

Customer experience

Our customers, including learners, educators, employers, governments and more, benefit from a great consumer experience with consistent focus on learning outcomes.

Supporting sustainable growth

Delivering returns for our shareholders through a long-term improvement in top line and bottom line growth. Over time this helps increase the share price and maintain a progressive, sustainable dividend.

Employee engagement

Through our transformation we are focused on supporting our people, driving equality and diversity, and helping them make progress at Pearson and in their lives.

Strengthen sustainability

Through our sustainability and social innovation work we are helping increase access to quality education for more people around the world and reducing our environmental footprint.

To read more about the value we create for our stakeholders

see p26

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Our business model and strategic priorities

Read more about our three strategic priorities:

1 Grow market share through digital transformation

2 Invest in structural growth markets

3 Become a simpler, more efficient and more sustainable business.

1 Grow market share through digital transformation

US Higher Education Courseware

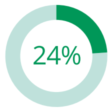
PERFORMANCE

2018 revenue

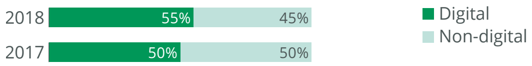
£976m

-5%[1]

Percentage of total revenue



Digital revenue



MARKET

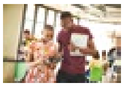
40%+[2]

Market share

PROGRESS AND PRIORITIES

- Total revenue in this segment declined by 5%[1] in 2018 due to a continuation of underlying market pressures on print courseware revenue
- Digital revenue grew 2% in 2018
- Accelerated shift to affordable and access initiatives, including our partner print rental programme, eBooks and Inclusive Access
- In Inclusive Access we signed 192 new institutions in 2018, taking the total of not-for profit and public institutions served to 617. See p227 for more on IA
- 8% of 2018 revenue in this segment derives from IA, equating to roughly 1.4m course enrolments
- Transitioning our product portfolio from primarily print-led product experiences to digital first products
- Launch of Global Learning Platform with Revel in 2019

Mastering makes learning personal see p55



BUSINESS MODEL

- Continuing to lead and shape the market by moving to digital first model
- Ability to deliver a portfolio of dynamic evidence-based, outcome-led, product experiences
- Investing heavily in IP and systems enabling us to draw on the latest technology, including AI and machine learning
- Greater customer choice with simple, affordable, convenient access
- Better data and insights for instructors to enable better outcomes

1 Underlying revenue growth.
2 Source: MPI.

US Student Assessment

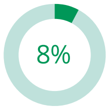
PERFORMANCE

2018 revenue

£332m

-4%[1]

Percentage of total revenue



Digital tests v paper tests – 2018 v prior year %

MARKET

c.$1.2bn[2]
Size of market

PROGRESS AND PRIORITIES

- Revenue declined moderately in 2018 due to the faster than expected contraction in revenue associated with our PARCC and ACT-Aspire multi-state volume-based contracts and our disciplined competitive approach
- These factors will extend into 2019, where we expect a modest decline in revenue in this segment
- Beyond 2019, we expect the business to benefit from continued good momentum in subcontractor contract wins leveraging our digital leadership and a strong pipeline of opportunities in key states
- Digital tests now account for 56% of all tests administered
- Digital tests enable a future of fewer, better tests more embedded in the workflow of teaching
- 33% of open questions marked by AI

BUSINESS MODEL

- We are the largest vendor in the market and we have led the shift towards digital testing with our best-in-class platform TestNav

Our strengths include:

- Investment in innovation
- Pioneer of digital assessment platform to encourage fewer, better tests
- Track record of delivery at scale

Core Student Assessment and Qualifications

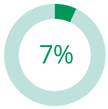
PERFORMANCE

2018 revenue

£292m

-3%[1]

Percentage of total revenue



BTEC registrations

2018	2017
922,000	1,009,000

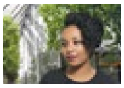
MARKET

c.£0.7bn	#1	#2	#1
Size of market	Market position	GCSE and A level market position	Vocational qualifications market position

PROGRESS AND PRIORITIES

- Total revenue fell 3%[1] in this segment in 2018
- In UK Assessment revenue fell as modest growth in BTEC Firsts and GCE A-Level was more than offset by declines in AS levels, international GCSEs in the UK and UK apprenticeships due to policy changes in the schools qualifications and the apprenticeships market
- After disruption in 2018, 2019 will benefit from new product investment coming through
- Identifying new opportunities in our Growth markets, working on promising initiatives in Thailand, Vietnam and China

BTECs provide students with real-world experience
see p52



BUSINESS MODEL

- We serve students, teachers, schools and government through our qualifications business where we are the awarding body and own the IP.

Our strengths include:

- Ability to leverage strong Intellectual Property
- Track record of delivery at scale
- Pioneering digital assessment platforms
- Investment in innovation and new products

1 Underlying revenue growth.
2 Source: Pearson estimate.

Our business model and strategic priorities

2 Invest in structural growth markets

Virtual Schools

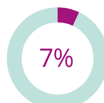
PERFORMANCE

2018 revenue

£288m

+8%[1]

Percentage of total revenue



Enrolments (Full Time Equivalent, continuing)

2018	2017
73,000	65,000

MARKET

>$1.5bn[2]
Total market size

>5%[2]
Market growth potential

PROGRESS AND PRIORITIES

- Full Time Equivalent students in continuing partner schools up 11% on last year
- Three new full time online partner schools opened for 2018-2019
- Strong pipeline – two to five new schools in 2019
- Scale up in existing states; target states with high growth potential

Connections allows students to learn at their own pace see p15

BUSINESS MODEL

A digital business where we offer complete services for charter school partners, support for district programmes and blended offerings.

Our strengths include:

- Strong brand
- Domain knowledge; end-to-end solution, and can further leverage strengths in content and assessment
- Proven partner school model
- Strong parental satisfaction, good learning outcomes and efficacy results

Global Online Program Management

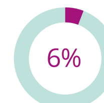
PERFORMANCE

2018 revenue

£234m

+10%[1]

Percentage of total revenue



Global registrations

2018	2017
401,000	352,000

MARKET

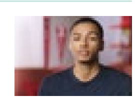
+10%[2]
Global OPM market growth per annum

c.9%
US graduate OPM market growth per annum

PROGRESS AND PRIORITIES

- Signed 57 programs in the year globally
- Global course registration growth of 14%
- Growth in 2019 from programs launched in previous years and 60+ programs to launch in 2019
- Entered new global market with ESSEC partnership in France
- Pipeline of new partnerships

OPM gives students the flexibility they need see p6



BUSINESS MODEL

The digital promise of "anywhere, anytime learning" opens up one of our biggest structural growth markets: Helping universities scale online.

Competitive advantages include:

- Unique position to offer services globally across postgraduate, undergraduate and short courses
- Strong brand and track record
- Domain knowledge; end-to-end solution, and can leverage further strengths in content and assessment

1 Underlying revenue growth.
2 Source: Pearson estimate.

Professional Certification

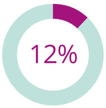
PERFORMANCE

2018 revenue

£482m

+4%[1]

Percentage of total revenue



Global test volumes

2018	2017
15.2m	14.6m

MARKET

c.$1.2bn[2]
Size of market

PROGRESS AND PRIORITIES

- Delivering testing programmes to 450+ credential owners
- Near-term growth from US MCAT; long-term a proven winner in a growing market
- Secured extension on DVSA contract to run the UK theory test

BUSINESS MODEL

From online practice tests to high-stakes, proctored exams that require the industry's most secure testing environments, Pearson VUE is a leader in computer-based testing.

Our competitive strengths include:

- Digital delivery, leading digital platform
- Flexibility and scalability of testing network: 20,000 centres worldwide
- Proven track record of secure test administration, reliable and accurate scoring

English

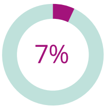
PERFORMANCE

2018 revenue

£305m

+7%[1]

Percentage of total revenue



PTE Academic test volume growth

2018

30%

MARKET

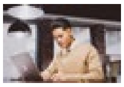
c.1.7bn[2]
Global English speakers

c.£1bn[2]
Size of market

PROGRESS AND PRIORITIES

- Secured two year extension of Australian immigration office contract
- Opportunity to obtain recognition for UK, Canada and China immigration/employment

PTE Academic trusted by universities, colleges and governments see p42



BUSINESS MODEL

We are one of the leaders in the global English language learning market.

Our competitive strengths include:

- Digital platform – taking a test on a computer, with consistent test-taking conditions and avoids human bias
- Global test centre utilising VUE network allowing more flexibility for time of test
- Faster, more accurate and consistent results – 95% of scores returned in five working days
- Aligned to Pearson's Global Scale of English

1 Underlying revenue growth.
2 Source: Pearson estimate.

Our business model and strategic priorities

3 Become a simpler, more efficient and more sustainable business

2017-2020 focus areas

Further simplification through **shared service centres**

Leaner organisations through **reduction in headcount**

Reduction in number of **legacy applications**, data centres and office locations

Progress in 2018

New US enterprise resource planning system go-live

>900 applications decommissioned

42 data centre and office closures

£130m Incremental cost savings achieved in 2018 as our cost efficiency programme runs ahead of plan

Supply chain consolidation

Sale of One Southwark Bridge

Simplification in practice

In 2018, Pearson sold its property at One Southwark Bridge for £115m. The sale represents further progress in Pearson's ongoing simplification strategy and the consolidation of its London property footprint, as Pearson becomes a leaner and more efficient company.

The education sector is undergoing tremendous change – we need to help our customers through that, rather than add complexity.

MARYKAY WELLS
SVP & CHIEF INFORMATION OFFICER,
NORTH CAROLINA, USA

As CIO, I'm here to modernise and simplify Pearson's technology estate to enable better experiences and outcomes for Pearson's millions of customers and learners globally.

The education sector is undergoing tremendous change – we need to help our customers through that, rather than add complexity. Success rides on us striking a healthy balance, allowing the global platforms we build to be used and enjoyed worldwide without compromising either unique regional needs or the ability to personalise learning experiences. Aiding, not impeding, each learner's progress is our goal.

This means Information Technology can't sit in isolation from the business or at arm's length from customers. We all have a stake in improving learning, so fostering the right partnerships and relationships is embedded in to my team's DNA.

Driving a culture of talent and innovation

Doing all of this requires something I'm really passionate about: building high-performing and innovative teams that are customer focused and as diverse as our learners across the globe.

This is unlocking great potential in our people, allowing us to test and use advanced technologies like robotics and artificial intelligence to deliver massive efficiencies in processes – whether internally or in the classroom to free up teachers to spend more time with their students and to personalise digital learning experiences.

We're also making further strides in diversity and inclusion through the launch of Pearson's new Women in Technology program, active participation in UK apprentice and US internship schemes, and increasing graduate hires.

It doesn't end there. Having built an environment where we can constructively challenge ourselves and each other each day, we can continue to push the boundaries on how we can bring innovation to the learning experience.

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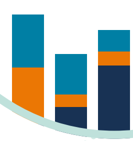
Value created for our stakeholders

Our strategy is driven by the belief that education is evolving to meet the changing demands of today's learners. In an increasingly digital world, we are a driving force behind that change. This enables us to create long-term sustainable growth for our investors and all stakeholders of the company.

£130m

Cost efficiency savings in 2018, enabling the modernisation and digital transformation of Pearson

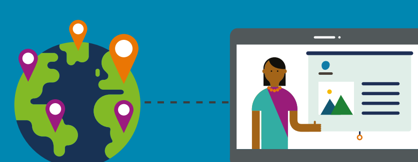


1000+

2018 members of Pearson's Alumni Network since launch in September 2018

89%

Educators surveyed said Pearson products allow students to study anywhere, anytime



3400+

Pearson employees across 40 countries participated in our Innovation Jam over 64 consecutive hours, to drive internal innovation

90%

BTEC students who are employed full time after graduation

How we serve and engage		Key concerns	Our response
Employees			
Our mission-driven employees are key to the sustainable success of Pearson. 57% of employees took part in our 2018 organisational health survey (OHS)	In 2018, we invited all our employees to take part in a survey to get a better understanding of where we can continue to improve. We started several bottom-up innovation programmes; held town halls with senior leaders and global conversations with our CEO. We launched a Pearson Alumni network to connect former, present and future Pearson people.	Three main themes emerge from our OHS findings: Our people want to feel aligned to Pearson's vision, strategy, culture and values; they want to be able to deliver with current capabilities and processes; and they want to understand more about Pearson's ability to innovate, and adapt to change. Our Innovation Jam generated ideas around how we can facilitate learning and design for a "YouTube" generation.	We are focused on creating a healthier company, encouraging and enabling more people to progress. We are working to grow and develop talent, drive more diversity, ensure greater employee engagement, drive innovation, support accessibility and inclusion efforts, and improve sharing of best practice across the company.
Shareholders			
We have a broad range of investors who entrust their capital with us. 625 investor meetings with 344 institutions in 2018	We engage with our investors on an ongoing basis. We communicate with them regularly, including at our financial results, our AGM and at investor meetings and conferences around the globe.	Our shareholder base has a diverse range of views covering financial, environmental and social issues.	We have a positive, ongoing dialogue with our shareholder base. We aim to deliver long-term sustainable value for our investors and all our company stakeholders.
Learners			
Pearson helps millions of learners across the world progress throughout their lives. 80% of students surveyed say our products help them get more out of the class	We regularly talk to and survey learners to understand how learning is evolving, observe changing demographics, attitudes and buying behaviour. We put learner needs at the centre of what we do and work to build world-class digital products and services to deliver amazing experiences and improve learning outcomes.	Learners have increasing expectations over the value of their education. They expect experiences both inside and outside the classroom that are more rewarding, more engaging and less time consuming. Digital is a normal, integral part of their day-to-day life and they expect digital education products to meet this expectation.	We are matching this expectation. For example, we are using predictive analytics to give us early alerts to identify where students are struggling much earlier in the process and therefore can help to get them back on track quickly.
Educational institutions & educators			
We work with teachers, instructors and educators across all stages of education. 89% of educators surveyed said our products allow students to study anywhere, anytime	We collaborate with educators on thought leadership and product development in order to give the next generation of learners the tools they need to be successful.	In a cost conscious environment, educators are focused on delivering high quality educational experiences that set their students on a course to a better career and life for them and their families.	We aim to provide more engaging ways to connect educators with their students, accelerated through the move to digital. This enables more timely feedback on student progress to help set them up for success. We also continue to listen and observe how things are changing in the classroom to adapt to the next generation of learners.

Read more on our approach to stakeholder engagement in the Governance report, on p93

Value created for our stakeholders

How we serve and engage		Key concerns	Our response
Employers			
Pearson works with employers, trade associations and industry bodies to meet the demands of the workforce and equip learners with the skills they need to progress and thrive. **62%** of large UK companies recruited graduates with a BTEC (CBI Skills Survey 2018)	Through assessment and qualifications, micro-certification, online learning, and professional badging, among other solutions, we are supporting the efforts of industry to prepare workers for the jobs of today and of the future.	Industry is looking for education systems to help drive innovation, tackle the global skills gap and contribute to long-term economic growth by ensuring learners enter the world of work better prepared to succeed in their careers.	We have listened hard to employers and are designing products that meet the needs of industry head on, whilst providing learners with the skills to succeed in the workforce. For example, in the UK our new generation BTEC offers career-focused pathways and a high-quality route into higher education or employment.
Governments & Regulators			
We partner with governments (local, state, federal, national) to ensure students have access to and can become proficient with world-class learning standards. **50** US States and a wide range of global markets in which Pearson works with government stakeholders	These standards will address students' needs, close skills gaps and meet the demands of the workforce. Governments and regulators also set policy to ensure that both businesses and consumers are provided with the most effective legislative frameworks that help drive sustainable growth and ensure that learners have access to affordable education and training opportunities.	Governments are looking for effective approaches to better connect educational institutions to employer needs, improving student outcomes.	We are committed to building strong relationships with political and educational leaders. We do not make policy. Instead, we share best practices, inform the policy-making process, and forge innovative partnerships aimed at increasing student access, affordability, and success.
Business partners			
From technology providers to suppliers, channel partners to our authors, we have a broad range of partners across our global business. **25** key global suppliers who help us deliver on our commitment to offering world-class business processes, systems and technologies	We are focused on building successful business partnerships across the education ecosystem to ensure joint success and growth.	We share similar goals and priorities with our business partners – from driving business transformation to developing world-class products; enhancing customer experience to ensuring adherence to data privacy and information security processes; managing political and regulatory risk to developing talent – and more. We align with our business partners and expect them to share our values.	We build relationships with world-class partners and suppliers for the benefit of all our stakeholders. We believe that working with partners who share our commitments not just to best-in-class business practices – but also best practice and international standards for human rights and environmental stewardship strengthens our value chain and reduces our business costs and risks.
Communities			
Educational opportunities and outcomes are closely linked to the prosperity of local communities and global development. **£5.7m** social contributions in 2018	We partner with organisations working to improve education for vulnerable, marginalised groups, and those focused on the impact of business on society and the environment. We partner to deliver programmes that strengthen global education systems.	Our communities around the world are interested and engaged in how we are using our products, services and community investments to reach the learners who need it most and the steps we are taking to have a positive impact on society and the environment.	We are investing in important areas of social innovation where we can reach learners who need it most, such as through Tomorrow's Markets Incubator and our partnership with Save the Children. Read more on this in our sustainability section, p35.

The best part of my job is **working directly with learners.**

LEAH JEWELL
MD, CAREER DEVELOPMENT & EMPLOYABILITY. HOBOKEN, NJ

I started at Pearson 31 years ago as a sales representative in higher education. Now, I'm the Managing Director for Career Development & Employability. My team helps high school, college, and adult learners prepare for their first job and a lifetime of learning around the skills needed for the future.

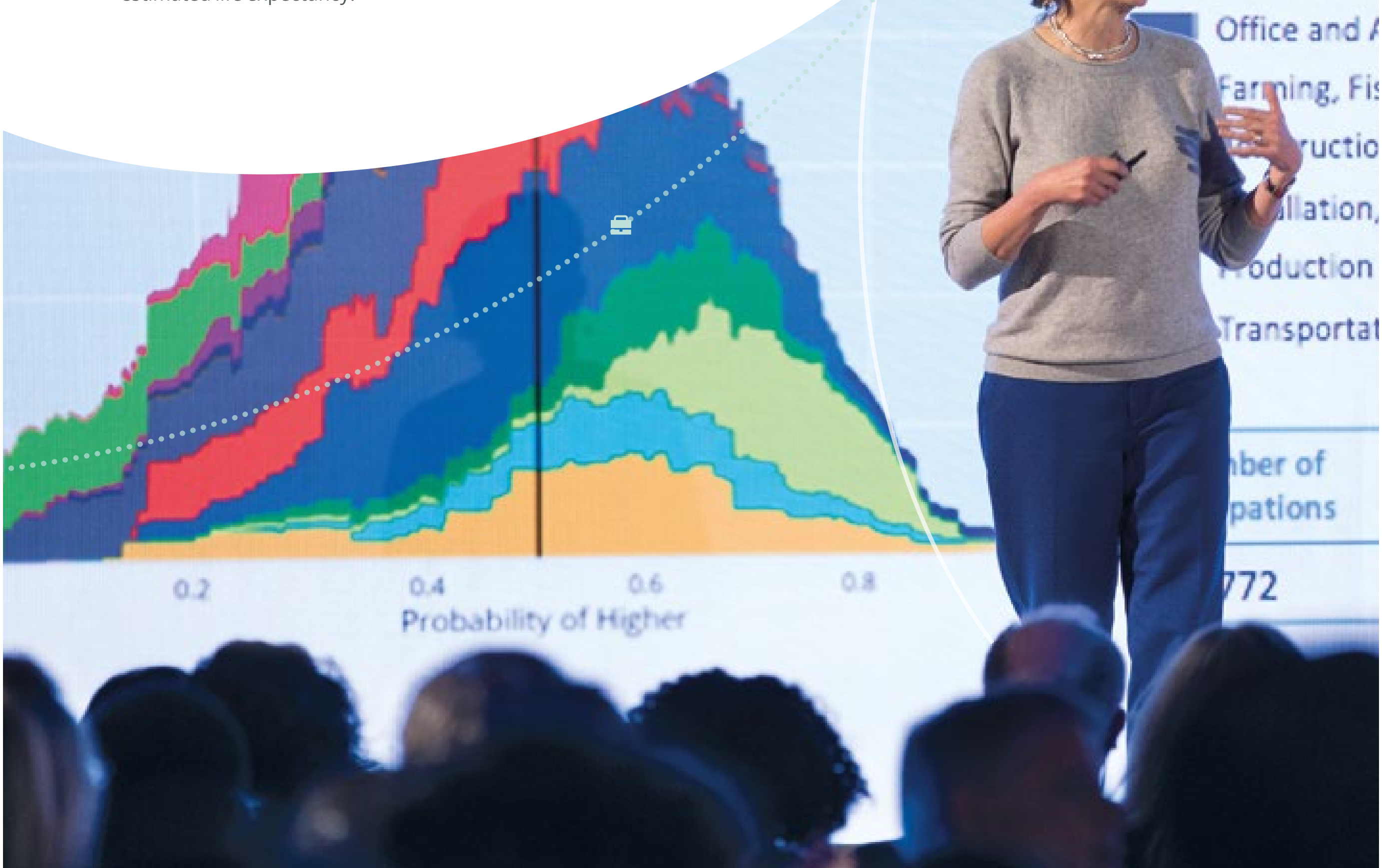
Career-driven learning

The best part of my job is working directly with learners to help them navigate multiple learning pathways, both traditional and non-traditional, and to build skills for future jobs. When I was in school, a degree prepared you for a lifetime career, but people born today will need continuous learning and training for what could amount to one hundred years in the workforce based on estimated life expectancy!

Embracing alternative pathways

I decided to pursue an alternative certification pathway myself, recently completing the 'Entrepreneurship & Innovation' certificate programme at Stanford University. The flexible, self-paced programme worked for me, and helped me obtain knowledge and skills for my current role as well as possible new jobs. I will also use my experience as a learner in that environment to help us build out services and solutions at Pearson.

At Pearson, we are helping people explore, understand, navigate, and successfully complete lifelong learning and up-skilling regardless of their pathway. It's what I'm passionate about and what our employability team does at Pearson.



Efficacy

Efficacy helps build trust with learners, educators, instructors and all our company stakeholders.

Pearson's mission is to help people make progress in their lives through learning. That's why efficacy is core to what we do: we are identifying the outcomes that matter most to learners and educators, designing products based on evidence of what works to improve those outcomes, measuring the impact the use of our products can have on learning, and continuously improving.

In 2013, Pearson made a commitment to begin reporting, by 2018, on the impact of use of our products on outcomes for learners. We reached this major milestone in April 2018, when we were the first education company to release publicly audited and peer reviewed Efficacy Reports. The reports help build a better understanding of not just what works, but how it works and in what context.

Our commitment to efficacy is a continuing and ongoing process. We are releasing a further series of efficacy reports this year, and will do so annually, staying true to our efficacy commitment.

The 2019 efficacy reports include the three rigorous efficacy research studies that were completed across the company over the last year and also cover one of our most frequently used assessment products. The reports highlight how those products are being used to support learners in their learning journey.

This includes three product efficacy reports:

1. Revel Psychology in North America,

2. MyPedia in India, and

3. Sistema COC in Brazil.

As well as an assessment product: Pearson Test of English Academic.

Listening to educators

We gathered feedback from educators and thought leaders around the world about the 2018 reports. While our commitment to efficacy was received positively, we were encouraged to find ways of ensuring that our reports supported changing teaching and learning practices when using digital products. We are responding by focusing on exploring examples of implementation in the research design and including guidance about how the findings can be applied in the reporting materials. In addition, we are working through multiple channels to engage in more, and more fruitful, conversations with educators about efficacy.

What we are doing next

Releasing an efficacy report is just one step in the process of supporting educators and learners to use our products to help improve outcomes that matter to them. In the last five years, efficacy at Pearson has evolved from focusing primarily on efficacy reporting and implementing outcomes-focused evidence-based product design, development and ongoing product improvement. As part of this broader approach, we are helping make foundational improvements across our content, our assessments, our technology capabilities and how our products are implemented.

We are also broadening the range of outcomes we are seeking to support. The 2018 Efficacy Reports focused on course and exam achievement outcomes because these are some of the outcomes that matter most to our customers and learners. Going forward, drawing on insights from our customers and learners and from the Employment in 2030: Future of Skills research we conducted with researchers from the Oxford Martin School and Nesta, we are committed to both designing products for, and evaluating impact on, a wider range of outcomes including skills to support learners' career readiness and employability prospects. In the process helping meet the needs of industry and government in tackling the skills gap – a growing global productivity challenge.

Pearson remains committed to learning and continuously improving our efficacy work to help Pearson grow and help more learners, learn more throughout their lives.

Explore more: www.pearson.com/corporate/efficacy-and-research.html

MyPedia India Efficacy Report Spotlight

MyPedia is a blended teaching and learning solution intended to help teachers improve their pedagogy, assessment and digital skills, and to give learners a positive, engaging experience that improves their skills and abilities.

In a study conducted with schools across India, research shows that teachers using MyPedia change their classroom practices over time—for the better.

› Averaged across classrooms, MyPedia teaching quality ratings increased each quarter from 2017 to 2018 moving from "does not meet standards" to "meets standards."

– The percentage of teachers whose average MyPedia teaching quality rating indicated they were "meeting standards" increased from 50% in the first and second quarters of 2017 to 67% in the second quarter of 2018.

› Teacher self-rated confidence in teaching with MyPedia also increased each quarter between 2017 and 2018.

– 18% of teachers were rated "very confident" in the first and second quarters of 2017, whereas 27% were "very confident" in the second quarter of 2018.

These higher observed MyPedia teaching quality ratings are then associated with better end-of-year student test scores.

› A one point increase in the MyPedia teaching quality rating is related to a 0.44 standard deviation increase (i.e., 17 percentile points) in students' end-of-year test scores.

› A one point increase in MyPedia teacher impact rating is related to a 0.71 standard deviation increase (i.e., 26 percentile points) in students' end-of-year test scores.

DIGITAL CAPABILITIES

Real-time data analytics

Virtual and augmented reality

Connecting our learning research to Pearson's product design process **to enhance impact on outcomes.**

DR KRISTEN DICERBO
VP, LEARNING RESEARCH & DESIGN

I've been at Pearson for seven years. As the VP of Learning Research & Design, I make sure we're connecting our learning research to the way we design products in order to impact the outcomes we want to achieve.

Uniquely human skills

In 2017 we embarked on an ambitious piece of research with the Oxford Martin School and Nesta, to map the future of work and skills. Our research shows that uniquely human skills, such as complex thinking, and interpersonal capabilities like collaboration and leadership, will be increasingly important in the jobs of the future. What makes us human is what will make us employable in the future.

We are working to apply insights from the learning sciences about how to teach and assess those skills consistently across our portfolio, and are designing and developing capabilities for our products based on this evidence that can support learners to develop these uniquely human skills.

If we take collaboration skills as an example, we know that having students do more group work does not automatically improve these skills. They need opportunities to practice different roles within a group, and receive feedback. We can also structure the kinds of collaboration activities so they move from simple skills like collective brainstorming to more advanced skills, like reaching consensus.

Leading with outcomes

We are increasingly taking a 'backwards design' approach. That is, we start with the outcome we are trying to improve, then apply evidence from the learning sciences to the design and development of the product, and then evaluate and report on the impact of product use on the outcome we are looking to improve. Our goal is to help more learners, learn more and in doing so help shape the future of learning.

Research supporting design

Efficacy & Research, once a standalone team and programme, has now become a key capability in our global product organisation. Specialist capabilities in outcomes-focused, evidence-based product design and development and the measurement of impact on learning are now integral parts of our research and development, innovation and product development process.

Sustainability

Sustainability is integral to our strategy and fundamental to achieving our mission to help people make progress in their lives through learning. Through our 2020 Sustainability Plan, we made a commitment to embed social and environmental issues across our business. We recognise the role sustainability plays in driving our long-term growth and in helping build a better society.

Our 2020 Sustainability Plan drives us to find innovative ways to reach new markets by helping learners overcome barriers, keeping abreast of the changing education landscape, and earning the trust of our stakeholders. By aligning with the UN Sustainable Development Goals (SDGs), the Plan ensures we think about business success in the context of our wider responsibilities as part of the global community. We have prioritised SDG 4 on quality education, SDG 8 on decent work and economic growth and SDG 10 on reducing inequalities.

2020 Sustainability Plan

Three focus areas drive our commitment to sustainability:

1. Reach more learners

2. Shape the future of learning

3. Be a trusted partner.

More information on our performance in each of these areas will be available later in 2019 when we publish our 2018 Sustainability Report, available at www.pearson.com/sustainability.

In this section, we:

- Set out the key material issues for the company and how these relate to our risk management process
- Outline how sustainability is governed at Pearson
- Report on highlights from each of the three pillars.

Our material issues

Our 2020 Sustainability Plan is informed by our material issues – those most relevant to the sustainability of the business. They were identified in consultation with senior leaders, employees, external experts and other stakeholders. We have prioritised nine key issues, which represent both opportunities for growth as well as operational risks. We map these sustainability issues against our enterprise risk management process.

As part of our risk management process, company-wide risks are tracked across geographies and functions.

See *Our material issues* matrix p33.

Sustainability governance

The Reputation & Responsibility Committee, a formal committee of the Board, provides ongoing oversight, scrutiny and challenge on matters relating to our sustainability strategy and our corporate reputation. Learn more on p106.

The Pearson Executive oversees implementation of business and sustainability strategy. The Responsible Business Leadership Council drives implementation of the strategy on behalf of the Board. It is chaired by our Chief Corporate Affairs Officer and comprises senior leaders from across the business.

1 Reach more learners

- Improve access to and affordability of products and services
- Collaborate to reach underserved learners

2 Shape the future of learning

- Build skills that foster employability and inclusive economic growth
- Promote education for sustainable development
- Engage in multi-stakeholder research, dialogue, and collective action to solve global challenges

3 Be a trusted partner

- Respect and support our people, customers, and communities
- Protect our natural environment
- Build a sustainable supply chain

Our material issues

Materiality matrix

The following matrix shows how we mapped our material issues, and highlights the nine that we have prioritised.

We will evaluate, refine and talk with stakeholders about our material issues on an ongoing basis, in the spirit of continuous iteration and improvement.

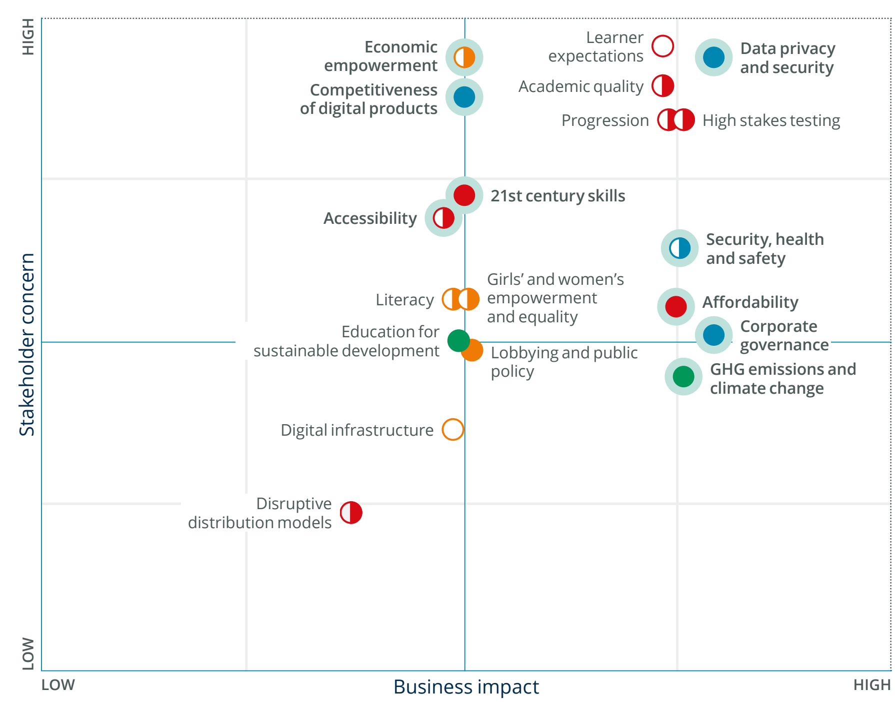
Key to material issues

Nine material issues in our sustainability plan and reporting

- Corporate functions
- Societal issues
- Education industry
- Environmental issues

Degree of control

High / Medium / Low



Alignment of material issues to principal and other Pearson risks

Sustainability Material issues	Annual report 2018 Principal risk	Company-wide risk	Business area risk monitoring		
Disruptive distribution models	2	YES	› Global Product › Core › Growth › North America › Environmental, Social & Governance		
Competitiveness of digital products	2				
Affordability	2				
Learner expectations	2				
Academic quality	2				
High stakes testing	5	YES	› Assessment	› Core	
Lobbying and public policy	4	YES	› Core › Growth	› North America › Assessment	
Data privacy and security	11	YES	› Global Product › Core › Growth	› North America › Assessment	› Legal › Tech & Ops
Digital infrastructure	8	YES	› Global Product	› North America	› Tech & Ops
Security, health and safety	6 7	YES	› Core › Growth › North America › HR	› Assessment › Environmental, Social & Governance	
Accessibility[1]	–	–	› Assessment	› Legal	› Environmental, Social & Governance
GHG emissions and climate change	–	–	› Environmental, Social & Governance		

1 Emerging risk.

See *Principal risks and uncertainties*, p62

Sustainability

1 Reach more learners

Commitments:

› Improve access to and affordability of products and services

› Collaborate to reach underserved learners

Our continued commitment is to better address the needs of vulnerable groups through our products, services and partnerships. We work to identify and remove barriers to education so that all learners can improve their lives – regardless of their income level, the way they learn, or their background. Reaching more learners helps us to innovate and grow our business, and it supports our commitment to quality education for all, decent jobs, and equality in line with the UN SDGs. Harnessing the power of new technologies to bring education and opportunities to more people in more places is central to these efforts.

Improve access to and affordability of products and services

In 2018, we continued to advance our commitment to improve access to and affordability of education through our core business offerings.

Our corporate education benefit programme, Accelerated Pathways (see p51), leverages tuition assistance funds to help adult learners overcome challenges to education attainment while positively impacting recruitment and retention initiatives. Through this benefit, employees have access to coaches and advisors, courses, certificates, degrees, and an education assistance platform that support skills and career development. Education programs are delivered online and are mobile optimised, so employees can learn anytime and anywhere.

Connections Academy, a tuition free, fully-accredited, US-based online public school for students in grades K12, offers an inclusive, collaborative learning experience that meets the unique needs of learners with a wide variety of backgrounds and abilities. An alternative to brick-and-mortar public schools, Connections provides a valuable option for students who are not finding success in the traditional classroom. For example, students with serious health issues, who have been bullied, or are struggling or advanced academically can benefit from attending a Connections Academy online school.

Our Inclusive Access model helps college students access their materials at a lower price.

Accessibility for Learners with Disabilities

Pearson has established a Global Accessibility Steering Group to drive support for people with disabilities through the intentional integration of accessibility standards in product development. We are committing to a process of continual improvement to increase the accessibility of both new and existing products.

As an employer, we work to ensure that appropriate procedures, training and support are in place for people with disabilities to ensure fair access to career and progression opportunities. One of our eight employee resource groups is Pearson Able – its remit is to improve company practice for learners and employees.

Tomorrow's Markets Incubator

The Tomorrow's Markets Incubator develops new products, services, and business models for low-income and underserved market segments by engaging employees in a robust venture innovation process. The incubator is Pearson's first step in reaching this market of more than 4 billion people in size and $5 trillion in value.

Supporting students with Smarthinking tutors

Service: Smarthinking

In a study we conducted with Morgan State University, instructors teaching writing-intensive courses indicated that their students' writing skills, confidence, and work quality improved as a result of the interaction with Pearson's Smarthinking tutors.

Morgan State is a leading public research university in Maryland. Many arrive with a mix of writing skill strengths and weaknesses. For the courses in the study, all students were required to use either Smarthinking or another tutor – the first time many of them were exposed to tutoring. The aim was to help all students, especially those who were behind or struggling, feel it is normal to use a tutor and empower them to use the resource for other courses going forward. Students expressed appreciation for the fast turnaround and expert grammar and writing assistance provided by Smarthinking tutors.

Learn more at: go.pearson.com/PearsonMorganState

Following a selection process, employee-led incubator teams receive seed funding and access to thought leaders and coaches with deep expertise in venture creation for new markets. These tools support teams to innovate commercially sustainable and socially impactful solutions, as well as develop their own professional skills and capabilities.

Today, the incubator has a global portfolio of ventures at different stages of maturity. Teams are selected by an investment committee comprising Pearson executives. They must demonstrate a compelling, feasible commercial solution that will improve learner outcomes and deliver social impact.

Collaborate to reach underserved learners

Through partnerships, we are tackling some of the biggest education challenges.

Every Child Learning

Since 2015, Pearson has been working with Save the Children on "Every Child Learning," a partnership delivering high-quality education to Syrian refugees and host community children in Jordan, and innovating new solutions that improve the delivery of education in emergency and conflict-affected settings. Between 2015 and 2019, Pearson has committed £4.5m.

The project includes "Space Hero" (Batlalfada), a fun and engaging maths learning app, designed by Pearson in collaboration with refugee and Jordanian children, aged 9-12, to strengthen their maths skills. In 2018, the app, which is available to download for free on Google Play, had over 28,000 new users and over 4,000 weekly average users regularly playing the game. It is Pearson's highest rated app in the Google Playstore. Space Hero also supports a broader in-school programme, led by Save the Children, that focuses on teacher training, school-community relations, after-school learning, and psychosocial support.

In 2019, 19 schools will be implementing the Every Child Learning programme, with the aim of impacting over 25,000 children.

Pearson Affordable Learning Fund

The Pearson Affordable Learning Fund invests 'patient capital' in independently run, for-profit, education start-ups using innovative approaches to improving learning outcomes and increasing access, at scale.

Social contributions

In 2018 our social contributions comprised £4.7m in community contributions and £1.0m invested in socially innovative business initiatives. Together this was equivalent to 1.1% of our pre-tax profits for the year. It included:

	Social contributions
Every Child Learning (see p35)	**£1.6m**
Tomorrow's Markets Incubator (see p34)	**£1.0m (social innovation)**
Camfed Learner Guides	**£0.1m**
Project Literacy	**£1.7m**
Employee Giving	**£0.7m**
Employee Volunteering	**£0.2m**
Programme Management	**£0.4m**
Total	**£5.7m**

Through Every Child Learning, we are helping Khaled*, 11, to achieve his dream of becoming a dentist

* name changed to protect identity.

Core4Stem Volunteering

Every year, the San Antonio Hispanic Chamber of Commerce hosts its CORE4 STEM event, which brings together more than 5,000 middle school students, from five inner city school districts to celebrate STEM education and career opportunities.

In 2018, a group of Pearson volunteers from the Infrastructure and Operations team in Assessment hosted a cloud infrastructure and security simulation at this event, with the goal of teaching these 7th and 8th grade students how we deliver technology today.

The Pearson simulation had students deploy and securely host a discreet application in the "cloud" building basic coding and platform management skills. These are the foundation of the skills that STEM employers need but schools in these districts struggle to find support for the programmes that build these skills, leaving a gap between the skills students need and the jobs they want.

Pearson aims to help fill the gap, understanding the skills employers need, and finding ways to work with schools in the district to help students build these skills. Pearson's simulation at CORE4 STEM was so well received that it's going to be scaled across a number of San Antonio School Districts. This is just one way Pearson is helping to connect the dots between employers, schools, and students.

Sustainability

2 Shape the future of learning

Commitments:

- › Build skills that foster employability and inclusive economic growth
- › Promote education for sustainable development
- › Engage in multi-stakeholder research, dialogue, and collective action to solve global challenges

Education and training for sustainable development

In October 2018, Pearson collaborated with Business Fights Poverty, Arizona State University and the UN Principles for Responsible Management Education (an initiative of the UN Global Compact) to publish 'The Role of Business in Education and Training for Sustainable Development'. Based on interviews with educators and companies, the report shared insights and recommendations for business to help people gain the skills and knowledge required to meet sustainability challenges, improve lives, and contribute to long-term prosperity and wellbeing.

The pace of change in education is faster than ever before. We envision a future in which learners are equipped with the skills they need to build careers and navigate the future of work, and where learning contributes to more inclusive, equitable societies and economies.

Pearson has focused on guiding students toward their career aspirations and equipping them with crucial workplace skills. We help learners prepare to enter specific careers – delivering vocational training, providing industry-focused qualifications and assessments, and teaching skills such as science, technology, engineering, maths and English.

For example, Pearson Career Success (see p55) aims to meet the needs of both colleges and employers by providing a digital suite of assessments, learning modules and tools that help students identify career goals and the gaps in their academic and career skills that they need to fill.

In response to our customers, we have developed content, courses, qualifications and other services that help students learn about sustainability. By integrating sustainability-related content into our products, we can explore new market opportunities while making a direct contribution to the SDGs and inspiring the next generation to improve their world. We work with a number of authors and professors who have made sustainability part of the materials they create for Pearson. We have also developed a number of sustainability qualifications, and have embedded sustainability within BTEC qualifications across sectors, including engineering, warehouse operations, animal management, science, and IT.

3 Be a trusted partner

Commitments:

- › Respect and support our people, customers and communities
- › Protect our natural environment
- › Build a sustainable supply chain

We are committed to being the best partner we can be to learners, educators, suppliers, and communities: living our values through how we do business, treat people, and protect the environment.

Respect human rights

Our vision is to respect and promote human rights, including the right to education, throughout our operations and with our customers, employees, contractors, and supply chain. We have a corporate responsibility to respect human rights, and our approach is guided by the Universal Declaration of Human Rights, the International Labour Organization's declarations on fundamental principles and rights at work, the UN Guiding Principles on Business and Human Rights, and the UN Global Compact Principles. We are a founding signatory to the UN Global Compact, and we are a member of the Global Compact's UK Local Network.

We published our first public Human Rights Statement in 2018.

We have identified priority human rights risks and opportunities related to content, learners, partnerships, technology and employees, and developed a roadmap to address them. We also have policies in place for key elements of human rights including editorial content, health and safety, safeguarding and data privacy. For more, see the section on compliance in Principal Risks on p62.

Our Business Partner Code of Conduct sets out our requirements of third parties and, as part of our global approach to procurement, we include specific obligations relating to human rights compliance in new and renewed supplier agreements and we audit suppliers in high-risk categories.

A priority across the value chain is to ensure our activities are free from slavery, servitude, forced or compulsory labour and human trafficking. A statement on the steps taken by Pearson to combat modern slavery was approved by the Board and can be viewed on the Pearson website (www.pearson.com).

Deliver relevant, appropriate, and inclusive content

In creating our products, we think specifically about the culture, background, and age of the learners that will access our content. We have implemented a common Editorial Policy across Pearson to guide product development teams and individuals involved in the content creation process on ensuring content is aligned to Pearson's values, and prevent inappropriate content from being published. The policy is overseen by a cross-regional and functional steering committee, chaired by a member of our executive team, which provides a space for escalation and issue resolution. A network of 35 policy champions are responsible for implementation and act as a point of escalation for queries in our businesses and markets around the world.

Safeguarding and protecting learners

We continue to view safeguarding as our fundamental obligation to learners and a high priority for Pearson. We have a set of safeguarding principles and we agreed a new safeguarding strategy for 2018-2020, which includes a focus on safeguarding in online and digital environments. In addition, we implemented a new set of safeguarding metrics. We also completed a gap analysis on the safeguarding assurance processes for each business. Safeguarding has been identified as a principal risk under our enterprise risk management system and there is more information on p60.

Key performance indicators: Safeguarding

100%

of targeted identified actions addressed

Respect and progress our employees

Our employees are integral to delivering Pearson's mission. Last year, we adopted four key strategies:

- Provide integrated people solutions that empower the business to drive results, outcomes, growth and employability for learners
- Establish Pearson as an employer of choice for diverse talent across the world
- Cultivate a high-performing global workforce that innovates and delivers dynamic learning experiences
- Promote lifelong learning and digital skills development to create an agile and mobile workforce

Pearson continues to manage considerable amounts of change both within the business and outside it. Our simplification programme is ahead of plan due to an increase and acceleration of savings delivered as a result of the recent implementation of our enterprise resource planning system. The difficult but necessary changes we have been making will allow us to speed up innovation, provide better customer experiences, eliminate duplication, and increase scalability in the long-term. We continue to do all we can to support our colleagues through this transformation, through regular communication and detailed consultation, and providing support for those leaving the company.

We are investing in talent and succession, helping our leaders and their teams define and develop new skills and capabilities, creating a rich and growing pipeline of diverse talent. We work to inform, support and equip colleagues to work collaboratively, and we encourage and reward high performance.

We are also committed to provide a safe and healthy work environment for our employees and the learners we serve (see the Principal Risks section on p63 for more detail).

In 2018, a key focus was innovation and organisational health. We conducted a company-wide organisational health survey to 22,000 permanent global employees in 13 languages plus an accessible version. We had a 57% completion rate. We are in the process of reviewing the results with Executive Management to produce clear, tangible action plans with specific focus areas and measurements that will help drive us forward.

In October, we hosted an Innovation Jam, which was an online, employee-driven discussion to openly exchange perspectives and ideas to support Pearson's growth, in line with our five year strategy.

Support our culture, mission and values

Our values – to be brave, imaginative, decent and accountable – continue to guide us in implementing our strategy. They are embedded into our performance assessment, which means all employees are evaluated on and rewarded for acting consistently with them.

The Pearson Code of Conduct underpins our values by setting out the global ethical, social and environmental standards of behaviour we expect from employees, and we have a companion code for business partners.

The Code was reviewed and refreshed in 2018 and included an interactive training course combined with the certification of the Code. We make sure everyone in Pearson is aware of the Code and confirms they understand and will comply with it. In 2018, we achieved our target of 100% completion by all employees. The Code is also assigned as part of the on-boarding process for all new Pearson employees.

Many of the areas covered by the Code are supported by detailed policies and procedures, including: anti-bribery and corruption, health and safety, and safeguarding. Learn more about these issues in our section on Principal Risks, p62.

We operate a free, independent, confidential telephone helpline and website available to anyone who wants to raise a concern. We have a clear non-retaliation policy in place to encourage people to share the issues they have and we gauge how comfortable people are in raising concerns in our employee engagement survey.

Sustainability

Key performance indicators: Gender diversity

Women in Pearson %

At Board level, 30% of our members were female as at the end of 2018. As a founding member of the 30% Club, we have endorsed and committed to work towards the target of a minimum of 33% representation of women on the Board by 2020. Below are key gender representation segments over the past three years:

	2016	2017	2018	
Board of Directors	30%	30%	**30%**	**3**
Senior leadership*	32%	30%	**31%**	**33**
All employees	60%	61%	**62%**	**17,065**

* Two reporting lines from the Chief Executive.

In the UK, the government introduced regulations designed to help address the gender pay gap. Pearson has provided information on its gender pay gap in the UK (see go.pearson.com/GenderPayReport) and has made a commitment to extend our reporting globally by 2020. Our action plan to address the gap is global in scope and focuses on five key areas:

- Supporting, mentoring, and fostering the professional development of high potential women;
- Encouraging the empowerment of women and the formation of networks;
- Improving recruitment and pipeline practices to enhance senior female representation;
- Shaping our policies and culture around returning to work and flexible working; and,
- Ensuring the consistent engagement of executive management and senior leaders in Diversity and Inclusion initiatives.

Key performance indicators: Health and safety

92%

of our H&S standards have been fully implemented around the world.

96%

of open H&S findings from audits prior to 2018 have been fully resolved.

82

H&S Coordinators were trained and successfully certified in Institution of Occupational Heath and Safety (IOSH) Managing Safely course in 2018.

Foster diversity, equality and inclusion

Every person is unique whether that be in terms of age, gender, identity, race, ethnicity, religion, disability, sexual orientation, education, learning style, national origin, personality type as well as across a range of many other factors. At Pearson, we value a diverse workforce and a workplace which reflects our learners – the customers we serve around the world. By celebrating and leveraging diversity, we can better harness our collective skills and talents, our imagination and ideas to design and deliver the best services and solutions for all learners. Our approach is described in our Diversity & Inclusion Statement.

In 2018, we appointed a senior global leader to drive this agenda and conducted a comprehensive review of the diversity and inclusion practice at Pearson, which resulted in a new diversity framework, governance and measurement models, a set of global priorities and a maturity model for evolving our employee resource groups into business resource groups. Highlights include:

- A new Diversity & Inclusion Council led by the CEO to provide strategic oversight and to extend our work into many more markets and countries. The Council includes business leaders, allies and advocates, as well as representatives from our ten employee resource groups.
- A set of seven priorities which will guide our 2019 action plan and major initiatives. These include a focus on improving gender representation at the top two levels of the company as well as improving the racial diversity for manager roles and above initially focusing on the United States.
- A significantly expanded global network of Diversity and Inclusion Advocates who provide support to advance our practice in their businesses and geographic locations.
- A plan to help our employee resource groups at Pearson evolve and mature. The networks are for women, parents, veterans, Latinos, the LGBT community, employees across generations, people with disabilities and employees of black and/or African ancestry. A new group launched this year that focuses on the Black, Asian and Minority Ethnic communities within Pearson.

Our work on diversity and inclusion continued to gain external marketplace recognition. In 2018, Pearson was recognised as follows:

- Named in the 2018 Forbes list of America's best employers for diversity and inclusion;
- Successful in scoring 100% in the 2018 Corporate Equality Index run by the Human Rights Campaign;
- Recognised as having one of the top 50 leading global LGBT Ally Executives by the FT/OutStanding;
- Awarded the Dynamic Mentoring Organisation of the Year for a second year by the 30% Club and Women Ahead for a programme led by our employee resource group on gender.

Improve health and safety

Our people work in diverse locations around the world, including schools, colleges, test centres, offices, data centres, call centres, printing sites, warehouses, as well as remote working. To be a sustainable company and a trusted partner we must ensure the safety and wellbeing of our people no matter where they are working.

At the beginning of 2018, we revised our 2018-2020 Health and Safety strategy. This updated strategy included a significantly revised Global Health and Safety Policy and Standards, to which 21,194 (87%) of our employees have certified their understanding of in our learning management system. A global network of nearly 150 "H&S coordinators" also work to ensure the H&S management system is implemented and maintained in their business. H&S has been identified as a principal risk under our enterprise risk management system and is subject to regular reporting to the Reputation & Responsibility Committee, a Board-level Committee (see p106).

Protect our natural environment

Greenhouse gas (GHG) emissions is one of our material sustainability issues and climate change remains a focus for us as one of the most serious issues facing the planet. Minimising our environmental impact is not just the right thing to do; it helps deliver operational efficiencies. The supply chain cost of our energy use and business travel accounts for around 1% of our spend. This is where we have the most control and where we have focused our efforts to date. Energy cost does not feature as a Principal Risk for the company. We know that our stakeholders expect good environmental stewardship, which is why GHG emissions was identified as a material sustainability issue for the company. Our Environment Policy provides more information on our approach.

We maintained our climate neutral status for our directly controlled operations – a commitment first introduced in 2009.

Our strategy is:

1. Reduction: Through both the rationalisation of our portfolio and energy efficiency, as well as divestments, we reduced our energy consumption vs our 2009 baseline by 60%.

2. Renewables: We maintained our record of purchasing 100% of the electricity we use from renewable sources and generate our own renewable electricity at four of our sites (down from five as one site with renewables was sold in 2018).

3. Offset: Since 2009, we have offset the emissions from our energy and fuel consumption and business travel.

In 2018 we were recertified against the Carbon Trust Standard for our global operations. Pearson was the second ever organisation to secure the standard, which recognises leadership in measuring, managing and reducing year-on-year carbon emissions.

We also continue to be certified against ISO 14001, the environmental management standard in the UK and Australia. This standard incorporates both internal and external audit.

Key performance indicators: Global Greenhouse Gas emissions data

Metric tonnes of CO_2e

Emissions from	2009	2016	2017	2018
Combustion of fuel and operation of facilities (GHG Protocol Scope 1)	44,649	19,093	15,691	**13,057**
Electricity (GHG Protocol Scope 2 – location based)	130,395	77,579	61,047	**49,920**
Electricity (GHG Protocol Scope 2 – market based)				**4,583**
Emissions relating to air and rail travel, electricity transmission, waste and water (GHG Protocol scope 3)	35,262	29,714	27,646	**21,672**
Total – Location based	**210,306**	**126,385**	**104,384**	**84,649**
Total – Market based				**39,312**

Intensity ratios	2009	2016	2017	2018
Sales Revenue (£m)	5,624	4,552	4,513	**4,129**
Scope 1 & 2 (location)	175,044	96,672	76,738	**62,977**
Scope 1 & 2 (market)				**17,640**
Scope 1 & 2/sales revenue (location)	31.12	21.24	17.00	**15.25**
Scope 1 & 2/sales revenue (market)				**4.27**
FTE		32,716	30,339	**24,322**
Scope 1 + 2/FTE		2.95	2.53	**2.59**

Methodology: We have reported on all of the emission sources required under the Companies Act 2006. These sources fall within our consolidated financial statement. We do not have responsibility for any emission sources that are not included in our consolidated statement. The method we have used to calculate GHG emissions is the GHG Protocol Corporate Accounting and Reporting Standard (revised edition), using the location-based scope 2 calculation method, together with the latest emission factors from recognised public sources, including, but not limited to, the UK Department for Business Energy & Industrial Strategy, the International Energy Agency, the US Energy Information Administration, the US Environmental Protection Agency and the Intergovernmental Panel on Climate Change. The data in the table above has been independently verified by Corporate Citizenship.

We have a policy on the sustainable sourcing of paper, which resulted in over 86% of the paper we purchased in 2018 in the UK being certified to an environmental standard such as the Forest Stewardship Council (FSC) or Programme for the Endorsement of Forest Certification (PEFC). Pearson is a member of industry bodies dedicated to responsible forest management. We hold FSC chain of custody in the UK as does LSC Communication, our outsource partner in North America, allowing books in those markets to carry the FSC label.

Our work is informed by the Task Force on Climate-related Financial Disclosures, and we will use its guidance to improve our environmental disclosures.

In 2018, we also started to more accurately understand the wider carbon emissions from our supply chain. Going forward we will continue to work with our suppliers to better understand the sustainability risks and opportunities associated with the products and services we buy.

Sustainability

Sustainability rankings

MEMBER OF
Dow Jones
Sustainability Indices
In Collaboration with RobecoSAM

Inclusion in Global 100
most sustainable corporations
(Corporate Knights)

FTSE4Good

Bloomberg
Gender-Equality Index

Non-financial information statement

The following table outlines where the key contents requirements of the Non-Financial Statement (as required by sections 414CA and 414CB of the Companies Act 2006) can be found in this document. In addition, our annual sustainability report (www.pearson.com/sustainability) contains more detail on these topics and follows international reporting frameworks including the Global Reporting Initiative, UN Global Compact, and UN Sustainable Development Goals.

Reporting requirement	Pearson policies and procedures	Section of annual report
Environmental matters	Environment Policy	Protect our natural environment, p39
	Paper Purchasing Policy	
Employees	Code of Conduct	Respect and progress our employees, p37
	Human Rights Statement	Support our culture, mission and values, p38
	Raising Concerns and Anti-Retaliation Policy	
	Global Health and Safety Policy and Standards	
	Diversity & Inclusion statement	
Human rights	Human Rights Statement	Respect human rights, p36
	Editorial Policy	Support our culture, mission and values, p37
	Modern Slavery Statement	Respect and progress our employees, p37
	Safeguarding Principles	Deliver relevant, appropriate, and inclusive content, p37
Social matters	Human Rights Statement	Social contributions, p35
Anti-corruption and bribery	Code of Conduct	Support our culture, mission and values p37
	Pearson Anti-Bribery and Corruption (ABC) Policy	Risk management, p60
	Raising Concerns and Anti-Retaliation Policy	Legal and compliance, p74
Policy embedding, due diligence and outcomes		Risk management, p60
		Sustainability, p32
Description of principal risks and impact of business activity		Risk management, p60
Description of business model		Strategy, p18
Non-financial key performance indicators		Sustainability, p32

Publicly available policies in the list above can be found at: go.pearson.com/OurPolicies

It's critical that we recognise **the importance of technical and vocational education.**

CINDY RAMPERSAUD
SVP, BTEC & APPRENTICESHIPS

I have been at Pearson for a little over a year and I oversee our BTECs – specialist work-related qualifications, grounded in the real world of work and available in schools, colleges and universities across a range of subjects.

For my own personal journey of learning and discovery – from a student in the mid 80's to a career in the entertainment industry – across retail, film and music, to my current role in education – discovery and technology have played a key role.

The future of jobs

As technology transforms big-player industries like education, we're finding that new jobs and careers are surfacing around every corner. The challenge right now is how you and I prepare ourselves and future generations for the world five, 10 and 20 years out. What is clear to me is that education and a culture of lifelong learning have a crucial role to play in preparing us for that 'yet to be imagined future'.

Alternate pathways to education

Education has been a powerful enabler for change but today is still focused on academics – acquiring knowledge in a traditional way where success is measured by passing exams. 'Skills' – technical and vocational education have often been seen as too alternative a pathway.

Yet, these are the skills – soft and hard skills alike – learners will need for the jobs of tomorrow. It's critical that we recognise the importance of technical and vocational education, and our BTECs and Apprenticeship programmes do just that. They're helping us keep pace with a landscape that now sees technical and vocational education as a key driver for growth, increased productivity – preparing for the yet to be imagined future.

To embrace a future that is constantly changing, we need to create a culture that fosters a love of lifelong learning because it's only through this that we'll be able to face the changes head-on as we prepare for the jobs of tomorrow.

90%
BTEC students who are employed full time after graduation (Source: HESA)

62%
Large UK companies have recruited graduates with a BTEC (Source: CBI Skills Survey 2018)

A high-stakes, computer-based English language test trusted by universities, colleges and governments around the world.

PTE Academic is a high-stakes, computer based English language test that people take to prove their English skills for studying abroad and visa applications.

"PTE Academic was first approved to support Australian visa applications in 2014 and has quickly become the test of choice for Australian student and migration visa applicants."

David Barnett Pearson Managing Director, Asia Pacific

It is accepted at prestigious institutions including Harvard Business School, Yale and the University of Melbourne.

In 2018 the Australian Department of Home Affairs renewed its endorsement of PTE Academic in supporting the Australian visa programme for a further two years.

The Test has seen 30% volume growth in 2018 with further growth expected in 2019. PTE Academic is delivered in hundreds of test centres year round, providing learners with the flexibility they need.

PTE Academic

£77m
Revenues

+30%
Test volume growth

2 Aligned to strategic priority, p23

DIGITAL CAPABILITIES

- Automated speech recognition
- Automated marking and scoring
- Advanced biometrics

Financial review

We expect to make further progress in 2019, with adjusted operating profit between £610m and £660m.[1]

Coram Williams
Chief Financial Officer

Profit and loss statement

In 2018, sales decreased by £384m in headline terms to £4,129m (2017: £4,513m) with portfolio changes reducing sales by £216m and currency movements decreasing revenue by £134m. Stripping out the impact of portfolio changes (including the adoption of new accounting standards) and currency movements, revenue was down 1% in underlying terms. Revenue in North America declined 1%, Core was flat and Growth up 1%.

The 2018 adjusted operating profit of £546m (2017: £576m) reflects a £130m year on year benefit from restructuring, offset by £50m of cost inflation, £22m of other operational factors, £15m negative contribution from trading and a £73m negative impact from currency movements and portfolio changes. Excluding the impact of currency movements and portfolio changes (including accounting changes) underlying adjusted operating profit grew 8%.

Net interest payable was £24m, compared to £79m in 2017. The decrease was primarily due to a reduction in gross debt achieved through the early redemption of bonds in 2017. Charges relating to early redemptions increased finance charges in 2017 but were not as significant in 2018. Additionally, there was a reduction in interest on tax provisions following reassessment of those provisions in 2018.

The effective tax rate on adjusted earnings in 2018 was a credit of 5.2% compared to an effective rate charge of 11.1% in 2017. The decrease in tax rate reflects several one-off benefits in 2018 including provision releases due to the expiry of relevant statutes of limitation and due to the reassessment of historical positions, as well as a one-off benefit from a reassessment of the tax treatment of certain items of income and expenditure.

Adjusted earnings per share of 70.3p (2017: 54.1p) included a c.20p one-off tax benefit and a lower finance charge.

Cash generation

Operating cashflow declined by £156m from £669m in 2017 to £513m in 2018 in headline terms. The decrease reflects lower dividends from Penguin Random House, following our divestment of a 22% stake in the business in 2017, higher incentive payments in 2018 relating to 2017 performance and movements in working capital. The equivalent statutory measure, net cash generated from operations, was £547m in 2018 compared to £462m in 2017. The main reason for the improvement in cash generated from operations was the absence of special pension contributions in 2018 which were £227m in 2017.

Financial summary

Business performance

£ millions	2018	2017	Headline growth	CER growth	Underlying growth
Sales	**4,129**	4,513	(9)%	(6)%	(1)%
Adjusted operating profit	**546**	576	(5)%	(2)%	8%
Operating cash flow	**513**	669			
Adjusted earnings per share	**70.3p**	54.1p			
Dividend per share	**18.5p**	17p			
Net debt	**(143)**	(432)			

Statutory results

£ millions	2018	2017	Headline growth	CER growth	Underlying growth
Sales	**4,129**	4,513	(9)%	(6)%	(1)%
Operating profit	**553**	451			
Profit for the year	**590**	408			
Cash generated from operations	**547**	462			
Basic earnings per share	**75.6p**	49.9p			

a) Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude both currency movements, portfolio changes and accounting changes, b) CER refers to Constant Exchange Rates, and c) The 'business performance' measures are non-GAAP measures and reconciliations to the equivalent statutory heading under IFRS are included in the financial key performance indicators section on p222–225.

1 Guidance includes impact of IFRS 16.

Return on invested capital

On a gross basis, ROIC increased from 4.3% in 2017 to 4.7% in 2018 and from 6.2% in 2017 to 6.7% in 2018 on a net basis. The movement largely reflects lower invested capital following disposals and decreased tax payments which were more than enough to offset the effect of lower adjusted operating profits primarily due to the disposal of a 22% stake in Penguin Random House and currency movements.

Statutory results

Our statutory profit was £553m in 2018 compared to a profit of £451m in 2017. The increase in 2018 is largely due to the increase in gains on disposal and reduced intangible charges which more than offset increased restructuring charges, the lost contribution from businesses disposed of and the impact of currency movements.

Capital allocation

Our capital allocation policy remains unchanged: to maintain a strong balance sheet and a solid investment grade rating, to continue to invest in the business, to have a sustainable and progressive dividend policy, and to return surplus cash to our shareholders where appropriate.

Balance sheet

Net debt to EBITDA was 0.2x. Net debt decreased to £143m (2017: £432m) reflecting disposal proceeds and operating cash flow, partially offset by the strengthening of the US Dollar relative to Sterling, dividend payments and the share buyback.

In January 2018, the Group repurchased €250m of its €500m Euro 1.875% notes due May 2021 and €200m of its €500m Euro 1.375% notes due May 2025. Borrowings at 31 December 2018 include drawings on the Group's revolving credit facility (RCF) of £nil (2017: £nil).

Pension plan

In 2018, our UK Pension Plan completed a new triennial valuation as at 1 January 2018 and re-confirmed the Plan as being well funded. The Plan has recently used this funding position to purchase a further insurance buy-in policy with Legal & General, amounting to approximately £500m. Together with the two policies purchased in 2017, around 50% of the Plan's total liabilities are now insured. This has put the Plan in an even stronger position and further reduced Pearson's future pension funding risk, at no additional cost to Pearson.

Dividend

In line with our policy, the Board is proposing a final dividend of 13p (2017: 12p), an increase of 8%, which results in an overall dividend of 18.5p (2017: 17p) subject to shareholder approval.

Share buyback

We launched a £300m share buyback, beginning on 18 October 2017 utilising part of the proceeds from the disposal of a 22% stake in Penguin Random House. We completed the programme on 16 February 2018.

Businesses held for sale

Following the decision to sell our US K12 Courseware business, the assets and liabilities of that business were classified as held for sale on the balance sheet at 31 December 2018. We announced the agreement to sell this business on 18 February 2019.

2019 outlook

2018 has been a year of progress for Pearson, delivering adjusted operating profit within our guidance range and continuing to invest in the digital transformation and simplification of the company. We expect to make further progress in 2019, with adjusted operating profit between £590m and £640m and adjusted earnings per share of 56.5p to 62.0p on a pre-IFRS 16 basis. This reflects our portfolio and exchange rates as at 31 December 2018 and the following factors:

Currency movement and portfolio changes

Adjusting for currency movement improves profit by £26m. We completed the sale of WSE in March 2018. WSE contributed £42m to 2018 revenue and £4m to 2018 adjusted operating profit. US K12 Courseware contributed £364m to 2018 sales and around £20m to 2018 operating profit.

Inflation and other operational factors.

Our 2019 guidance incorporates cost inflation of c.£50m together with other operational factors of £33m due to increased investment in our strategic growth areas and the expectation of a lower contribution from Penguin Random House.

Restructuring benefits

We expect incremental in-year benefits from the 2017-2019 restructuring programme of £130m in 2019. Exceptional restructuring costs of £150m will continue to be excluded from adjusted operating profit.

Interest and tax

We expect a 2019 net interest charge of c.£30m and a tax rate of 21%.

Currency

In 2018, Pearson generated approximately 64% of its sales in the US, 3% in Greater China, 5% in the Eurozone, 3% in Brazil, 3% in Canada, 3% in Australia, 2% in South Africa and 1% in India and our guidance is based on exchange rates at 31 December 2018.

We calculate that a 5c move in the US Dollar exchange rate to Sterling would impact adjusted EPS by around 2p to 2.5p.

IFRS 16

Including IFRS 16, we expect to report adjusted operating profit of between £610m and £660m, a net interest charge of c.£60m and adjusted earnings per share of 55.5p to 61.0p for 2019.

Financial review

Adjusted performance measures

The Group's adjusted performance measures are non-GAAP financial measures and are included as they are key financial measures used by management to evaluate performance and allocate resources to business segments. The measures also enable investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments over time by separating out those items of income and expenditure relating to acquisition and disposal transactions, major restructuring programmes and certain other items that are also not representative of underlying performance.

The Group's definition of adjusted performance measures may not be comparable to other similarly titled measures reported by other companies. A reconciliation of the adjusted measures to their corresponding statutory reported figures is shown in summary below and in more detail on p222–225.

Adjusted operating profit

Adjusted operating profit includes the operating profit from the total business including the results of discontinued operations when relevant. There were no discontinued operations in either 2017 or 2018. A reconciliation of the statutory measure to the adjusted measure is shown below:

£ millions	2018	2017
Operating profit	**553**	451
Add back: Cost of major restructuring	**102**	79
Add back: Other net (gains) and losses	**(230)**	(128)
Add back: Intangible charges	**113**	166
Add back: Impact of GMP equalisation	**8**	–
Add back: Impact of US tax reform on profit from associate	**–**	8
Adjusted operating profit	**546**	576

In May 2017, we announced a restructuring programme, to run between 2017 and 2019, to drive significant cost savings. This programme began in the second half of 2017 and net costs incurred were £79m in 2017 and £102m in 2018 and relate to delivery of cost efficiencies in our enabling functions and US Higher Education Courseware business together with further rationalisation of the property and supplier portfolio. The restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation. Included in the property rationalisation in 2018 is the impact of the consolidation of our property footprint in London which resulted in a charge for onerous leases of £91m partially offset by profit from the sale of property of £81m. The onerous lease provisions are the main driver for the overall increase in provisions on the balance sheet at 31 December 2018.

These major restructuring costs are analysed below:

£ millions	2018	2017
Adjusting the cost base in our Higher Education Courseware business	**21**	23
Further efficiency improvements in enabling functions through back office change programmes in Human Resources, Finance and Technology	**48**	23
Further rationalisation of property and supplier agreements	**21**	33
Associate restructuring	**12**	–
Total	**102**	79

Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group. Other net gains (before tax) of £230m in 2018 relate to the sale of the Wall Street English language teaching business (WSE), realising a gain of £207m, the disposal of the equity interest in UTEL, the online University partnership in Mexico, realising a gain of £19m, and various other smaller disposal items for a net gain of £4m. Gains of £128m in 2017 largely relate to the sale of the test preparation business in China which resulted in a profit on sale of £44m and the part sale of the share in PRH which resulted in a profit of £96m.

Charges relating to acquired intangibles and acquisitions are also excluded from adjusted operating profit when relevant as these items reflect past acquisition activity and do not necessarily reflect the current year performance of the Group. In 2018, intangible charges declined from £166m in 2017 to £113m in 2018. This decline reflects the reduction in acquisition activity in recent years.

In 2018, the impact of adjustments arising from clarification of guaranteed minimum pension (GMP) equalisation legislation in the UK have been excluded from adjusted operating profit as outlined below in the section on post-retirement benefits.

As a result of US tax reform at the end of 2017, the reported tax charge in that year on a statutory basis included a benefit from revaluation of deferred tax balances to the reduced federal rate of £5m and a repatriation tax charge of £6m. In addition to the impact on the reported tax charge, the Group's share of profit from associates was adversely impacted by £8m. These adjustments were excluded from adjusted operating profit and the adjusted tax charge as they were considered as transition adjustments that were not expected to recur in the near future.

Underlying growth rates

Sales decreased on a headline basis by £384m or 9% from £4,513m in 2017 to £4,129m in 2018 and adjusted operating profit decreased by £30m or 5% from £576m in 2017 to £546m in 2018.

The headline basis simply compares the reported results for 2018 with the reported results for 2017. The Group also presents sales and profits on an underlying basis which excludes the effects of foreign exchange, the effect of portfolio changes arising from acquisitions and disposals and the impact of adopting new accounting standards that are not retrospectively applied. The portfolio change is calculated by taking account of the contribution from acquisitions and by excluding sales and profits made by businesses disposed in either 2017 or 2018. In 2017, portfolio changes mainly relate to the sale of the test preparation business in China and reduction in the equity interest in PRH. This reduction in equity interest is reflected in the reduction in share of results of joint ventures and associates. In 2018, portfolio changes mainly relate to the sale of our Wall Street English language teaching business. Acquisitions were not significant in either 2017 or 2018.

In 2018, the underlying basis excludes the impact of IFRS 15 'Revenue from Contracts with Customers'. This new standard was adopted on 1 January 2018 but the comparative figures for 2017 have not been restated. On 1 January 2018, the Group also adopted IFRS 9 'Financial Instruments' but this did not have a material impact on profit in 2018. The impact of adopting these standards is discussed further below and in note 1 of the financial statements.

On an underlying basis, sales decreased by 1% in 2018 compared to 2017 and adjusted operating profit increased by 8%. Currency movements decreased sales by £134m and adjusted operating profit by £21m. Portfolio changes decreased sales by £225m and adjusted operating profit by £61m. The impact of adopting IFRS 15 on the results for 2018 was to increase sales by £9m and adjusted operating profit by £9m.

Adjusted earnings per share

Adjusted earnings includes adjusted operating profit and adjusted finance and tax charges. A reconciliation to the statutory profit is shown below:

£ millions	2018	2017
Profit for the year	**590**	408
Non-controlling interest	**(2)**	(2)
Add back: Cost of major restructuring	**102**	79
Add back: Other net (gains) and losses	**(230)**	(128)
Add back: Intangible charges	**113**	166
Add back: Other net finance (income)/costs	**31**	(49)
Add back: Impact of GMP equalisation	**8**	–
Add back: Impact of US tax reform on profit from associate	**–**	8
Tax benefit relating to items added back	**(65)**	(42)
Adjusted earnings	**547**	440
Weighted average number of shares (millions)	**778.1**	813.4
Adjusted earnings per share	**70.3p**	54.1p

Net finance costs classified as other net finance costs or income are excluded in the calculation of adjusted earnings.

Finance income relating to retirement benefits is excluded as management believe the presentation does not reflect the economic substance of the underlying assets and liabilities. Finance costs relating to acquisition transactions are also excluded as these relate to future earn outs or acquisition expenses and are not part of the underlying financing.

Foreign exchange and other gains and losses are also excluded as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity.

In 2018, the total of these net finance cost items excluded from adjusted earnings was a loss of £31m compared to a gain of £49m in 2017. Finance income relating to retirement benefits increased from £3m in 2017 to £11m in 2018 but this increase was more than offset by foreign exchange losses on unhedged cash and cash equivalents and other financial instruments that generated gains in 2017.

The adjusted income tax charge excludes the tax benefit or charge on items that are excluded from the profit or loss before tax. In addition, the tax benefit from tax deductible goodwill and intangibles is added to the adjusted income tax charge as this benefit more accurately aligns the adjusted tax charge with the expected rate of cash tax payments.

Operating cash flow

Operating cash flow is presented in order to align the cash flows with corresponding adjusted operating profit measures. A reconciliation to operating cash flow from net cash generated from operations, the equivalent statutory measure, is shown below:

£ millions	2018	2017
Net cash generated from operations	**547**	462
Dividends from joint ventures and associates	**67**	146
Capital expenditure on property, plant, equipment and software	**(204)**	(237)
Proceeds from sale of property, plant, equipment and software	**128**	–
Add back: Net (proceeds from) /costs paid on major restructuring projects	**(25)**	71
Add back: Special pension contribution paid	**–**	227
Operating cash flow	**513**	669

Financial review

In addition to the dividends received from associates above there were dividends from PRH in 2018 of £50m and in 2017 of £312m relating to the recapitalisation of PRH following the sale of part of the Group's interest in the venture. This cash flow is not related to the underlying trading of the business and has not been included in the adjusted operating cash measure.

Major restructuring costs paid in 2017 included cash flow from both the 2016 restructuring programme (£44m) and the 2017-2019 programme (£27m). In 2018, restructuring costs paid were offset by proceeds from the sale of property as part of the restructuring programme to give a net cash inflow from restructuring of £25m.

Special pension contributions of £227m in 2017 were made as part of the agreements relating to the PRH merger in 2013 (£202m) and the sale of the FT Group in 2015 (£25m). There were no special pension contributions in 2018.

Return on invested capital (ROIC)

ROIC is a non-GAAP measure and has been disclosed as it is one of Pearson's key business performance measures. ROIC is used to track investment returns and to help inform capital allocation decisions within the business. Average values for total invested capital are calculated as the average monthly balance for the year.

ROIC is presented on a gross and net basis. The net basis is calculated after removing impaired goodwill from the invested capital balance. The net approach assumes that goodwill that has been impaired is treated in a similar fashion to goodwill disposed as it is no longer being used to generate returns.

	2018	2017	2018	2017
£ millions	Gross basis		Net basis	
Adjusted operating profit	**546**	576	**546**	576
Operating cash tax paid	**(43)**	(75)	**(43)**	(75)
Return	**503**	501	**503**	501
Average invested capital	**10,672**	11,568	**7,544**	8,126
ROIC	**4.7%**	4.3%	**6.7%**	6.2%

Other financial information

Net finance costs

£ millions	2018	2017
Net interest payable	**(24)**	(79)
Finance income in respect of retirement benefits	**11**	3
Other net finance (costs)/income	**(42)**	46
Net finance costs	**(55)**	(30)

Net interest payable was £24m, compared to £79m in 2017. The decrease was primarily due to a reduction of gross debt achieved through the early redemption of bonds in 2017. Charges relating to early redemptions increased finance charges in 2017 but were not as significant in 2018. Additionally there was a reduction in interest on tax provisions following reassessment of those provisions in 2018. In February 2018, the Group bought back an aggregate nominal amount of €450,000,000 of 2021 and 2025 notes. There was a charge in respect of these early redemptions however there were partial year savings as a result which have flowed through the income statement in the period since redemption.

In 2018, the total of other items excluded from adjusted earnings was a loss of £31m compared to a gain of £49m in 2017. Finance income relating to retirement benefits increased from £3m in 2017 to £11m in 2018 reflecting the comparative funding position of the plans at the beginning of each year. This increase was more than offset by foreign exchange losses on unhedged cash and cash equivalents and other financial instruments that generated gains in 2017.

Capital risk

The Group's objectives when managing capital are:

- To maintain a strong balance sheet and a solid investment grade rating;
- To continue to invest in the business;
- To have a sustainable and progressive dividend policy, and;
- To return surplus cash to our shareholders where appropriate.

The Group is currently rated BBB (negative outlook) with Standard and Poor's and Baa2 (stable outlook) with Moody's.

Net debt

The net debt position of the Group is set out below.

£ millions	2018	2017
Cash and cash equivalents	**568**	645
Marketable securities	**–**	8
Derivative financial instruments	**9**	–
Bank loans and overdrafts	**(43)**	(15)
Bonds	**(672)**	(1,062)
Finance lease liabilities	**(5)**	(8)
Net debt	**(143)**	(432)

Net debt was reduced during the year following the sale of property, repayment of loans to PRH and proceeds from disposals.

Bond debt was reduced to £672m from £1.1bn through a combination of debt repayments. The Group holds a portion of its debt in US dollars as a natural hedge of the Group's largest earnings generating region, North America.

Despite the low year end balance sheet net debt, the Group has significant operating lease liabilities which are not currently included as balance sheet liabilities but are included by the credit rating agencies and will be included during 2019 as the group adopts IFRS16, increasing net debt by c£0.7bn. The Group's cash flow is also seasonal and so we would typically see higher net debt at the half-year results than at a year-end.

Liquidity and funding

The Group had a strong liquidity position at 31 December 2018, with over £500m of cash and an undrawn Revolving Credit Facility due in 2021 of $1.75bn (at 31 December 2017, the Group had cash of over £600m and an undrawn Revolving Credit Facility due in 2021 of $1.75bn). In March 2019, the Group announced the refinancing of the Revolving Credit Facility with a new Facility of $1.19bn due in 2024.

Taxation

The effective tax rate on adjusted earnings in 2018 was a credit of 5.2% compared to an effective rate charge of 11.1% in 2017. The decrease in tax rate reflects several one-off benefits in 2018 including provision releases due to the expiry of relevant statutes of limitation and due to the reassessment of historical positions (£86m), as well as a one-off benefit from a reassessment of the tax treatment of certain items of income and expenditure (£25m).

The reported tax credit on a statutory basis in 2018 was £92m (18.5%) compared to a charge of £13m (3.1%) in 2017. The statutory tax credit in 2018 was primarily due to the items above, provision releases and credits related to previous business disposals (£31m) and tax credits on restructuring charges.

Operating tax paid in 2018 was £43m compared to £75m paid in 2017 mainly due to refunds received in the US. Tax provision releases were the primary reason for the reduction in current tax liabilities on the balance sheet whilst net deferred tax remained consistent year on year.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The gain on translation of £90m in 2018 compares to a loss in 2017 of £262m. The gain in 2018 mainly arises from the strength of the US dollar. A significant proportion of the Group's operations are based in the US and the US dollar strengthened in 2018 from an opening rate of £1:$1.35 to a closing rate at the end of 2018 of £1:$1.27. At the end of 2017, the US dollar had weakened from an opening rate of £1:$1.23 to a closing rate of £1:$1.35 and this movement was the main reason for the loss in 2017.

Also included in other comprehensive income in 2018 is an actuarial gain of £25m in relation to the retirement benefit obligations of the Group and our share of the retirement benefit obligations of PRH. The gain arises from the favourable impact of changes in the assumptions used to value the net assets in the plans and in particular movements in the discount rate. The gain in 2018 compares to an actuarial gain in 2017 of £182m.

Post-retirement benefits

Pearson operates a variety of pension and post-retirement plans. Our UK Group pension plan has by far the largest defined benefit section. We have some smaller defined benefit sections in the US and Canada but, outside the UK, most of our companies operate defined contribution plans.

The charge to profit in respect of worldwide pensions and retirement benefits amounted to £56m in 2018 (2017: £72m) of which a charge of £67m (2017: £75m) was reported in statutory operating profit and income of £11m (2017: £3m) was reported against other net finance costs. The decrease in the operating charge in 2018 is partly explained by a past service credit of £11m relating to changes made to the US post-retirement medical plan in the year and reduced administration costs. This credit was partially offset by a past service charge of £8m relating to guaranteed minimum pension (GMP) equalisation in the UK.

The GMP equalisation charge arises from the ruling in the Lloyds Bank High Court case in October 2018 that provided clarity on how pension plans should equalise GMP between males and females. The case ruling results in an income statement charge, an additional liability and the potential requirement to make back-payments to pensioners who may have been retired for some years. This charge has been excluded from our adjusted earnings as this relates to historical circumstances. The charge is an estimate based on available data and revisions to these estimates in future years will be treated as assumption changes and recorded in other comprehensive income rather than the income statement.

The overall surplus on UK pension plans of £545m at the end of 2017 has increased to a surplus of £571m at the end of 2018. The increase has arisen principally due to favourable movements in assumptions used to value the liabilities offsetting some decline in asset values.

In total, our worldwide net position in respect of pensions and other post-retirement benefits increased from a net asset of £441m at the end of 2017 to a net asset of £471m at the end of 2018.

Adoption of new accounting standards in 2018

The adoption of IFRS 15 and IFRS 9 has impacted both the income statement as described on p47 and has had an impact on certain lines in the balance sheet. Although the impact of IFRS 9 was not significant, the restatements in relation to IFRS 15 are the main reason for increases in 2018 in balances for inventories, trade and other receivables, trade and other liabilities and held for sale assets and liabilities. The full impact of the adoption of both standards is outlined in note 1 of the financial statements.

Dividends

The dividend accounted for in the 2018 financial statements totalling £136m represents the final dividend in respect of 2017 (12.0p) and the interim dividend for 2018 (5.5p). The Board are proposing a final dividend for 2018 of 13.0p bringing the total paid and payable in respect of 2018 to 18.5p. This final 2018 dividend which was approved by the Board in February 2019, is subject to approval at the forthcoming AGM and will be charged against 2019 profits. For 2018, the dividend is covered 3.8 times by adjusted earnings. After excluding the one-off tax benefit in adjusted earnings of c.20p the dividend is covered 2.7 times.

Financial review

Share buyback

The share buyback programme announced in October 2017 was completed on 16 February 2018. In 2017, our brokers purchased 21m shares and in 2018 purchased a further 22m shares. Cash payments for these purchases and related costs were £149m in 2017 and £153m in 2018. The shares bought back were cancelled and the nominal value of these shares was transferred to a capital redemption reserve. The nominal value of shares cancelled under the programme was £11m. A liability for the share buy-back payments due in 2018 was recorded in trade and other liabilities on the 2017 balance sheet.

Businesses held for sale

Following the decision in 2017 to sell both our Wall Street English language teaching business and the US K12 Courseware business, the assets and liabilities of those businesses were classified as held for sale on the balance sheet at 31 December 2017. During 2018, the Wall Street business was sold and the US K12 Courseware business remains on the balance sheet as a held for sale asset prior to the disposal announced in February 2019.

Goodwill and intangible assets

Amortisation and impairment charges relating to acquired intangible assets in 2018 were £113m compared to a charge of £166m in 2017. There were no impairments to goodwill and intangibles in 2018 or 2017 following impairment charges in preceding years.

Acquisitions and disposals

There were no significant acquisitions in 2018 or 2017. In 2018, the Group disposed of the Wall Street English language teaching business (WSE), realising a gain of £207m, and the equity interest in UTEL, the online University partnership in Mexico, realising a gain of £19m. Various other smaller disposal items resulted in a net gain of £4m in 2018. In 2017, disposals included the sale of the test preparation business in China (GEDU) which resulted in a profit on sale of £44m and the sale of a portion of the stake in PRH to the venture partner, Bertelsmann, resulting in a reduction in the Group's interest from 47% to 25% and a profit on sale of £96m.

Related party transactions

Transactions with related parties are shown in note 36 of the financial statements.

Post-balance sheet events

On 18 February 2019, the Group announced the sale of the US K12 Courseware business to Nexus Capital Management LP for headline consideration of $250m comprising an initial cash payment of $25m and an unconditional vendor note for $225m expected to be repaid in three to seven years. Following the repayment of the vendor note, the Group is entitled to 20% of all future cash flows to equity holders and 20% of net proceeds if the business is sold. The transaction is expected to complete in the first half of 2019.

Also in February 2019, the UK Group pension plan purchased a further pensioner buy-in policy valued at approximately £500m with Legal & General. As a result of this latest transaction, 95% of the UK Group plan's pensioner liabilities are now matched with buy-in policies which significantly reduces longevity risk of the Group. The buy-in will be accounted for in 2019 and is expected to reduce the retirement benefit asset on the balance sheet but is not expected to have a material impact on the income statement.

On 6 March 2019, the Group announced a tender offer for up to €75m of its €500m 1.875% notes due 2021 of which €250m were outstanding at 31 December 2018. In addition, the Group also announced the refinancing of its bank facility with a new $1.19bn Revolving Credit Facility due to mature in February 2024.

Coram Williams
Chief Financial Officer

We know we already have the best people working in our restaurants – they just need the opportunity to build the right skills to move up.

ROBERT VALENCIA
ACCELERATED PATHWAYS STUDENT

Accelerated Pathways is a corporate education benefit, where Pearson partners with companies to strategically align their educational assistance spending to the talent objectives of the organisation, helping to build a workforce that's more skilled, more engaged and, most importantly, more prepared for the future of work. In 2018, Pearson announced a partnership with Brinker International, Inc., owner of Chili's® Grill & Bar and Maggiano's Little Italy®, to launch Best You EDU™, a Brinker education benefit programme that allows all eligible Team Members to earn Foundational, GED, and associate degrees with full tuition coverage.

For Robert Valencia, a 27-year old cook who's worked at Chili's for two years, it helped him earn his GED credential and completely altered the path of his career. One of the first applicants in Best You EDU™, Robert applied only a few days after the programme was launched, and received his GED a month later.

Three days after he earned his GED, he applied for the Associate Degree Programme. In December, he completed his third semester of college, studying business. In 2018, Robert received the GED Testing Service GEDWorks™ National Award, recognising his drive to overcome educational barriers and to pursue a better path for himself.

"We know we already have the best people working in our restaurants – they just need the opportunity to build the right skills to move up," says Rick Badgley, Chief Administrative Officer. Accelerated Pathways leverages resources, such as online and mobile-optimised education tools, technology and course materials to support the unique challenges of adult learners, while addressing barriers to education – such as cost, time and access.

Accelerated Pathways

500,000+

The number of corporate client employees who have access to educational benefits through Accelerated Pathways

Overview
Our strategy in action
Our performance
Governance
Financial statements

I'm not just learning for me.

It's for me and my daughter... she is the main motivation. I want to show her she can achieve whatever she wants.

FEVEN ZERAY

BTEC – 2018 ADULT LEARNER OF THE YEAR

Feven Zeray's ultimate goal is to be an aeronautical engineer. She recently received top marks in her BTEC Level 3 Extended Diploma in Electrical Engineering and is on track and racing full throttle towards a career with the Mercedes Formula 1 team.

From the start of her course, she faced resistance from those who thought it was too difficult and that a woman couldn't succeed in engineering. That did not stop Feven from finding a way to pursue her dream.

BTECs are career-focused qualifications, taught in number of subjects in colleges, schools and universities throughout the world. Through BTEC learners acquire the knowledge and skills they need for career success. Throughout their course, BTEC learners work on a series of tasks set in real-life scenarios to which they apply the knowledge and skills they have learned during their course. BTECs enable successful progression towards a chosen career path, whether that's through further or higher education, an apprenticeship or directly into employment.

For Feven, not only did BTEC teach her the skills she needed for a career in engineering, but she also learned valuable employability skills including communication and flexibility, which she has found useful in single handedly raising her daughter while funding herself to get her dream job.

Alex Fau Goodwin, Assistant Principal at Trafford College says that success like Feven's 'really does emphasise the importance of adult education in colleges'. Feven is making the most of her education – her latest accolade is winning the coveted Mercedes AMG High Performance Powertrains (HPP) Student of the Year Award, guaranteeing her an interview for the prestigious Apprenticeship scheme run by HPP who design, develop and manufacture the Mercedes-Benz Formula 1 racing engines and hybrid systems.

Feven is widely regarded as a role model at Trafford College and continues to prove to her daughter that learning makes anything possible.

BTEC

1m+

BTEC programmes starting each year

41%

of students using BTEC to enter higher education come from lower economic groups

1 Aligned to strategic priority, p21

Operating performance

North America

Market summary

Our largest market includes all 50 US states and Canada.

Contribution to Group revenues

67%

Sales

£2,784m

Adjusted operating profit

£362m

Sustainability

200+

institutions use the GED College Ready score level, including community colleges, to help students bypass placement tests and developmental education courses

Revenue declined 1% in underlying terms, primarily due to North American Higher Education Courseware declining 5%, School Courseware which was down mid-single digit %, impacted by weak Open Territory sales in the second half of the year, the continued decline in Learning Studio as we move towards the retirement of the product in 2019 and Student Assessment which declined moderately. Offsetting that, we saw good growth in Virtual Schools, Online Program Management (OPM) and Professional Certification revenue.

Adjusted operating profit rose 1% in underlying terms, as restructuring savings offset the impact of lower sales, inflation and other operating factors.

Courseware

School

In School Courseware, revenue declined mid-single digit percent primarily due to declines in Open Territory states. This was partially offset by growth in Adoption state revenue on strong performance in Science in Florida, South Carolina and Tennessee, Elementary Math in Oklahoma and Elementary Social Studies in California and South Carolina.

Our new adoption participation rate rose to 80% from 61% in 2017. We won an estimated 33% share of adoptions competed for (38% in 2017) and 26% of total new adoption expenditure of $509m (29% of $365m in 2017).

Higher Education

In Higher Education Courseware, total US college enrolments, as reported by the National Student Clearinghouse, fell 1.4%, with combined two-year public and four-year for-profit enrolments declining 4.8%. Enrolment weakness was particularly focused on part-time students where enrolment declined 2.9% compared to full time enrolment which declined 1.1%.

Net revenue in our US Higher Education Courseware business declined 5% during the year. We estimate around 2% of this decline was driven by lower enrolment; around 1.5% from the adoption of Open Educational Resources (OER); around 2.5% from the combined impact of shifts in the secondary market, more cautious buying by the channel and lower returns; offset by c.1% benefit from the shift to digital.

In 2018, Pearson's US Higher Education Courseware market share, as reported by MPI, was within the c.40-41.5% range seen over the last five years.

Digital revenue grew 2% benefiting from continued growth in direct sales and favourable mix. Global digital registrations of MyLab and related products were flat. In North America, digital registrations fell 3% with good growth in Science, Business & Economics and Revel offset by lower overall enrolment and continued softness in Developmental Mathematics. Revel registrations grew more than 40%. Including stand-alone eBook registrations, total North American digital registrations rose 1% and global registrations rose 3%.

The actions announced in early 2017 to promote access over ownership met with continued success. Stand-alone eBook volumes grew 34% in the US with revenue up 25% and our partner print rental programme has had a successful start with 130 titles in the programme in 2018. We plan to increase the number of titles in the programme to around 400 by fall 2019.

We continue to make good progress with our Inclusive Access (Direct Digital Access) solutions signing 192 new institutions in 2018, taking the total of not-for-profit and public institutions served to 617. Including 80 longer-standing contracts with for-profit colleges, we now have direct courseware relationships with nearly 700 institutions.

Inclusive Access ensures that students have affordable access to the courseware that they need on day one of the course, whilst further shifting our business model in this segment away from ownership and towards subscription. During the year, we delivered over 1.4m course enrolments with inclusive access revenues from non-profit and public institutions rising to c.8% of our higher education courseware revenue as more colleges and faculties see the benefit of this model.

Assessment

Student Assessment

In Student Assessment, revenue declined moderately in 2018 due to the faster than expected contraction in revenue associated with our PARCC and ACT-Aspire multi-state volume-based contracts and our disciplined competitive approach. These factors will extend into 2019, where we expect a modest decline in revenue in this segment. Beyond 2019, we expect the business to benefit from continued good momentum in subcontractor contract wins leveraging our digital leadership and a strong pipeline of opportunities in key states.

Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and accounting changes. Underlying measures are reconciled to the equivalent statutory measures on p222–225.

During 2018, Pearson successfully renewed contracts in Arizona and Kentucky through competitive procurements and secured business with the District of Columbia, New Jersey, New Mexico, and Maryland under new contracts with these PARCC states. We also won new contracts for Utah's High School Assessments and with the University of Iowa for the delivery of Iowa's new assessment system.

We delivered 24m standardised online tests to K12 students, down 5% from 2017. TestNav 8, Pearson's next-generation online test platform, supported a peak load of 825,000 tests in a single day and provided 99.99% up time. Our AI scoring systems scored 36m responses to open-ended test items, around 33% of the total. Paper based standardised test volumes fell 9% to 18.5m.

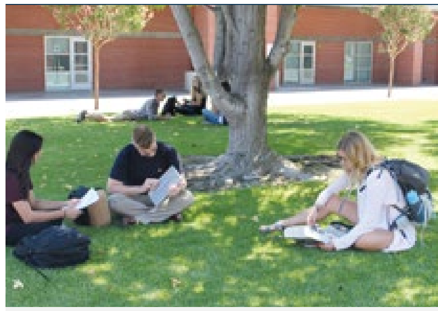
Professional Certification

In Professional Certification, VUE global test volume rose 4% to over 15m. Revenue in North America was up mid-single digit %, due to growth in medical college admissions testing and certification for professional bodies, offset by continued declines in volumes in the GED High School Equivalency Test and higher-level IT certifications in an environment of low unemployment.

We signed over 70 new contracts in 2018 and our renewal rate on existing contracts continues to be over 95%. During the year we renewed over 80 contracts including the National Council of State Boards of Nursing (NCLEX exam), Microsoft and Adobe.

Clinical Assessment

Clinical Assessment sales declined slightly on an absence of new major product introductions impacting 2018. Late in Q4 we launched a refresh of the Peabody Picture Vocabulary Test and Expressive Vocabulary Test (PPVT/EVT). Q-interactive, Pearson's digital solution for Clinical Assessment administration, saw continued strong growth in license sales with sub-test administrations up more than 37% over the same period last year.



Partnering with institutions to help students become career ready

Product: Career Success Program

80,000 students

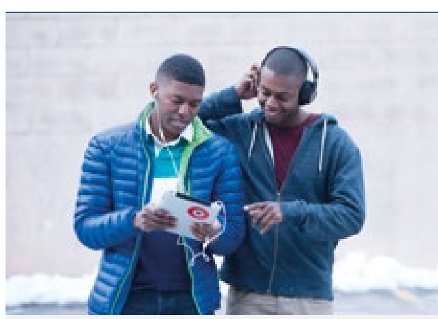
currently enrolled in the Career Success Program

"As a recent college graduate and applying for full time jobs for the first time in my life... I am finding it difficult to show potential employers my "soft skills", my traits outside of my resume. It means one thing to say I am a team player, but I want to show the employers how I earned that trait. Thankfully, Pearson Career Success allows me to demonstrate my skills outside of my resume and earn badges such as critical thinking and teamwork from an accredited and respected source."

Jessica Albright, recent Marketing Bachelor's graduate (Spring 2017) and MBA graduate (December 2018) at Missouri State University in Springfield, MO

The Career Success Program is an integrated solution designed to help learners discover, develop, and demonstrate the occupational and personal and social capabilities that are vital for successful 21st century employment and lifelong success.

Pearson works with institutions at a variety of different levels to provide resources and services to students from the time they enroll at a university to the time they graduate, all with the goal of preparing them for the career they want. Over the next four years, over 80,000 students will go through this program.



Pearson makes learning personal

Product: Mastering

Pearson partners with

3,700 institutions

annually to provide Mastering to students all over the world

"Mastering gives students feedback as they do the work... they have more confidence tackling problems, because they've had experience, and with more experience comes more confidence."

Evelyn Landers, Chemistry Lecturer at Waterford Institute of Technology has used Mastering Chemistry since 2010. Landers says it has made her teaching more efficient and personalised because students have access to personalised learning resources that empower them to learn at their own pace.

Mastering is one of the world's leading collections of online homework, tutorial, and assessment products. It is designed to improve the results of all higher education students, one student at a time.

Pearson partners with 3,700 institutions annually to provide Mastering to students all over the world, primarily in North America but also in South America, Europe, Asia, Australia and Africa.

DIGITAL CAPABILITIES

Real-time data analytics

Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and accounting changes. Underlying measures are reconciled to the equivalent statutory measures on p222–225.

Operating performance

Services

Connections Academy

Connections Academy, our K12 online school business grew revenue 8%. Connections Academy served 73,000 Full Time Equivalent (FTE) students through 37 continuing full time virtual partner schools in 28 states, up 11% on last year. Total FTE virtual school students declined 3% to 75,400 as expected due to contract exits at Commonwealth Charter Academy in Pennsylvania and Florida Virtual School.

Three new full time online, state-wide partner schools opened in the 2018-19 school year in Florida, Michigan, and Ohio. We anticipate the opening of between two and five new partner schools in the 2019-20 school year.

The 2018 Connections Academy Parent Satisfaction Survey continues to show solid endorsement for the schools with 93% of families with enrolled students stating they would recommend our virtual schools to others and 95% agreeing that the curriculum is of high quality.

Pearson Online Services

In Pearson Online Services, revenue grew 3%, primarily due to growth in OPM, partially offset by a decline in Learning Studio revenue as we retire the product and as we restructured smaller non-OPM contracts.

Online Program Management

In OPM, we grew revenue 9% as course registration grew strongly, up 14% to more than 388,000 on strong growth in programs at key partners including Arizona State University Online, Maryville University, Regis College, Bradley University, Ohio University and the University of Southern California.

Our overall active program count grew by 33 to 325. The launch of 46 new programs were offset by 13 discontinued programs. During 2018 we signed 27 multi-year programs, including programs at new partners the University of North Dakota and Rider University. We closed nine out of 15 renewal opportunities and as part of broader efforts around portfolio optimisation agreed with our partners to terminate 23 programs that were not mutually viable.

2019 outlook

US Higher Education Courseware

In US Higher Education Courseware, we expect revenue to be flat to down 5% on the continuation of the pressures we saw on end demand in 2018 with ongoing declines in enrolment and modest growth in OER adoptions. For print revenue in this segment, we see scope for further declines in gross sales and improvements in returns. Print continues to be impacted by the ongoing rise of secondary channels, such as rental, but channel inventory has now returned to more normalised levels following the 2016 inventory correction and its after effects. The channel is now optimising the stock it holds, both through reducing purchases and returns, and we expect that to continue in 2019. Growth in digital and direct sales provides some offset to the continuing pressures on print.

Assessment

In Assessment, we expect good growth in Professional Certification and stable revenue in our Clinical Assessment business in the US. We expect a modest decline in revenue in North America Student Assessment on continued contraction in revenue associated with our PARCC and ACT Aspire contracts.

Connections Academy and Online Program Management

We expect good growth in revenue and enrolment at Connections Academy and in North America Online Program Management.

Core

Market summary

Our international business in established and mature education markets.

Contribution to Group revenues

20%

Sales

£806m

Adjusted operating profit

£57m

Sustainability

40%

Students from the lowest four socio-economic groups (as defined by the UK ONS) on average progress to HE in a subject related to their BTEC.

Revenue was flat in underlying terms with growth in Pearson Test of English Academic, OPM in the UK and Australia and Professional Certification offset by declines in Higher Education and Student Assessment and Qualifications.

Adjusted operating profit increased 10% in underlying terms, due to restructuring savings partially offset by inflation.

Courseware

School and Higher Education

Courseware revenue declined moderately. Slight growth in School Courseware was offset by declines in Higher Education Courseware. In Higher Education Courseware, revenue was down due to market declines in Europe and Asia, partially offset by growth in digital sales to institutional partners in the UK and Australia.

Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and accounting changes. Underlying measures are reconciled to the equivalent statutory measures on p222–225.

Assessment

Student Assessment and Qualifications

In Student Assessment and Qualifications, revenue fell as modest growth in BTEC Firsts and GCE A-Level was more than offset by declines in AS levels, international GCSEs in the UK and UK Apprenticeships due to policy changes in the schools qualifications and the apprenticeships market. We successfully delivered the National Curriculum Test (NCT) for 2018, marking 3.6m scripts, up slightly from 2017. We will deliver the NCT again in 2019 before the test transitions to another provider in 2020.

Clinical Assessment

Clinical Assessment sales declined primarily in Australia due to an absence of new major product introductions. Q-Interactive, Pearson's digital solution for Clinical Assessment administration, saw continued strong growth.

Pearson Test of English Academic

Pearson Test of English Academic saw continued strong growth in test volumes and we successfully extended our agreement with Department of Home Affairs in Australia for another two years.

Professional Certification

In Professional Certification, revenue was up modestly due to the launch of additional computer-based exams for an existing customer in the UK and the MOI, the French Driving Test.

Services

Higher Education Services

In Higher Education Services, revenue grew strongly. Our OPM revenue was up 34%. In Australia, we saw good growth due to our successful partnership with Monash University, and continued success of the Graduate Diploma in Psychology. We have a total of c.10,200 course registrations across the seven programs in Australia up from c.9,300 in 2017. In the UK, we launched 11 new programs and course registrations grew, reaching c.3,000 compared to c.1,400 in 2017. During the year, we also announced new partnerships with the University of Northumbria in the UK, and ESSEC Business School in France.

2019 outlook

We expect stable revenue across Core, including student qualifications and assessment, with further revenue growth in OPM and PTEA, offset by continued declines in our Courseware businesses.

CBI

Partnering with the voice of British industry

CBI & Pearson's Annual Skills Report

Pearson partners with CBI, the UK's premier business organisation, every year to deliver an annual skills report. In 2018, we found:

- Employers expect to recruit more workers but worry there are not enough skilled people to fill vacancies
- 4/5 businesses aim to spend more on training, but the Apprenticeship Levy has driven a sharp drop in apprenticeship programmes
- The number of businesses actively engaged with schools or colleges is down by c.10%

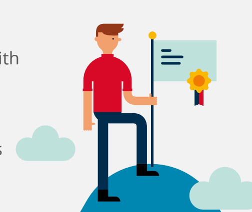
By helping to gather these insights, Pearson is connecting the dots between students and employers, ensuring learners have the skills they need to excel in their career and employers have the people they need for a rapidly changing workplace.

Providing world-class qualifications in the UK

Product: Pearson Edexcel

#1

Overall market leader with number two position in GCSE and A-Level and number one position in vocational qualifications



In the UK, Pearson is the largest awarding organisation to offer academic and vocational qualifications, including A levels, GCSEs and vocational qualifications such as BTECs.

Aswin Nasiketh Vivekanandan (pictured) is a 19 year old student at Tanglin Trust School, Singapore. In 2018 she received the Pearson Edexcel Award for the highest mark in Asia for A-level Chemistry and Physics.

Commenting on her award she said: "I am thrilled to be able to pursue my career aspirations thanks to my Pearson qualifications.

"I have always had a keen interest in science and passing these two subjects was a requirement for me to get a place on the course. And it worked, as I am now studying my chosen option at Imperial College London.

"On graduation, I am looking to explore ways to help tackle some of the many problems we face in the world today, like global warming and climate change."

Many congratulations Aswin – we think you will go on to achieve great things!

Operating performance

Growth

Market summary

Emerging and developing economies with investment priorities in Brazil, India, South Africa, Hispano-America, Hong Kong & China and the Middle East.

Contribution to Group revenues

13%

Sales

£539m

Adjusted operating profit

£59m

Sustainability

28,000

New users downloaded our Space Hero app designed in collaboration with refugee children in Jordan as part of our Save the Children partnership.

Revenue grew 1% in underlying terms due to strong growth in China and modest growth in Brazil and Hispano America partially offset by declines in South Africa.

Adjusted operating profit increased 97%, £30m, in underlying terms, reflecting higher revenue in China and Brazil, together with the benefits of restructuring, partially offset by lower revenue in South Africa.

Courseware

Courseware revenue grew slightly, with strong growth in English Language Courseware in China, partially offset by declines in School Courseware in South Africa following a large one-off order in 2017.

Assessment

Professional Certification and Pearson Test of English Academic

Professional Certification grew well due to a new ICT infrastructure certification contract. Pearson Test of English Academic saw strong growth in revenue with over 10% growth in the volume of tests taken in India, China and Middle East and moderate price increases.

Services

English Services

In English Services, revenue grew slightly in our English language school franchise, Wizard, due to new product launches.

School Services

In School Services, revenue was flat, with declines in student enrolment in our public sistemas business in Brazil offset by price increases, improved products and better student retention across our private sistemas. In India, Pearson MyPedia, an inside service 'sistema' solution for schools, expanded to over 700 schools with over 200,000 learners.

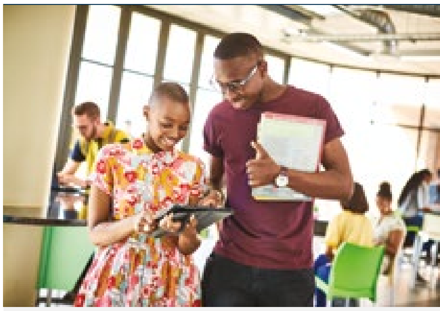
Higher Education Services

In Higher Education services revenue declined slightly due to business exits in India and slight revenue decline at Pearson Institute of Higher Education (formerly CTI), our university in South Africa, due to a change in mix with total enrolment broadly flat and new student enrolment up 18%.

2019 outlook

In our Growth segment, we expect revenue to continue to increase in 2019 benefiting from new products and services across all divisions.

Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and accounting changes. Underlying measures are reconciled to the equivalent statutory measures on p222–225.



Pearson Institute embeds career outcomes into curricula

Service: Pearson Institute of Higher Education

7000+

Students enrolled at Pearson Institute of Higher Education

Pearson Institute of Higher Education In South Africa offers a range of different degrees, higher certificate, foundation and academic support programmes in South Africa, with a focus on preparing learners for the world of work.

Career outcomes are embedded into the curriculum of each programme and students are provided with the knowledge, skills and mindset to help them positively change the world.

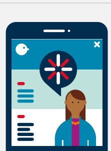
"I gained invaluable skills at PIHE, which I implement in my everyday life. These include time management, planning, communication skills and self-care, which is fundamental in maintaining a balance in life," says Xia Coetzer, a PIHE graduate who is now a registered counsellor at ICAS Southern Africa.

App delivers personalised English language learning

Product: Longman English+

35,000+

Students use Longman English+ to learn the English language skills they need to thrive in school and beyond



Pearson takes the best of our 'Longman Welcome to English' curriculum and adds Microsoft's AI capabilities to create an app that personalises English language learning at its highest possible level. Delivered through WeChat, which has nearly a billion monthly users, this app is giving users the opportunity to learn on their own terms, when and where they want. It is easy to use, it is specifically tailored for Chinese users as it 'listens' to the spoken practice exercises, and it is precisely tasked to correct common pronunciation errors. Learners receive immediate feedback and so they are able to keep track of their progress and remain interested.

"Longman English+ provides extensive English resources for students and enables them to practice in various methods. They are able to learn the content and knowledge in the text book, as well as improve their speaking skills. I believe it will provide solid ground for our students' future English learning," says Leo Liu, a teacher at Zhoushan Greentown Yuhua International School.

Over 35,000 students use Longman English+ to learn the English language skills they need to thrive in school and beyond. Ultimately, Longman English+ is meeting learners where they already are, making it easy for them to practice English and prepare for their future.

DIGITAL CAPABILITIES

- Automated speech recognition
- Automated marking and scoring

Penguin Random House

Pearson owns 25% of Penguin Random House, the first truly global consumer book publishing company.

Penguin Random House performed well with underlying revenue growth on increased audio sales and stable print sales, whilst the business benefitted from international bestseller "Becoming" by Michelle Obama, the year's top-selling U.S. title, and bestsellers from Bill Clinton & James Patterson, Jordan Peterson, Jamie Oliver, Dr. Seuss, John Grisham, and Lee Child.

2019 outlook

In Penguin Random House, we anticipate a normalised publishing performance and expect an annual after-tax contribution of around £60-65m to our adjusted operating profit.

Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and accounting changes. Underlying measures are reconciled to the equivalent statutory measures on p222–225.

Enterprise risk management

Ensuring effective identification and management of risk.

Our approach to risk management is summarised in the framework below. Our goal is to support Pearson in meeting its strategic and operational objectives, as described earlier in the Annual Report.

Our enterprise risk management (ERM) framework aligns to international standards (e.g. COSO and ISO 31000) and aids our continued compliance with the Financial Reporting Council's (FRC) UK Corporate Governance Code guidance on risk management, as well as enabling us to adapt to any required or desired changes in approach.

Foundations

All the elements that make up this framework come together to provide the foundations for successful ERM, and risk management more broadly, across Pearson.

Governance and oversight

The Audit Committee assists the Board in overseeing our ERM framework. They validate target risk appetite, risk status and mitigation plans, as well as verifying the viability statement process.

Roles and responsibilities

The ERM framework covers the day-to-day work on principal and business-level risks. For a list of responsibilities of key risk stakeholders, see p104 in 'Governance'.

Policy, framework, processes and tools

Our policy, framework and supporting guidance set out why risk management is important and the minimum standards. These can be tailored by a business area as long as they align with the policy. The process is assessed during the annual effectiveness review, covered in more detail on p104 in 'Governance'.

Appetite and tolerance

Pearson's leadership team sets the target risk appetite for each risk they own (validated by the Audit Committee and Board). Clarity on the degree of risk the Board is willing to accept determines the most appropriate risk treatment to manage an individual risk. For example, a legal or compliance risk has a low target risk appetite. We try to eliminate the risk as much as we can. Customer experience represents a strategic opportunity and is therefore likely to have a higher risk appetite, thus we would take well-informed and well-managed risks to achieve our goals in some areas.

Working with third parties

The use of third parties, such as suppliers or partnerships, can create risk. For example, an interruption to our business operations as a result of the actions of an external provider may prevent us from meeting our strategic goals or could impact our reputation. In 2018, we built on the third party risk management policy and activities initiated in previous years with continued roll-out of procurement processes that help us flag third parties requiring further due diligence. We also increased our due diligence on third parties in certain areas (see data privacy and compliance risks on p72 and p74 respectively for more on this).

Managing risk

Our approach to managing risk has remained consistent with prior years.

Context

Risk context sets the criteria against which risks are identified and assessed, defining the external and internal parameters to be taken into account.

The risk management policy, framework and supporting guidance set out how to manage risks, such as how to determine probability and impact as well as instructions on how to translate these into an overall risk rating. Adaptations of these matrices, tailored for a specific business area, are in use and align with the policy.

Assessment

At least annually, we facilitate a risk assessment process through discussions with leadership, senior management and key stakeholders from each business area. For each risk identified, the probability of it materialising and its potential impact is rated. The adequacy of action plans to address any remaining control gaps is then assessed.

We do this for both new risks identified as well as those already being monitored. Horizon scanning also takes place throughout the year to aid in the identification of new risks.

Continuous improvement

At the end of 2014, we reviewed our risk management maturity against the risk framework, setting out and monitoring maturity targets. At the start of 2018, we expanded this into a three year ERM vision, strategy and goals to further improve risk management across Pearson.

Progress and challenges in 2018

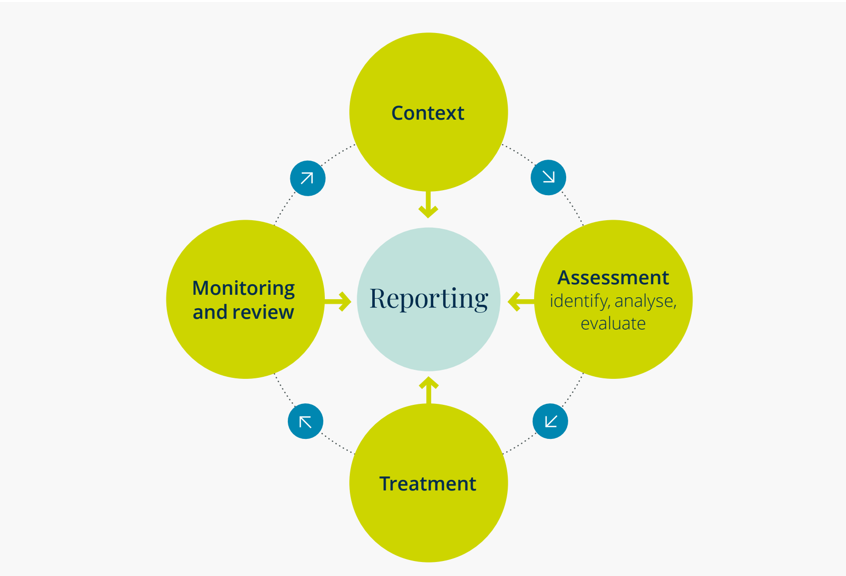
As we began to implement our strategy, our reliance on manual processes quickly became a key challenge we needed to overcome. We began to design and test an online risk tool in 2018 in order to overcome this challenge. In the interim, we made use of existing internal collaboration tools to streamline processes.

One area where we have made good progress in 2018 is implementing a more robust analysis of emerging or new risks, undertaking a documented gap analysis of Pearson's risks against our strategy as well as external risk data and reports plus competitor analysis.

Priorities for 2019

In 2019, we will continue to implement our three-year risk plan, including:

- Embedding emerging risk processes in line with the FRC's 2018 revisions to the UK Corporate Governance Code guidance that comes into effect for 2019 reporting
- Deploying a risk tool which will support not just our risk monitoring across the business, but also improve our ability to undertake more thorough risk analysis such as risk trends over time. We have built into the tool's design the criteria we need to further develop our integrated assurance approach, by bringing together different sources of assurance information into one place for the first time.



Treatment

Once assessed, the most appropriate course of action for each risk is decided, taking into account the size of the gap between its current risk status against its risk appetite target. This can include 'avoid' (i.e., not doing something); implementing mitigation or contingency plans to change the probability or reduce the impact of a risk; accepting increased risk in order to pursue an opportunity, or sharing the risk with another party or parties.

Monitoring and review

The Board and Audit Committee review ERM risk update reports twice per year at a minimum. This gives them the opportunity to review, challenge and validate the ERM process and key risks. The reports cover current risk status as well as an update on risk mitigation initiatives and their effectiveness. Discussions focus on where there is either a) the greatest change in rating or b) the biggest gap between current rating and the target risk appetite, with the emphasis on the strength of mitigation plans in place. Risk maps for each business area are also included in these reports.

Risk deep dives also take place at the Audit Committee throughout the year. In 2018, some of the areas covered include business transformation, anti-bribery and corruption (including third party due diligence) and data privacy (including GDPR readiness). You can read the details in the Chair of the Audit Committee's letter on p97-98.

Culture

The ERM framework is also used to promote a risk aware culture across the organisation, with the aim of integrating risk management into day-to-day decision making.

Communication, training, education and awareness

Our Code of Conduct certification was revised and implemented in 2018, supporting our commitment to ethical behaviours across the organisation. We are committed to raising awareness among employees on the importance of better managing day-to-day risks. In 2018, we regularly attended leadership and team meetings to highlight best practice and conducted specific risk workshops, including targeted efforts on the risks involving programme interdependencies.

Embedding risk in decision making

All Pearson business functions continued to maintain their own risk map, with the spotlight in 2018 on the further improvement of mitigation plans. Business functions follow the same framework for identifying, assessing, treating and monitoring risk. Each identified risk is also assigned a risk appetite target.

Principal risks and uncertainties

The Board of Directors confirms that throughout 2018 they undertook a robust assessment of the principal risks facing Pearson, in accordance with provision C.2.1 of the 2016 UK Corporate Governance Code.

Our principal risks
(as of 31 December 2018)

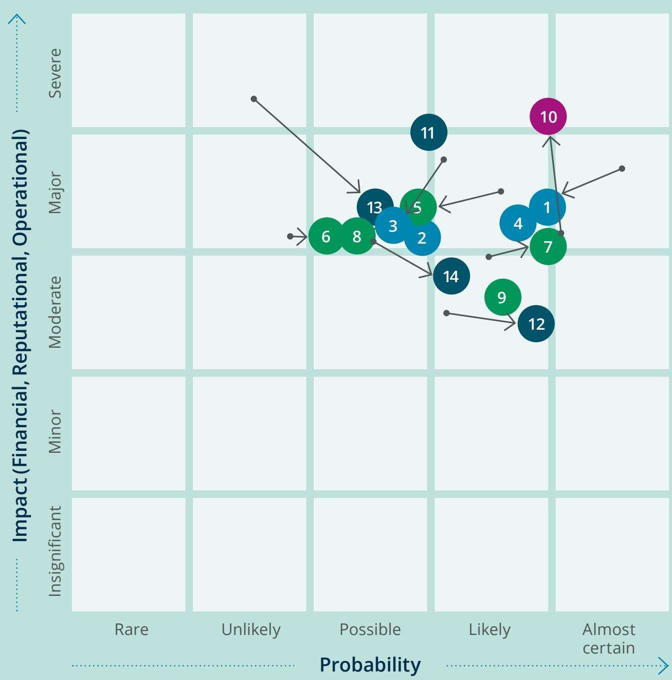
Listed in the table and shown on the adjacent risk map are the most significant risks that may affect Pearson's future. A longer list of business area and company-wide risks is monitored and reviewed internally throughout the year. The most material risks are those which have a higher probability and significant impact on strategy, reputation or operations, or a financial impact greater than £50m, and are classed as our principal risks.

Due to internal mitigation efforts, treasury risk reduced in 2018 to the extent that it now falls below our threshold to be included as a principal risk.

At the time of publication, the UK remains due to leave the EU on 29 March 2019. Given the scheduled exit date and significant risk of no deal, we have advanced mitigation plans underway. These do not involve material cost and we will be able to unwind those plans without significant disruption or cost if it later becomes appropriate. Work continued throughout 2018 (led by a Steering Committee chaired by the CFO) to identify and mitigate any potential impact on our principal risks below, such as supply chain and operations (covered in the customer experience risk), tax and data privacy, as well as other areas such as treasury and workforce mobility, particularly in the event of a 'no deal' scenario. By virtue of that analysis and mitigation planning, we continue to believe that Brexit will not have a material adverse impact on Pearson as a whole; in particular we believe we have plans in place that will largely mitigate against the impact of a 'no deal' scenario.

The following principal risks also relate to the material issues considered in the 2018 Sustainability Report: products and services, testing failure, political and regulatory, information security and data privacy, customer experience, and safety and security. You can read more in the Sustainability section on p32–40.

Principal risks: status and 2018 change



Key

0 Net risk

Probability and impact are based on residual risk, i.e. after taking into account controls already in place and assumed to be operating effectively.

Indicates change in 2018

For more information see principal risks and uncertainties tables p63-75.

Risks are categorised into four main areas:

Category	No.	Risk	Executive responsibility
Strategy and change Relating to the goals that are aligned with and support our strategy. This category is the most likely to contain 'opportunity' risks which are likely to have a higher risk appetite	1	**Business transformation and change**	Chief Executive Officer
	2	**Products and services**	President, Global Product
	3	**Talent**	Chief Human Resources Officer
	4	**Political and regulatory risk**	Chief Corporate Affairs Officer
Operational Involving people, systems and processes	5	**Testing failure**	President, Assessments; President, UK and Core Markets
	6	**Safety and security**	Chief Human Resources Officer
	7	**Customer experience**	President, Global Product; Chief Technology and Operations Officer
	8	**Business resilience**	Chief Financial Officer
	9	**Data**	President, Global Product; Chief Technology and Operations Officer
Financial Involving financial planning, investments, budgeting, potential losses of and exposures to Pearson's assets	10	**Tax**	Chief Financial Officer
Legal and compliance Relating to the adherence to applicable laws and regulations. Risks in this category typically have a very low risk appetite.	11	**Information security and data privacy**	Chief Technology and Operations Officer; General Counsel
	12	**Intellectual property**	General Counsel
	13	**Compliance**	General Counsel
	14	**Competition law**	General Counsel

Strategy and change

1 Business transformation and change

The accelerated pace and scope of our transformation initiatives increase our risk to execution timelines and to business adoption of change. The risk is that benefits may not be fully realised, costs may increase, or that our business as usual activities are adversely impacted.

Decrease in impact and probability

Strategic priorities:

1 Grow market share through digital transformation

3 Become a simpler, more efficient and more sustainable business

Reason for risk rating

This risk has reduced due to the ongoing implementation of The Enabling Programme (TEP) in North America in the first half of 2018. This has reduced our financial risk impact.

However, the scale, volume and accelerated pace of change, combined with the execution interdependencies, keep this as a high risk going into 2019.

The 2017-2019 simplification programme is performing ahead of plan and now expects to deliver increased annualised cost savings in excess of £330m by the end of 2019, ahead of our original plan of £300m.

Existing controls

- Change and Transformation office
- The Global Learning Platform (GLP) and The Enabling Programme (TEP) are standing Audit Committee agenda items
- Independent assurance regularly undertaken on the key programmes.

Outcome of 2018 activities

In 2018, we continued to invest in the digital transformation and simplification of the company:

- We continued to develop the GLP – described in more detail under risk 2 – 'Products and Services'
- We implemented the next phase of TEP – primarily in North America – to progress the simplification of our business.

The 2017-2019 simplification programme moved into its implementation phase in 2018, with many initiatives now complete.

2019 outlook and plans

Business transformation and change initiatives will continue to support our strategic goals to accelerate our digital transition in higher education, to manage the print decline, and to reshape our portfolio, as outlined by our Chief Executive on p10-12 and covered in more detail under our strategy in action on p18-32.

In 2019, we will continue to roll out TEP to other geographies worldwide. All key programmes will continue to be closely monitored by the Audit Committee at each meeting (you can read more about their oversight of TEP and the GLP on p97-98).

We will continue to use our change and transformation office to drive plans to completion in 2019. Change management expertise and dedicated support have been put in place across North America, Finance and Human Resources teams.

Principal risks and uncertainties

Strategy and change

2 Products and services

Failure to successfully invest in, develop and deliver (to time and quality) innovative, market leading global products and services that will have the biggest impact on learners and drive growth, ensuring Pearson:

- Responds to market needs, as well as threats from both traditional competitors as well as disruptive innovation
- Offers products to market in line with our strategy, at the right price and with a deal structure that remains competitive.

This risk was revised and expanded in 2018 following a risk review against the strategic priorities, as well as a thorough analysis of underlying risk drivers. The definition has been changed as a result.

No overall change

Strategic priorities:

1 Grow market share through digital transformation

2 Investing in structural growth opportunities

Reason for risk rating

We have made significant progress in managing risks around our competition and the product and investment portfolio in 2018 due to the ongoing progress we have made in improving our processes and strategic investment recommendations.

However, due to the importance of product innovation (such as the ongoing development of the Global Learning Platform (GLP) and our investment in AI research) to achieving Pearson's strategic priority of digital transformation, the impact if this risk materialises remains high.

Competition

We have made significant progress understanding the competitive and structural threats, especially to our US Higher Education Courseware business, and made progress mitigating these.

We operate in competitive markets with many competitors across these markets. As the consumption of educational products and services shifts to digital and subscription models, this has the potential to lead to changes in the competitive structure of the markets in which we operate.

Existing controls

- Global product lifecycle process
- Portfolio governance and management
- Audit Committee oversight of the GLP.

Outcome of 2018 activities

Product Innovation

Further investment was made in 2018 in development of the GLP – our single, cloud-based platform to support our learners and enable us to innovate faster in the future.

The first of our pilots – Rio – went live in September 2018: Pearson used the software to run a number of focus groups and targeted interactions with different schools and instructors during the latter half of 2018.

In addition, we are investing in other innovations, such as Artificial Intelligence (AI), to ensure that our products provide leading personalised learning experiences and better outcomes. In 2018, we appointed an industry expert to lead on the development of our AI products and solutions strategy.

Product and investment portfolio

Progress was made during 2018 in consolidating our key product portfolios. Portfolio investment allocation decisions were made using an agreed data-driven framework and the investment governance criteria and process were revised, spanning partnerships, portfolio strategy and geographies.

Competition

In 2018, we scaled the rental access model initiative from c.50–c.150 titles in total by the end of the year.

We also continued initiatives (e.g. pricing, format, policies, marketing, channel) to incentivise customers to move from print to digital products to help mitigate risks arising from the secondhand market and achieve our digital business transformation goals.

2018 saw the launch of additional anti-piracy initiatives (see risk 12, Intellectual Property, which includes piracy, for more on this risk).

2019 outlook and plans

Turning this risk into an opportunity – successfully accelerating our shift to digital as well as investing in and delivering the right products and services – is as critical to successful business performance in 2019 as we have flagged in previous years. As our Chief Executive highlights on p10, over time our aim is to transition to a digital first model for our learners, with print resources available as an 'add on' service.

Product Innovation

We will continue to invest in our development of the GLP (focusing on an enhanced Revel platform) and expect to launch in the second half of the year. The GLP will also enable us to better deploy AI and machine learning to drive advances in educational technology.

Investment in the development of AI will also continue, such as using it to build on existing automated scoring capabilities using natural language processing.

Product and investment portfolio

2019 priorities include improving decision making effectiveness, for example by implementing a decision playbook to support how we make decisions for our products plus identify gaps in the decision making process and how to close them.

Competition

Our aims in 2019 are to significantly increase the number of US Higher Education Courseware products in the 'access first' or Subscription business model, as well as continuing our pricing simplification efforts in order to clarify and simplify our pricing structure for both sales representatives and customers.

Strategy and change

3 Talent

Failure to maximise our talent – Risk that we are unable to attract the talent we need and to create the conditions in which our people can perform to the best of their ability.

Decrease in impact and probability

Strategic priorities:

1 Grow market share through digital transformation

2 Investing in structural growth opportunities

3 Become a simpler, more efficient and more sustainable business

Reason for risk rating

This risk has reduced due to:

- Impact of improved financials: Stabilising financial performance has driven an improving outlook for employee incentivisation helping raise morale; also positive sentiment of strategy approved by the Board
- Compensation toolkit enabling managers to address specific retention risks as needed (with Executive approval); primary retention managed through total reward
- Better data enabling improved decision making
- Leadership development programmes.

Existing controls

- Detailed monthly reporting of HR data and insights to proactively identify and manage risks, including turnover (voluntary and involuntary) data as well as gender diversity at all career grades, with regular Executive review to identify areas for improvement
- Consistent performance, talent and succession management processes
- Employee policies including the Code of Conduct
- Employee engagement forums and action plans
- Exit interviews conducted and monitored globally to identify any trends and concerns
- 'Pearson U' learning platform
- External careers website and talent acquisition approach to improve attraction of digital skills
- Wide range of employee benefits.

Outcome of 2018 activities

To support our digital transformation, acquisition of digital talent is a high priority. Challenges continue with digital hiring but we are seeing some improvement, driven by clarity of skillset needed and a targeted compensation guide enabling Pearson to be more competitive. As a result, year over year percentage of digital hires is up by 37%. We also:

- Focused Leadership development programmes for senior leaders with specific mentoring programmes for high potential employee (HiPO) women in these roles
- Continued targeted learning throughout the organisation with 'Pearson U' learning platform enhancements, career development workshops, manager fundamentals training and emphasis on all employees having development goals
- Launched the Alumni programme
- Put greater focus on diversity and inclusion (D&I): we designed our future state diversity framework, governance and measurement model. We received awards for our localised D&I efforts and increased marketplace recognition. You can read more about our diversity, equality and inclusion activities under Sustainability on p38
- Released the organisational health index survey for all Pearson employees, the results of which will influence the priority order of the 2019 action planning.

2019 outlook and plans

HR will continue to work with Pearson leaders to increase engagement and organisational health, acting on the findings from the organisational health survey taken in late 2018. Our aims in 2019 are to:

- Develop sustainable total reward programmes aligned to the business strategy
- Develop awards and recognition for the workforce and marketplace
- Deliver organisational design and change management to support business deliverables
- Upskill the workforce on digital customer channels B2B, while continuing to acquire new digital talent and expertise
- Drive sales performance through embedding best practice sales incentive design
- Empower managers with greater flexibility to make reward decisions for their teams, underpinned by greater transparency of our pay practices to our employees
- Refresh leadership skills, competencies and behaviours and continue leadership development programmes
- Refresh approach to performance management, adapting more contemporary practices to drive high performance
- Utilise new approach to talent review, assessing all VPs against required capabilities and culture needed
- Drive internal mobility through increased visibility to talent and cross-business development opportunities
- Promote enterprise-wide talent management mindset, owned by leadership across all areas. Develop a mindset for analytical, digital and innovation skills
- Deliver refreshed global diversity and inclusion approach, operational plan and measurement model; increase gender diversity, especially in senior leadership roles.

Overview
Our strategy in action
Our performance
Governance
Financial statements
AZ

Principal risks and uncertainties

Strategy and change

4 Political and regulatory risk

Changes in policy and/or regulations have the potential to impact business models and/or decisions across all markets.

No overall change

Reason for risk rating

Despite a slight reduction in our risk exposure in the US from an educational standpoint, this risk remains high at the time of publication due to the potential for political instability in the UK arising from the potential for Brexit 'no deal' plus wider uncertainty and instability in the rest of the world.

Existing controls

- Board and Executive oversight
- Government relationship teams
- Steering Committee monitoring the UK's departure from the EU.

Outcome of 2018 activities

In 2018, we continued to build global political and regulatory relationships in the US and the UK, as well as an international political profile in order to understand future international risks and proactively mitigate them.

In the US, we worked hard to highlight Pearson's credentials as an innovator in education and workforce readiness, specifically referencing Accelerated Pathways, Inclusive Access and workforce credentialing; we maintained fair market access through national and state partnerships and direct lobbying; and we worked with the National Governors Association Chair to shape his Initiative on developing workforce skills.

In the UK, we continued to monitor actions associated with the UK's departure from the EU, working with government to mitigate business risk associated with regulatory changes. We also implemented our own internal mitigation and contingency plans in the event of a 'no deal'.

We also:

- Responded to the government's post-18 funding review, creating a commission to oversee research into vocational education and lifelong learning
- Continued executing thought leadership work to establish the role of BTECs in supporting learners into work and higher education as an alternative pathway
- Submitted responses to enquiries and consultations regarding technical/vocational education and related issues
- Continued to position Pearson in the UK as a leader, expert and innovator in T Levels. We were awarded the contract to develop, deliver and award two of the first three T Levels.

Internationally, we continued our ongoing efforts to position Pearson for PTE Academic accreditation in China, Canada and the UK, well as pursuing BTEC opportunities in Southeast Asia.

2019 outlook and plans

Pearson will continue to position itself as a leader in the education space, an innovator in higher education and establish the company as a key engine in workforce development and economic growth. We are also driving opportunities to engage directly with other businesses.

In the US, we are likely to see a push to increase higher education funding from new Democratic Governors and State Legislators, as well as a focus on connecting education to jobs. Pearson will continue to work with Governors and educate officials at the Federal and State level on Pearson's expertise in education and workforce.

Brexit may cause political instability in the UK arising from the potential for 'no deal' plus wider uncertainty and instability in the rest of the world. Pearson will continue to implement its mitigation and contingency plans in case of a 'no deal' (See 'customer experience' risk for supply chain specific Brexit mitigation actions).

Internally, trade tensions and political uncertainty with rising populism and nationalism could lead to further protectionist measures. We will continue to position Pearson with government officials and influencers in key markets for PTE Academic accreditation and BTEC opportunities, as well as widening participation in international forums and with national government contacts to mitigate regulatory risks.

We will continue to monitor legislation around the world for major shifts in education policy.

Operational

5 Testing failure

Failure to deliver tests and assessments and other related contractual requirements because of operational or technology issues, resulting in negative publicity impacting our brand and reputation.

Decrease in impact and probability

Strategic priorities:

3 Become a simpler, more efficient and more sustainable business

Reason for risk rating

As Pearson is an educational content, assessment and related services company, successfully managing this risk remains a priority.

This risk decreased in 2018 due to the continued migration of all student testing in North America to a secure cloud computing environment – Amazon Web Services (AWS). This has resulted in improved availability and stability.

We successfully delivered exams and testing in 2018 to a high standard of quality. We experienced minimal disruption of the ePEN (online marking system). However, the impact should we experience issues in our testing platforms or processes keeps this as a risk.

Existing controls

We seek to minimise the risk of a breakdown in our student marking systems with the use of:

- Robust quality assurance procedures and controls
- Oversight of contract performance
- Investment in technology, project management and skills development of our people, including software security controls, system monitoring, pre-deployment testing, change controls and the use of root cause analysis procedures to learn from incidents and prevent recurrence
- Use of AWS in Clinical and Schools
- IBM counter-fraud tool (Pearson VUE).

Outcome of 2018 activities

In North America, SchoolNet plus all Clinical products have now been successfully migrated to AWS. The next iteration of ePEN (UK and Australia) is also now AWS hosted. Pearson VUE also began the process of moving systems to more stable platforms.

Our Functional Skills qualifications were the first to go live on the new version of ePEN in the UK (in July) followed by General Qualifications in November. PTE Academic was also upgraded to stabilise the system.

In June 2018, a GCE A Level Maths C4 paper (taken by 50,000 pupils in England) was offered for sale online the night before the exam. This was the same paper that was leaked the year before. A police investigation was opened, however, the incident was far more limited in scope than it was the prior year, due to the additional security measures put in place as a result of the previous incident. Ultimately, the paper-based nature of examinations and the scale of the system means that security is heavily reliant on schools to maintain the security of the material. The investigation was able to make good progress in identifying the source of the leak.

The IBM security tool implemented by Pearson VUE started to yield benefits in terms of client adoption and positive feedback of the web monitoring. Alongside this, a new third party governance and assurance process was developed which will continue to be rolled out in 2019.

2019 outlook and plans

The drive to continue improvements to availability and stability of testing systems, migrating and retiring legacy systems will continue in 2019, for example, migrating PTE Academic to AWS and further automating test publishing processes to reduce the risk of human manual error.

In UK qualifications, the potential impact should this risk materialise is potentially higher due to the fact that:

1) 2019 will see the main implementation of the ePEN upgrade. We will take into account the complexity of our systems, as well as external marking contract requirements

2) We still have a number of reformed qualifications being delivered in 2019 which includes GCE Maths.

Given the high stakes nature of the UK testing business, the risk of security breaches remains, either malicious in nature or as a result of error. We are launching a malpractice review as part of the Joint Council for Qualifications. This will include question paper breaches but also cheating allegations more broadly.

Principal risks and uncertainties

Operational

6 Safety and security

Risk to the safety and security of our people and learners arising from either the risk of injury and illness; our failure to adequately protect children and learners; or due to increasing local and global threats.

This risk has been expanded to incorporate all risks that could impact the safety and security of our people and learners into one risk. As a result, it now includes:

- *Corporate security*
- *Travel safety*
- *Safeguarding and protection.*

↑ Increase in probability

Reason for risk rating

Corporate security risk probability increased, reflecting an increase in incidents in 2018 compared to 2017. The variety and global range of risks/threats we face are undiminished. The impact of an event occurring (and not just externally) could be significant.

There has been no change in terms of the overall risk status for both Health & Safety and Safeguarding. Serious safeguarding incidents may not be frequent but their impact remains high, both to the individual affected as well as to Pearson's reputation (there continues to be a focus on these issues worldwide, both in the government and in the media).

Existing controls

- Global policies and minimum standards in place for Health & Safety, Security and Safeguarding
- Global audit and assurance programme
- Training and communication (e.g. global animation, new internal Health & Safety intranet site, IOSH Managing Safety Course)
- Staff Code of Conduct
- Third party risk management policy
- Local Safeguarding coordinators
- Everbridge mass notification system
- External travel management and intelligence.
- Key Performance Indicators in place (see p37-38 in Sustainability).

Outcome of 2018 activities

Safeguarding

We continue to view Safeguarding as a fundamental obligation to our learners and a high priority for Pearson and as such it also forms part of our sustainability strategy (see p37 in Sustainability). We agreed a new Safeguarding strategy for 2018-2020, which includes a focus on Safeguarding in online and digital environments.

In addition, we implemented a new set of Safeguarding metrics, which enable a better analysis of how robust each business' Safeguarding is; and we completed a gap analysis on the Safeguarding assurance processes for each business. This identified eight areas where we will strengthen and deepen our assurance processes.

In April 2018, we co-hosted a seminar with the Lucy Faithfull Foundation: Creating 'child safe, child friendly organisations.' It explored the use of Situational Prevention in addressing abuse in schools. It was well attended with 97% saying they would apply the theory to their current role.

Corporate security and travel safety

Travel security continues to grow in support of new areas, not limited solely to higher risk locations.

Our Everbridge tool is now live in 21 countries and we released mandatory training and awareness for people travelling to high risk locations.

The corporate security team led reviews in 16 countries in 2018, identifying areas for improvement or further adoption of security policy/standards.

Health & Safety (H&S)

Due to ongoing implementation of H&S risk mitigation actions, we have seen a slight reduction in risk in 2018. Completed activities include:

- A significant revision of our Global H&S policy and standards with animation
- A global round of International IOSH 'Managing Safely' course
- The implementation of a business focused and risk-based health and safety assurance programme: in our 48 priority locations, implementation of the global H&S Standards continues to improve.

2019 outlook and plans

In 2019, we will continue to promote the message of prevention as well as reaction.

Safeguarding

We will continue to develop our practice and policy in regards to online Safeguarding: we have appointed an external consultant, who is a recognised expert in online Safeguarding, to assist us with our plans. Our plans include:

- Hosting a seminar which looks at best practice in online Safeguarding for internal staff and external partners
- Ongoing work on the Safeguarding action plan for the Pearson Institute of Higher Education in South Africa
- Publication and implementation of a sexual harassment policy in Pearson College London
- Ensure that our Safeguarding practice fully reflects the company's commitment to diversity.

Corporate security and travel safety

In 2019, we are forming a combined security and resilience governance group which will oversee management of this risk. Physical and travel security reviews of higher risk locations will be ongoing and we will continue to refine data specific to our Everbridge notification system.

Health & Safety

Our aims in 2019 are to:

- Deliver a real-time, global solution to report, escalate, investigate and action H&S Incidents
- Continue our robust business-focused and risk-based global assurance programme for 2019, which includes third party vendors where Pearson has outsourced risk activities
- Further develop the analysis of Occupational Health data in partnership with HR to ensure proactive and reactive intervention strategies are aligned.

Operational

7 Customer experience

Failure of either our current operations, supply chain or customer support to deliver an acceptable service level at any point in the end-to-end journey; or to accelerate Pearson's lifelong learner strategy and transformation.

Previously 'customer digital experience,' this risk has been redefined and expanded following a review of the global strategy implications, as well as a thorough analysis of the underlying risk drivers undertaken as part of the H2 2018 risk update process. As a result, we have expanded the customer experience and learner experience component of the risk and added operations (including supply chain) to better reflect the risks to delivering an optimal end-to-end customer journey.

↑ Slight increase in impact

↑ Increase in probability

Strategic priorities:

1 Grow market share through digital transformation

3 Become a simpler, more efficient and more sustainable business

Reason for risk rating

This risk is crucial to Pearson a) delivering a good service to our customers and b) enabling our digital transformation. As a result, we expanded and redefined the risk to include the end-to-end customer journey, whether for print or digital products and services (or a blend of the two).

This redefined risk remains rated high due to our ongoing transformation efforts which have the potential to impact on the customer experience.

We continued to make further improvements to our product platform stability and execution in 2018 and had good stability throughout both North America Back to School periods. This was our best year to date in terms of up time.

In the UK, we began the implementation of mitigation and contingency plans to manage a potential 'no deal' scenario regarding the UK's exit from the EU, given the possibility of a 'no deal' at the time of publication.

Existing controls

- Real-time monitoring of systems (for service disruptions) and reporting of operational performance used to identify issues
- Release readiness reviews for our major product platforms
- Programme governance and hypercare
- Board oversight of Brexit risk
- In the UK, the Audit and Quality team have a secure supplier annual audit programme for suppliers dealing with Pearson confidential material (e.g. exam papers)
- New structure put in place to prevent fraud and incorrect orders to be placed by customers.

Outcome of 2018 activities

Operations and supply chain

Our efforts in 2018 were focused primarily on the UK and North America. The Enabling Programme (TEP) went live for the first time in North America in May 2018, with ongoing hypercare put in place as a contingency plan to support supply chain stabilisation during implementation.

In the UK, as well as a TEP retrofit deployment, we also completed our move from the UK warehouse previously shared with Penguin. This was phased from the end of 2017 and completed in spring 2018. In parallel, we also undertook an in depth analysis into the impact on our supply chain and operations in the event of a 'no deal' Brexit, commencing work on implementing our mitigation and contingency plans to address these.

Customer experience

The customer experience is recognised as a key enabler and 'license to operate' in terms of Pearson's future strategy. In 2018, we realigned our priorities and plans across the business, in readiness to refocus on the learner experience in 2019.

Customer services

Customer services have made a lot of progress in terms of reducing this risk in 2018 and managing the challenges of the TEP deployments in North America and the UK.

Operational stability

We continued to focus in 2018 on performance and stability across all of our product platforms with roadmaps underway for stability, the user experience (UX) and competitive features across all product platforms.

2019 outlook and plans

Operations and supply chain

In the US, our primary focus is to ensure that we are prepared for the Back to School periods, the first of which is in the spring of 2019.

In the UK, a team has been established that is taking end to end responsibility for our Learning Services operational delivery. We will continue to implement our mitigation and contingency plans to prepare for the possibility of a 'no deal' Brexit whilst we monitor the outcome.

Customer experience

In 2019, we will focus on learners and modernising our customer experience for clinical assessments, expanding our efforts to instructors and educators in 2020 and beyond.

Customer services

The focus in North America is preparing for and supporting further TEP implementations in order to minimise customer impacts as we move to new business processes and adopt new technology.

Operational stability

Our 2019 roadmap for North America Higher Education continues to be increasingly focused on security and performance of non functional requirements as well as well as third party interoperability.

Principal risks and uncertainties

Operational

8 Business resilience

Failure to plan for, recover, test or prevent incidents at any of our businesses or locations.

Incident management and technology disaster recovery (DR) plans may not be comprehensive across the enterprise.

Risk definition has been changed to focus on resilience, DR and incident management. Corporate security and travel safety now forms part of the expanded 'Safety and security' risk.

No overall change

Reason for risk rating

The business resilience programme continues to mature, although Pearson's global footprint means there remains a possibility of single events with major impact.

Work to improve incident management continues to see positive improvements.

Existing controls

- Policy in place
- Incident management process, including global notification and incident reporting tools
- Resilience Governance Board meetings
- Incident management and recovery teams
- ISO 22301 independent accreditation.

Outcome of 2018 activities

A new Pearson wide resilience policy and incident management framework was delivered in 2018 and work continued to improve business resilience and incident management capability across the organisation, including:

- Annual reviews and further refinement of the 'Top 40' and other locations involved in planning, testing and response to actual incidents
- Pearson Qualification Services recertified to ISO 22301, Business Continuity Management
- Developing the approach to digital resilience, including for the GLP and future digital product.
- Worked with Health & Safety, Facilities Management and Global Property towards embedding improvements across North America, although delivery is primarily in 2019
- High Impact Event (HIE) awareness and education took place across 13 Pearson locations in the second half of the year. This was well received and more are planned for 2019.

2019 outlook and plans

In 2019, we will continue to focus on prevention rather than reaction and refine our resilience approach to be responsive to both current and emerging risks.

A combined Security and Resilience Governance Group will form in 2019.

Specific focus areas will be to:

- Better understand and mitigate risks to supply chain and vendor management
- Continue support to the GLP and TEP programmes
- Continue to refine DR planning for legacy systems
- Continue to support Data Centre resilience.

9 Harnessing the power of our data

New risk: Failure to:
1) Maximise our use of data to enhance the quality and scope of current products and services in order to improve learning outcomes while managing associated risks.
2) Maintain data quality, accuracy and integrity to enable informed decision-making and reduce the risk of non-compliance with legal and regulatory requirements.

We have previously included the second component under risk 1, business transformation and change.

Strategic priorities:

1 Grow market share through digital transformation

3 Become a simpler, more efficient and more sustainable business

Reason for risk rating

This is a new principal risk for 2018 and reflects the importance of data analytics in education (as outlined by our Chair on p8) such as driving improvements in learning, improving classroom productivity and making learning more affordable and more accessible.

We continue to evolve our business model so we are able to use our data in ways in which we can better service the needs of our customers.

Existing controls

- TEP with Master Data Management (MDM) now live in both the UK and North America
- Data governance in place.

Outcome of 2018 activities

One of the outcomes of the work undertaken across Pearson in 2018 is that the concept and approach to data governance across customer and product is maturing. Our MDM footprint was expanded as part of TEP going live in North America in May 2018 – this consolidated North American customer and product data from three existing ERPs with what was already live in the UK. The product data footprint was also expanded in 2018 to meet the needs of our new rights and royalties system.

Work is continuing on customer data harmonisation, definitions and data representation which will also help support the ongoing promotion of data governance.

We began user capability work in the second half of 2018 which will allow us to begin to retire legacy systems.

Data privacy guidelines (concerning GDPR) were issued and are being taken into account in our data activities (see risk 11 which covers our data privacy risk and GDPR readiness in more detail).

2019 outlook and plans

We will start work to expand MDM and ERP user capabilities to enable decommissioning of legacy product data systems (target retirements to start Q4 2019). This is expected to highlight issues in data harmonisation that will need to be resolved.

Expanded customer data harmonisation and quality activities are also being planned for early 2019.

We will continue to develop the concept of data governance through defining ownership, policies, and funding for transactional and reference data governance.

Future mitigation plans for this risk will focus on how we collect data, how we use it and the structures we have in place to manage associated risks, both regulatory and reputational.

Financial

10 Tax

Legislative change caused by the OECD Base Erosion and Profit Shifting (BEPS) initiative, the UK exit from the EU, or other domestic government initiatives, including in response to the European Commission State Aid investigation into the UK CFC exemption, results in a significant change to the effective tax rate, cash tax payments, double taxation and/or negative reputational impact.

↑ Increase in impact

↓ Decrease in probability

Reason for risk rating

The risk impact increased in 2018 due to the ongoing potential financial (cash) impact of the announcement in November 2017 of the European Commission opening decision on the UK Controlled Foreign Companies exemption (see note 34, contingent liabilities, on p206). We continue to await a final decision from the investigation.

We have recorded a significant one off tax benefit in 2018 (please see our CFO's commentary on p44 for more on this), however we do not anticipate a significant change in the ongoing effective tax rate of 21%.

Existing controls

Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders, in line with our broader fiduciary duties. We do not seek to avoid tax by the use of 'tax havens' or by transactions that we would not fully disclose to a tax authority. We are guided by our taxation principles, which include complying with all relevant laws, including claiming available tax incentives and exemptions that are available to all market participants.

The CFO is responsible for the tax strategy; the conduct of our tax affairs and the management of tax risk are delegated to a global team of tax professionals. The Audit Committee oversees the tax strategy and receives a report, including a risk deep dive, on this topic at least once a year (see p97).

Our published tax report provides our position on tax.

Outcome of 2018 activities

In 2018, the Audit Committee reviewed our updated tax strategy and approved our second tax report which was published in the second half of the year.

During 2018 we worked through the implications of the State Aid opening decision, with the support of external advisors.

We took appropriate action in response to US tax reform at the end of 2017.

2019 outlook and plans

Our focus in 2019 will be the monitoring of (and to react accordingly to):

› EU State Aid decisions

› The implications of the UK's exit from the EU. The ongoing uncertainty does not allow us to confirm the tax implications, although we continue to expect that there should not be material incremental taxes payable (in either a 'deal' or 'no deal' scenario).

We will continue to assess US tax legislation changes, including guidance issued in December 2018, as well as monitoring potential tax law changes globally, and implement mitigation plans if required. In addition, we will monitor the most recent initiatives in the BEPS Project.

Media and public scrutiny on tax issues will continue to be actively monitored by both the Tax and Corporate Affairs teams.

Principal risks and uncertainties

Legal and compliance

11 Information security and data privacy

Risk of a data privacy incident or other failure to comply with data privacy regulations and standards, and/or a weakness in information security, including a failure to prevent or detect a malicious attack on our systems, could result in a major data privacy or confidentiality breach causing damage to the customer experience and our reputational damage, a breach of regulations and financial loss.

No overall change

Reason for risk rating

Risks concerning cyber-security and data privacy remain high due to complex external factors.

Data privacy risk has reduced slightly due to the work undertaken to remediate risks under the EU's General Data Protection Regulation (GDPR). However, this mitigation is offset by risks associated with the proliferation of data privacy laws outside of the EU and North America.

Existing controls

- Information Security and Data Privacy Offices
- ISO 27001 controls including strong encryption, patching, monitoring, and access controls
- Privacy impact assessment process
- Regular audits
- Automated tools
- Published policies, processes and guidelines, global training and awareness including annual awareness week
- Risk management framework
- Vendor oversight
- Audit Committee risk 'deep dive'. See p98.

Outcome of 2018 activities

GDPR regulations came into force across the EU on 25 May 2018. This introduced more onerous privacy obligations and more stringent penalties for non-compliance. As Pearson operates across several EU Member States, Pearson will still need to comply with GDPR even when the UK leaves the EU. A key focus of our data privacy efforts in 2018 has been putting plans in place to ensure that we were appropriately prepared for GDPR.

In addition to the work undertaken to prepare for GDPR, we continued to work to improve the security of our critical products, implementing a joint privacy and security process for new vendors.

The information security team worked proactively to identify and remediate security threats to Pearson. The improvement programme continued, ensuring that infrastructure, core platform and product deliveries across Technology (including Cloud and network transformation, the GLP, Enterprise Core platforms) include security controls and protection as fundamental components.

The programme to review our top vendor contracts from an information security standpoint was implemented in 2018, gaining good traction with different business areas.

2019 outlook and plans

With an evolving regulatory landscape, in addition to ongoing GDPR compliance, the Data Privacy Office will assess new laws and regulations coming into force in a number of jurisdictions and prepare for their implementation.

The information security team will continue to drive security maturity with the expansion of Vendor Risk Assessments, Multi-Factor Authentication, and pervasive data encryption (and also thus security compliance to regulatory requirements such as GDPR, PCI, HIPAA and FERPA).

Legal and compliance

12 Intellectual property (including piracy)

Failure to adequately manage, procure, register or protect intellectual property rights (including trademarks, patents, trade secrets and copyright) in our brands, content and technology, may (1) prevent us from enforcing our rights, and (2) enable bad actors to illegally access and duplicate our content (print and digital counterfeit, digital piracy), which will reduce our sales and/or erode our revenues.

Rights, permissions and royalties have been removed from this risk as it has reduced to the extent it no longer meets our threshold for a principal risk and we expect this to remain the case going forward.

↑ Increase in probability

Reason for risk rating

The probability of digital piracy risk has increased as online copying and security circumvention have become increasingly sophisticated and resistant to available countermeasures.

Notably, 2018 introduced more sophisticated-appearing 'digital counterfeit' websites now selling unprotected PDF files of certain Pearson's titles, using modern and sophisticated ecommerce methods. This is a nascent challenge that we are now addressing and 'flat PDFs' are a small portion of our portfolio and revenues.

From an IP perspective, increasing our digital business exposes us to more trademark, copyright and patent infringement risks.

Existing controls

- Robust set of policies, copyright clearance standards, procedures and systems in place
- Global trademark monitoring platform
- Cooperation with trade associations and other educational publishers
- Monitoring of technology and legal advances
- Patent programme in place
- IP protection programme in place
- Legal department provides ongoing monitoring and enforcement of print counterfeit and digital piracy
- Employee awareness and training, including a site to improve best practice around patents
- Single rights management system in place for UK, US and Canada.
- Close cooperation with US higher education channel partners (e.g. Amazon, Barnes & Noble, Follett) to prevent print counterfeit.

Outcome of 2018 activities

A very active patent filing took place to ensure protection of our rapidly evolving next gen technology for the GLP (this is expected to continue).

We also recorded key Pearson trademarks with U.S. Customs and Border Protection (CBP) to enable CBP's seizure of suspected counterfeit textbooks. This recordation has already resulted in several seizures by CBP.

Piracy

We increased our focus and awareness around digital and print counterfeit, and digital piracy, across Pearson's ecosystem, via policies, best practices, and channel partner reviews – effectively coordinated via Pearson's IP Protection Programme.

Print counterfeit via authorised partners was greatly reduced in 2018 following successful enforcement against overseas distributors.

2019 outlook and plans

We will continue to streamline our portfolios; procure and register expanded rights in our high value IP globally, including expanding our patent portfolio; monitor activities and regulations; and proactively enforce our rights, taking necessary legal action.

We are in the process of drafting the broader IP policy for launch in 2019. This will be accompanied by additional IP training modules.

In 2019, we will continue to:

- Undertake ongoing monthly test buys
- Closely monitor and enforce against marketplace piracy and digital counterfeit sites
- Explore watermarking to detect sources of digital piracy
- Investigate use of vendors to gain better visibility and enforcement tools against marketplace piracy (both print and digital)
- Review product requirements to make Pearson products and infrastructure more resistant to piracy.

Principal risks and uncertainties

Legal and compliance

13 Compliance including anti-bribery and corruption (ABC) and sanctions

Failure to effectively manage risks associated with compliance (global and local legislation), including failure to vet third parties, resulting in reputational harm, ABC liability, or sanctions violations.

↑ Increase in probability

↓ Decrease in impact

Reason for risk rating

As a result of the due diligence programme we are currently undertaking, it is likely we will uncover more risks.

Conversely, as a result of the more robust due diligence, training and awareness currently being undertaken, we are less likely to see future risks with a 'severe' impact and, where risks appear, we are more likely to see effective mitigation strategies and follow up that reduce potential exposure.

Existing controls

- Internal policies, procedures and controls including employee ABC policy certification
- Employee and business partner codes of conduct (see also 'Respect for human rights" under Sustainability on p36)
- Local Compliance Officers (LCOs) in place
- Corporate Compliance and Ethics awareness week
- Audit Committee risk 'deep dive'. See p98.

Outcome of 2018 activities

Internal procedures, controls and training continue to mature, which are designed to prevent corruption. Pearson's Code of Conduct was 100% completed in 2018. The Code of Conduct includes references to ABC policy and requirements. Pearson's ABC policy establishes a consistent set of expectations and requirements regarding ABC for all our personnel and business partners to adhere to.

In 2018, we took lessons learned from our pilot project in 2017 and revamped a global approach to our third party ABC due diligence process. We improved contractual provisions, outlined a flow chart as to when certain terms should be used, and implemented the due diligence process in all of Growth and most of Core markets. We conducted due diligence on over 2,800 third party suppliers last year, and have conducted due diligence on thousands of third party test centres.

In addition to the two key areas of activity above, we also:

- Conducted fieldwork for ABC assessments as well as revising the risk assessment process itself to make it more efficient and in line with FCPA and UKBA specifications
- Undertook gifts and hospitality and travel and expenses training for North America Higher Education Sales, other key North America businesses, plus face-to-face training on ABC in all our geographies
- Rolled out a gifts and hospitality monitoring tool in all of our Growth geographies in 2018
- Remediated all items in riskiest markets from 2017 risk assessments.

Ethics whistleblowing hotline reports using a third party platform have remained steady, with overall numbers in line with the reports of previous years. Our time to close cases has remained consistent with 2017 numbers. In addition, we have increased collaborative reporting with other investigations teams within Pearson.

We also rolled out revised policies for the following in 2018:

- Sanctions
- Global Conflicts of Interest
- ABC policy and training course, including due diligence, that is mandatory for high-risk populations
- Raising concerns and anti-retaliation policy, plus launched Speak Up campaign.

2019 outlook and plans

In 2019, we will continue to expand our third party due diligence programme, implementing the process for all new third parties across the UK, USA, Western Europe and Canada.

The Code of Conduct is being revised for 2019 with updates and revisions due to be launched in the spring.

2019 will also see further promotion of the Conflict of Interest policy; additional checks around sanctions; additional ABC risk assessments; further consideration of pan-Pearson fraud issues plus strengthened investigations processes and reporting with other teams.

Additionally, we will continue work started in 2018 rolling out our gifts and hospitality tool as well as exploring the possibility of an automated tool appropriate for the US market.

Legal and compliance

14 Competition law

Failure to comply with antitrust and competition legislation could result in costly legal proceedings and/or adversely impact our reputation.

Increase in probability

Decrease in impact

Reason for risk rating

The likelihood increased from 2017 due to recent increased activity by regulators looking into historical issues e.g. two recent investigations into Industry Association practices commenced in South Africa, following the similar investigation in Spain. Investigations in South Africa are still ongoing and the authority has yet to evidence that Pearson has committed significant wrongdoing. A final decision in Spain is still pending.

However, the impact of the risk has generally gone down. Risks uncovered to date do not carry exposure that is material for Pearson at a group/worldwide level. While the risk of material issues remains, we believe we have mitigated this risk as a result of our better controls and initiatives.

Existing controls

- Global policy in place
- Training and guidance, including live and video training
- Regular internal communications
- Lawyer network
- Additional individual training to employees representing Pearson in Industry Association meetings.

Outcome of 2018 activities

In 2018, we significantly increased our employee training to include videos, with the target of getting every relevant employee certified. The lawyer network supported this with one to one communications with every employee attending Industry Association meetings to ensure that they were risk aware.

- Development of e-learning modules and gamified learning continued
- Plans were developed to track engagement, for example in terms of the number of employees trained, those undertaking e-learning tests, etc.

2019 outlook and plans

In 2019, we will continue to conduct ongoing training and release e-learning modules.

Pearson's lawyer network actively reviews our engagement with trade associations and other organisations, to ensure that it remains appropriate.

Principal risks and uncertainties

Risk assessment of prospects and viability

This section should be read together with the full viability statement on p127.

Pearson's principal risks and our ability to manage them as outlined above are linked to our viability as a company. These risks have therefore been taken into account when preparing the viability statement.

The Board assessed the prospects of the company over a three-year period, longer than the minimum 12 months of the annual going concern review. The three-year period corresponds with Pearson's strategic planning process and represents the time over which the company can reasonably predict market dynamics and the likely impact of additions to the product portfolio.

The Board discusses the company's strategic plan on an annual basis taking account of a range of factors including market conditions, the principal risks to the group above, product and capital investment levels as well as available funding. Pearson's strategy and business model are discussed in more detail on p15-42.

The key assumptions which underpin our three year strategic plan to December 2021 are as follows:

- Implementation of our 2017-2019 cost efficiency programme reducing our annualised cost base exiting 2019 by c.£330m
- Increased investment in the product technology platform to accelerate the shift to digital and enhance courseware service capabilities
- Further declines in enrolments and other downwards pressures in the US Higher Education Courseware market
- US Higher Education Courseware returns rates continue to improve as sales become more direct to consumer
- Online Program Management grows, driven by global enrolment in undergraduate and postgraduate online courses
- US Assessment revenues stabilise
- Other strategic priorities, including Virtual Schools and Professional Certification show good growth

In assessing the company's viability for the three years to December 2021, the Board analysed a variety of downside scenarios including a scenario where the company is impacted by all principal risks. The primary modelling overlaid a 'severe but plausible' downside scenario onto the base case strategic plan for Pearson, focusing on the impact of the following assumptions and key risks:

- Failure to materialise anticipated benefits of our 2017-2019 cost efficiency programme
- Further declines in enrolments and further channel disruption in US Higher Education Courseware
- Failure to accelerate our shift to digital while successfully investing and delivering market leading global products and services
- Online Program Management fails to generate expected revenue growth
- US Assessment revenues fail to stabilise
- Other strategic priorities, including Virtual Schools and Professional Certification do not achieve modest growth amid global economic uncertainty and local market pressures
- A negative ruling by the European Commission on the controlled foreign company group financing partial exemption tax legislation

At the time of publication, the UK remains due to leave the EU on 29 March 2019. Given the scheduled exit date and significant risk of no deal, we have advanced mitigation plans underway. These do not involve material cost and we will be able to unwind those plans without significant disruption or cost if it later becomes appropriate. As stated in the principal risks section above on p62-75, we continue to believe that Brexit will not have a material impact on Pearson as a whole and is not a principal risk, therefore the Board did not specifically factor it into viability statement considerations.

The Board also stress-tested the impact on our liquidity of all the principal risks occurring together. Although this is not regarded as a plausible scenario, the test showed that the company would still have liquid resources subject to a limited number of management actions.

The Board's confirmation of Pearson's viability for the three years to 2021, based on this assessment, is included alongside the going concern statement on p127.

Governance report

In this section

Governance overview

Chair

Sidney Taurel

In this Governance section

Dear shareholders,

As I say elsewhere, 2018 was a pivotal year for Pearson and, as our operational and financial performance continues to improve, the Board can focus more on future prospects for the business. Throughout the year, we have continued to pay close attention to the simplification of our portfolio and investment in our transformation programmes, including The Enabling Programme (TEP) and the Global Learning Platform (GLP). We are now in a position where, in addition to regularly monitoring performance and simplification, the Board has turned its attentions towards longer-term strategic opportunities in areas which enjoy structural growth, digital transformation and in the lifelong learning sector.

As a Board, we continue to organise our work around five major themes where we believe we can add value: strategy, performance, leadership and people, governance and risk, and shareholder engagement. We are committed to the highest standards of corporate governance and the following pages set out details on Board composition, corporate governance arrangements, processes and activities during 2018, together with Board Committee reports. A summary of the key items covered by the Board throughout the year appears on p85, and I have set out below further detail on our particular areas of focus during 2018.

Leadership & effectiveness

See full section on p80–95

In my letter to shareholders at this time last year, I explained that the Board's main focus for 2018 would be to pivot towards our longer- term growth opportunities by delivering on Pearson's three strategic priorities and to continue to monitor progress against our dashboard and key milestones for 2018. I am pleased to report that good progress has been made on all fronts, summarised below, and with further detail given throughout this report.

Delivering on our strategic priorities

Pearson has identified three strategic priorities:

› To grow market share through digital transformation

› To invest in structural growth markets

› To become a simpler, more efficient and more sustainable business.

One particular theme arising from our 2017 Board evaluation was that, as a Board, we planned to spend even more time considering our long-term strategy during 2018 including to ensure that we remain aligned on process and deliverables. During the year, Board members and other senior leaders from across the business participated in facilitated strategic discussions and, building on this work, we continued to evolve our strategy through a number of focused Board sessions during the year. As part of this process, the Board reviewed and updated the way in which we consider and undertake our strategic and financial planning, including helping to refine Pearson's five-year strategy (**what** we will do) and our three-year plan (**how** we will do it). As a Board, we have agreed that our three strategic priorities remain appropriate, and underpin Pearson's strategic vision of delivering lifelong learning to customers, leading to increased employability and work-related skills, as part of a wider ecosystem of delivery partners and stakeholders.

Crucial to successful delivery of our strategy is developing an inclusive and innovative culture and attracting and retaining strong, diverse talent. During the year, the Board discussed talent and succession planning including consideration of succession plans for the Chief Executive, Chief Financial Officer and all members of the Pearson Executive. We also considered the wider pool of talent in our senior leadership group, and the themes of talent, succession, diversity and inclusion have formed a thread throughout the Board and Committees' sessions during the year.

Board meeting focus

In addition to our focus on our three strategic priorities, and on the talent and culture needed to support them, the Board also visited Milan, Italy and Cape Town, South Africa, during the year, where we held meetings focused on our Core and Growth markets. Our Core and Growth markets present opportunities for products such as BTEC and Pearson Test of English Academic, and the visits allowed us the chance to engage with a wide range of stakeholders, including on the subjects of employability and lifelong learning.

During the year, the Board also monitored progress on the proposed sale of our US K12 Courseware business, and our Audit Committee provided support on the appropriate accounting treatment, determining that it was correct to continue to treat the business as 'held for sale' at 31 December 2018. In February 2019, we announced that we had reached an agreement to sell this business. We also oversaw the conclusion of our sale of the Wall Street English business, which completed in March 2018, and considered financial policy in the round – including our balance sheet, our debt and equity investors, and working capital requirements – as we discussed the detailed operating plan for 2019.

In addition, we considered the business's ongoing preparations for Brexit. The Board is supported in this role by a steering committee chaired by the Chief Financial Officer, with representatives from across the UK business and enabling functions. You can read more about Pearson's preparations for Brexit on p66.

Board changes

Pearson has a fully engaged Board, including a strong Non-Executive team with a breadth of experience and perspectives. We were pleased to welcome Michael Lynton to the Pearson Board, following his appointment as a Non-Executive Director with effect from 1 February 2018. Michael's experience leading businesses through times of digital disruption has further strengthened our capabilities in this area, and Michael is already making a valuable contribution to our deliberations as a Board, and to the Audit and Reputation & Responsibility Committees. You can read more about Michael's induction to the Pearson Board on p89.

During 2018, we also said goodbye to Harish Manwani, a Non-Executive Director of Pearson since 2013, who retired from the Board at the AGM in May 2018. The Board joins me in thanking Harish for his commitment and contribution to Pearson.

Board evaluation

The 2018 Board evaluation, which was overseen by our Nomination & Governance Committee, confirmed that we have an effective and well-functioning Board, which has an appropriately balanced agenda, and which has made progress during the year in continuing to develop and articulate Pearson's strategy. Progress on recommendations arising from our annual Board evaluations is reported at each Committee meeting until such recommendations are completed or embedded to the Committee's satisfaction.

Focus on shareholder returns

The Board continues to pay attention to ensuring an optimal allocation of capital, and our policy in this regard remains unchanged: to maintain a strong balance sheet and a solid investment grade credit rating, to continue to invest in the business, to have a sustainable and progressive dividend policy, and to return surplus cash to our shareholders. In line with this policy, we completed a £300m share buyback in February 2018 following our disposal of a 22% stake in Penguin Random House in 2017. Details of other actions taken in support of our capital allocation policy are set out in my introductory statement on p08.

Accountability

See full section on p96–105

As a Board, we are accountable for Pearson's successes and addressing its challenges. We aim to communicate to you in a transparent manner the steps we have taken to ensure that we have a clear oversight of the business and the work we have undertaken in respect of Pearson's strategy throughout the year. Our Audit Committee, led by Tim Score, plays a key role in monitoring and evaluating our risk management processes, providing independent oversight of our external audit and internal control programmes, accounting policies, business transformation projects, such as TEP, and in assisting the Board in reporting in a fair, balanced and understandable manner to our shareholders.

Engagement

See full section on p106–109

In common with most large, public companies, we have a wider range of stakeholders than just traditional investors, and our Reputation & Responsibility Committee monitors our sustainability and social impact initiatives, government and public affairs matters, and engagement with the education community. Board members also engage with the wider stakeholder population, including employees, customers and partners, both through formal Board events and by way of individual contributions to internal and external initiatives. The Reputation & Responsibility Committee will lead the Board's oversight of Pearson's stakeholder engagement framework from 2019, as required by the updated UK Corporate Governance Code.

During 2018, Board members engaged with the workforce at structured talent events as well as through initiatives such as the Pearson Innovation Jam. As a Board, we are delighted to be able to help support our talent pipeline through the introduction of a new mentoring programme. You can read more about our employee engagement and talent initiatives in the Nomination & Governance Committee's report, which begins on p90.

Remuneration

See full section on p110–126

With the release of the updated UK Corporate Governance Code in July 2018, Elizabeth Corley, who chairs the Remuneration Committee, has led work to review how Pearson's remuneration policy complies with the code and can more closely align with emerging best practice while remaining simple, transparent and closely linked to Pearson's strategy and business performance. This included continuing to engage with investors and shareholders as the Committee prepares to review the Directors' remuneration policy in 2019 ahead of a policy vote at the 2020 AGM. Pearson's current approach to Executive remuneration is explained in more detail in the remuneration section of this report on p110.

Conclusion

I hope this report clearly sets out how your company is run, and how we align governance and our Board agenda with the strategic direction of Pearson. We always welcome questions or comments from shareholders, either via our website (www.pearson.com) or in person at our AGM.

Sidney Taurel
Chair

UK Corporate Governance Code

This year, we are reporting against the 2016 edition of the UK Corporate Governance Code (the Code). The Board believes that during 2018 the company was in full compliance with all relevant provisions of the Code, and this Governance Report sets out how the Code's principles have been applied throughout the year. A detailed account of the provisions of the Code can be found on the FRC's website at www.frc.org.uk and we encourage readers to view our compliance schedule on the company website at www.pearson.com/governance.

The Board is mindful of the changes to the corporate governance and reporting landscape introduced during 2018, including the publication of a new edition of the UK Corporate Governance Code. You can read more about our preparations for the new landscape on p93.

Overview
Our strategy in action
Our performance
Governance
Financial statements

Board of Directors

Pearson Board members bring a wide range of experience, skills and backgrounds which complement our strategy. All Board members have strong leadership experience at global businesses and institutions and, as a group, their experience covers:

- Business strategy and governance
- Innovation and disruption
- Education
- Digital and technology
- Talent, people and culture
- Finance and investment
- Sustainability and environmental matters
- Marketing, brand and media
- Government, international and regulatory affairs

Our Board members' biographies illustrate the contribution each Director makes to the Board by way of their individual experience.

Chair

N R

Sidney Taurel Chair
aged 70, appointed 1 January 2016

Sidney has over 45 years of experience in business and finance, and is currently a Director of IBM Corporation, where he also serves on the directors and corporate governance committee. Sidney is an advisory board member at pharmaceutical firm Almirall. He was Chief Executive Officer of global pharmaceutical firm Eli Lilly and Company from 1998 until 2008, Chairman from 1999 until 2008, and has been Chairman Emeritus since 2009. He was also a Director at McGraw Hill Financial, Inc., a role which he held from 1996 until April 2016 and at ITT Industries from 1996 to 2001. In 2002, Sidney received three US presidential appointments to: the Homeland Security Advisory Council, the President's Export Council and the Advisory Committee for Trade Policy and Negotiations, and is an officer of the French Legion of Honour.

Current notable commitments:
IBM Corporation (Non-Executive Director)

Non-Executive Directors

A N R

Elizabeth Corley, CBE Non-Executive Director
aged 62, appointed 1 May 2014

Elizabeth has extensive experience in the financial services industry, having been CEO of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016, and continues to act as a senior adviser to the firm. She was previously at Merrill Lynch Investment Managers and Coopers & Lybrand. Elizabeth is a Non-Executive Director of BAE Systems plc and Morgan Stanley Inc. Elizabeth is active in representing the investment industry and developing standards within it. She currently chairs a Taskforce for the UK government on social impact investing. She is a member of the Committee of 200. She was appointed Commander of the British Empire in the 2015 New Year Honours for her services to the financial sector.

Current notable commitments: BAE Systems plc (Non-Executive Director), Morgan Stanley Inc. (Non-Executive Director)

A RR

Michael Lynton Non-Executive Director
aged 59, appointed 1 February 2018

Michael served as CEO of Sony Entertainment from 2012 until 2017, overseeing Sony's global entertainment businesses. He also served as Chairman and CEO of Sony Pictures Entertainment from 2004. Prior to that, he held senior roles within Time Warner and AOL, and earlier served as Chairman and CEO of Penguin Group where he extended the Penguin brand to music and the internet. Michael is Chairman of Snap, Inc., and currently serves on the boards of IEX, Warner Music and Ares Management Corporation LLC.

Current notable commitments:
Ares Management Corporation LLC (Non-Executive Director), Snap, Inc. (Chairman)

Executive Directors

John Fallon Chief Executive
aged 56, appointed 3 October 2012

John became Pearson's Chief Executive on 1 January 2013. Since 2008, he had been responsible for the Company's education businesses outside North America and a member of the Pearson management committee. He joined Pearson in 1997 as Director of Communications and was appointed President of Pearson Inc. in 2000. In 2003, he was appointed CEO of Pearson's educational publishing businesses for Europe, Middle East & Africa. Prior to joining Pearson, John was Director of Corporate Affairs at Powergen plc and was also a member of the company's executive committee. Earlier in his career, John held senior public policy and communications roles in UK local government. He is an advisory board member of the Global Business Coalition for Education.

Coram Williams Chief Financial Officer
aged 45, appointed 1 August 2015

Coram joined Pearson in 2003 and has held a number of senior positions including Finance and Operations Director for Pearson's English language teaching business in Europe, Middle East & Africa, Interim President of Pearson Education Italia and Head of Financial Planning and Analysis for Pearson. In 2008, Coram became CFO of The Penguin Group and was latterly appointed CFO of Penguin Random House in 2013, where he oversaw the integration of the two businesses. Coram trained at Arthur Andersen, and subsequently worked in both the auditing and consulting practices of the firm. He is a Non-Executive Director and Chairman of the audit committee for the Guardian Media Group.

A N RR

Vivienne Cox, CBE Senior Independent Director
aged 59, appointed 1 January 2012

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years in global roles including Executive Vice President and Chief Executive of BP's gas, power and renewables business and its alternative energy unit. She is Chair of the supervisory board of Vallourec S.A., a leader in the seamless steel pipe markets, Non-Executive Director at pharmaceutical company GlaxoSmithKline plc and serves as Chair of the Rosalind Franklin Institute. She was appointed Commander of the British Empire in the 2016 New Year Honours for her services to the economy and sustainability.

Current notable commitments: GlaxoSmithKline plc (Non-Executive Director), Vallourec S.A. (Chair of the supervisory board)

N R

Josh Lewis Non-Executive Director
aged 56, appointed 1 March 2011

Josh's experience spans finance, education and the development of digital enterprises. He is founder of Salmon River Capital LLC, a New York-based private equity/venture capital firm focused on technology-enabled businesses in education, financial services and other sectors, through which he has taken on the role of Non-Executive Director of several enterprises. Over a 25-year career in active, principal investing, he has been involved in a broad range of successful companies, including several pioneering enterprises in the education sector. In addition, he has long been active in the non-profit education sector.

Current notable commitments: Salmon River Capital LLC (Founder & Managing Principal)

A RR

Linda Lorimer Non-Executive Director
aged 66, appointed 1 July 2013

Linda has spent almost 40 years serving higher education. She retired from Yale in 2016 after 34 years at the university where she served in an array of senior positions including Vice President for Global & Strategic Initiatives. She oversaw the development of Yale's burgeoning online education division and the expansion of Yale's international programmes and centres. During her tenure, she was responsible for many administrative services, ranging from Yale's public communications and alumni relations to sustainability, human resources and the university press. She also served on the boards of several public companies, including as Presiding Director of the McGraw-Hill companies. Linda is a member of the board of Yale New Haven Hospital, where she chairs the nominating and governance committee.

A N R

Tim Score Non-Executive Director
aged 58, appointed 1 January 2015

Tim has extensive experience of the technology sector in both developed and emerging markets, having served as Chief Financial Officer of ARM Holdings plc, the world's leading semiconductor IP company, for 13 years. He is an experienced non-executive director and currently sits on the boards of The British Land Company plc and HM Treasury, in addition to being a Trustee of the National Theatre. He served on the board of National Express Group plc from 2005 to 2014, including time as interim Chairman and six years as the Senior Independent Director. Earlier in his career Tim held senior finance roles with Rebus Group, William Baird, LucasVarity plc and BTR plc.

Current notable commitments: The British Land Company plc (Non-Executive Director and Chairman-elect)

A RR

Lincoln Wallen Non-Executive Director
aged 58, appointed 1 January 2016

Lincoln has extensive experience in the technology and media industries, and is currently CTO of Improbable, a technology start-up supplying next-generation cloud hosting and networking services to the video game industry. Lincoln was CEO of DWA Nova, a software-as-a-service company spun out of DreamWorks Animation Studios in Los Angeles, a position he held until 2017. He worked at DreamWorks Animation for nine years in a variety of leadership roles including Chief Technology Officer and Head of Animation Technology. He was formerly CTO at Electronic Arts Mobile, leading their entry into the mobile gaming business internationally. Lincoln is a Non-Executive Director of the Smith Institute for Industrial Mathematics and Systems Engineering. His early career involved 20 years of professional IT and mathematics research, including as a reader in Computer Science at Oxford.

Current notable commitments: Improbable (Chief Technology Officer)

Key to Committees

- A Audit
- N Nomination & Governance
- RR Reputation & Responsibility
- R Remuneration
- Committee chair

Current notable commitments include other listed company directorships and full time or executive roles.

Board governance and activities

Board of Directors

Composition of the Board As at the date of this report, the Board consists of the Chair, Sidney Taurel, two Executive Directors: the Chief Executive, John Fallon, and Chief Financial Officer, Coram Williams, and seven independent Non-Executive Directors. During the year, Harish Manwani stepped down from the Board at the AGM held on 4 May 2018 and Michael Lynton joined the Board on 1 February 2018.

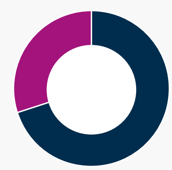
Chair and Chief Executive There is a defined split of responsibilities between the Chair and the Chief Executive. The roles and responsibilities of the Chair and Chief Executive are clearly defined, set out in writing and reviewed and agreed by the Board on an annual basis. These can be found on the Company website at www.pearson.com/governance

Chair's significant commitments There were no changes to the Chair's significant commitments during 2018. However, during the year, Mr Taurel stepped down as chair of the compensation committee of IBM Corporation and joined its directors and corporate governance committee.

Roles and composition of the Board

Role	Name	Responsibility
Chair	Sidney Taurel	The Chair is primarily responsible for the leadership of the Board and ensuring its effectiveness. He ensures that the Board upholds and promotes the highest standards of corporate governance, setting the Board's agenda and encouraging open, constructive debate of all agenda items for effective decision-making. He regularly meets the Chief Executive to stay informed. He also ensures that shareholders' views are communicated to the Board.
Chief Executive	John Fallon	The Chief Executive is responsible for the operational management of the business and for the development and implementation of the Company's strategy as agreed by the Board and management. He is responsible for developing operational proposals and policies for approval by the Board, and promotes Pearson's culture and standards.
Chief Financial Officer	Coram Williams	The Chief Financial Officer is responsible for the preparation and integrity of Pearson's financial reporting and statements and also oversees other functional areas including tax, treasury, internal audit and corporate finance. He supports the Chief Executive in developing and implementing the strategy of the Company as agreed by the Board and management.
Senior Independent Director	Vivienne Cox	The Senior Independent Director's role includes meeting regularly with the Chair and Chief Executive to discuss specific issues, as well as being available to shareholders generally should they have concerns that have not been addressed through the normal channels. She also leads the evaluation of the Chair on behalf of the other Directors.
Committee Chairs	Elizabeth Corley Vivienne Cox Linda Lorimer Tim Score	The Committee Chairs are responsible for leading the Board Committees and ensuring their effectiveness. They set the Committees' agendas, in consultation with management, and report to the Board on Committee proceedings. They lead on engagement with shareholders regarding matters within the remit of the Committees, alongside senior management.
Non-Executive Directors	Elizabeth Corley Vivienne Cox Josh Lewis Linda Lorimer Michael Lynton Tim Score Lincoln Wallen	The Non-Executive Directors contribute to the development of our strategy and scrutinise and constructively challenge the performance of management in the execution of strategy and risk planning. They also engage with various stakeholders of the Company and provide guidance and independent perspective to management.
Company Secretary	Stephen Jones	The Company Secretary acts as secretary to the Board and its Committees, ensuring compliance with Board procedures and advising on governance matters. He is responsible, under the direction of the Chair, for ensuring the Board receives accurate, timely and clear information. The Company Secretary supports the Chair in delivery of the corporate governance agenda and organises Director inductions and ongoing training.

Gender balance of Board

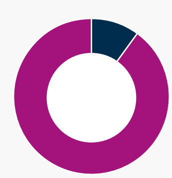


- Men 7
- Women 3

Nationality of Directors

- British 6
- USA 4

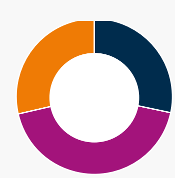
Ethnicity



- Mixed 1
- White 9

Mixed – White & Black Caribbean (1)
White – English/Welsh/Scottish/Northern Irish/British (6)
White – Any other White Background (3)

Length of tenure of Non-Executive Directors



- Under 3 years 2
- 3 to 6 years 3
- Over 6 years 2

All information correct as at 31 December 2018.

Governance at Pearson

FLOW OF INFORMATION

Board of Directors

Board Committees

Audit Committee
Appraises our financial management and reporting and assesses the integrity of our accounting procedures and financial control.

Nomination & Governance Committee
Reviews corporate governance matters, including Code compliance and Board evaluation, considers the appointment of new Directors, Board experience and diversity, and reviews Board induction and succession plans.

Remuneration Committee
Determines the remuneration and benefits of the Executive Directors and oversees remuneration arrangements for the Pearson Executive.

Reputation & Responsibility Committee
Considers the Company's impact on society and the communities in which Pearson operates, including to ensure that strategies are in place to manage and improve Pearson's reputation.

Pearson Executive management (PEM)

see p13

PEM consists of John Fallon (Chief Executive) and his direct reports. They are the executive leadership group for Pearson, responsible for delivering Pearson's strategy under clearly defined accountabilities and in line with agreed governance and processes.

- Chief Executive
- Chief Financial Officer
- Chief Technology & Operations Officer
- Chief Corporate Affairs Officer
- Chief Human Resources Officer
- Chief Strategy Officer
- General Counsel & Chief Legal Officer
- President UK & Core Markets
- President Growth Markets
- President North America
- President Pearson Assessments
- President Global Product

Independence of Chair In accordance with the Code, Sidney Taurel was considered to be independent upon his appointment as Chair on 1 January 2016.

Independence of Directors All of the Non-Executive Directors who served during 2018 were considered by the Board to be independent for the purposes of the Code. The Board reviews the independence of each of the Non-Executive Directors annually. This includes reviewing their external appointments and any potential conflicts of interest as well as assessing their individual circumstances in order to ensure that there are no relationships or matters likely to affect their judgement. In addition to this review, each of the Non-Executive Directors is asked annually to complete an independence questionnaire to satisfy requirements arising from Pearson's US listing and, from the beginning of 2019, the new UK Corporate Governance Code.

Josh Lewis and Vivienne Cox have served on the Board for more than six years. Accordingly, their performance was subject to a rigorous review during 2018, including with regard to their independence. The Board has determined that Josh Lewis and Vivienne Cox continue to be independent, taking into account their valuable contribution to Board discussions and constructive challenge of management.

Conflicts of interest Under the Companies Act 2006, Directors have a statutory duty to avoid conflicts of interest with the Company. The Company's Articles of Association allow the Directors to authorise conflicts of interest. The Company has established a procedure to identify actual and potential conflicts of interest, including all directorships or other appointments to, or relationships with, companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Once notified to the Chair or Company Secretary, such potential conflicts are considered for authorisation by the Board at its next scheduled meeting. The relevant Director cannot vote on an authorisation resolution, or be counted in the quorum, in relation to the resolution relating to his/her conflict or potential conflict. The Board reviews any authorisations granted on an annual basis.

Board governance and activities

The role and business of the Board

The Board is deeply engaged in developing and measuring the Company's long-term strategy, performance, culture and values. We believe that it adds a valuable and diverse set of external perspectives and that robust, open debate about significant business issues brings an additional discipline to major decisions.

A schedule of formal matters reserved for the Board's decision and approval is available on our website, at www.pearson.com/governance

The key responsibilities of the Board include:

- Overall leadership of the Company and setting the Company's values and standards including monitoring culture
- Determining the Company's strategy in consultation with management, reviewing performance against it and overseeing management execution thereof
- Major changes to the Company's corporate, capital, management and control structures
- Approval of all transactions or financial commitments in excess of the authority limits delegated to the Chief Executive and other Executive management
- Assessment of management performance and Board and Executive succession planning.

The Board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive meeting papers are circulated to the Board and Committee members at least one week in advance of each meeting and the Board receives a regular dashboard and key milestones report and regular updates from the Chief Executive and Chief Financial Officer. In addition to meeting papers, a library of current and historical corporate information is made available to Directors electronically to support the Board's decision-making process. Directors can obtain independent professional advice, at the Company's expense, in the performance of their duties as Directors. All Directors have access to the advice and services of the Company Secretary.

Strategic planning

In 2018, following continued improvements in our operational and financial performance, the Board was in a position to focus particularly on strategy and future prospects for the business. In honing our strategic and financial plans, the Board considered findings from a dedicated workstream involving contributors from across Pearson which sought to:

- Review the education landscape, present and future state
- Articulate key conclusions around which to build our strategy
- Identify the customer problems we are best placed to solve
- Identify the capabilities we need to utilise and build to deliver our five-year strategy
- Identify implications for our business which will drive our future investments and planning process.

Following detailed consideration and discussion of these themes over a number of focused sessions during the year, the Board confirmed its strategic priorities, as described on p20–24.

Standing Committee

A Standing Committee of the Board is established to approve certain operational and ordinary course of business items such as banking matters, guarantees, intra-group transactions and to make routine approvals relating to employee share plans.

The Committee has written terms of reference, reviewed and approved each year, which clearly set out its authority and duties. These can be found on the Company website at www.pearson.com/governance.

Board meetings

The Board held seven formal meetings in 2018, with discussions and debates focused on the key strategic issues facing the Company. This included a meeting in Milan, Italy, when the Board considered its Core markets, and a meeting in Cape Town, South Africa, at which Growth markets was the main focus; together with deeper dives into the local business on both trips. Major items covered by the Board in 2018 are shown in the table opposite. In addition to the formal meetings, the Board meets in person or by telephone as necessary to consider matters of a time-sensitive nature.

Milan, Italy At a two-day meeting in Milan in June, the Board and Pearson Executive spent time focused on Pearson's businesses in our Core markets as well as on the local Italian business. They considered the ways in which Pearson aims to innovate the delivery of access to high-quality career-focused education, and the opportunities to collaborate, challenge and support across the Core markets. Throughout the meeting the Board engaged with the Core leadership team and met with representatives of the local employee population. The Board also had the opportunity to observe an example of career-focused education in schools, by viewing a robotics class and also participated in a facilitated exercise with the Core leadership team around the theme of how Pearson can best drive the opportunity to connect education and work, preparing people for lifelong learning and future skills. There were also two stakeholder panel sessions, allowing the Board to hear directly from customers about the challenges they face in delivering high-quality content, assessment and qualifications in schools, and from employers and the higher education sector about preparing students for work.

Cape Town, South Africa The Board and the Pearson Executive visited Cape Town in October for a three-day meeting. They were joined by members of senior management from the Growth leadership team who provided an overview of the Growth business including country-specific updates and a deeper dive into the South African learning services and direct delivery businesses. The Board and Executive participated in a range of engagement opportunities with a variety of Pearson stakeholders, including a Rapid Prototyping workshop and a customer panel session with the theme of putting employability at the heart of Pearson's strategy – Read more about the Rapid Prototyping workshop and the Board's engagement with these stakeholders on p108–109. The Board also spent some time hearing from each member of the Executive team about the prospects for and performance of their individual business units, or areas of control, before taking some time to review Pearson's talent pipeline and in particular how it aligns with the organisation's culture and capabilities. During the meeting, the Board also attended a facilitated breakfast meeting with new and emerging local talent and gained a valuable insight into employees' views on Pearson's current challenges and opportunities.

Board meeting focus during 2018

→ Strategy

- WSE and US K12 Courseware – updates
- Review of Core and Growth markets at offsite meetings
- Efficiency and simplification initiatives
- US Higher Education Courseware
- Interactive product demonstrations
- Product, technology and operations strategies
- Operating and strategic plan discussions

→ Performance

- 2017 preliminary results and annual report and accounts
- Interim results and trading updates
- Regular dashboard and milestone reports
- Oversight of 2018 operating plan and goals, and preparation for 2019
- Final and interim dividend proposals

→ Leadership & people

- Talent and succession planning
- Organisational health including review of Pearson's culture
- Chief Executive's goals
- Chief Human Resources Officer's first impressions of HR and talent at Pearson
- Dinner with senior local management and facilitated breakfasts with key talent at overseas strategy meetings. Read more on employee engagement on p109

→ Governance & risk

- Compliance with UK Corporate Governance Code
- Regular Brexit and Pensions updates
- Shareholder activism and defence planning
- Enterprise risk management review
- Approval of income statement and going concern and viability
- Board evaluation
- Approval of division of responsibilities between Chair and Chief Executive
- Annual review of conflicts of interest
- Investor relations updates
- Approval of Committee terms of reference
- Tax update

→ Shareholders & engagement

- Investor relations strategy and share price performance
- Major shareholders and share register analysis
- Shareholder issues and voting
- Focus on forthcoming AGM
- Digital advisory network update

Board governance and activities

Culture and values

Pearson's core values – to be brave, imaginative, decent and accountable – go to the heart of our mission to improve learning outcomes, and the Board and employees are committed to demonstrating these characteristics throughout their work and deliberations. During 2018, the focus was to foster a culture of innovation, organisational health, diversity and inclusion at all levels and which included engaging with employees from across Pearson through various platforms and events during the year. The Board recognises that the Company's culture is also undergoing transformation through the simplification of our portfolio and investment through structured programmes such as The Enabling Programme (TEP) and the Global Learning Platform (GLP). The Board monitors the culture of the Company and levels of employee engagement and advocacy with the assistance of its Reputation & Responsibility Committee and through regular updates from the Chief Human Resources Officer.

Board attendance

Directors are expected to attend all Board and Committee meetings but in certain exceptional circumstances, such as due to pre-existing business or personal commitments, it is recognised that Directors may be unable to attend. There was full attendance by Directors at Board and Committee meetings in 2018.

The following table sets out the attendance of the Company's Directors at scheduled Board meetings during 2018:

	Board meetings attended
Chair	
Sidney Taurel	7/7
Executive Directors	
John Fallon	7/7
Coram Williams	7/7
Non-Executive Directors	
Elizabeth Corley	7/7
Vivienne Cox	7/7
Josh Lewis	7/7
Linda Lorimer	7/7
Michael Lynton[1]	6/6
Harish Manwani[2]	3/3
Tim Score	7/7
Lincoln Wallen	7/7

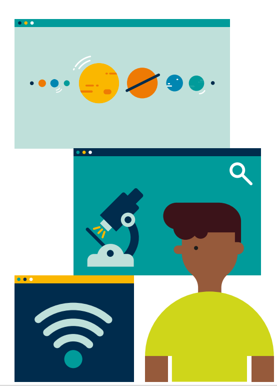
1 Mr Lynton joined the Board on 1 February 2018.
2 Mr Manwani resigned from the Board on 4 May 2018.

Board in action

Global Learning Platform

Pearson is building a Global Learning Platform (GLP), which is a single, cloud-based platform that's highly scalable and reliable, and allows us to innovate faster and support a lifelong learning ecosystem for learners. As the GLP is a key customer and learner-facing element of the transformation programme, it remains an item closely monitored by the Board. The Board continued to receive regular updates throughout the year, which enabled them to monitor the progress of Pearson's delivery of agreed metrics for growing market share through digital transformation.

At each meeting, the Board was joined by the President of Global Product and by the Chief Technology and Operations Officer to review the development of the GLP, including progress of the Rio Limited Pilot, a new mastery-based developmental maths product, and Revel, our next-generation US higher education digital courseware product. At its meeting in May, the Board reviewed the learnings from the Digital Advisory Network and considered Pearson's digital transformation in the context of building the GLP. Throughout the year, the Board assessed Pearson's strategy and three-year plan linking it to delivery of the GLP. At its December meeting, the Board received a live software demonstration of Rio and discussed customer feedback and steps taken to improve learning experiences and better outcomes on the GLP across Pearson. In addition, the SVP AI Products and Solutions, who joined Pearson this July to lead our newly formed AI Products and Solutions team, also presented a strategy and roadmap for artificial intelligence-based product development to the Board.



1 Grow market share through digital transformation

Link to strategic priorities, see p20

Succession planning

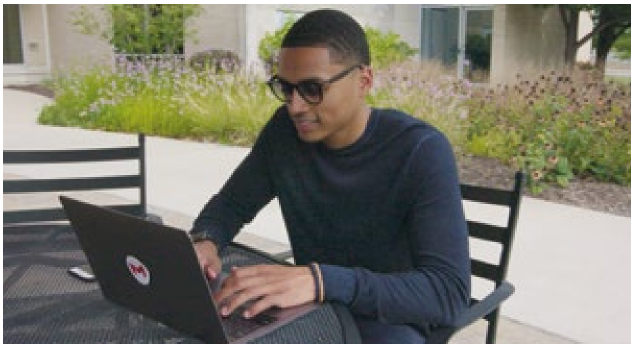
The Board considers oversight of succession planning as one of its prime responsibilities, assisted by the Nomination & Governance Committee. The Company has formal contingency plans in place for the temporary absence of the Chief Executive for health or other reasons. The matter of Chief Executive succession is a standing item for discussion and review by the Chair and the Board annually. Succession planning for the Board and Chair is also considered annually by the full Board and on an ongoing basis by the Nomination & Governance Committee. There is also discussion and oversight of key positions at Executive management level, including the recent appointment of a new Chief Corporate Affairs Officer. In early 2018, Pearson recruited a Chief Strategy Officer and a new Chief Human Resources Officer. As we continue to transform the business at Pearson, the new members of the Executive team had a key role to play in our strategic planning process and in succession planning and fostering a culture of diversity and inclusion.

As well as Board and Executive management succession, the Board also oversees our leadership pipeline. In December, the Board's discussions on succession planning focused on the executive pipeline from which the future leaders of Pearson were likely to emerge, both at PEM level and other key roles. Strong successors have been identified for PEM roles and future considerations have been taken into account in identifying successors both immediately below PEM level and those who would be ready to take up a PEM-level position in one or two moves. A diverse pipeline of 'ready later' emerging talent has been identified, and plans are put in place to accelerate their path to succession where possible. The Company also has targeted development programmes for high-potential talent, mentorship programmes for senior women leaders as well as a Managers Fundamentals programme for middle management.

Board in action

Online Program Management

Pearson considers Online Program Management (OPM), virtual schools, professional certification and English language learning to be among its biggest growth opportunities. In light of this potential, OPM continued to be a regular reporting item on the Board's agenda for 2018. During the year, the Board considered Pearson's prospects in the OPM business, and spent some time reviewing the business model, some proposed operational improvements and the existing contract pipeline. At its meeting in June, the Board conducted a deeper dive into the global operations strategy of the OPM business, and with the Executive team also discussed leveraging learnings more widely. This included a consideration of how Pearson's expertise in courseware and assessment could continue to support partners in the development and delivery of online programmes that demonstrate innovation and superior student learning experiences. OPM was also discussed in relation to the three-year planning process, with the Board focusing on the operating model for the business and considering the impact of the very specific economics of a typical OPM contract.



Studying an online degree powered by Pearson Online Program Management, at Maryville University see p06

2 Invest in structural growth markets

Link to strategic priorities, see p22

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Board governance and activities

Directors' indemnities

A qualifying third party indemnity (QTPI), as permitted by the Articles and sections 232 and 234 of the Act, has been granted by the Company to each of its Directors. Under the provisions of the QTPI, the Company undertakes to indemnify each Director against liability to third parties (excluding criminal and regulatory penalties) and to pay Directors' costs as incurred, provided that they are reimbursed to the Company if the Director is found guilty, the court refuses to grant the relief sought or, in an action brought by the Company, judgement is given against the Director. The indemnity has been in force for the financial year ended 31 December 2018 and is currently in force. The Company has purchased and maintains Directors' and Officers' insurance cover against certain legal liabilities and costs for claims in connection with any act or omission by such Directors and Officers in the execution of their duties.

Board Committees

The Board has established four formal Committees: Audit, Nomination & Governance, Remuneration, and Reputation & Responsibility. The Chairs and members of these Committees are appointed by the Board on the recommendation (where appropriate) of the Nomination & Governance Committee and in consultation with each relevant Committee Chair. In addition to these formal Board Committees, the Standing Committee also operates with Board-level input.

Learn more about Pearson's governance structure on p83

Board in action

Simplification programme

In 2017, we announced plans to reduce Pearson's cost base by a further £300m exiting 2019. In January 2019, we announced that we are saving ahead of that plan, and now expect to deliver increased annualised cost savings in excess of £330m by the end of 2019. During the year, the Board had an oversight of the planned implementation of finance and operations systems throughout our North American business, enabling us to adjust the cost base in our US Higher Education courseware business. The programme also includes simplification of our technology architecture which has facilitated the increased use of shared service centres and automation, enabling us to standardise processes and reduce headcount. This has also enabled us to develop centralised procurement and reduce our number of office locations.

The Board receives regular updates on the simplification programme through the dashboard and key milestones report as well as updates from the Chief Executive and Chief Financial Officer at every Board meeting. At the Board meeting in June, each member of the Executive team provided an update on their particular function or business units describing their initiatives, outcomes and efficiencies arising from the simplification programme. The Board believes that the changes arising from the simplification programme will help Pearson speed up innovation, provide better customer experiences, eliminate duplication and increase scalability in the long-term.

3 Become a simpler, more efficient and more sustainable business

Link to strategic priorities, see p24

More Committee information:

Audit Committee	**p96**
Nomination & Governance Committee	**p90**
Remuneration Committee	**p110**
Reputation & Responsibility Committee	**p106**
Standing Committee	**p84**

The Committees focus on their own areas of expertise, enabling the Board meetings to focus on strategy, performance, leadership and people, governance and risk, and shareholder engagement, thereby making the best use of the Board's time together as a whole. The Committee Chairs report to the full Board at each Board meeting immediately following their sessions, ensuring a good communication flow while retaining the ability to escalate items to the full Board's agenda if appropriate.

Directors' training and induction

All Directors receive training in the form of presentations about the Company's operations, through Board meetings held at operational locations and by encouraging the Directors to visit local facilities and management as and when their schedule allows, including if they are travelling to a country or region on non-Pearson business. The Company Secretary and General Counsel, in conjunction with Pearson's advisers, monitor legal and governance developments and update the Board on such matters as agreed with the Chair. As part of the Board's focus on diversity and inclusion, the Directors received an overview of the training on unconscious bias which is being delivered to employees, and participated in elements of this programme.

Our Directors can also make use of external courses. Directors receive a significant bespoke induction programme and a range of information about Pearson when they join the Board. This includes background information on Pearson and details of Board procedures, Directors' responsibilities and various governance-related issues, including procedures for dealing in Pearson shares and their legal obligations as Directors. The induction also typically includes a series of meetings with members of the Board, external legal advisers and brokers, the Pearson Executive and senior management, presentations regarding the business from senior executives and a briefing on Pearson's investor relations programme.

The induction programme for Michael Lynton, our most recently appointed Non-Executive Director, took place in 2018. A tailored and bespoke induction programme was designed for him which aligned with the Board's focus areas.

"The bespoke induction programme was terrific. It provided me with helpful insights into Pearson with a range of topics and meetings with both internal stakeholders and company advisers. I found the meetings with division heads particularly useful in developing my understanding of the drivers of Pearson's businesses. It was extremely important to undertake this induction programme, and I'm sure the knowledge I've gained through the programme has helped me in making an effective contribution to the Board during my first year."

Michael Lynton

The induction included meetings with other Board members, business area familiarisation with members of the Pearson Executive, a briefing on Directors' duties and sessions with the SVP Internal Audit, Compliance and Risk, SVP Investor Relations, and MD, Pearson Online Learning Services. The Company Secretary sought Michael's feedback following completion of his induction programme. Michael was very positive about the benefits of the programme, and suggested a small number of enhancements based on his own experience. These suggestions will be taken into account by the Nomination & Governance Committee as it continues to oversee the format of the Non-Executive Director induction.

Nomination & Governance Committee report

Committee Chair

Vivienne Cox

Members

Elizabeth Corley, Vivienne Cox, Josh Lewis, Tim Score and Sidney Taurel

Committee responsibilities include:

→ Appointments

Identifying and nominating candidates for Board vacancies.

→ Balance

Ensuring that the Board and its Committees have the appropriate balance of skills, experience, independence, diversity and knowledge to operate effectively.

→ Succession

Reviewing the Company's leadership needs with a view to ensuring the continued ability of the organisation to compete in the marketplace.

→ Governance

Review and oversight of Pearson's corporate governance framework, Board evaluation and training plans, and Board diversity policy.

Terms of reference

The Committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the Company website www.pearson.com/governance.

Committee attendance

Attendance by Directors at Nomination & Governance Committee meetings throughout 2018:

	Meetings attended
Elizabeth Corley	4/4
Vivienne Cox	4/4
Josh Lewis	4/4
Harish Manwani[1]	2/2
Tim Score	4/4
Sidney Taurel	4/4

1 Mr Manwani stepped down from the Committee on 4 May 2018.

Role and business of the Committee

The Committee monitors the composition and balance of the Board and of its Committees, identifying and recommending to the Board the appointment of new Directors and/or Committee members.

The Committee has oversight of the Company's compliance with, and approach to, all applicable regulation and guidance related to corporate governance matters.

The Committee also oversees talent and succession plans for senior roles. The Committee comprises four independent Non-Executive Directors and the Chair of the Board. The Chief Executive and other senior management, including the Chief Human Resources Officer, attend Committee meetings by invitation.

Areas of focus during 2018

During 2018, the Committee's areas of focus included oversight of the annual Board evaluation process, reviewing Committee membership and Committee remits in order to ensure balanced remits and composition of all Committees, and reviewing its own terms of reference. The Committee also conducted a benchmarking exercise in respect of the frequency and duration of Board meetings and the Committee was satisfied that the Board had sufficient meeting time under the current arrangements.

At its February meeting, the Committee considered arrangements for the induction of new Non-Executive Directors, including finalising Michael Lynton's induction programme. The Committee also had oversight of Non-Executive Director succession planning and search activity, and this was a regular agenda item throughout the year.

At its December meeting, the Committee received an update from the Chief Human Resources Officer and SVP, Diversity & Inclusion about Pearson's detailed action plan to address the gender pay gap. In addition, the Committee received an update on planned events scheduled for 2019 for next-generation female executives, delivering upon a recommendation by Committee member Elizabeth Corley. The Board also devoted time to diversity and inclusion initiatives across the business – see overleaf for further detail.

The Committee also considered the Company's corporate governance framework in light of the new UK Corporate Governance Code which took effect for Pearson from 1 January 2019. We will report in accordance with the 2018 Code in the 2019 annual report, and you can read more about our preparation for the new UK Corporate Governance Code on p93.

Board search

Pearson uses a number of leading firms in its Board search activities and ensures that we retain good relationships with them. Acting on the results of the 2017 Board evaluation, the Committee has paid particular attention to Non-Executive Director succession planning, including for future Committee chairs. Accordingly, during the year, the Committee undertook a market study for potential search firms and reviewed the process by which it will select candidates. The Committee also agreed upon specific criteria for potential new Non-Executive Directors, in particular giving consideration to the skills and experience required in any candidates. Pearson expects all Non-Executive Directors to demonstrate the highest level of integrity and credibility, independence of judgement, maturity, collegiality, a high interest in education and the commitment to devote the necessary time.

Taking into account the agreed person specification as well as diversity in its broadest sense, in 2018 the Committee engaged Russell Reynolds Associates to undertake a search process for new Non-Executive Directors. In addition to the Non-Executive Director search process, Russell Reynolds Associates undertakes broader executive search activity for the Group, and is a signatory to the Voluntary Code of Conduct for Executive Search Firms.

Committee evaluation

The Committee undertook an annual evaluation to review its own performance and effectiveness. The process involved the distribution of questionnaires to Committee members, as well as key stakeholders, seeking views on matters including Committee roles and responsibilities, quality and timeliness of meeting materials, opportunity for discussion and debate, dialogue with management and access to independent advice. Responses were then evaluated and presented to the Committee at a scheduled meeting, with key themes being drawn out for discussion.

The Committee was considered to have operated effectively throughout 2018 with a clear agenda and effective leadership. In response to the findings of the 2018 evaluation, and as part of its forward planning for the 2019 agenda, the Committee will continue to devote time to Board succession planning, including for Committee Chair positions, and has agreed that its focus on the requirements of the new UK Corporate Governance Code will continue to be a priority in 2019. The Company Secretary will ensure that meeting frequency and time allocation remains appropriate to achieve these aims. The Committee has also given consideration to the processes relating to Non-Executive Director search activity, which was a particular recommendation arising from its 2018 evaluation.

Committee aims for 2019

We will have a full agenda for 2019, with a particular focus on implementation of changes to the corporate governance framework including establishment of the employee engagement network, Non-Executive Directors' succession planning activity, Board diversity and inclusion plan and findings of the Board evaluation.

Vivienne Cox
Chair of Nomination & Governance Committee

Nomination & Governance Committee meeting focus during 2018

→ Appointments

- Ongoing search for potential Non-Executive Directors

→ Balance

- Agreement of desired skills and experience of new Non-Executive Directors
- Update on diversity and inclusion initiatives at Pearson

→ Succession

- Succession planning and updates on search for Non-Executive Directors
- Induction outline for Non-Executive Directors

→ Governance

- Consideration of Board evaluation feedback
- Compliance with UK Corporate Governance Code
- Oversight of development of the employee engagement network
- Schedule and length of meetings
- Approval of Committee terms of reference

Nomination & Governance Committee report

Diversity

The Board embraces the Code's underlying principles with regard to Board balance and diversity, including in respect of ethnicity, gender and age. The objectives set out in the Board's diversity and inclusion (D&I) policy and our progress towards these objectives are shown in the table below. The Committee ensures that the Directors of Pearson demonstrate a broad balance of skills, background and experience, to support Pearson's strategic development and reflect the global nature of our business. The Committee also ensures that appointments are made on merit and relevant experience, while taking into account the broadest definition of diversity. In the ongoing Non-Executive Director search process, emphasis is given to candidates who would enhance the overall diversity of the Board.

The gender diversity of the Board was 30% female representation as at 31 December 2018. However, as noted in the Board diversity and inclusion policy, we are committed to work towards the recommendations suggested by the Hampton-Alexander Review aimed at having at least 33% female representation on the Board by 2020.

During the year, the Board received an overview of the training on unconscious bias which is being delivered to employees and participated in elements of this programme. The Board received a detailed progress update in December on the Company's refreshed diversity and inclusion strategic approach, framework, governance and measurement models and 2019 priority areas. The Board also received an update on a new internal mentoring scheme, and agreed to join the programme whereby each Director is paired with a high-potential Senior Vice President female leader at Pearson. This launched at the end of 2018 and runs through 2019.

Board diversity & inclusion objectives

The Committee has agreed the following objectives to support the Board diversity & inclusion policy:

Objectives	Progress
We will strive to maintain a Board composition of: › At least 25% female Directors, with a target of at least 33% female Directors by 2020 › At least one Director of colour.	› 25% female Directors achieved. › Board includes one Director who identifies as Mixed – White & Black Caribbean.
All Board appointments will be made on merit, in the context of the skills and relevant experience that are needed for the Board to oversee Pearson's strategic development and that reflect the global nature of our business.	Achieved. Rigorous process used during recent search for Michael Lynton who has relevant experience and skills.
The Board will prioritise use of search firms which adhere to the Voluntary Code of Conduct for Executive Search Firms when seeking to make Board-level appointments.	Achieved.
The Board will continue to adopt best practice, as appropriate, in response to the Davies Review, the Hampton Alexander Review and the Parker Review.	The recommendations of the Davies Review, Hampton Alexander Review and Parker Review in respect of gender and ethnic diversity have been noted by the Board.
Where appropriate, we will assist with the development and support of initiatives that promote all forms of diversity and inclusion in the Board, Pearson Executive and our senior management.	Board mentoring scheme of senior leadership talent launched.

Diversity and talent in Executive pipeline

Our Code of Conduct sets out our global standards and responsibilities with regard to D&I at all employee levels, including the Pearson Executive, and covers many aspects, including gender, age, ethnicity, disability and sexual orientation. This is underpinned by a global statement on D&I along with country and business specific policies. A new Global Diversity and Inclusion Council is launching in early 2019 and will be chaired by Chief Executive, John Fallon. For more information on the Company's approach to diversity and inclusion, please see p38 in the Sustainability section.

We are a founder member of the 30% Club and the Chief Executive has also signed a personal commitment to set an aspirational target of at least 30% women in Pearson's senior management team by 2020. On our Executive team, there are currently two women out of ten members (20%) – this excludes the Chief Executive and Chief Financial Officer who are counted in the Board's metric. The senior leadership group, comprising the direct reports of the Pearson Executive, had 31% female representation as of 31 December 2018.

We believe that we have a multi-pronged plan in place to build our pipeline of women in leadership and senior management positions, and the Board and Committee will carefully monitor their development, and the development of all key talent. Pearson published its first gender pay gap report in Great Britain in March 2018 and has made a commitment to extend our gender pay reporting globally by 2020. Read more about our initiatives to address the gender pay gap on p38.

Preparation for the new UK Corporate Governance Code

The new UK Corporate Governance Code (the 2018 Code) applies to Pearson from the 2019 financial year. To ensure appropriate preparations were made in advance of the effective date, the Nomination & Governance Committee received a briefing from the Company Secretary shortly after the publication of the 2018 Code on key themes and the main areas of change. At its next meeting, the Committee considered a detailed comparative analysis of Pearson's existing corporate governance practices against the 2018 Code. The report highlighted areas of particular focus or change between the 2016 and 2018 Codes, as well as areas where Pearson was already in compliance with proposed new principles and provisions.

The Committee was satisfied that there were no particular areas of concern within the 2018 Code and that Pearson's corporate governance practices were already of a standard to ensure compliance with the majority of the 2018 Code. The Committee then discussed in further detail the specific areas where it believed further steps could be taken to ensure a robust response to the 2018 Code.

Stakeholder engagement

The Committee considered the 2018 Code's focus on the importance of the stakeholder voice in the boardroom, as well as increased legislative disclosures in this regard for Pearson and a number of its UK subsidiaries.

The Committee noted that Pearson already uses a wide range of mechanisms to engage with employees, including town halls, global conversations, employee resource groups, employee engagement and organisational health surveys, as well as the Board having the opportunity to engage both formally and informally with the workforce during events such as Board site visits and talent breakfasts. The Committee agreed that existing mechanisms provide sufficiently effective ways for the Board to keep a pulse on the organisation and on employees' views on Pearson's strategy, communications, compensation and benefits, and the senior leadership team overall. However, in the spirit of the 2018 Code, the Committee reviewed and approved a proposal on an additional mechanism – an Employee Engagement Network – as a means for the Board to hear directly from employees. The network will include a Non-Executive Director, an Executive Director, Human Resources Executive, and a group of employees from across Pearson reflecting geographical, generational, operational and cultural diversity as well as length of service. The network is expected to meet twice a year with periodic rotation of employee representatives in order to bring different employee perspectives to the group. The network will also provide an opportunity to gain additional insight on how to enhance employee satisfaction and work effectiveness within Pearson and help engage and retain high performers. The Committee agreed to oversee the governance framework for workforce engagement on behalf of the Board however, any employee views arising through the network or other means would remain a matter for the Board as a whole.

Pearson's engagement and communications with broader stakeholder groups, including customers, suppliers and communities, sit within the remit of the Reputation & Responsibility Committee. The Reputation & Responsibility Committee therefore agreed to continue to oversee the governance framework for stakeholder engagement within Pearson as required by the 2018 Code, and agreed a proposal that a detailed stakeholder engagement mapping exercise be undertaken with input from Global Corporate Affairs and Marketing. The Reputation & Responsibility Committee will consider the outputs of this exercise at its first meeting of 2019.

Other key items considered

Other actions arising in connection with the Committee's preparations for the 2018 Code include:

- The Committee is mindful of the 2018 Code's attention to Directors' commitments and has agreed a form of internal guidance to be taken into account when considering changes to a Director's commitments, or when appointing a new Director, as well as formalising the Board approval process for such matters
- The Senior Independent Director's duties and responsibilities have been formalised, as suggested by the 2018 Code, and are available on the Company website at www.pearson.com/governance
- The Committee agreed that the Remuneration Committee will be responsible for ensuring compliance with Section 5 of the 2018 Code.

We will report in accordance with the 2018 Code in our 2019 annual report.

Overview
Our strategy in action
Our performance
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AZ

Board evaluation

Board evaluation

The Board evaluation for 2018 was an internally facilitated process led by the Nomination & Governance Committee with support from the Company Secretary, and conducted by means of a tailored questionnaire. The Nomination & Governance Committee spent time during 2018 in scoping the evaluation and reviewed the headlines at its meeting in December 2018. The Committee will develop an action plan to address areas for improvement and will monitor progress during the year. Key findings included:

- Board members were supportive of work undertaken during the year in continuing to develop and articulate the strategy, with this being identified by a number of Directors as a key achievement upon which the Company would continue to build
- The Board's agenda was felt to be well prioritised with the key issues covered to an appropriate level of detail and a good balance of strategic, operational, financial and governance matters
- The main areas identified by the Board for continued focus during 2019 were leadership development and succession planning, culture, the competitive landscape and customer views.

In addition to leading the 2018 process, the Nomination & Governance Committee also gave consideration to the ongoing evaluation cycle. The Committee agreed that a three-yearly cycle utilising a variety of methodologies would be appropriate to ensure the most effective evaluation outcomes. The planned cycle is:

- Year 1 – in-depth evaluation, externally facilitated (undertaken in 2017)
- Year 2 – questionnaire, tailored to specific needs of the business (undertaken in 2018)
- Year 3 – internally facilitated interview, to be led by the Chair, Senior Independent Director and/or Company Secretary as appropriate (due in 2019).

A number of actions were taken during the year in response to findings arising from the 2017 externally facilitated Board evaluation process. You can read more about progress on these in the table opposite. The Committee confirmed that these items, as well as those identified in the 2016 evaluation, had been addressed to its satisfaction, with recommendations having been put into practice or a clear action plan identified.

Individual evaluation

In addition to the evaluation of the Board as a whole, Executive Directors are evaluated each year on their overall performance against goals agreed by the Board, and in respect of personal objectives under the Company's annual incentive plan. These goals and objectives are linked to certain strategic metrics, including efficiency and cost saving initiatives, driving the digital agenda and growing market opportunities. Progress against each of these metrics is reviewed by the Board on a regular basis, as part of the dashboard of KPIs which we believe to be central to Pearson's turnaround.

The Chair meets with each Non-Executive Director individually on a regular basis and, in assessing the contribution of each, has confirmed that each Director continues to make a significant contribution to the business and deliberations of the Board. At least once a year, the Chair's meetings with individual Non-Executive Directors include reciprocal feedback on the functioning of the Board, to augment the collective Board evaluation process. The Non-Executive Directors, led by the Senior Independent Director, also conduct an annual review of the Chair's performance, with the Senior Independent Director providing feedback from this review to the Chair.

Committee evaluation

All Committees undertake an annual evaluation process to review their performance and effectiveness. For 2018, the process was facilitated internally by the Chair and Secretary of each Committee through use of a tailored questionnaire, the findings of which were discussed at a subsequent meeting of each Committee. Read more on this in the Committees' reports.

Progress on findings of 2017 evaluation

Finding	Response/Action taken
Ensure ongoing strategic development aligned with business transformation strategy.	The new Chief Strategy Officer led a process to capture strategic perspectives from all Board members, as well as senior leaders across Pearson. The outputs from this work formed the basis of the five-year strategic plan which was discussed by the Board in July 2018, with detailed follow-up sessions later in the year. The Board also examined the three-year and one-year plans based on the five-year vision.
Ensure continued understanding by the Board of significant shareholders' views to encourage constructive dialogue and clear communication of strategy.	The Chair and Executive Directors meet with significant shareholders regularly and feed back to the Board. The Board and Nomination & Governance Committee also receive regular updates on correspondence and other meetings with significant shareholders. Investor sessions facilitated by Investor Relations allowed shareholders to meet with the President – Global Product, President – North America, and Chief Technology & Operations Officer, to better understand Pearson's strategy on our digital transformation and simplification. Investor engagement will be kept under review with the possibility of further sessions between investors and senior leaders to be considered during 2019.
Board succession planning should consider future Committee Chairs, and other desirable experience in new Board members.	Committee Chair succession is regularly reviewed by the Nomination & Governance Committee, and forms part of the broader Non-Executive Director succession planning process. Specific desired experience is taken into consideration and built into the specifications in any Non-Executive Director search processes.
New Chief Human Resources Officer to continue executive succession planning and complete a talent review aligned to the strategic needs of the business.	Initial observations were discussed by the Board in May 2018, with a follow-up review of progress taking place in October 2018. This is planned to be an annual item for substantial discussion by the Board.
Ongoing Board education to continue to focus on the competitive landscape and digital technologies.	The competitive landscape formed part of strategy discussions throughout 2018 and will continue to do so. A formal update on the Digital Advisory network was provided to the Board in May 2018, and informal updates on the work of the network are provided to the Board on a regular basis.

Audit Committee report

Committee Chair

Tim Score

Members

Elizabeth Corley, Vivienne Cox, Linda Lorimer, Michael Lynton, Tim Score and Lincoln Wallen

Committee responsibilities include:

→ Reporting

The quality and integrity of financial reporting and statements and related disclosure.

→ Policy

Group policies, including accounting policies and practices.

→ External audit

External audit, including the appointment, qualification, independence and performance of the external auditor.

→ Risk & internal control

Compliance with legal and regulatory requirements in relation to financial reporting and accounting matters.

→ Compliance & governance

Compliance with legal and regulatory requirements in relation to financial reporting and accounting matters.

Terms of reference

The Committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the Company website www.pearson.com/governance.

Committee attendance

Attendance by Directors at Audit Committee meetings throughout 2018:

	Meetings attended
Elizabeth Corley	4/4
Vivienne Cox	4/4
Linda Lorimer	4/4
Michael Lynton[1]	1/1
Tim Score	4/4
Lincoln Wallen	4/4

1 Appointed to the Audit Committee on 1 October 2018.

Audit Committee role

The Committee has been established by the Board primarily for the purpose of overseeing the accounting, financial reporting, internal control and risk management processes of the Company and the audit of the financial statements of the Company. As a Committee, we are responsible for assisting the Board's oversight of the quality and integrity of the Company's external financial reporting and statements and the Company's accounting policies and practices.

Pearson's SVP Internal Audit, Risk and Compliance has a dual reporting line to the Chief Financial Officer and to me, and external auditors have direct access to the Committee to raise any matters of concern and to report on the results of work directed by the Committee. As Audit Committee Chair, I report to the full Board at every Board meeting immediately following a Committee meeting. I also work closely with the Chief Financial Officer and senior financial management outside the formal meeting schedule to ensure robust oversight and challenge in relation to financial control and risk management.

Audit Committee composition

Following his appointment to the Board in February 2018, Michael Lynton was appointed to the Audit Committee in October 2018. Michael's experience in leading complex global businesses will complement the Committee's existing skill set, and I look forward to working closely with him. Following Michael's appointment, the Committee comprises six independent Non-Executive Directors. As a Committee, we have a good balance of skills and knowledge with competence and experience covering all aspects of the sectors in which Pearson operates – education, digital and services – and our key geographic markets.

Fair, balanced and understandable reporting

We are mindful of the Code's provision C.1.1 relating to fair, balanced and understandable reporting and we build sufficient time into our annual report timetable to ensure that the full Board receives sufficient opportunity to review, consider and comment on the report as it progresses. Learn more about fair, balanced and understandable reporting on p130

Risk assessment, assurance and integrity

A key role of the Committee is to provide oversight and reassurance to the Board with regard to the integrity of the Company's financial reporting, internal control policies and procedures for the identification, assessment and reporting of risk. During 2018, we conducted a number of deep dives into selected principal risks, and the key risks on which the Committee focused throughout the year are set out below. Learn more about principal risks and uncertainties on p62

Business transformation

Ongoing business transformation is one of Pearson's key risks and opportunities, and The Enabling Programme (TEP) is an important operational simplification project covering Pearson's key enterprise resource planning technology and processes, including financial, operations and HR systems and processes. The Committee received an update at each meeting from the senior management team in charge of the transformation programme, as well as from PwC who updated the Committee on the work that the external auditors had conducted in respect of testing associated controls.

The primary area of focus for the Committee in 2018 was oversight of the implementation of finance and operations systems throughout a substantial part of our North American business. In particular, the Committee considered the preparatory steps, progress on system integration and testing, and status of key readiness milestones in advance of the implementation in May 2018. At its next meeting, the Committee reviewed certain operational challenges which had arisen following implementation, with a particular focus on customer experience, impact upon workforce including customer services teams, and steps being taken to resolve any remaining issues in advance of the back-to-school season. Lessons learned from this phase of the implementation were then discussed by the full Board at its next scheduled meeting.

Audit Committee meeting focus during 2018

→ Reporting

- Accounting and technical updates
- Impact of legal claims and regulatory issues on financial reporting
- Fair, balanced and understandable, going concern and viability statements
- 2017 annual report and accounts: preliminary announcement, financial statements and income statement
- Review of interim results and trading updates
- Form 20-F and related disclosures, including annual Sarbanes-Oxley Act section 404 attestation of financial reporting internal controls
- Significant issues reporting

→ Policy

- Accounting matters and Group accounting policies
- Analysis supporting viability statement
- Annual review and approval of external auditors' policy
- Treasury policy and strategy
- Tax strategy, including an update on EU state aid

→ External audit

- Provision of non-audit services by PwC
- Receipt of external auditors' report on Form 20-F and year-end audit
- Report on half-year procedures
- Reappointment of external auditors
- Confirmation of auditor independence
- 2018 external audit plan
- Remuneration and engagement letter of external auditors
- Review opinion on interim results
- Review of the effectiveness of external auditors

→ Risk & internal control

- Internal audit activity reports and review of key findings
- Enterprise risk management
- 2019 internal audit plan
- Travel and expenses controls
- Assessment of the effectiveness of internal audit function, internal control environment and risk management systems
- Oversight of The Enabling Programme
- Risk deep dives: information and cyber-security; data privacy; treasury; anti-bribery and corruption (ABC); tax; business resilience
- Oversight of the programme to develop the Global Learning Platform
- Controls Centre of Excellence updates
- ABC third party due diligence programme

→ Compliance & governance

- Fraud, whistleblowing reports and compliance investigations
- Schedule of authorities
- Compliance with accounting and audit-related aspects of the UK Corporate Governance Code
- Audit Committee, Verification Committee and internal audit function terms of reference
- Audit Committee evaluation

Audit Committee report

Enhancements to the UK systems were also made during the year, following on from lessons learned during the prior UK implementation, and the Committee heard that this 'retrofit' had proceeded smoothly. In addition to the continued finance and operations system implementation, a new global payroll system was introduced in the UK with the rest of the world planned for 2019, deployment of a new royalties, rights and permissions system in the UK and North America markets commenced during the year, and will continue in 2019, and the roll-out of a common HR system across Pearson was completed. The Committee will continue to monitor TEP progress at each meeting during 2019, including preparations for the next phase of implementation during the year to the remainder of the North America businesses. Learn more about business transformation and change on p63

Data privacy

A key area for the Committee's focus throughout the year was data privacy, including readiness for, and next steps following, the implementation of the General Data Protection Regulation (GDPR) in May 2018.

In early 2018, the Committee considered the Group's data privacy roadmap, with the Deputy General Counsel updating on Pearson's GDPR readiness. Pearson's data privacy framework was viewed as solid in respect of governance, consent and processing arrangements, as well as ensuring vendor compliance at the onboarding stage, supported by new procurement systems and processes. The Committee encouraged a robust approach and clear lines of accountability, with a particular focus on large and/or high-risk vendors with existing or legacy contracts.

At the Committee's mid-year review, the Chief Privacy Officer described the actions which had been taken to address the remaining pre-GDPR implementation items.

At a separate deep dive, the Committee considered the broader global landscape on data privacy, noting that many jurisdictions – including in California and markets such as India and Brazil – had recently implemented new data privacy laws, or would soon do so. The Committee also received an update on the learnings from a recent internal review of the privacy programme, and considered planned next steps on Pearson's privacy roadmap as well as processes for incident response and notifiable events.

Anti-bribery and corruption (ABC)

In a deep dive led by the VP of Global Compliance, the Committee considered the global anti-corruption landscape, including legislation and sanctions, and the continued strengthening of Pearson's Group-wide compliance and ABC framework.

During 2018, there was a particular focus on continued implementation of Pearson's third party due diligence programme to ensure robust processes are in place aimed at vetting third parties acting on Pearson's behalf in high-risk categories to reduce reputational, sanctions and ABC risk. Building on a pilot project in 2017, the Committee reviewed possible options for the next phase of the programme, which would bring all new in-scope third parties into the due diligence process, ensure that any existing high-risk third parties go through this process, and facilitate the necessary checks for legacy contracts at the time of renewal. The Committee agreed that the proposed process would appropriately balance the risk profile of certain geographies and contracts with the needs of the business and resources available.

In December 2018, the Committee considered the substantial progress made on the due diligence programme, noting that all of Pearson's global markets (outside of UK, US and Western Europe) had been covered, with over 3,400 third parties reviewed. Various types of remediation efforts occurred as a result of those efforts where necessary, from increased contractual controls to termination of a small number of relationships. US, UK and Western Europe, as well as the VUE business, while large and complex markets, are inherently lower risk from an ABC perspective and will be covered by the next phase of the programme during 2019.

During the year, the Committee also monitored the investigations programme conducted through Pearson's ethics hotline, supported the annual roll-out of Pearson's Code of Conduct (from biannual), completion rates on mandatory code of conduct declarations (100% completion in 2018), supported improved procedures and associated training on gifts and hospitality reporting in US sales teams, and oversaw the strengthening of the 'tone from the top' on ethics and compliance, led by the Chief Executive.

Members

All of the Audit Committee members are independent Non-Executive Directors and have financial and/or related business experience due to the senior positions they hold or have held in other listed or publicly traded companies and/or similar large organisations. Tim Score, Chair of the Committee since April 2015, is the Company's designated financial expert, having recent and relevant financial experience, and is an Associate Chartered Accountant. He also serves as Audit Committee Chair for The British Land Company plc. The qualifications and relevant experience of the other Committee members are detailed on p80–81

Audit Committee meetings and activities

At every meeting, the Committee considered reports on the activities of the internal audit and compliance functions, including the results of internal audits, risk reviews, project assurance reviews and fraud and whistleblowing reports. The Committee also monitored the Company's financial reporting and risk management procedures, reviewed the services provided by PwC and considered any significant legal claims and regulatory issues in the context of their impact on financial reporting, each on a regular basis.

During the year, the Committee also discussed the finance and IT controls environment at each meeting, including Sarbanes-Oxley testing and scope, updates on prior year items, and the ongoing transformation of the Group-wide controls framework which was extended to a number of Core and Growth markets during 2018. In addition to the risk deep dives described above, the Committee also conducted deep dives into business resilience, treasury, tax and information security. In February 2019, the Committee considered the 2018 annual report and accounts, including the preliminary results announcement, financial statements, strategic report and Directors' report.

Learn more about the key activities of the Audit Committee on p97

Internal audit evaluation

At its July meeting, the Committee considered the findings of the review of the performance and effectiveness of Pearson's internal audit function, a process which is undertaken annually. This review was conducted by distributing a questionnaire to the key stakeholders of the internal function – including Committee members, the lead external audit partner, members of the Pearson Executive, and senior financial, legal and operational management.

The findings indicated an effective internal audit function, with particular acknowledgement of the function's efforts in resolving a number of outstanding actions from previous internal audits, which is an ongoing area of focus for the Committee.

A specific recommendation arising from the internal audit evaluation was to consider whether there is an appropriate level of liaison between internal audit and the external auditors, in order to utilise combined audit efforts effectively. In response to a request from the Committee for more detail in this regard, an analysis of financial assurance coverage was undertaken, with inputs from internal audit and PwC. The results of this analysis were considered by the Committee at its December 2018 meeting, and the Committee was satisfied that the level of combined financial assurance was appropriate.

In order to continue to ensure a robust and effective internal audit function, the Committee will consider plans for an external quality review during 2019 to be facilitated by an independent third party.

Additional meeting attendees

In addition to the Committee members, advisers and executives from across the business also attended meetings during the year, as outlined in the table below. This gives the Committee direct contact with key leadership. The Chair and Chief Executive each attend at least one meeting per year, and the Chief Executive also attends for discussion of matters with an operational focus. The Committee also meets regularly in private with the external auditors, SVP Internal Audit, Risk and Compliance, and VP Internal Audit.

Attendees	Meetings attended
Chief Financial Officer	4/4
Deputy CFO	4/4
Legal Counsel	4/4
SVP Internal Audit, Risk and Compliance	4/4
SVP Finance, Group Reporting	4/4
VP Internal Audit	3/4
Committee Secretary	4/4

Audit Committee training

The Committee receives technical updates at each meeting, including on matters such as accounting standards and the audit and governance landscape, as well as specific or personal training as appropriate.

Committee members also meet with local management on a periodic basis, such as when travelling for overseas Board meetings, in order to gain a better understanding of how Pearson's policies are embedded in operations.

Committee evaluation

In 2018, the Committee evaluation was conducted by way of a questionnaire which was distributed to key stakeholders including Committee members, the Chair of the Board, Chief Executive, Chief Financial Officer, the lead external audit partner, and senior executives with regular exposure to the Committee.

The responses illustrated an effective Committee, which uses its time well and has an appropriate focus on the key issues. No areas of concern were identified, and the Committee will consider how best to implement a small number of suggestions arising from the process. These suggestions included:

- Invite a wider range of business leaders to Committee meetings, enabling the leaders to engage in Board-level discussions, as well as facilitating a greater understanding of the Committee's role in the wider business
- As progress continues to be made with the implementation of TEP and transformation of Pearson, consider a review to confirm that Pearson has maximised the opportunity to strengthen the control environment and better manage risk.

Audit Committee report

Progress on findings of 2017 evaluation

The responses to the 2017 evaluation, which was externally facilitated, found an effective and well-functioning Audit Committee, which uses its time well and has an appropriate focus on the key issues. One area highlighted was that succession for the role of Audit Committee Chair should be borne in mind with future Non-Executive Director appointments, although this was not considered to be immediately pressing.

External audit

Oversight of external auditors

The Committee reviews and makes recommendations to the Board in respect of the appointment and compensation of the external auditors. This recommendation is made by the Committee after considering the external auditors' performance during the year, reviewing external auditor fees, conducting an effectiveness review and confirming the independence, objectivity, qualifications and experience of the external auditors.

The Committee reviewed the effectiveness and independence of the external auditors during 2018, as it does every year, and remains satisfied that the auditors provide effective independent challenge to management.

The external auditors' review was conducted by distributing a questionnaire to key audit stakeholders, including members of the Audit Committee, Chief Financial Officer, Deputy CFO, SVP Internal Audit, Risk and Compliance, SVP Finance for each business area and other heads of corporate functions. Overall, responses to the questionnaire were positive, indicating an effective external audit process in a year of transition to the new lead audit partner.

The Committee will continue to review the performance of the external auditors on an annual basis and will consider their independence and objectivity, taking account of all appropriate guidelines. There are no contractual obligations restricting the Committee's choice of external auditors. The external auditors are required to rotate the audit partner responsible for the Pearson audit every five years and, accordingly, a new lead audit partner, Giles Hannam, rotated onto the Pearson audit from the beginning of 2018.

Audit tendering and rotation

Pearson's last audit tender was in respect of the 1996 year end, and resulted in the appointment of Price Waterhouse as auditors. Developments at an EU level regarding mandatory audit rotation for listed companies have changed the UK landscape on audit tendering and rotation. The Committee has reviewed the timetable for tendering and has taken into account relevant regulation and guidance. EU regulations and the ruling by the Competition and Markets Authority (CMA) impose mandatory tendering and rotation requirements, with EU rules requiring a new auditor to be appointed no later than for the 2024 financial year end.

In considering the appropriate audit tender timetable for Pearson in light of these requirements, the Committee has also taken account of the significant business change being experienced by the Group and is monitoring the extent to which the Group is drawing upon the services of other accounting firms. As previously explained to shareholders, and as noted elsewhere within this report, a series of programmes is well underway throughout Pearson to implement major simplification and efficiency improvements across all our enabling functions – particularly technology, finance, HR – to continue to bring the general and administrative costs of running Pearson more in line with global best practice. These include a major transformation programme – The Enabling Programme (TEP) – which includes the implementation of new financial systems and changes to our transaction processing and control activities, which launched in the UK during 2016, and is expected to be rolled out throughout our businesses by 2021. Pearson is supported in these changes, such as in project assurance matters and, more broadly, by external advisers, including accounting firms.

Due to the status of TEP and the involvement of accounting firms advising on TEP and other change projects, the Committee is of the opinion that the level of disruption likely with a change of auditor, as well as the focus required by finance and management teams to conduct the tender process thoroughly and effectively, may unduly impact the Group and would not be in the best interests of shareholders. The rotation of the lead audit partner at the start of 2018 has given us further confidence in the ongoing effectiveness, independence and challenge brought by the external auditor.

As noted previously, it is the current expectation of the Committee that an audit tender process would commence in 2022 in order for the auditor selected as a result of the tender to be appointed for the financial year ending 31 December 2023. It would be our intention to look to accelerate this timing if feasible and appropriate following the completion of TEP, and we would communicate any change in our plans to shareholders in advance of any decision. For the reasons outlined above, the Committee considers this timing to be in the best interests of Pearson's shareholders and will continue to monitor this annually in light of the effectiveness and independence of the current auditors, as well as considering whether the timing remains appropriate in light of business developments.

Once the next audit tender occurs, Pearson will adopt a policy of putting the audit contract out to tender at least every ten years, as required. The Committee will continue to pay close attention to developments in the audit landscape in response to the findings of the CMA's ongoing statutory audit services market study, and will factor any resulting changes into its plans for audit tender once the CMA's recommendations are finalised.

Compliance with the CMA Order

Pearson confirms that it was in compliance with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 during the financial year ended 31 December 2018.

Review of the external audit

During the year, the Committee discussed the planning, conduct and conclusions of the external audit as it proceeded.

At its July 2018 meeting, the Committee discussed and approved the external audit plan and reviewed the key risks of misstatement of Pearson's financial statements. The external auditors provided an update at the December 2018 Committee meeting, having concluded that their analysis of significant and elevated risks remained the same.

The table on p102–103 sets out the significant issues considered by the Committee together with details of how these items have been addressed. The Committee discussed these issues with the auditors at the time of their review of the half-year interim financial statements in July 2018 and again at the conclusion of their audit of the financial statements for the full year in February 2019.

All the significant issues were also areas of focus for the auditors. Learn more in the Independent auditor's report on p134–141

In December 2018, the Committee discussed with the auditors the status of their work, focusing in particular on internal controls and Sarbanes-Oxley testing.

As the auditors concluded their audit, they explained to the Committee:

- The work they had conducted over revenue, including over more complex revenue contracts and judgements in relation to provisions for returns
- Their work in evaluating management's goodwill impairment exercise, on a fair value less costs to dispose basis, including assessing assumptions around sales and operating cash flow forecasts, long-term growth rates and discount rates
- The work performed over the nature and presentation of non-trading items, including new property provisions recorded in 2018, focusing on subjective judgements and the transparency with which related adjusted measures are presented
- The work they had done to audit the provisioning levels in respect of potential tax exposures and uncertain tax positions including the release of brought forward provisions and related disclosures
- Their evaluation of the recoverability of investments in digital platforms and pre-publication assets
- Their work over the assessment of the US K12 Courseware business meeting the criteria to be held for sale at 31 December 2018 and completed disposals including WSE, UTEL and One Southwark Bridge
- The results of their controls testing for Sarbanes-Oxley Act section 404 reporting purposes and in support of their financial statements audit
- The results of their work over the Company's going concern and viability statement reports
- Their work over finance transformation related to the TEP implementation at US Higher Education and the UK retrofit
- Their work in relation to the impact of new accounting standards, including the adoption of IFRS 9 and 15 from 1 January 2018 and IFRS 16 from 1 January 2019
- Their work in relation to other matters which are not classified as key audit matters, but may give rise to additional disclosure requirements e.g. pensions.

The auditors also reported to the Committee the misstatements that they had found in the course of their work, which were insignificant, and the Committee confirmed that there were no material items remaining unadjusted in these financial statements.

Auditors' independence

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

The Audit Committee approves all audit and non-audit services provided by PwC. Our policy on the use of the external auditors for non-audit services reflects the restriction on the use of pre-approval in the 2016 FRC Guidance on Audit Committees and, accordingly, all non-audit services, irrespective of value, are required to be approved by the Audit Committee. In particular, we expressly prohibit the provision of certain tax, HR and other services by the external auditor. We review non-audit services on a case-by-case basis, including reviewing the ongoing effectiveness and appropriateness of our policy.

The Audit Committee receives regular reports summarising the amount of fees paid to the auditors. During 2018, Pearson spent £0.4m less on non-audit fees with PwC compared with 2017, due to a reduction in billing on controls assurance services. For 2018, non-audit fees represented 17% of external audit fees (23% in 2017).

For all non-audit work in 2018, PwC was selected only after consideration that it was best able to provide the services we required at a reasonable fee and within the terms of our policy on external auditors. Where PwC is selected to provide audit-related services, we take into account its existing knowledge and experience of Pearson. Where appropriate, services were tendered prior to a decision being made as to whether to award work to the auditors.

Significant non-audit work performed by PwC during 2018 included:

- Audit-related work in relation to disposal transactions
- Audit of Pearson's efficacy programme
- Half-year review of interim financial statements.

A full statement of the fees for audit and non-audit services is provided in note 4 to the financial statements on p167.

Tim Score
Chair of Audit Committee

Audit Committee report

Significant issues considered by the Audit Committee

Issue	Action taken by Audit Committee	Outcome
→ Impairment reviews		
Pearson carries significant goodwill and other intangible asset balances. There is judgement exercised in the identification of cash-generating units (CGUs) and the process of allocating goodwill to CGUs and aggregate CGUs and in the assumptions underlying the impairment review. In 2015 and 2016, Pearson made significant impairments to goodwill across a variety of its businesses. There were no impairments recorded in 2017 or 2018.	The Committee considered the results of the Group's annual goodwill impairment review and the key assumptions which are considered to be the cash flows derived from strategic and operating plans, long-term growth rates and the weighted average cost of capital. The Committee considered the sensitivities to changes in assumptions and the related disclosures required by IAS 36 'Impairment of Assets' in relation to the Group's CGUs noting that they remain sensitive to assumption changes after a number of impairments in recent years.	Annual impairment review finalised with confirmation of sufficient headroom in each of the CGUs.
→ Leases and IFRS 16		
Pearson will adopt IFRS 16 in respect of its lease portfolio in 2019. The Group has a significant number of property leases and a number of other low value vehicle and equipment leases. The implementation of the standard will result in the recognition, on the balance sheet, of right of use assets in respect of these leases and corresponding lease liabilities.	The Committee monitored progress on the IFRS 16 lease conversion process, reviewed the transition options taken and the quantification of the impact including sensitivities relating to the selection of appropriate discount rates. The impact of the change was also considered in the light of banking arrangements and strategic plans.	The Committee reviewed and approved the transition options taken, discount rates applied and disclosures made.
→ Revenue recognition and IFRS 15		
Pearson has a number of revenue streams where revenue recognition practices are complex and management assumptions and estimates are necessary. The Group also adopted IFRS 15 'Revenue from Contracts with Customers' during 2018.	The Committee regularly reviews revenue recognition practices and the underlying assumptions and estimates. In addition, the Committee has visibility of internal audit findings relating to revenue recognition controls and processes and routinely monitors the views of external auditors on revenue recognition issues. During the year, the Committee continued to monitor the implementation of IFRS 15 'Revenue from Contracts with Customers'. The Committee noted the changes to revenue streams and the quantification of the impact on the opening balance sheet and reviewed disclosures made in the Group's interim and year-end reporting.	Assumptions underlying revenue recognition were reviewed and challenged and considered to be appropriate. Quantification and disclosures relating to IFRS 15 were reviewed and also agreed as appropriate.
→ Financial instruments		
Pearson adopted IFRS 9 'Financial Instruments' in 2018.	The Committee reviewed the impact of the transition to IFRS 9 and noted the Group's new approach to hedge accounting, investment valuation and impairment. The Committee reviewed the impact on the opening balance sheet and in particular the impact on bad debt provisions and noted that these had been relatively small.	Adjustments relating to IFRS 9 were reviewed and disclosure of impact in 2018 was considered appropriate.

Issue	Action taken by Audit Committee	Outcome
→ Disposal transactions		
The Group sold its English language teaching business in China, Wall Street English (WSE) and its equity interest in UTEL, the online University partnership in Mexico, and continued to consider offers for its US K12 Courseware business.	The Committee reviewed the accounting for the disposals of WSE and UTEL and the rationale for held for sale treatment in respect of the US K12 Courseware business.	The Committee determined that disposal accounting had been correctly recorded and that the criteria for held for sale treatment in respect of the US K12 Courseware business had been met as at 31 December 2018 following continued interest from a number of bidders.
→ Pension valuations		
Pearson's UK Pension Plan includes a large defined benefit section. The valuation of this plan under IAS 19 'Employee Benefits' requires significant judgement. In particular, in 2018, the UK Pension Plan considered the impact of the clarification of pension law in respect of Guaranteed Minimum Pension (GMP) equalisation.	The Committee considered the recent High Court decision about GMP equalisation noting that the new ruling impacted most companies and might result in adverse cost and liability implications. The Committee reviewed the impact in the light of other companies' responses to the new development and with detailed technical accounting and actuarial guidance.	The Committee agreed the quantification and appropriate accounting treatment in respect of the additional liabilities arising from clarification of GMP equalisation legislation.
→ Restructuring		
Pearson announced a new restructuring programme in May 2017 to run from 2017 until 2019. There are a number of accounting judgements to be made regarding categorisation and timing of recognition of cost.	The Committee reviewed progress on the restructuring programme and considered the judgements required in accounting for the costs of redundancy, asset impairment and property rationalisation mainly in respect of the Group's North America operations and enabling functions. In particular, in 2018, the Committee reviewed property disposal transactions and the assumptions underlying onerous lease provisions crystallised by the rationalisation of the Company's property portfolio.	The Committee confirmed that the accounting and disclosure for the restructuring programme were appropriate and that assumptions underlying onerous lease provisions were in accordance with the Group's property strategy.
→ Tax		
The impact of tax legislation changes including US tax reform, EU state aid and the trend for increased tax transparency, and provision levels.	The Committee was updated on the details of US tax reform during the year, including internal refinancing of the group's US operations. In September, the outcome of this combined with provision releases resulted in a significant reduction in the 2018 adjusted tax rate, which was reported to the Board. The Committee reviewed the classification of these credits. The chair of the Committee approved the second report on tax strategy issued in October 2018 prior to publication.	The Committee was satisfied with Pearson's approach to managing the impact of tax legislation changes and agreed with the views of management regarding tax provisioning levels.
→ Returns		
The determination of appropriate provisions for product returns requires a significant amount of judgement and in the light of recent volatility in returns in the US Higher Education courseware business, the Committee continued to review returns data and our policy on providing for returns.	The Committee considered returns provisioning for the US Higher Education courseware business and reviewed the methodology for establishing provisions.	Assumptions underlying the returns reserve methodology were reviewed and agreed as still being appropriate in the light of actual returns noted in 2018.

Risk governance and control

Control environment

The Board has overall responsibility for Pearson's systems of internal control and risk management, which are designed to manage, and where possible mitigate, the risks facing Pearson, safeguard assets and provide reasonable, but not absolute, assurance against material financial misstatement or loss. The Board confirms that it has conducted a review of the effectiveness of Pearson's systems of risk management and internal control in accordance with provision C.2.3 of the Code and the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (FRC Guidance). The Board confirms these systems operated satisfactorily throughout the year and to the date of this report, and no significant failings or weaknesses were identified in the review process.

The Board has delegated responsibility for monitoring the effectiveness of the Company's risk management and internal control systems to the Audit Committee. The Audit Committee oversees a risk-based internal audit programme, including periodic audits of the risk processes across the organisation. It provides assurance on the management of risk (including risk deep dives, as described on p96), and receives reports on the efficiency and effectiveness of internal controls. Each business area maintains internal controls and procedures appropriate to its structure, business environment and risk assessment, while complying with Company-wide policies, standards and guidelines.

Internal control and risk management

Our internal controls and risk oversight are monitored and continually improved to ensure their compliance with FRC Guidance. Our risk framework, outlining improvements made in 2018, is described more thoroughly in the risk management section on p60–76.

The Board is ultimately accountable for effective risk management in Pearson and determines our strategic approach to risk. It confirms our enterprise risk management (ERM) framework as well as our enterprise risk appetite targets. Twice yearly it receives and reviews reports on the status of top enterprise-wide risks. It is supported in the following ways:

- The Audit Committee is responsible for overseeing internal controls within Pearson which includes determining the risk appetite (recommended by Pearson Executive management), reviewing and commenting upon key risks and ensuring that risk management is effective
- Pearson's Executive and leadership teams are responsible for identifying and mitigating principal risks
- Leaders and managers at all levels in Pearson are responsible for managing risk in their area of responsibility, including the identification, assessment and treatment of risk
- The Internal Audit, Compliance and Risk team owns the overall risk management framework for the Company and facilitates consolidated reporting on risk
- The internal audit team provides independent assurance on the adequacy of the risk management arrangements in place. The internal audit plan is aligned to identified enterprise-wide risks and it presents issues and risks arising from internal audits at each Audit Committee meeting.

The involvement of the Board and Audit Committee in the design, implementation, identification, monitoring and review of risks (including setting risk appetite and reviewing how risk is being embedded in our culture) is outlined in more detail in the risk management section on p60–76.

Financial management and reporting

There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the Board. Monthly financial information, including trading results, balance sheets, cash flow statements, capital expenditures and indebtedness, is reported against the corresponding figures for the plan and prior years, with corrective action outlined by the appropriate Senior Executive. Pearson's senior management meets regularly with business area management to review their business and financial performance against plan and forecast. Major risks relevant to each business area as well as performance against the stated financial and strategic objectives are reviewed in these meetings.

There is an ongoing process to monitor the risks and effectiveness of controls in relation to the financial reporting and consolidation process, including the related information systems. This includes up-to-date Pearson financial policies, formal requirements for finance to certify that they have been in compliance with policies and that the control environment has been maintained throughout the year, consolidation reviews and analysis of material variances, finance technical reviews, and review and sign-off by senior finance managers. The Group finance function also monitors and assesses these processes and controls through finance and technology compliance functions and a Controls Steering Committee comprising cross-functional experts.

These controls include those over external financial reporting which are documented and tested in accordance with the applicable regulatory requirements, including section 404 of the Sarbanes-Oxley Act, which is relevant to our US listing. One key control in this area is the Verification Committee, which submits reports to the Audit Committee. This Committee is chaired by the SVP Internal Audit, Risk and Compliance, and members include the Chief Financial Officer and/or their deputy, the Deputy General Counsel, SVP Investor Relations and the Company Secretary as well as senior members of financial management. The primary responsibility of this Committee is to review Pearson's public reporting and disclosures to ensure that information provided to shareholders is complete, accurate and compliant with all applicable legislation and listing regulations. In addition, our separate Market Disclosure Committee is responsible for considering potential inside information and its treatment in accordance with the EU Market Abuse Regulation. The effectiveness of key financial controls is subject to management review and self-certification and independent evaluation by the external auditors.

Internal audit

The internal audit function is responsible for providing independent assurance to management and the Audit Committee on the design and effectiveness of internal controls to mitigate strategic, financial, operational and compliance risks. The SVP Internal Audit, Risk and Compliance reports formally to the Chair of the Audit Committee and the Chief Financial Officer, with a reporting line to the General Counsel on compliance matters. The VP Internal Audit, responsible for the day-to-day operations of internal audit and execution of the annual audit plan, also reports formally to the Chair of the Audit Committee and the SVP Internal Audit, Risk and Compliance.

The internal audit mandate and plan are approved annually by the Audit Committee. Completion and changes to the plan are also reviewed and approved by the Audit Committee throughout the year. The internal audit plan is aligned to our greatest areas of risk as identified by the ERM process, and the Audit Committee considers issues and risks arising from internal audits. Management action plans to improve internal controls and to mitigate risks, or both, are agreed with the business area after each audit. Formal management self-assessments allow internal audit to monitor business areas' progress in implementing management action plans agreed as part of internal audits to resolve any control deficiencies. Progress of management action plans is reported to the Audit Committee at each meeting. Internal audit has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. Regular reports on the findings and emerging themes identified through internal audits are provided to Executive management and, via the Audit Committee, to the Board.

The SVP Internal Audit, Risk and Compliance oversees compliance with our Code of Conduct and works with senior legal and HR personnel to investigate any reported incidents, including ethical, corruption and fraud allegations. The Audit Committee is provided with an update of all significant matters received through our whistleblowing reporting system, together with an annual review of the effectiveness of this system. The Pearson anti-bribery and corruption programme provides the framework to support our compliance with various anti-bribery and corruption regulations such as the UK Bribery Act 2010 and the US Foreign Corrupt Practices Act.

Treasury management

The treasury department operates within policies approved by the Audit Committee on behalf of the Board, and treasury transactions and procedures are subject to regular internal audit. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the Chief Financial Officer and regular reports are prepared for the Audit Committee and the Board. The treasury policy is described in more detail in note 19 to the financial statements.

Insurance

Pearson reviews its risk financing options regularly to determine how the Company's insurable risk exposures are managed and protected. Pearson purchases comprehensive insurance cover and annually reviews coverage, insurers and premium spend, ensuring the programme is fit for purpose and cost-effective.

Pearson's insurance subsidiary, Spear Insurance Company Limited, is used to leverage Pearson's risk retention capability and to achieve a balance between retaining insurance risk and transferring it to external insurers.

Reputation & Responsibility Committee report

Committee Chair

Linda Lorimer

Members

Vivienne Cox, Linda Lorimer, Michael Lynton and Lincoln Wallen

Committee responsibilities include:

→ Reputation

Pearson's reputation among major stakeholders, including governments, investors, employees, customers, learners and the education community.

→ Risk

Oversight of Pearson's approach to reputational risk, including ensuring that clear roles have been assigned for management.

→ Sustainability

Oversight of 2020 sustainability plan and performance against sustainability goals and commitments.

→ Brand & culture

Management of the Pearson brand to ensure that its value and reputation are maintained and enhanced. Pearson's approach to monitoring and supporting the values and desired behaviours that form our corporate culture.

→ Ethics

Ethical business standards, including Pearson's approach to issues relevant to its reputation as a responsible corporate citizen.

→ Strategy

Strategies, policies and communication plans related to reputation and responsibility issues and the people and processes that are in place to manage, anticipate and adapt to them.

Terms of reference

The Committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the Company website www.pearson.com/governance.

Committee attendance

Attendance by Directors at Reputation & Responsibility Committee meetings throughout 2018:

	Meetings attended
Vivienne Cox	3/3
Linda Lorimer	3/3
Michael Lynton[1]	1/1
Harish Manwani[2]	1/1
Lincoln Wallen	3/3

1 Appointed to the Committee on 1 October 2018.
2 Stepped down from the Committee on 4 May 2018.

Reputation & Responsibility Committee role

The Committee forms an important part of the Board's governance structure. It works to advance and assess Pearson's reputation across the range of its stakeholders and to maximise the Company's positive impact on society and the communities where we work and serve.

The Committee's agenda includes issues and initiatives relating to the Company's reputation and its civic responsibilities. These include those matters that are material to Pearson's stakeholders and the Company's long-term sustainability, as well as review of incidents that could adversely affect the Company's reputation. We promote Pearson's 2020 sustainability plan and assess the progress in advancing its tenets. The Committee works in alignment with the Company's Responsible Business Leadership Council which comprises senior leaders from across the business.

Read more about our 2020 sustainability plan on p32–40

Changes to the Committee

Harish Manwani stepped down from the Committee in May 2018, upon his retirement from the Pearson Board, and I would like to thank him warmly for his service. Michael Lynton, who joined the Board in February 2018, was appointed to the Reputation & Responsibility Committee on 1 October 2018. Michael brings valuable experience in leading businesses through times of digital disruption, and I look forward to working closely with him on the Committee.

Areas of focus during 2018

The Committee conducts in-depth reviews of issues identified as important to the sustainability of our business. These key sustainability issues, which are monitored by the Committee and discussed either by the Board or one of its Committees, include:

1. Competitiveness of digital products
2. Data privacy and information security
3. Security, health and safety
4. Corporate governance
5. Economic empowerment
6. Access to education
7. Affordability of products/services
8. 21st-century skills
9. Greenhouse gas emissions and climate change.

The Committee has an integral role in the oversight of these issues, in particular considering the public goals the Company is setting to address these issues, and examining their associated reputational impacts.

During 2018, the Committee reviewed proposed public statements on human rights and modern slavery, as well as considering Pearson's broader human rights strategy, both of which are important to Pearson's values and delivery of its 2020 sustainability plan.

During the year, we also examined progress on supplier partnership and engagement, in particular studying supply chain risks and reviewing the work to build strong relationships with our top suppliers. The Committee also took the opportunity to review how Pearson's 2018 efficacy reports were received, and we discussed future plans for both reporting and continued integration of efficacy findings into our product development cycle. Read more about efficacy on p30

In our report to shareholders last year, we noted that, as a Committee, we would continue to monitor the Pearson culture. However, due to the importance of these topics, particularly during times of Company-wide change, it has been agreed that culture and organisational health will now form part of the remit of the full Board. This is also in line with the increased emphasis on such matters in the new UK Corporate Governance Code which asks boards as a whole to monitor and set the tone on culture and engagement.

Committee evaluation

In 2018, the Committee evaluation was conducted by way of a questionnaire which was distributed to key stakeholders including Committee members, the Chief Executive, and senior executives with regular exposure to the Committee. The key findings were:

- The Committee has continued its journey towards maturity, with increasing focus on strategically material issues
- A recommendation to introduce private sessions as part of each meeting, in common with Audit and Remuneration Committees, to enable Committee members to discuss and agree on key issues to take forward with management
- Recognition that the addition of a fourth meeting to the annual calendar will allow greater coverage of issues.

Progress on findings of 2017 evaluation

The responses to the 2017 evaluation, which was externally facilitated, highlighted that the Committee was very engaged and worked collaboratively and that its agendas were increasingly aligned with the strategic objectives of the Company. The evaluation suggested that there might have been some overlap with the work of the Audit Committee. As a result, efficacy, health and safety and safeguarding now sit within the remit of this Committee rather than being shared with the Audit Committee, and we considered each of these topics during 2018.

The Committee's agendas have been adjusted to allow 'deeper dives' into issues of consequence, and we have introduced a regular verbal update at the start of each meeting on recent incidents that may have reputational impact.

Committee aims for 2019

Over the next year, we will take the lead on behalf of the Board in addressing the stakeholder engagement requirements under the new UK Corporate Governance Code. We will continue to explore Pearson's material sustainability issues, monitor progress on supply chain responsibility, engage in the development of our next sustainability plan and, with the help of our new Chief Corporate Affairs Officer, Deirdre Latour, we will review progress on brand strategy.

Linda Lorimer
Chair of Reputation & Responsibility Committee

Reputation & Responsibility Committee meeting focus during 2018

Reputation
- Supplier partnership and engagement
- Issues and incidents reports
- Project Literacy

Risk
- Safeguarding
- Health and safety

Sustainability
- Sustainability report – highlights and 2030 plan
- Education for sustainable development
- Climate and environmental strategy
- Greenhouse gas emissions

Brand & culture
- Brand and insights update
- Efficacy update and future plans

Ethics
- Human rights review – implementation strategy
- Modern Slavery Act statement

Strategy
- Social innovation

Governance
- Committee terms of reference
- Committee effectiveness evaluation
- Stakeholder engagement – UK Corporate Governance Code requirements

Overview
Our strategy in action
Our performance
Governance
Financial statements

Engagement

Engaging with shareholders

Access to capital is key to the long-term performance of our business. We work to ensure that our investors, analysts and other investment professionals have a good understanding of our strategy, performance and purpose.

Pearson has an extensive programme of communication with all of its shareholders – large and small, institutional and private.

Shareholder outreach In 2018, we continued with our shareholder outreach programme, conducting over 600 meetings in the UK, US, Canada and Continental Europe with over 340 investment institutions.

Trading updates There are five trading updates each year including the preliminary and interim results which are presented by the Chief Executive and Chief Financial Officer. They also attend regular meetings throughout the year with investors in the UK and around the world, tailored to investor requirements, to discuss the performance of the Company, the Company's strategy, our change programme, structural and cyclical changes in our markets, and risks and opportunities for the future.

The investor relations team Led by Joanne Russell, SVP Investor & Media Relations, the Investor Relations team met with investors throughout the year, including attending several investor conferences, and addressed regular investor and analyst enquiries.

Chair and Non-Executive Directors The Chair meets regularly with shareholders to understand any issues and concerns they may have. This is in accordance with the Code and consistent with the duties of investors under the UK Stewardship Code.

The Non-Executive Directors meet informally with shareholders both before and after the AGM and respond to shareholder queries and requests as necessary. The Chair ensures that the Board is kept informed of investors' and advisers' views on strategy and corporate governance. At each Board meeting, the Directors consider commentary from advisers on major shareholders' positions and Pearson's share price. In addition, the Nomination & Governance and Remuneration Committees consider shareholder views on corporate governance and remuneration matters, respectively, as required.

Private investors Institutional investors' holdings in Pearson account for around 90% of total shares outstanding, but private investors represent over 91% of the shareholders on our register and we make a concerted effort to engage with them regularly. Shareholders who cannot attend the AGM are invited to e-mail questions to the Chair in advance at chairman-agm@pearson.com

We encourage our private shareholders to become more informed investors and have provided a wealth of information on our website about managing Pearson shareholdings. We also encourage all shareholders, who have not already done so, to register their e-mail addresses through our website and with our registrar. This enables them to receive e-mail alerts when trading updates and other important announcements are added to our website. See Shareholder information on p229 or visit our website: www.pearson.com/corporate/investors/managing-your-shares.html.

Annual General Meeting Our AGM, on 26 April 2019, is an opportunity for all shareholders to meet the Board and to hear presentations about Pearson's businesses and results.

Rapid prototyping

What is rapid prototyping?

Rapid prototyping is a technique used to develop a quality product, process or outcome through quick experimentation and iteration. The ultimate goal of rapid prototyping is to speed up the rate of learning in an organisation. When used well, rapid prototyping will improve the quality of designs and reduce the risk of building something that will go unused.

Innovation and engagement

Pearson first introduced this technique to the senior leaders at the Pearson Leadership Summit in Berkeley, California in early 2018 to encourage agility and a culture of innovation.

Building on the success of this experience, the Board and Pearson Executive joined a group of school-age learners during the Board's visit to Cape Town to engage in a rapid prototyping session with the goal of designing a hypothetical example of a digital solution for use in the schools market. By the final day of the Cape Town meeting, the Board and Pearson Executive were able to review the results of the session including a live demonstration of the application which had been developed in-house from the group's prototyping conversations.

The Board thought it was an excellent experience to illustrate the power of this new way of working and model it for the rest of the organisation and found the interaction with students enjoyable and insightful. Read more about the Board's meeting in Cape Town on p85.

Engagement in action

Industry & marketplace

- The Chair, Sidney Taurel, and Non-Executive Director, Lincoln Wallen, attended the Pearson Leadership Summit in Berkeley, California. This event brought together senior leaders from across Pearson, who engaged with industry thought leaders and external speakers, and focused on maximising the opportunities of digital disruption, becoming a lifelong partner to learners and creating a culture of innovation.
- During its meeting in South Africa, the Board attended a discussion event on 'Putting employability at the heart of our strategy'. The event was hosted by Pearson and attended by external business, policy and thought leaders from the Cape Town area.

Employees

- The Board met with local staff and senior management during 2018 visits to Milan and Cape Town. Dinners with senior local management and breakfasts with key talent allowed the Non-Executive Directors to share their experience and expertise with employees as well as allowing the Directors to better understand employees' abilities and motivations, helping them to assess the Company's prospects and plans for succession.
- A number of the Non-Executive Directors participated in the Pearson Innovation Jam – an online, global collaborative event – for all employees. The event allowed the Directors to have direct engagement with employees on a platform where all participants had an opportunity to share their thoughts, best practices, and ideas.

Customers

- In Milan, the Board heard from customers about the challenges and opportunities they face with digital teaching and learning in schools and higher education. The panels discussed the demand for high-quality digital content, assessment and tools, closing the gap between school and workplace, and the need for access to a high-quality career-focused education. This session enabled the Board to understand the customer context to our schools and higher education strategy and explore the issues posed and how Pearson might be part of the solution.

Remuneration overview

Committee Chair
Elizabeth Corley
Members
Elizabeth Corley, Josh Lewis, Tim Score and Sidney Taurel

Key features of our remuneration arrangements in 2018 and 2019

- 2018 has been an important year for Pearson with the business meeting strategic expectations and hitting financial targets, while recognising that there is more to do over the coming years. For 2018, a bonus of 45% of maximum opportunity was achieved.
- Long-term incentives for Executive Directors vested for the first time since 2013, reflecting the improving performance of the business. Overall, 42% of the shares granted under the 2016 LTIP will vest in 2019, subject to a further two-year holding period until 2021.
- Base salaries have been increased in line with the wider employee population. No other changes to our reward framework for 2019.
- During 2019, we will review Executive Director remuneration policy, including in relation to the application of the 2018 Code, in advance of submitting it to shareholders for approval at the 2020 AGM.

Terms of reference

The Committee's terms of reference have been updated in line with the new UK Corporate Governance Code and are available on the Governance page of the company's website www.pearson.com/governance. A summary of the Committee's responsibilities is shown on p126.

Board Committee attendance

The following table shows attendance by Directors at Committee meetings throughout 2018:

	Remuneration
Elizabeth Corley	5/5
Josh Lewis	5/5
Tim Score	5/5
Sidney Taurel	5/5

In this remuneration section

Dear shareholders,

Our approach to remuneration is supporting progress against the delivery of company strategy

Pearson's purpose is to help people make progress in their lives through learning. In recent years, the company has focused on combining content, assessment and technology to deliver personalised learning at scale. To make progress on this ambitious agenda requires a strong global management team. Pearson competes for talent and key skills in a demanding marketplace and needs to attract and retain high-calibre executives and incentivise them to deliver results and progress against our strategy, in line with the shareholder experience.

Working within our shareholder approved policy, over the past 24 months, the Committee has undertaken a thorough review of our Executive Director remuneration and its implementation to ensure that it supports the execution of strategy while remaining consistent with shareholder expectations.

Strong support at the AGM in 2018

As part of the review, we engaged extensively with our shareholders. This process culminated in the publication of our 2017 Remuneration Report, which received a vote of over 99% in favour at the AGM in 2018. The Committee and Board appreciated the feedback we received as part of this review and thank you for the support. We will continue to consult with our shareholders as we review policy during 2019 ahead of submitting it for shareholder approval at the 2020 AGM.

We have reduced LTIP awards for 2017, 2018 and 2019

In 2017 and 2018, we adopted an approach to remuneration that is simpler, more transparent and with lower maximum levels of reward as the business goes through a phase of transformation. We intend to continue this approach for a third year in 2019, with the Committee deciding to maintain 2019 Long-Term Incentive Plan (LTIP) award levels at the same reduced percentage of salary as in 2017 and 2018: 275% of salary for the CEO and 245% of salary for the CFO.

We have reviewed performance against targets rigorously

The Committee considered the following factors in assessing the performance against targets for the annual bonus and LTIP in order to satisfy itself that the outcomes were a fair reflection of performance delivered by the Executive team:

- The Committee reviewed and was satisfied that the performance targets set were appropriately stretching
- Progress is continuing to make the company leaner and more agile
- The pace of strategic delivery has been strong and this is reflected in the share price and the returns delivered to shareholders over the three-year performance period.

As a result, the annual bonuses payable to the CEO and CFO under the Annual Incentive Plan (AIP) for 2018 and the 2016 LTIP vesting outcome are considered to be fair, reasonable and commensurate with value delivered to shareholders over the period.

How we have rewarded performance and strategic progress in the annual bonus for 2018

Pearson made good progress in 2018, improving both operational and financial performance and returning to underlying adjusted operating profit growth for the first time since 2014. Continued strong progress in simplifying the portfolio puts the company ahead of plan, with increased and accelerated cost savings and expected total annualised cost savings in excess of £330m by the end of 2019 – ahead of the original plan for £300m of savings.

While the business is still in the midst of a transformation and the environment in US Higher Education Courseware remains challenging, a strong performance in structural growth opportunities largely offset the declines in this market. Good progress has also been made on the digital transformation with digital and digitally-enabled sales increasing to 62% of revenues.

The Board expects the business to build on the 2018 performance and deliver further profit growth in 2019, and remains confident about Pearson's longer-term prospects and on building shareholder value through the delivery of profitable growth, strong cash generation and continued progress in strategic priorities.

The Committee took this progress and performance into account when determining the outcomes under the Group incentive plans for 2018.

- During 2018, the Board again set a demanding plan for the business, taking into account market consensus expectations at the time
- The company delivered results in line with this plan on operating profit, cash flow and progress against strategic objectives
- Sales in the year did not reach the stretching targets set for the annual incentive plan, in part due to continued challenges in the US Higher Education Courseware business
- There was no benefit from foreign exchange movements in determining the outcome of the annual bonuses for the year for the Executive Directors.

Based on performance against targets, in 2018 the CEO and CFO achieved a bonus outcome of 45% of their maximum opportunities. The prior year outcome for the CEO was 44% of maximum and 47% for the CFO.

Around 12,500 Pearson colleagues across the business also participate in an annual incentive arrangement which paid out based on performance during the year, sharing in success across the business.

> "Pearson returned to underlying profit growth for the first time since 2014, while maintaining progress against strategic goals. Payouts reflect that improving performance."

How our 2016 LTIP outcome reflects progress achieved

In May 2016, the Executive Directors were made awards under the LTIP, which vest based on performance of the business delivered over the three-year period from 2016 to 2018. The target ranges were set at that time based on the shape of the business in 2016 and taking into account internal and external expectations of performance when the awards were made. The targets were considered by the Committee to be appropriately stretching.

Given the changes in the business since 2016, the Committee has been very thoughtful about how to assess the performance of the business against targets set to ensure that the outcomes appropriately reflect the principles against which they were originally set and the underlying performance of the business over the period.

In determining the outcomes, the Committee has made adjustments in three areas: we have adjusted the targets to remove the contribution expected at the time for businesses we disposed of during 2017 and 2018 to ensure that performance is assessed on a like for like basis; we have made adjustments so that management does not benefit from the share buybacks; and we have adjusted outcomes so that management does not benefit from the changes in effective tax rate which relate to US tax reforms.

The overall outcome is that 42% of the maximum awards will vest. This is the first time that LTIP awards to Executive Directors have vested since 2013. Awards are subject to a further two-year holding period following vesting.

The LTIP is not limited to Executive Directors with around 1,300 Pearson colleagues also benefiting from the vesting of this and other share awards during the year.

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Remuneration overview

Understanding total remuneration for the CEO for 2018

Given the level of performance achieved and the corresponding payouts under the AIP and LTIP, the overall reported 'single figure' for the total remuneration of John Fallon for 2018 increased to £3.142m from £1.758m in 2017. This is primarily as a result of the first payout under the 2016 LTIP for Executive Directors since 2013. Excluding the LTIP payout the 'single figure' for John Fallon for 2018 is 4% lower than for 2017. A detailed breakdown of the single figure can be found on p116.

Looking forward to 2019 – continued progress and restraint

The base salary for the CEO and CFO will be increased by 2.2% in 2019 in line with the average increases for UK employees.

In the interest of simplicity, reflecting support for our approach to implementation at last year's AGM, and after consideration of the achievements required in the coming year, the Committee does not intend to make any changes to how we implement remuneration policy for Executive Directors in 2019. We will continue to set appropriate targets for the year under the AIP and these will be disclosed in the 2019 Directors' remuneration report.

The Committee will not increase the percentage of salary face value of long-term incentive awards granted in 2019.

We will continue to evolve policy for emerging best practice

While the Committee considers that we are already well placed against the revised UK Corporate Governance Code, we will continue to monitor best practice and adapt our policy to ensure it remains fit for purpose and aligned with our strategy and shareholders. The Committee intends to review remuneration policy for Executive Directors in its entirety in 2019 and this will be put to a shareholder vote at our 2020 AGM.

Gender pay gap for 2018

Pearson's Great Britain gender pay gap report for 2018 was published earlier this month based on data as at 5 April 2018.

Overall, we have seen a slight improvement in the overall median gender pay gap which has reduced from 15% to 14%.

While some progress has been made, it is clear there is still more to be done. Since publishing our first report last year, a broader Diversity & Inclusion action plan has been put in place, which will keep us focused on tackling this issue in the coming year and beyond. Further details of this are outlined within Pearson's published report.

Conclusion

› Discipline and restraint in decisions made against the backdrop of continued progress and delivery

› 45% payout under the AIP, reflecting operating profit within guidance range, continued strong cash flow generation and progress against strategic objectives but also sales that did not reach the stretching targets set

› 42% payout under 2016 LTIP, reflecting good progress but an acknowledgment of work still to do

› Base salary increases in line with wider employee population.

It is important to the Committee to ensure that remuneration continues to support the sustained delivery of company strategy while rewarding management appropriately in the context of business performance and shareholder experience.

Continuing conversations with shareholders have been invaluable. I look forward to receiving your support at the AGM and to further dialogue as we review Remuneration Policy for Executive Directors in 2019.

Elizabeth Corley
Chair of Remuneration Committee

11 March 2019

The following summarises how current policies and implementation compare against the main provisions of the 2018 Code.

→ Pension alignment

As part of our review of policy in 2017, we lowered the pension opportunity such that new appointments are eligible to receive pension contributions of up to 16% of pensionable salary or a cash allowance of up to 16% of salary.

During 2019 we will further review our approach to pension to ensure it remains appropriate in the context of the retirement provisions provided across the wider workforce.

→ Holding periods

Our LTIP awards are subject to a two-year holding period following vesting and therefore already comply with this aspect of the 2018 Code.

→ Post-employment shareholding guidelines

With effect from 2018, Pearson introduced a requirement whereby Executive Directors are required to retain half of the current guideline for a period of two years post-retirement in respect of shares vested from company incentive plans.

We will continue to monitor market practice and shareholder sentiment in this area to ensure our approach remains appropriate.

→ Apply judgement and discretion

Policy already allows the exercise of discretion to adjust outcomes under incentive frameworks. We have in place the Committee's ability to do this and therefore already comply with the Code in this area.

→ Recovery provisions

Incentive arrangements are already subject to malus and clawback provisions and therefore already comply with the Code in this area. During 2019, we will review the circumstances in which malus and clawback may be applied to ensure that this continues to be appropriate.

→ Wider workforce remuneration

The Committee already reviews remuneration arrangements for Pearson Executive Management and our terms of reference have now been amended to include these roles formally within the Committee's remit. During the year, the Committee took steps to strengthen further the information provided to the Committee regarding broader workforce remuneration and related policies to ensure that these are fully taken into account when determining Remuneration Policy and implementation for Executive Directors.

Remuneration framework

Executive remuneration framework and how it will be implemented in 2019

B Base salary

see p116

Key features

- **Fixed pay** which reflects the level, role, skills, experience, the competitive market and individual contribution
- Under the Policy, **base salary** increases will not ordinarily exceed 10% per annum
- **Salary review** takes into account a range of factors, including: the level of increases made across the company as a whole; particular circumstances such as changes in role, responsibilities or organisation; the remuneration and level of increases for Executives in similar positions in comparable companies; general economic and market conditions; and individual performance.

2019 implementation

Salaries effective 1 April 2019:

- John Fallon: £817,400 (+2.2%)
- Coram Williams: £539,500 (+2.2%)

When reviewing salaries, the Committee took into account the level of increases made across the company as a whole, business and individual performance, and general economic and market conditions. The increases awarded to Executive Directors are in line with the general increase across the UK which was 2.2%.

A&B Allowances and benefits

see p116

Key features

- **Allowances and benefits** which reflect the local competitive market and can include travel and health-related benefits
- The **total value of allowances and benefits** for Executive Directors will not ordinarily exceed 15% of base salary in any year.

2019 implementation

No changes for 2019.

R Retirement benefits

see p116, 121

Key features

- **Current Executive Directors** are members of the Final Pay section of The Pearson Pension Plan, which is closed to new members. Additional cash allowances may apply in specific circumstances.
- In October 2017, the CEO reached the maximum service accrual under the Pearson Pension Plan as he had over 20 years of service. He therefore receives no further service-related benefits under this Plan but continues to receive a taxable cash supplement of 26% of base salary in lieu of the previous FURBS arrangement.
- **New appointments** are eligible to join the Money Purchase section of The Pearson Pension Plan and receive contributions of up to 16% of pensionable salary or may receive a cash allowance of up to 16% of salary.

2019 implementation

There will be **no changes** to the pension provision of the existing Executive Directors.

As noted above, during 2019 we will further review our approach to pension to ensure that it remains appropriate in the context of the retirement provisions provided across the wider workforce.

AIP Annual incentive plan

see p116, 117, 118

Key features

- **Motivate the achievement of annual business goals** aligned to financial and strategic priorities
- Performance measures, weightings and targets are set annually by the Committee to ensure continued alignment with strategy
- **Each AIP component is independent.** For the CEO to achieve the maximum overall payout (180%) would require maximum performance on each individual component and outperformance on any one element cannot compensate for others
- **Performance metrics linked to strategic priorities are selected to support Pearson's transformation strategy.** A payout will only be made if a minimum level of performance has been achieved under the financial metrics
- **Stretching performance targets** are fully disclosed in the annual remuneration report following the end of the performance period
- **Malus and clawback** provisions apply.

2019 implementation

Maximum opportunity unchanged for 2019:

- 180% of base salary for the CEO
- 170% of base salary for the CFO

The CEO's target bonus is half of the maximum bonus allowed under policy. However, as a measure to restrict the level of maximum payouts for the CEO, his payout is capped at 180% of salary. The CFO's target bonus is 50% of his maximum opportunity.

For 2019, the following balanced mix of financial and strategic measures will be used, which is **unchanged from the previous year**:

Adjusted operating profit	Sales	Operating cash flow	Strategic measures
40%	20%	20%	20%

Targets are considered by the Board to be commercially sensitive and will be disclosed in the 2019 Directors' remuneration report.

LTIP Long-term incentive plan

see p116, 118, 119

Key features

- **Drive long-term earnings, share price growth and value creation**
- **Align the interests of Executives and shareholders**
- **Awards** are made annually, and vest based on performance against stretching targets measured over a three-year performance period
- An additional **two-year holding** period applies following vesting
- The Committee will determine the performance measures, weightings and targets governing an award prior to grant to ensure continuing alignment with strategy and that targets are sufficiently stretching
- **Malus and clawback** provisions apply.

2019 implementation

Award levels as a percentage of salary will remain the same as those granted in 2017 and 2018:

- 275% of base salary for the CEO
- 245% of base salary for the CFO

Performance metrics, weightings and targets:
When setting targets, the Committee took into account the disposal of Wall Street English, share buyback and the adjustments to tax in 2018, resulting in a 2018 EPS outcome for incentive purposes of 63.1p and ROIC of 4.7%. These adjustments are explained in further detail on p118 and p119. The Committee also took into account the sale in early 2019 of the US K12 Courseware business which contributed £364m to 2018 sales and around £20m to 2018 operating profit.

Adjusted EPS (one-third)

Vesting schedule (% max)	EPS for FY21
15%	65p
65%	70p
100%	80p

ROIC (one-third)

Vesting schedule (% max)	ROIC for FY21
15%	5%
65%	6%
100%	9%

Relative TSR (one-third)

Vesting schedule (% max)	Ranked position versus FTSE 100
25%	Median
100%	Upper quartile

Note: Straight-line vesting in between points shown, with no vesting for performance below threshold.

SG Shareholding guidelines

see p120

Key features

- **Align the interests of Executives and shareholders** and encourage long-term shareholding and commitment to the company
- Executive Directors are expected to build up a substantial **shareholding in the company**. The target holding is 300% of salary for the Chief Executive and 200% of salary for other Executive Directors
- Executive Directors have five years from the date of appointment to reach the guideline
- In 2017, Pearson introduced a requirement whereby Executive Directors are required to retain half of the current guideline for a period of two years post-retirement in respect of shares vested from company incentive plans.

2019 implementation

No changes for 2019.

NEF Non-Executive fees

see p122

Key features

- The **Chairman** is paid a single fee for all of his responsibilities
- The **Non-Executive Directors** are paid a basic fee. The Chairs and members of the main Board Committees and the Senior Independent Director are paid an additional fee to reflect their extra responsibilities
- The **Chairman and Non-Executive Directors** receive no other pay or benefits, except for reimbursement of expenses, and do not participate in incentive plans
- A minimum of 25% of the Chairman's and Non-Executive Directors' basic fee is paid in shares.

2019 implementation

There will be no changes to fees for 2019:

Role	Fees for 2019
Chairman of the Board	£500,000
Base fee for Non-Executive Directors	£70,000
Additional SID fee	£22,000

Role	Chair	Member
Audit Committee	£27,500	£15,000
Remuneration Committee	£22,000	£10,000
Nomination & Governance Committee	£15,000	£8,000
Reputation & Responsibility Committee	£13,000	£6,000

Our Remuneration Policy was approved by shareholders at the AGM held on 5 May 2017 (and can be found in the Governance section of our website Pearson.com/governance). The table above summarises the key elements of the remuneration framework for Directors as set out in our Policy, including how we intend to implement it in 2019.

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2018 remuneration report

Certain parts of this report have been audited as required by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended. Those tables which have been subject to audit are marked with an asterisk.

Single total figure of remuneration and prior year comparison*

Total aggregate emoluments for Executive and Non-Executive Directors were £6,241m in 2018. These emoluments are included within the total employee benefit expense in note 5 to the financial statements (p167).

Executive Directors

The remuneration received by Executive Directors in respect of the financial years ended 31 December 2018 and 31 December 2017 is set out below.

Executive Director 'single figure' remuneration

Element of remuneration £000s	John Fallon		Coram Williams	
	2018	2017	2018	2017
B Base salary	**795**	780	**525**	515
A&B Allowances and benefits	**43**	45	**14**	39
AIP Annual incentives	**644**	624	**401**	412
LTIP Long-term incentives	**1,454**	0	**843**	0
R Retirement benefits	**206**	309	**54**	52
Total remuneration	**3,142**	1,758	**1,837**	1,018

Notes to single figure table

B Base salary

The base salary shown in the single figure table reflects salary paid in the financial year.

A&B Allowances and benefits

The breakdown of benefits is as follows for 2018:

	John Fallon	Coram Williams
Travel	**41**	**12**
Healthcare	**2**	**2**

Travel benefits comprise company car, car allowance, private use of a driver and reimbursements of a taxable nature resulting from business travel and engagements. Health benefits comprise healthcare, health assessment and gym subsidy. In addition to the above benefits and allowances, Executive Directors may also participate in company benefit or policy arrangements that have no taxable value.

AIP Annual incentives

The 2018 annual bonus for the Executive Directors was based on a mix of financial (80% weighting) and strategic measures (20% weighting). Annual bonuses are paid in cash. For more detail on performance metrics and performance against targets, see below.

LTIP Long-term incentives

The single figure of remuneration for 2018 includes the vesting of the 2016 LTIP award, which was subject to performance conditions assessed to 31 December 2018. For more detail on performance metrics and performance against targets, see below. The values of vested LTIP awards included in the figures for total remuneration have been calculated using a three-month average share price to year end of 904p and do not reflect any dividends accrued on those shares.

R Retirement benefits

Further detail on retirement benefits is set out later in this report.

AIP Executive Directors' annual incentive payments for 2018*

The following summarises bonus outcomes, performance targets for 2018 AIP awards and performance against these targets:

Summary

CEO		CFO	
Bonus paid	**% of maximum**	**Bonus paid**	**% of maximum**
£643,889	45%	£401,376	45%

Overall outcome

		Performance range				Payout
Performance measure	**% of total**	**Threshold**	**Target**	**Max**	**Actual results**	**% of max bonus opportunity**
Adjusted operating profit	40%	£518m	£543m	£598m	**£546m**	58%
Sales	20%	£4,200m	£4,250m	£4,325m	**£4,129m**	0%
Operating cash flow	20%	£485m	£506m	£558m	**£513m**	61%
Strategic measures	20%		See below			47%
	100%					**45%**

Note 1: The overall outcome is 45% of maximum (2017: 44% of max for the CEO and 47% of max for the CFO).

Note 2: The CEO's target bonus is half of the maximum bonus allowed under policy. However, as a measure to restrict the level of maximum payouts for the CEO, his payout is capped at 180% of salary. The CFO's target bonus is 50% of his maximum opportunity.

Note 3: The outcomes under all measures have been reviewed by internal audit.

2018 remuneration report

Performance against strategic measures

The targets (and outcomes) for performance against each of the strategic measures are shown in the table and supporting narrative below.

Strategic Priority	Measure	% of total funding	Threshold	Target	Max	Outcome
Gain share through digital transformation	Growth in digital and digitally-enabled sales as a proportion of revenues (excluding WSE and K12 Courseware)	5%	59.8% (+0.5% on 2017 result)	60.3% (+1% on 2017 result)	60.8% (+1.5% on 2017 result)	Made significant progress with Pearson's digital transformation in 2018 with digital and digitally-enabled sales increasing to 62% of revenues in 2018 vs. 59% in 2017.
	Global Learning Platform (GLP) – delivery of key 2018 milestones related to Rio and Revel pilots	5%	Critical milestones on track	Critical milestones and key deliverables on track	All milestones and deliverables on track	Continued to invest in the Global Learning Platform and innovative product and feature pipeline. In 2018, launched pilot versions of new Developmental Math courseware – 'Rio' – and will launch multiple Revel titles with enhanced assignment options and data analytics on the GLP during 2019.
Growing market opportunities	› Virtual schools FTE enrolment growth › Growth 'Big Bets' › Pearson VUE contract wins and renewals › US OPM partners, programs and enrolment › English PTE growth	5%	No payout below target	Progress in three areas	Progress in all five areas	Strong performance in structural growth opportunities with enrolment up 14% in US Online Program Management (revenue up 10% globally), enrolment up 11% in Virtual Schools (revenue up 8% in Connections Academy), revenue up 4% in Professional Certification and Pearson Test of English Academic test volume growth of 30%.
Become simpler and more efficient	The Enabling Programme (TEP) – linked to key deliverables/milestones including (successful) deployment of Wave 7 Release 1, 2 & 3 and progress on RoW and Release 4	5%	Critical milestones on track	Critical milestones and key deliverables on track	All milestones and deliverables on track	Went live with new enterprise software system in the US in May, replacing decades-old technology with a new platform that reduces risk, accelerates digital transformation, and enables us to become even more efficient. As a result of the roll-out, there were some supply chain challenges, but issues were dealt with quickly. Made good progress.

Taking into account the above assessment of performance, the Committee judged that the overall payout on the strategic element was 47% of maximum.

Executive Directors' Long-Term Incentive Plan award vesting for 2018*

In May 2016, the Executive Directors were made awards under the LTIP which vest based on performance of the business delivered over the three-year period from 2016 to 2018. The target ranges were set at that time based on the shape of the business in 2016, and took into account internal and external expectations of performance when the awards were made. The targets were considered by the Committee to be appropriately stretching.

How the Committee has exercised its discretion

The Committee has been very thoughtful about how to assess the performance of the business against targets set to ensure that the outcomes appropriately reflect the principles against which targets were originally set and the underlying performance of the business over the period. In determining the outcomes, the Committee has made adjustments in three areas: business disposals, share buybacks and the reduced effective corporate tax rate for 2018. Further details are outlined below.

The overall outcome is 42% of the maximum awards will vest. This is the first time that LTIP awards have vested for Executive Directors since 2013.

Business disposals

Since the targets were set, the Group has made a number of disposals; GEDU in August 2017, a 22% stake in Penguin Random House (PRH) in October 2017, and the disposal of Wall Street English (WSE) in March 2018. The adjusted earnings per share (EPS) and return on invested capital (ROIC) target ranges have been adjusted to remove the contribution that was anticipated from the businesses which no longer form part of the Pearson Group. These adjustments ensure that the performance of the retained portion of the Group is being assessed on a like-for-like basis over the performance period. The Committee considers this approach ensures that the revised targets represent the same degree of stretch as the original target ranges taking into account the evolving shape of the business.

Share buyback

The proceeds of the partial sale of PRH were used to fund the share buyback of £300m. The Committee determined that it was appropriate to remove the positive impact of the buyback on EPS in 2018 when determining the outcome of the LTIP awards.

Corporate tax rate for 2018

The effective corporate tax rate for 2018 is lower than for a number of years due to a combination of external corporate tax rate changes and the conclusion of some long outstanding matters. The Committee did not believe that management should benefit from the rate changes which relate to US tax reforms, but should receive the benefit of the release of tax provisions which have been built up over prior years as these reflected prudent financial management.

Taking into account the share buyback and the adjustments to tax, the Committee therefore considered the appropriate EPS outcome for incentive purposes to be 63.1p and the appropriate ROIC outcome to be 4.7%. This compares to adjusted EPS of 70.3p and a ROIC of 4.7%.

The adjusted targets and performance against these adjusted targets are as follows:

		Performance range					Vesting	
Performance measure	% of total	Threshold unadjusted (25% payout)	Maximum unadjusted (100% payout)	Threshold as adjusted (25% payout)	Maximum as adjusted (100% payout)	Actual	% achievement	% of total award
Adjusted EPS	1/2	61.4p	78.3p	55.3p	73.1p	63.1p	58%	29%
ROIC	1/3	5.5%	6.7%	4.9%	6.3%	4.7%	0%	0%
Relative TSR	1/6	Median	Upper quartile	Median	Upper quartile	26 out of 78	78%	13%
	100%						**Total**	**42%**

Relative TSR was measured against the constituents of the FTSE World Media Index at the start of the performance period.

The Committee considers that the overall vesting outcome is fair and appropriately reflects the underlying performance during the relevant period.

LTIP Long-term incentives awarded in 2018*

The following LTIP awards were granted during the year:

Director	Date of award	Vesting date	Number of shares	Face value	Face value (% of base salary)	Value for threshold performance (% of maximum)*	Performance Period
John Fallon	8 May 2018	1 May 2021	246,000	£2,198,256	275%	18%	1 Jan 18–31 Dec 20
Coram Williams	8 May 2018	1 May 2021	145,000	£1,295,720	245%	18%	1 Jan 18–31 Dec 20

* Under the EPS and ROIC element 15% vests for threshold performance, under the TSR element 25% vests for threshold performance. This is the weighted average of vesting for threshold.

Face value was determined using a share price of 893.60p (previous trading day closing price as at the date of grant).

Any shares vesting based on performance will be subject to an additional two-year holding period to 1 May 2023.

2018 remuneration report

Details of the performance targets for the 2018 long-term incentive awards are set out in the tables below.

Adjusted earnings per share (EPS) (one-third)		Return on invested capital (ROIC) (one-third)		Relative total shareholder return (TSR) (one-third)	
Vesting schedule (% max)	Adjusted EPS for FY20	Vesting schedule (% max)	Adjusted ROIC for FY20	Vesting schedule (% max)	Ranked position vs FTSE 100
15%	65p	15%	5%	25%	Median
65%	68p	65%	6%	100%	Upper quartile
100%	80p or above	100%	8% or above		

Note 1: Straight-line vesting will occur in between the points shown, with no vesting for performance below threshold.

Note 2: Pearson's total shareholder return performance is measured relative to the constituents of the FTSE 100 Index over the performance period.

SG Directors' interests in shares and value of shareholdings

Shareholding guidelines

Executive Directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee share ownership and to align further the interests of Executive Directors and shareholders. The target holding is 300% of salary for the Chief Executive and 200% of salary for the other Executive Directors. Shares that count towards these guidelines include any shares held unencumbered by an Executive Director, their spouse and/or dependent children plus any shares vested but held pending release under a share plan. Executive Directors have five years from the date of appointment to reach the guideline. Once the guideline has been met, it is not retested, other than when shares are sold.

With effect from 2018, shareholding guidelines for Executive Directors were extended post-retirement. Executive Directors are required to retain half of the current guideline for a period of two years post-retirement in respect of shares vested from company incentive plans.

The shareholding guidelines do not apply to the Chairman and Non-Executive Directors. However, a minimum of 25% of the basic Non-Executive Directors' fee is paid in Pearson shares that the Non-Executive Directors have committed to retain for the period of their directorships.

Directors' interests*

The share interests of the Directors and their connected persons are as follows:

Director	Current shareholding (ordinary shares) at 31 Dec 18	Conditional shares at 31 Dec 18	Total number of ordinary and conditional shares at 31 Dec 18	Guideline (% salary)	Guideline met?
Chair					
Sidney Taurel	89,422	–	–	–	–
Executive Directors					
John Fallon	326,784	995,000	1,321,784	300%	Yes
Coram Williams	15,010	582,000	597,010	200%	n/a (see note 4)
Non-Executive Directors					
Elizabeth Corley	13,245	–	–	–	–
Vivienne Cox	6,282	–	–	–	–
Josh Lewis	12,524	–	–	–	–
Linda Lorimer	8,902	–	–	–	–
Michael Lynton	3,488	–	–	–	–
Tim Score	26,489	–	–	–	–
Lincoln Wallen	6,346	–	–	–	–

Note 1: The current value of the Executive Directors' shareholdings is based on the closing market value of Pearson shares of 841.4p on 1 March 2019 against base salaries at 31 December 2018.

Note 2: Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals under the long-term incentive plan and any legacy share plans they might have participated in.

Note 3: Conditional shares means unvested shares which remain subject to performance conditions and continuing employment for a pre-defined period.

Note 4: Coram Williams has five years from the date of his appointment as an Executive Director on 1 August 2015 to reach the shareholding guideline.

Note 5: There have been no changes in the interests of any Director between 31 December 2018 and 1 March 2019, being the latest practicable date prior to the publication of this report.

Movements in Directors' interests in share awards during 2018*

Plan	Date of award	Vesting date	Number of shares as at 1 Jan 2018	Awarded	Released	Lapsed	Number of shares as at 31 Dec 2018	Status
John Fallon								
LTIP	8 May 2018	1 May 2021		246,000			246,000	Outstanding subject to performance
	11 Sep 2017	1 May 2020	366,000				366,000	Outstanding subject to performance
	3 May 2016	3 May 2019	383,000				383,000	Performance tested to 31 December 2018 (see Note 3)
			749,000	246,000			995,000	
Coram Williams								
LTIP	8 May 2018	1 May 2021		145,000			145,000	Outstanding subject to performance
	11 Sep 2017	1 May 2020	215,000				215,000	Outstanding subject to performance
	3 May 2016	3 May 2019	222,000				222,000	Performance tested to 31 December 2018 (see Note 3)
			437,000	145,000			582,000	

Note 1: Released means where shares have been transferred to participants.

Note 2: TSR is measured relative to the constituents of the FTSE World Media Index for 2016 LTIP awards. For the LTIP awards granted in 2017 and 2018, TSR is measured relative to the constituents of the FTSE 100.

Note 3: The performance targets for the 2016 award were partially met and therefore 42% of this award will vest on 1 May 2019 and the remaining portion will lapse. Vested shares will be subject to an additional two-year holding period to 3 May 2021.

Performance targets for outstanding awards under the Long-Term Incentive Plan (LTIP)

The details of outstanding awards and their performance conditions under the Long-Term Incentive Plan (LTIP) as described in the table above is set out in the following table.

Date of award	Share price on date of award	Vesting date	Performance measures	Weighting	Performance period	Payout at threshold	Payout at maximum
8 May 2018	893.6p	1 May 2021	Relative TSR	One-third	1 Jan 2018 to 31 Dec 2020	25% at median	100% at upper quartile
			ROIC	One-third	FY 2020	15% for ROIC of 5%	100% for ROIC of 8%
			Adjusted EPS	One-third	FY 2020	15% for EPS 65p	100% for EPS 80p
11 September 2017	586.0p	1 May 2020	Relative TSR	30%	1 Jan 2017 to 31 Dec 2019	25% at median	100% at upper quartile
			ROIC	30%	FY 2019	15% for ROIC of 4.5%	100% for ROIC of 7.5%
			Adjusted EPS	40%	FY 2019	15% for EPS 55p	100% for EPS 75p

R Executive Directors' retirement benefits and entitlements*

Details of the Directors' pension entitlements and pension-related benefits during the year are as follows:

Director	Value of defined benefit over the period £000s	Other allowances in lieu of pension £000s	Total annual value in 2018 £000s	Accrued pension at 31 Dec 18 £000s
John Fallon		206	206	106
Coram Williams	54		54	36

Note 1: The accrued pension at 31 December 2018 is the deferred annual pension to which the member would be entitled on ceasing pensionable service on 31 December 2018. It relates to the pension payable from the UK Plan. Normal retirement age is 62.

Note 2: The value of defined benefit over the period comprises the defined benefit input value, less inflation, less individual contribution.

Note 3: Other allowances in lieu of pension represent the cash allowances paid in lieu of the previous FURBS arrangements.

Note 4: Total annual value is the sum of the previous two columns and is disclosed in the single figure of remuneration table.

2018 remuneration report

Plans

John Fallon – The Pearson Group Pension Plan

John attained the maximum service accrual for this benefit when he reached 20 years' service in October 2017. With effect from this date, he had accrued a benefit of two-thirds of his final pensionable salary and no further service-related benefits can accrue under the Plan. Based on the 2018/2019 earnings cap of £160,800, he will have accrued a pension of £105,884 per annum at this time. When the earnings cap under the Plan rules is increased in the future in line with increases in the UK retail price index, his final salary pension benefit will increase accordingly.

In addition, he received a taxable and non-pensionable cash supplement (of 26% of salary) in lieu of the previous FURBS arrangement. During 2018, John received the pension supplement of 26% of salary only. There are no enhanced early retirement benefits.

Coram Williams – The Pearson Group Pension Plan

Accrual rate of 1/60th of pensionable salary per annum, restricted to the Plan earnings cap (£160,800 per annum in 2018/19), with continuous service with a service gap. There are no enhanced early retirement benefits.

Chair and Non-Executive Director remuneration*

The remuneration paid to the Chairman and Non-Executive Directors in respect of the financial years ended 31 December 2018 and 31 December 2017 are as follows:

Director £000s	2018 Total fees	2018 Taxable benefits	2018 Total	2017 Total fees	2017 Taxable benefits	2017 Total
Sidney Taurel	**500**	**11**	**511**	500	12	512
Elizabeth Corley	**115**	**–**	**115**	112	–	112
Vivienne Cox	**128**	**3**	**131**	123	3	126
Josh Lewis	**88**	**4**	**92**	85	59	144
Linda Lorimer	**98**	**4**	**102**	97	5	102
Michael Lynton	**69**	**–**	**69**	–	–	–
Harish Manwani	**29**	**1**	**30**	81	4	85
Tim Score	**116**	**–**	**116**	113	–	113
Lincoln Wallen	**91**	**5**	**96**	91	6	97
Total	**1,234**	**28**	**1,262**	1,202	89	1,291

Note 1: A minimum of 25% of the Chairman's and Non-Executive Directors' basic fee is paid in shares, effective from the 2017 AGM policy approval.

Note 2: Taxable benefits refer to travel, accommodation and subsistence expenses incurred while attending Board meetings during the period that were paid or reimbursed by the company which are deemed by HMRC to be taxable in the UK. The amounts in the table above include the grossed-up cost of UK tax to be paid by the company on behalf of the Directors. Michael Lynton joined the Pearson Board as a Non-Executive Director with effect from 1 February 2018. Harish Manwani retired from the Board at the AGM in May 2018.

Payments to former Directors*

There were no payments to former Directors in 2018.

Payments for loss of office*

There were no payments for loss of office made to or agreed for directors in 2018.

Service contracts

The terms and conditions of appointment of our Directors are available for inspection at the company's registered office during normal business hours and at the annual general meeting. The Executive Directors have notice periods in their service contracts of 12 months from the company and six months from the Executives. Their contracts are dated 31 December 2012 (John Fallon) and 26 February 2015 (Coram Williams). Non-Executive Directors serve Pearson under letters of appointment which are renewed annually and do not have service contracts. The Non-Executive Directors' letters of appointment do not contain provision for notice periods or for compensation if their appointments are terminated.

Executive Directors' non-executive directorships

Coram Williams is engaged as a non-executive director of Guardian Media Group plc where he also chairs the audit committee. He received fees of £39,000 during 2018 in respect of this role. In accordance with our policy, he is permitted to retain these fees.

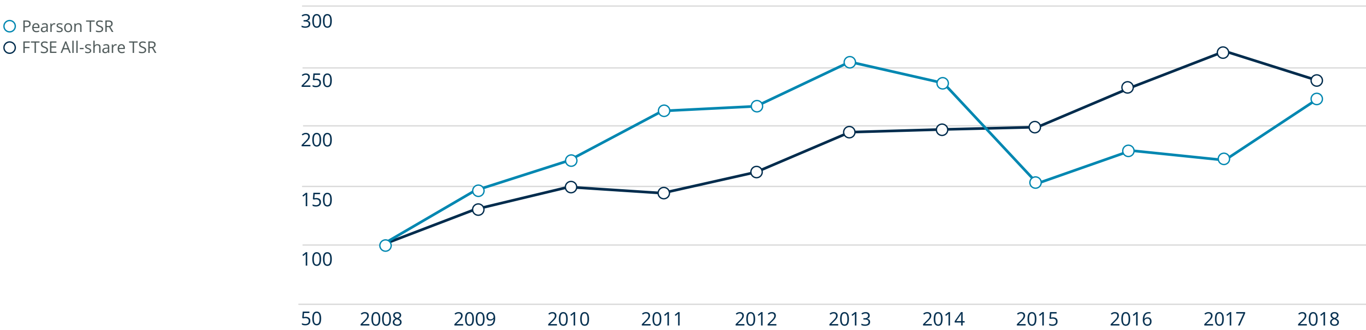
Historical performance and remuneration

Total shareholder return performance

We set out below Pearson's total shareholder return (TSR) performance relative to the FTSE All-Share index on an annual basis over the ten-year period 1 January 2009 to 31 December 2018. This comparison has been chosen because the FTSE All-Share represents the broad market index within which Pearson shares are traded. TSR is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends (source: Datastream).

In accordance with the reporting regulations, this section also presents Pearson's TSR performance alongside the single figure of total remuneration for the CEO over the last nine years and a summary of the variable pay outcomes relative to the prevailing maximum at the time.

Total shareholder return £



CEO remuneration	Marjorie Scardino				John Fallon					
Total remuneration (single figure, £000s)	6,370	8,466	8,340	5,330	1,727	1,895	1,263	1,518	1,758	**3,142**
Annual incentive (% of maximum)	91%	92%	76%	24%	34%	51%	Nil	24%	44%	**45%**
Long-term incentive (% of maximum)	80%	98%	68%	37%	Nil	Nil	Nil	Nil	Nil	**42%**

Annual incentive is the actual annual incentive received by the incumbent as a percentage of maximum opportunity.

Long-term incentive is the payout of performance-related restricted shares under the LTIP where the year shown is the final year of the performance period for the purposes of calculating the single total figure of remuneration.

Total remuneration is as reflected in the single total figure of remuneration table.

John Fallon's total remuneration opportunity is lower than that of the previous incumbent. Variable payouts under the Annual and Long-Term Incentive Plans reflect performance for the relevant periods.

Comparative information

The following information is intended to provide additional context regarding the total remuneration for Executive Directors.

Relative percentage change in remuneration for CEO

The following table sets out the change between 2017 and 2018 in three elements of remuneration for the CEO, in comparison with the average for all employees. While the Committee reviews base pay for the CEO relative to the broader employee population, benefits are driven by local practices and eligibility is determined by level and individual circumstances which do not lend themselves to comparison.

Average employee base salary has increased due to the disposal of businesses which included a significant number of employees in lower cost locations. Annual incentives for employees were higher in 2017 relative to the CEO whose bonus was reduced to reflect shareholder experience at the time.

Change in CEO remuneration 2017/18

Base salary	Allowances and benefits	Annual incentives
↑ 2%	↓ 4%	↑ 3%

Change in employee remuneration 2017/18

Base salary	Allowances and benefits	Annual incentives
↑ 14%	↑ 19%	↓ 17%

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Relative importance of pay spend

The Committee considers Directors' remuneration in the context of the company's allocation and disbursement of resources to different stakeholders. In particular, we chose adjusted operating profit because this is a measure of our ability to reinvest in the company. We include dividends because these constitute an important element of our return to shareholders.

All figures in £ millions	2018	2017	Change £m	Change %
Adjusted operating profit	**546**	576	(30)	**-5%**
Dividends & share buy-backs	**136**	618	(482)	**-78%**
Total wages and salaries	**1,421**	1,567	(146)	**-9%**

Note 1: Adjusted operating profit is as set out in the financial statements.

Note 2: 2017 figure for dividends & share buy-backs includes one-off share buyback of £300m in 2017.

Note 3: Wages and salaries include continuing operations only and include Directors. Average employee numbers for continuing operations for 2018 were 24,322 (2017: 30,339). Further details are set out in note 5 to the financial statements on p167.

Note 4: Total wages and salaries would be -7% at constant exchange rates.

Dilution and use of equity

Pearson can use existing shares bought in the market, treasury shares or newly issued shares to satisfy awards under the company's various share plans. For restricted stock awards under the LTIP, the company would normally expect to use existing shares.

There are limits on the amount of new-issue equity we can use. In any rolling ten-year period, no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans, and no more than 5% of Pearson equity will be issued, or be capable of being issued, under Executive or discretionary plans. The headroom available for all Pearson plans, Executive or discretionary, and shares held in trust is as follows:

Headroom	2018
All Pearson plans	**8.5%**
Executive or discretionary plans	**5.0%**
Shares held in trust	**4.6%**

The Remuneration Committee in 2018

Role	Name	Title
Chair	Elizabeth Corley	Independent Non-Executive Directors
	Josh Lewis	
	Tim Score	
	Sidney Taurel	Chairman of the Board
Internal attendees	John Fallon	Chief Executive
	Coram Williams	Chief Financial Officer
	Anna Vikström Persson	Chief Human Resources Officer
	Stuart Nolan	SVP, Reward
	Stephen Jones	Company Secretary
External advisers	Deloitte LLP	

Sidney Taurel was a member of the Committee throughout 2018 as permitted under the UK Corporate Governance Code.

Advisers to the Remuneration Committee

During 2018, the Remuneration Committee received advice from independent Remuneration Committee advisers, Deloitte LLP. Deloitte LLP were appointed by the Committee in July 2017 following a tender process.

Deloitte LLP supplied the Committee with advice on current market trends and developments, incentive plan design and target setting, investor engagement and other general Executive remuneration matters. In respect of their services to the Committee, Deloitte LLP were paid fees, which were charged on a time spent basis, of £135,900. During the year, separate teams within Deloitte LLP also provided Pearson PLC with certain tax and other advisory and consultancy services.

Deloitte LLP are founding members of the Remuneration Consultants' Group and adhere to its code of conduct.

The Committee remains satisfied that the advice provided by Deloitte LLP was objective and independent and that the provision of other services in no way compromised their independence. It is the view of the Committee that the Deloitte LLP engagement partner and team that provide remuneration advice to the Committee do not have connections with Pearson that may impair their independence. The Committee reviewed the potential for conflicts of interest and judged that there were appropriate safeguards against such conflicts.

Remuneration Committee meeting focus during 2018

Area of responsibility	Activities			
Market	Noted Deloitte's overview of the current remuneration and governance environment.	Received a number of updates on and considered changes to the corporate governance environment for executive compensation in particular in relation to the new UK Corporate Governance Code.		
Performance	Received input from the Audit Committee, internal audit and from management on the financial performance of the business and progress against strategic measures. Received input from investor relations on market consensus expectations.	Noted and reviewed the status of outstanding long-term incentive awards based on the current view of likely Pearson financial performance.	Reviewed and approved 2017 annual incentive performance and payouts for Executive Directors, Pearson executive management, senior leaders and eligible employees.	Noted report on talent, retention and voluntary leavers from CHRO.
Implementation	Reviewed annual salary increases for Pearson's Executive Directors, Executive management and senior leaders.	Reviewed and approved 2018 individual annual incentive opportunities for the Executive Directors and Pearson executive management. Reviewed and approved 2018 employee annual incentive plan targets.	Approved nil payout under 2015 long-term incentive plan awards. Reviewed and approved 2018 long-term incentive awards for the Executive Directors and Pearson Executive management, including the quantum of awards and targets. Noted 2018 long-term incentive awards for managers.	Noted remuneration packages for new appointments to the Pearson Executive management team and termination arrangements for leavers.
Governance	Noted the activity of the Standing Committee of the Board in relation to the operation of the company's equity-based reward programmes.	Noted company's use of equity for employee share plans.	Conducted an evaluation of the Committee's performance.	
Policy	Reviewed wider workforce remuneration and related policies.	Reviewed and reconfirmed the operation of the Policy for 2019 taking into account workforce remuneration and related polices.		
Disclosure and engagement	Considered feedback from key shareholders and governance bodies.	Reviewed and approved 2017 Directors' remuneration report. Noted shareholder feedback on 2017 Directors' remuneration report.	Reviewed 2018 Annual General Meeting season, shareholder voting and engagement strategy.	Noted template and outline of 2018 Directors' remuneration report and shareholder engagement strategy. Reviewed 2017 gender pay gap report, feedback on actions taken and draft 2018 report.

2018 remuneration report

Terms of reference

The Committee's full charter and terms of reference are available on the Governance page of the company's website. A summary of the Committee's responsibilities is set out below.

The terms of reference have been updated to reflect the provisions of the 2018 Code.

Committee responsibilities:

Determine and review policy	Determine and regularly review the remuneration policies for the Executive Directors, the presidents and other members of the Pearson executive management (who report directly to the CEO), and overview the approach for the senior leadership group. These policies include base salary, annual and long-term incentives, pension arrangements, any other benefits and termination of employment. When setting remuneration policy the Committee also takes into account remuneration practices and related policies for the wider workforce.
Shareholder engagement	Ensure the company maintains an appropriate level of engagement with its shareholders and shareholder representative bodies in relation to the remuneration policy and its implementation.
Review and approve implementation	Regularly review the implementation and operation of the remuneration policy and approve the individual remuneration and benefits packages of executive management.
Approve performance-related plans	Approve the design of, and determine targets for, any performance-related pay plans operated by the Group for Pearson executive management and approve the total payments to be made under such plans.
Review long-term plans	Review the design of the company's long-term incentive and other share plans operated by the Group and where relevant recommend such plans for approval by the Board and shareholders.
Set termination arrangements	Advise and decide on general and specific arrangements in connection with the termination of employment of executive management.
Review targets	Review and approve corporate goals and objectives relevant to executive management remuneration and evaluate the Executive Directors' performance in light of those goals and objectives.
Determine Chairman's remuneration	Delegated responsibility for determining the remuneration and benefits package of the Chairman of the Board.
Appoint remuneration consultants	Appoint and set the terms of engagement for any remuneration consultants who advise the Committee and monitor the cost of such advice.
Talent, retention and gender pay gap	Review updates from management on talent, retention and gender pay gap.

Committee evaluation

Annually, the Committee reviews its own performance, constitution, and charter and terms of reference to ensure it is operating at maximum effectiveness and recommends any changes it considers necessary to the Board for approval. The Committee participated in a survey to review its performance and effectiveness in September 2018, looking at areas such as the clarity of roles and responsibilities, the composition of the Committee, the use of time, the quality and timeliness of meeting materials, the opportunity for discussion and debate, dialogue with management and shareholders and access to independent advice. The Committee concluded that it continued to operate effectively but should keep looking for opportunities for greater simplicity and clarity, and that maintaining the high quality of papers continues to be important for the effectiveness of the Committee.

Voting on remuneration resolutions

The following table summarises the details of votes cast in respect of the remuneration resolutions.

	% of votes cast for	% of votes cast against	Votes withheld
Annual remuneration votes (2018 AGM)	99.4% (622,728,372)	0.6% (4,001,793)	5,547,864
2017 Remuneration Policy vote (2017 AGM)	68.8% (404,615,934)	31.2% (183,100,737)	43,738,267

The Directors' remuneration report has been approved by the Board on 11 March 2019 and signed on its behalf by:

Elizabeth Corley
Chair of Remuneration Committee

Additional disclosures

Pages 78–131 of this document comprise the Directors' report for the year ended 31 December 2018.

Set out below is other statutory and regulatory information that Pearson is required to disclose in its Directors' report.

Going concern

The Directors have made an assessment of the Group's ability to continue as a going concern and consider it appropriate to adopt the going concern basis of accounting.

Viability statement

As set out on p76, the Board has also reviewed the prospects of Pearson over the three-year period to December 2021 taking account of the Company's strategic plans, a 'severe but plausible' downside case and further stress testing based on the principal risks set out on p62.

Based on the results of these procedures, and considering the Company's strong balance sheet, the Directors have a reasonable expectation that Pearson will be able to continue in operation and meet its liabilities as they fall due over the three-year period ending December 2021. Further details of the Group's liquidity are shown in Financial review (see p44–50).

Share capital

Details of share issues and cancellations are given in note 27 to the financial statements on p201. The Company has a single class of shares which is divided into ordinary shares of 25p each. The ordinary shares are in registered form. As at 31 December 2018, 781,078,167 ordinary shares were in issue. At the AGM held on 4 May 2018, the Company was authorised, subject to certain conditions, to acquire up to 78,065,281 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 26 April 2019.

Share buyback

In line with our capital allocation priorities, the Board decided to use part of the proceeds from the transaction regarding our stake in Penguin Random House in 2017 to return £300m of surplus capital to shareholders, in addition to continuing to invest in our business and maintain a strong balance sheet.

We launched a £300m share buyback, beginning on 18 October 2017 and completed the programme on 16 February 2018, repurchasing a total of 42,835,577 shares at an average price of 700p.

Major shareholders

Information provided to the Company pursuant to the Financial Conduct Authority's Disclosure and Transparency Rules (DTR) is published on a Regulatory Information Service and on the Company's website.

As at 31 December 2018, the Company had been notified under DTR 5 of the following holders of significant voting rights in its shares.

	Number of voting rights	Percentage as at date of notification
Schroders plc	97,090,310	12.43%
Silchester International Investors LLP	77,889,093	9.98%
The Goldman Sachs Group, Inc	49,024,780	6.33%
Lindsell Train Limited	41,393,237	5.03%
Ameriprise Financial, Inc. and its group	41,236,375	5.02%
Libyan Investment Authority[1]	24,431,000	3.01%

1 Based on notification to the Company dated 7 June 2010. We have been notified of no change to this holding since that date. Assets belonging to, or owned, held or controlled on 16 September 2011 by the Libyan Investment Authority and located outside Libya on that date, are frozen in accordance with Article 5(4) of Regulation 2016/44 of the Council of the European Union.

Between 31 December 2018 and 11 March 2019, being the latest practicable date before the publication of this report, the Company received further notifications under DTR 5, with the most recent positions being as follows:

› Schroders plc disclosed a holding of 11.73%

› The Goldman Sachs Group, Inc disclosed a holding of 7.75%.

Additional disclosures

Annual General Meeting

The notice convening the AGM, to be held at 12 noon on Friday, 26 April 2019 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 25 March 2019.

Registered auditors

In accordance with section 489 of the Act, a resolution proposing the reappointment of PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the AGM, at a level of remuneration to be agreed by the Audit Committee.

Amendment to Articles of Association

Any amendments to the Articles of Association of the Company ('the Articles') may be made in accordance with the provisions of the Act by way of a special resolution.

Rights attaching to shares

The rights attaching to the ordinary shares are defined in the Articles. A shareholder whose name appears on the Company's register of members can choose whether his/her shares are evidenced by share certificates (i.e. in certificated form) or held electronically (i.e. uncertificated form) in CREST (the electronic settlement system in the UK).

Subject to any restrictions below, shareholders may attend any general meeting of the Company and, on a show of hands, every shareholder (or his/her representative) who is present at a general meeting has one vote on each resolution and, on a poll, every shareholder (whether an individual or a corporation) present in person or by proxy shall have one vote for every 25p of nominal share capital held. A resolution put to the vote at a general meeting is decided on a show of hands unless before, or on the declaration of the result of, a vote on a show of hands, a poll is demanded. A poll can be demanded by the Chair of the meeting, or by at least three shareholders (or their representatives) present in person and having the right to vote, or by any shareholders (or their representatives) present in person having at least 10% of the total voting rights of all shareholders, or by any shareholders (or their representatives) present in person holding ordinary shares on which an aggregate sum has been paid up of at least 10% of the total sum paid up on all ordinary shares. At this year's AGM, voting will again be conducted on a poll, consistent with best practice.

Shareholders can declare a final dividend by passing an ordinary resolution but the amount of the dividend cannot exceed the amount recommended by the Board. The Board can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. In all cases the distributable profits of the Company must be sufficient to justify the payment of the relevant dividend.

The Board may, if authorised by an ordinary resolution of the shareholders, offer any shareholder the right to elect to receive new ordinary shares, which will be credited as fully paid, instead of their cash dividend.

Any dividend which has not been claimed for 12 years after it became due for payment will be forfeited and will then belong to the Company, unless the Directors decide otherwise.

If the Company is wound up, the liquidator can, with the sanction of a special resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the Company and he/she can value assets and determine how the division shall be carried out as between the shareholders or different classes of shareholders. The liquidator can also, with the same sanction, transfer the whole or any part of the assets to trustees upon such trusts for the benefit of the shareholders.

Voting at general meetings

Any form of proxy sent by the shareholders to the Company in relation to any general meeting must be delivered to the Company (via its registrars), whether in written or electronic form, not less than 48 hours before the time appointed for holding the meeting or adjourned meeting at which the person named in the appointment proposes to vote.

The Board may decide that a shareholder is not entitled to attend or vote either personally or by proxy at a general meeting or to exercise any other right conferred by being a shareholder if he/she or any person with an interest in shares has been sent a notice under section 793 of the Act (which confers upon public companies the power to require information with respect to interests in their voting shares) and he/she or any interested person failed to supply the Company with the information requested within 14 days after delivery of that notice. The Board may also decide, where the relevant shareholding comprises at least 0.25% of the nominal value of the issued shares of that class, that no dividend is payable in respect of those default shares and that no transfer of any default shares shall be registered.

Pearson operates an employee benefit trust to hold shares, pending employees becoming entitled to them under the Company's employee share plans. There were 3,224,665 shares held as at 31 December 2018. The trust has an independent trustee which has full discretion in relation to the voting of such shares. A dividend waiver operates on the shares held in the trust.

Pearson also operates two nominee shareholding arrangements which hold shares on behalf of employees. There were 2,387,192 shares held in the Sharestore account and 443,616 shares held in the Global Nominee account as at 31 December 2018. The beneficial owners of shares held in Sharestore are invited to submit voting instructions online at www.shareview.co.uk and Global Nominee participants are invited to submit voting instructions by e-mail to nominee@equiniti.com. If no instructions are given by the beneficial owner by the date specified, the trustees holding these shares will not exercise the voting rights.

Transfer of shares

The Board may refuse to register a transfer of a certificated share which is not fully paid, provided that the refusal does not prevent dealings in shares in the Company from taking place on an open and proper basis. The Board may also refuse to register a transfer of a certificated share unless: (i) the instrument of transfer is lodged, duly stamped (if stampable), at the registered office of the Company or any other place decided by the Board, and is accompanied by the certificate for the share to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer; (ii) it is in respect of only one class of shares; and (iii) it is in favour of not more than four transferees.

Transfers of uncertificated shares must be carried out using CREST and the Board can refuse to register a transfer of an uncertificated share in accordance with the regulations governing the operation of CREST.

Variation of rights

If at any time the capital of the Company is divided into different classes of shares, the special rights attaching to any class may be varied or revoked either:

(i) With the written consent of the holders of at least 75% in nominal value of the issued shares of the relevant class; or

(ii) With the sanction of a special resolution passed at a separate general meeting of the holders of the shares of the relevant class.

Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any share may be issued with such preferred, deferred or other special rights, or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the Company may from time to time by ordinary resolution determine.

Appointment and replacement of Directors

The Articles contain the following provisions in relation to Directors:

Directors shall be no less than two in number. Directors may be appointed by the Company by ordinary resolution or by the Board. A Director appointed by the Board shall hold office only until the next AGM and shall then be eligible for reappointment, but shall not be taken into account in determining the Directors or the number of Directors who are to retire by rotation at that meeting. The Board may from time to time appoint one or more Directors to hold Executive office with the Company for such period (subject to the provisions of the Act) and upon such terms as the Board may decide and may revoke or terminate any appointment so made.

The Articles provide that, at every AGM of the Company, at least one-third of the Directors shall retire by rotation (or, if their number is not a multiple of three, the number nearest to one-third). The first Directors to retire by rotation shall be those who wish to retire and not offer themselves for re-election. Any further Directors so to retire shall be those of the other Directors subject to retirement by rotation who have been longest in office since they were last re-elected but, as between persons who became or were last re-elected on the same day, those to retire shall (unless they otherwise agree among themselves) be determined by lot. In addition, any Director who would not otherwise be required to retire shall retire by rotation at the third AGM after they were last re-elected.

Notwithstanding the provisions of the Articles, the Board has resolved that all Directors should offer themselves for re-election annually, in accordance with the UK Corporate Governance Code (the Code).

The Company may by ordinary resolution remove any Director before the expiration of his/her term of office. In addition, the Board may terminate an agreement or arrangement with any Director for the provision of his/her services to the Company.

Additional disclosures

Powers of the Directors

Subject to the Articles, the Act and any directions given by special resolution, the business of the Company will be managed by the Board who may exercise all the powers of the Company, including powers relating to the issue and/or buying back of shares by the Company (subject to any statutory restrictions or restrictions imposed by shareholders in general meeting).

Significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the Company:

At 31 December 2018, the Group had a $1,750m revolving credit facility agreement dated August 2014 which matures in August 2021 between, among others, the Company, Barclays Bank plc (Agent) and the banks and financial institutions named therein as lenders (the Facility), under which any such bank may, upon a change of control of the Company, require its outstanding advances, together with accrued interest and any other amounts payable in respect of such Facility, and its commitments, to be cancelled, each within 60 days of notification to the banks by the Agent. On 19 February 2019, this revolving credit facility was amended to total $1,190m and the maturing date was extended to February 2024 with the same provisions. For these purposes, a 'change of control' occurs if the Company becomes a subsidiary of any other company, or one or more persons acting either individually or in concert obtains control (as defined in section 1124 of the Corporation Tax Act 2010) of the Company.

Shares acquired through the Company's employee share plans rank *pari passu* with shares in issue and have no special rights. For legal and practical reasons, the rules of these plans set out the consequences of a change of control of the Company.

Other statutory information

Other information that is required by the Companies Act 2006 (the Act) to be included in the Directors' report, and which is incorporated by reference, can be located as follows:

Summary disclosures index	See more
Dividend recommendation	p45
Financial instruments and financial risk management	p186–189
Important events since year end	p50
Future development of the business	p10–43
Research and development activities	p30
Employment of disabled persons	p34
Employee involvement	p32–40
Greenhouse gas emissions	p39

With the exception of the dividend waiver described on p128–129 there is no information to be disclosed in accordance with Listing Rule 9.8.4.

No political donations or contributions were made or expenditure incurred by the Company or its subsidiaries during the year.

Fair, balanced and understandable reporting and disclosure of information

As required by the Code, we have established arrangements to ensure that all information we report to investors and regulators is fair, balanced and understandable. A process and timetable for the production and approval of this year's report was agreed by the Board at its meeting in December 2018. The full Board then had the opportunity to review and comment on the report as it progressed.

Representatives from financial reporting, corporate affairs, company secretarial, legal and internal audit, compliance and risk are involved in the preparation and review of the annual report to ensure a cohesive and balanced approach and, as with all of our financial reporting, our Verification Committee conducts a thorough verification of narrative and financial statements. We also have procedures in place to ensure the timely release of inside information, through our Market Disclosure Committee.

The Audit Committee is also available to advise the Board on certain aspects of the report, to enable the Directors to fulfil their responsibility in this regard. The Directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

The Directors also confirm that, for each Director in office at the date of this report:

- So far as the Director is aware, there is no relevant audit information of which the Group and Company's auditors are unaware
- They have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Group and the company's auditors are aware of that information.

Directors in office

The following Directors were in office during the year and up until the signing of the financial statements:

E P L Corley	**H Manwani** (stepped down 4 May 2018)
V Cox	**T Score**
J J Fallon	**S Taurel**
S J Lewis	**L Wallen**
L K Lorimer	**C Williams**
M M Lynton (appointed 1 February 2018)	

The Directors' report has been approved by the Board on 11 March 2019 and signed on its behalf by:

Stephen Jones
Company Secretary

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Statement of Directors' responsibilities

Statement of Directors' responsibilities

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group for that period. In preparing the financial statements, the Directors are required to:

› Select suitable accounting policies and then apply them consistently

› State whether applicable IFRSs as adopted by the European Union have been followed for the Group and Company financial statements, subject to any material departures disclosed and explained in the financial statements

› Make judgements and accounting estimates that are reasonable and prudent

› Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed on p80–81, confirms that, to the best of their knowledge:

› The Group and Company financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Company

› The strategic report contained in the annual report includes a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that they face.

This responsibility statement has been approved by the Board on 11 March 2019 and signed on its behalf by:

Coram Williams
Chief Financial Officer

Financial statements

In this section

Independent auditor's report to the members of Pearson plc

Report on the audit of the financial statements

Opinion

In our opinion, Pearson plc's Group financial statements and parent company financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the parent company's affairs at 31 December 2018 and of the Group's profit and of the Group's and the parent company's cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: the consolidated and company balance sheets at 31 December 2018; the consolidated income statement and consolidated statement of comprehensive income, the consolidated and company cash flow statements and the consolidated and company statements of changes in equity for the year then ended; and the notes to the consolidated financial statements and notes to the company financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or to the parent company.

Other than those disclosed in note 4 to the financial statements, we have provided no non-audit services to the Group or to the parent company in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview

Materiality

- Overall Group materiality: £25 million (2017: £22 million) based on approximately 5% of adjusted profit before tax.
- Overall parent company materiality: £45 million (2017: £20 million) based on approximately 1% of net assets.

Audit scope

- We conducted work in four key territories, being the UK, US, Brazil and Italy. This included full scope audits at three reporting components and specific audit procedures at a further 20 components. In addition, we obtained an audit opinion on the financial information reported by the Group's associate, Penguin Random House.
- The territories where we conducted audit procedures, together with work performed at corporate functions and at the Group level, accounted for approximately: 69% of the Group's revenue; 64% of the Group's profit before tax; and 63% of the Group's adjusted profit before tax.

Areas of focus for the 2018 audit were as follows:

- Carrying values of goodwill and intangible assets (Group)
- Returns provisioning (Group)
- Recoverability of pre-publication assets (Group)
- Accounting for major transactions (Group)
- Provisions for uncertain tax positions (Group)
- Finance transformation (Group)
- Risk of fraud in revenue recognition (Group)
- Carrying values of investments in subsidiaries (parent company)

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and the industry in which it operates, we identified that the principal risks of non-compliance with laws and regulations related to the failure to comply with international tax regulations and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls) and determined that the principal risks were related to posting inappropriate journal entries, management bias in accounting for estimates and manipulation of cut-off of shipments at major warehouse locations. The Group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the Group engagement team and/or component auditors included:

- Discussions with management, internal audit and the Group's legal advisors, including consideration of known or suspected instances of non-compliance with laws and regulations and fraud;
- Evaluation of the effectiveness of management's controls designed to prevent and detect irregularities; and
- Identifying and testing significant manual journal entries and reviewing assumptions and judgements made by management in making significant accounting estimates.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations or through collusion.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud, and the risk of fraud in revenue recognition.

Independent auditor's report to the members of Pearson plc

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Carrying values of goodwill and intangible assets	
Refer to note 11 in the Group financial statements. The Group recorded goodwill of £2,111m and intangible assets of £898m at 31 December 2018, including software, acquired customer lists, contracts and relationships, acquired trademarks and brands and acquired publishing rights. The Group recorded an impairment charge of £2,548m in 2016 against the North America CGU. The carrying values of goodwill and intangible assets are dependent on future cash flows of the underlying CGUs and there is a risk that if management does not achieve these cash flows it could give rise to further impairment charges. This risk increases in periods when the Group's trading performance and projections do not meet expectations. The impairment reviews performed by management contain a number of significant judgements and estimates. Changes in these assumptions can result in materially different impairment charges or available headroom.	We obtained management's fair value less costs of disposal impairment model and tested and evaluated the reasonableness of key assumptions, including CGU identification; operating cash flow forecasts and key inputs into these forecasts; the appropriateness of the inclusion of restructuring cost savings; perpetuity growth rates; and discount rates. We tested the mathematical integrity of the forecasts and carrying values in management's impairment model and we confirmed that management's estimate of each CGU's recoverable amount is appropriately based on the higher of fair value less costs of disposal and value-in-use. Our procedures focused on the North America, Core and Brazil CGUs where there was lower available headroom. We agreed the forecast cash flows to board approved budgets, assessed how these budgets are compiled and understood key related judgements and estimates, including short-term growth rates, corporate cost allocations and restructuring costs and related savings. We deployed valuations experts to assess the perpetuity growth rate and discount rate for each CGU by comparison with third party information, past performance and relevant risk factors. We also considered management's estimate of disposal costs for reasonableness. We performed our own sensitivity analyses to understand the impact of reasonably possible changes in key assumptions. We agreed with management's decision to provide additional disclosures and sensitivities in note 11 of the consolidated financial statements in relation to the North America, Core and Brazil CGUs.
Returns provisioning	
Refer to notes 1b and 24 in the Group financial statements. The Group has provided £173m for sales returns at 31 December 2018. The most significant exposure to potential returns within the Group arises in the US higher education courseware business. Trends in the US market, including the growth of textbook rentals and the availability of free online content, continue to affect this business and have the potential to impact returns levels if shipping practices and arrangements with retailers are not managed in response to these trends. Management provides for returns based on past experience by customer and channel, using a three year average methodology.	We assessed management's evaluation of market trends and the Group's responses and considered whether management's methodology and three year averaging remained appropriate. We tested the returns provision calculations at 31 December 2018 and agreed inputs such as historical sales and returns experience to underlying records. We performed detailed testing over shipment and returns levels around the year-end in particular at major shipping locations in the US and UK and evaluated whether these gave rise to an increased risk of future returns. We concluded that management had adopted methods and reached estimates for future returns that were supportable and appropriate.
Recoverability of pre-publication assets	
Refer to notes 20 and 32 in the Group financial statements. The Group has £817m of pre-publication assets at 31 December 2018 and a further £242m recorded in businesses classified as held for sale. Pre-publication assets represent direct costs incurred in the development of education platforms, programmes and titles prior to their public release. Judgement is required to assess the recoverability of the carrying value of these assets. This judgement is further complicated by the transition to digital as the Group invests in new, less proven, inter-linked digital content and platforms.	We assessed the appropriateness of capitalisation and amortisation policies and selected a sample of costs deferred to the balance sheet as pre-publication assets to test their magnitude and appropriateness for capitalisation and the reasonableness of amortisation profiles against sales forecasts, including considering the impact of the transition towards digital products. We challenged the carrying value of certain pre-publication assets where products are yet to be launched, are less proven or where sales are lower than originally anticipated. We assessed forecast cash flows against historical experience and obtained supporting evidence for management's explanations. Where the pre-publication assets formed part of a held for sale business, we considered whether the expected disposal proceeds are expected to exceed the carrying value of those assets. We found the Group's policies to be appropriate and consistently applied. While recoverability of the carrying values of certain assets depends on future sales growth, we considered the year-end carrying values to be appropriate and supported by reasonable forecasts.

Key audit matter	How our audit addressed the key audit matter
Accounting for major transactions	
Refer to notes 31 and 32 in the Group financial statements. The Group has disposed of Wall Street English and UTEL during 2018. Pre-tax gains on disposal of £207m and £19m respectively have been recorded on these disposals. Additionally, at 31 December 2018 the US K12 courseware business remains classified as held for sale. Therefore, assets of £648m and liabilities of £573m have been classified as held for sale on the face of the balance sheet. The Group has recorded the net held for sale assets at the lower of carrying value and fair value less costs to dispose. No impairments were recorded on classification of the US K12 courseware business as held for sale.	We obtained and reviewed the sale agreements and evidence of proceeds received for both disposals completed during 2018. We reviewed the contractual agreements to assess the accounting treatment and classification of proceeds and the gains on disposal of both Wall Street English and UTEL. We consider the accounting treatment to be appropriate and the gains to have been appropriately calculated and disclosed. We have obtained evidence to support the held for sale determination including board approval and evidence in support of a well advanced sales process at 31 December 2018. From the evidence we have obtained, including the post year-end announcement that a disposal transaction has been agreed and is expected to complete in 2019, we were satisfied that the US K12 courseware business has been appropriately measured and classified as held for sale at 31 December 2018.
Provisions for uncertain tax liabilities	
Refer to notes 7 and 34 in the Group financial statements. The Group is subject to several tax regimes due to the geographical diversity of its businesses. At 31 December 2018, the Group held provisions for uncertain tax positions of £181m. Management is required to exercise significant judgement in determining the appropriate amount to provide in respect of potential tax exposures and uncertain tax positions. The most significant potential exposures relate to US tax, transfer pricing, tax on prior year disposals and EU state aid. Changes in assumptions about the views that might be taken by tax authorities can materially impact the level of provisions recorded in the financial statements.	We engaged our tax specialists in support of our audit of tax and obtained an understanding of the Group's tax strategy and risks. We recalculated the Group's tax provisions and determined whether the treatments adopted were in line with the Group's tax policies and had been applied consistently. We evaluated the key underlying assumptions, particularly in the US and UK. In making this evaluation, we considered the status of tax authority audits and enquiries. We considered the basis and support in particular for provisions not subject to tax audit in comparison with our experience for similar situations. We evaluated the consistency of management's approach to establishing or changing prior provision estimates and validated that changes in prior provisions reflected a change in facts and circumstances during 2018. Where provisions have not been established, including for material potential exposures like EU state aid, we evaluated the basis for management's judgements, including an assessment of the treatment of similar exposures at comparable companies. We noted that the assumptions and judgements required to formulate these provisions mean that the range of possible outcomes is broad. However, based on the evidence obtained, we were satisfied that management's provisioning estimates for uncertain tax positions were prepared on a consistent basis with the prior year and were adequately supported. We also evaluated the disclosures in notes 7 and 34 in relation to uncertain tax provisions and we were satisfied that the disclosures were consistent with the underlying positions and with the requirements of IAS 1.
Finance transformation	
The Group is in the midst of a period of significant change with the continued roll-out of The Enabling Programme (TEP) and the organisational change resulting from implementing the target operating model. The ERP implementation programme continued in 2018 with certain US and Canadian businesses going live. This change represents a risk as controls and processes that have been established and embedded over a number of years are changed and migrated to the new ERP environment. There is an increased risk of break-down in internal control during the transition.	We centrally managed the work performed by component audit teams at Pearson Finance Services and in migrating markets like the US, which consisted of controls and substantive testing, and we conducted oversight visits to key sites impacted by the transformation activities to direct the work performed. We evaluated the design and tested the operating effectiveness of key automated and manual controls both before and after the migration including IT general controls and controls over the migration of data into the new ERP environment. We also tested balance sheet reconciliations for migrating entities to identify any migration issues. Where issues were identified, we performed testing of compensating controls and we increased the level of transaction testing to address any residual risk.

Independent auditor's report to the members of Pearson plc

Key audit matter	How our audit addressed the key audit matter
Risk of fraud in revenue recognition	
Refer to notes 1b and 3 in the Group financial statements. There are two types of complex contracts into which the Group enters that require significant judgements and estimates, which could be subject to either accidental error or deliberate fraud: › Multiple element arrangements, such as the sale of physical textbooks accompanied by digital content or supplementary workbooks, where revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its relative fair value; › Certain long-term contracts that span year-end, where revenue is recognised using estimated percentage of completion based on costs. These include contracts to design, develop and deliver testing and accreditation and contracts to secure students and support the online delivery of their teaching. These complex contracts generate material deferred revenue and accrued income balances and are areas where misstatements in the underlying assumptions or estimation calculations could have a material effect on the financial statements. The accounting for certain of these arrangements has been impacted in 2018 by the adoption of IFRS 15. In addition, there are material shipments around year-end from major distribution locations giving rise to the potential risk of a cut-off error.	Where books are sold together with workbooks that are delivered later or companion digital materials that are made available online, we assessed the basis for allocation of the purchase price between each element based on individual contractual arrangements and tested the detailed calculations supporting the revenue deferral calculations. This included validating adjustments for the extent of user take-up of digital content to underlying support. We found the revenue deferrals to be based on reasonable estimates of the relative fair value of each element and to be properly and consistently calculated. For a selection of the larger, more judgemental and more recent long-term contracts, covering both assessment activities and online delivery of teaching, we reviewed the contracts and assessed the accounting methodologies being applied to calculate the proportion of revenue being recognised. We also tested costs incurred to date and management's estimates of forecast costs and revenues by reference to historical experience and current contract status. We reviewed revenue recognised around year-end to ensure that it was recognised in the right period, focusing on the Group's major shipping locations. In addition, we have performed manual journals testing focusing on unusual or unexpected entries to revenue and we have tested the more significant adjustments required on adoption of IFRS 15 for accuracy and completeness. Our testing showed that revenue recognition practices are in accordance with Group policies and related accounting standards with appropriate methods for calculating the revenue recognised.
Carrying values of investments in subsidiaries	
Refer to note 2 in the company financial statements. The company holds investments in subsidiaries of £6,710m at 31 December 2018. Investments in subsidiaries are accounted for at cost less impairment in the company balance sheet. Investments are tested for impairment if impairment indicators exist. If such indicators exist, the recoverable amounts of investments in subsidiaries are estimated in order to determine the extent of the impairment loss, if any. Any such impairment loss is recognised in the income statement. Impairment indicators were identified in connection with certain of the investments in subsidiaries due to the carrying value of investments exceeding their net assets. As a result, an impairment loss of £57m was recognised against the carrying value of the company's investment in Pearson International Finance Limited. The impairment assessment performed by management was considered a key audit matter given the size of the underlying investment carrying values and recognising the significance of the impairment loss that has been recorded. The assessment required the application of management judgement, particularly in determining whether any impairment indicators have arisen that trigger the need for an impairment assessment and in assessing whether the carrying value of each investment can be supported by the recoverable amount.	We evaluated management's assumption whether any indicators of impairment existed by comparing the carrying values of investments in subsidiaries with their net assets at 31 December 2018. For the investment in Pearson International Finance Limited where an impairment of £57m was recorded, we challenged management on the basis of the impairment recognised and considered how it had been calculated by reference to the relevant accounting requirements to conclude on its reasonableness. For other investments where the net assets were lower than the carrying values but no impairment was recognised, we considered their recoverable value by reference to the fair value less costs of disposal of the investments compared to their carrying values at 31 December 2018. As a result of our work, we agreed with management that the impairment charge was appropriate and that the remaining carrying values of the investments held by the company at 31 December 2018 are supportable in the context of the company financial statements taken as a whole.

How we tailored our audit scope

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

The consolidated financial statements are a consolidation of 479 reporting units, each of which is considered to be a component. We identified three components in the UK, US and Italy that required a full scope audit due to their size. Audit procedures over specific financial statement line items were performed at a further 20 components in the UK, US and Brazil to give appropriate audit coverage. In addition, we obtained an audit opinion on the financial information reported by the US component of the Group's associate, Penguin Random House.

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

We performed full scope audits in respect of US Higher Education, Pearson Education UK, Pearson Italy and Penguin Random House US which, in our view, required a full scope audit due to their size.

We performed specified procedures at 20 components over financial statement line items including revenue, trade and other receivables and deferred income, cash, software intangibles, accruals, provisions for returns, product development and amortisation, fixed assets and depreciation, cost of sales and operating expenses. This ensured that sufficient and appropriate audit procedures were performed to achieve sufficient coverage over these financial statement line items.

In addition to instructing and reviewing the reporting from our component audit teams, we conducted visits to component teams in the US (New York and Minneapolis), Italy, Brazil and the UK (Belfast), which included file reviews and attendance at key meetings with local management. We also had regular dialogue with component teams throughout the year.

The Group consolidation, financial statement disclosures and corporate functions were audited by the Group audit team. This included our work over taxation, goodwill and intangible assets, post-retirement benefits and major transactions.

Taken together, the components and corporate functions where we conducted audit procedures accounted for approximately 69% of the Group's revenue, 64% of the Group's statutory profit before tax and 63% of the Group's adjusted profit before tax. This provided the evidence we needed for our opinion on the consolidated financial statements taken as a whole. This was before considering the contribution to our audit evidence from performing audit work at the Group level, including disaggregated analytical review procedures, which covers certain of the Group's smaller and lower risk components that were not directly included in our Group audit scope.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate, on the financial statements as a whole.

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

	Group financial statements	Parent company financial statements
Overall materiality	£25 million (2017: £22 million).	£45 million (2017: £20 million).
How we determined it	Approximately 5% of adjusted profit before tax.	Approximately 1% of net assets
Rationale for benchmark applied	Note 8 of the financial statements explains that the Group's principal measure of performance is adjusted operating profit (£546m), which excludes one-off gains and losses, costs of major restructuring and acquired intangible asset amortisation, in order to present results from operating activities on a consistent basis. From adjusted operating profit, we deducted net finance costs.	We consider net assets to be an appropriate benchmark for a Group holding company. Certain account balances were included in scope for the Group audit and were audited to a materiality level set below Group overall materiality.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £3m and £20m.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2 million (2017: £2 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Independent auditor's report to the members of Pearson plc

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the parent company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and parent company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, which is currently due to occur on 29 March 2019, are not clear and it is difficult to evaluate all of the potential implications on the Group's trade, customers, suppliers and the wider economy.
We are required to report if the directors' statement relating to going concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the strategic report and governance report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic report and governance report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Governance report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and parent company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Governance report. (CA06)

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The directors' confirmation on p62, p76 and p127 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; and
- The directors' explanation on p76 and p127 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the "Code"); and considering whether the statements are consistent with the knowledge and understanding of the Group and parent company and their environment obtained in the course of the audit. (Listing Rules).

Other Code provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the directors, on p130, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and parent company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and parent company obtained in the course of performing our audit;

- The section of the Annual Report on p96-103 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; and
- The directors' statement relating to the parent company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the statement of directors' responsibilities set out on p132, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

- We have not received all the information and explanations we require for our audit; or
- Adequate accounting records have not been kept by the parent company or returns adequate for our audit have not been received from branches not visited by us; or
- Certain disclosures of directors' remuneration specified by law are not made; or
- The parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 6 February 1996 to audit the financial statements for the year ended 31 December 1996 and subsequent financial periods. The period of total uninterrupted engagement is 23 years, covering the years ended 31 December 1996 to 31 December 2018.

Giles Hannam
(Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

11 March 2019

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Consolidated income statement

Year ended 31 December 2018

All figures in £ millions	Notes	2018	2017
Continuing operations			
Sales	2	**4,129**	4,513
Cost of goods sold	4	**(1,943)**	(2,066)
Gross profit		**2,186**	2,447
Operating expenses	4	**(1,907)**	(2,202)
Other net gains and losses	4	**230**	128
Share of results of joint ventures and associates	12	**44**	78
Operating profit	2	**553**	451
Finance costs	6	**(91)**	(110)
Finance income	6	**36**	80
Profit before tax		**498**	421
Income tax	7	**92**	(13)
Profit for the year		**590**	408
Attributable to:			
Equity holders of the company		**588**	406
Non-controlling interest		**2**	2
Earnings per share attributable to equity holders of the company during the year (expressed in pence per share)			
– basic	8	**75.6p**	49.9p
– diluted	8	**75.5p**	49.9p

Consolidated statement of comprehensive income

Year ended 31 December 2018

All figures in £ millions	Notes	2018	2017
Profit for the year		**590**	408
Items that may be reclassified to the income statement			
Net exchange differences on translation of foreign operations – Group		**91**	(158)
Net exchange differences on translation of foreign operations – associates		**(1)**	(104)
Currency translation adjustment disposed		**(4)**	(51)
Attributable tax	7	**(4)**	9
Items that are not reclassified to the income statement			
Fair value gain on other financial assets		**8**	13
Attributable tax	7	**–**	(4)
Remeasurement of retirement benefit obligations – Group	25	**22**	175
Remeasurement of retirement benefit obligations – associates		**3**	7
Attributable tax	7	**9**	(42)
Other comprehensive income/(expense) for the year	29	**124**	(155)
Total comprehensive income for the year		**714**	253
Attributable to:			
Equity holders of the company		**712**	251
Non-controlling interest		**2**	2

Consolidated balance sheet

As at 31 December 2018

All figures in £ millions	Notes	2018	2017
Assets			
Non-current assets			
Property, plant and equipment	10	**237**	281
Intangible assets	11	**3,009**	2,964
Investments in joint ventures and associates	12	**392**	398
Deferred income tax assets	13	**60**	95
Financial assets – derivative financial instruments	16	**67**	140
Retirement benefit assets	25	**571**	545
Other financial assets	15	**93**	77
Trade and other receivables	22	**100**	103
		4,529	4,603
Current assets			
Intangible assets – pre-publication	20	**817**	741
Inventories	21	**164**	148
Trade and other receivables	22	**1,178**	1,110
Financial assets – derivative financial instruments	16	**1**	–
Financial assets – marketable securities	14	**–**	8
Cash and cash equivalents (excluding overdrafts)	17	**568**	518
		2,728	2,525
Assets classified as held for sale	32	**648**	760
Total assets		**7,905**	7,888
Liabilities			
Non-current liabilities			
Financial liabilities – borrowings	18	**(674)**	(1,066)
Financial liabilities – derivative financial instruments	16	**(36)**	(140)
Deferred income tax liabilities	13	**(136)**	(164)
Retirement benefit obligations	25	**(100)**	(104)
Provisions for other liabilities and charges	23	**(145)**	(55)
Other liabilities	24	**(155)**	(133)
		(1,246)	(1,662)

Consolidated balance sheet continued

As at 31 December 2018

All figures in £ millions	Notes	2018	2017
Current liabilities			
Trade and other liabilities	24	**(1,400)**	(1,342)
Financial liabilities – borrowings	18	**(46)**	(19)
Financial liabilities – derivative financial instruments	16	**(23)**	–
Current income tax liabilities		**(72)**	(231)
Provisions for other liabilities and charges	23	**(20)**	(25)
		(1,561)	(1,617)
Liabilities classified as held for sale	32	**(573)**	(588)
Total liabilities		**(3,380)**	(3,867)
Net assets		**4,525**	4,021
Equity			
Share capital	27	**195**	200
Share premium	27	**2,607**	2,602
Treasury shares	28	**(33)**	(61)
Capital redemption reserve		**11**	5
Fair value reserve		**19**	13
Translation reserve		**678**	592
Retained earnings		**1,039**	662
Total equity attributable to equity holders of the company		**4,516**	4,013
Non-controlling interest		**9**	8
Total equity		**4,525**	4,021

These financial statements have been approved for issue by the Board of Directors on 11 March 2019 and signed on its behalf by

Coram Williams
Chief Financial Officer

Consolidated statement of changes in equity

Year ended 31 December 2018

All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Fair value reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
	Equity attributable to equity holders of the company									
At 1 January 2018	200	2,602	(61)	5	13	592	662	4,013	8	4,021
Adjustment on initial application of IFRS 15 net of tax (see note 1b)	–	–	–	–	–	–	(108)	(108)	–	(108)
Adjustment on initial application of IFRS 9 net of tax (see note 1c)	–	–	–	–	–	–	(10)	(10)	–	(10)
At 1 January 2018 (restated)	200	2,602	(61)	5	13	592	544	3,895	8	3,903
Profit for the year	–	–	–	–	–	–	588	588	2	590
Other comprehensive income	–	–	–	–	8	86	30	124	–	124
Total comprehensive income	–	–	–	–	8	86	618	712	2	714
Equity-settled transactions	–	–	–	–	–	–	37	37	–	37
Tax on equity settled transactions	–	–	–	–	–	–	4	4	–	4
Issue of ordinary shares under share option schemes	1	5	–	–	–	–	–	6	–	6
Buyback of equity	(6)	–	–	6	–	–	(2)	(2)	–	(2)
Release of treasury shares	–	–	28	–	–	–	(28)	–	–	–
Transfer of gain on disposal of FVOCI investment	–	–	–	–	(2)	–	2	–	–	–
Changes in non-controlling interest	–	–	–	–	–	–	–	–	–	–
Dividends	–	–	–	–	–	–	(136)	(136)	(1)	(137)
At 31 December 2018	195	2,607	(33)	11	19	678	1,039	4,516	9	4,525

All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Fair value reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
	Equity attributable to equity holders of the company									
At 1 January 2017	205	2,597	(79)	–	–	905	716	4,344	4	4,348
Profit for the year	–	–	–	–	–	–	406	406	2	408
Other comprehensive income/(expense)	–	–	–	–	13	(313)	145	(155)	–	(155)
Total comprehensive income/(expense)	–	–	–	–	13	(313)	551	251	2	253
Equity-settled transactions	–	–	–	–	–	–	33	33	–	33
Tax on equity settled transactions	–	–	–	–	–	–	–	–	–	–
Issue of ordinary shares under share option schemes	–	5	–	–	–	–	–	5	–	5
Buyback of equity	(5)	–	–	5	–	–	(300)	(300)	–	(300)
Release of treasury shares	–	–	18	–	–	–	(18)	–	–	–
Transfer of gain on disposal of FVOCI investment	–	–	–	–	–	–	–	–	–	–
Changes in non-controlling interest	–	–	–	–	–	–	(2)	(2)	2	–
Dividends	–	–	–	–	–	–	(318)	(318)	–	(318)
At 31 December 2017	200	2,602	(61)	5	13	592	662	4,013	8	4,021

The capital redemption reserve reflects the nominal value of shares cancelled in the Group's share buyback programme. The fair value reserve arises on revaluation of other financial assets. The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments.

Consolidated cash flow statement

Year ended 31 December 2018

All figures in £ millions	Notes	2018	2017
Cash flows from operating activities			
Net cash generated from operations	33	**547**	462
Interest paid		**(42)**	(89)
Tax paid		**(43)**	(75)
Net cash generated from operating activities		**462**	298
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	30	**(5)**	(11)
Purchase of investments		**(10)**	(3)
Purchase of property, plant and equipment		**(70)**	(82)
Purchase of intangible assets		**(130)**	(150)
Disposal of subsidiaries, net of cash disposed	31	**83**	19
Proceeds from sale of associates	31	**18**	411
Proceeds from sale of investments		**6**	–
Proceeds from sale of property, plant and equipment	33	**128**	–
Proceeds from sale of liquid resources		**10**	20
Loans repaid by/(advance to) related parties		**46**	(13)
Investment in liquid resources		**(2)**	(18)
Interest received		**20**	20
Dividends received from joint ventures and associates		**117**	458
Net cash generated from investing activities		**211**	651
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	**6**	5
Buyback of equity	27	**(153)**	(149)
Proceeds from borrowings		**–**	2
Repayment of borrowings		**(441)**	(1,294)
Finance lease principal payments		**(4)**	(5)
Dividends paid to company's shareholders	9	**(136)**	(318)
Dividends paid to non-controlling interest		**(1)**	–
Net cash used in financing activities		**(729)**	(1,759)
Effects of exchange rate changes on cash and cash equivalents		**(49)**	16
Net decrease in cash and cash equivalents		**(105)**	(794)
Cash and cash equivalents at beginning of year		**630**	1,424
Cash and cash equivalents at end of year	17	**525**	630

Notes to the consolidated financial statements

General information

Pearson plc (the company), its subsidiaries and associates (together the Group) are international businesses covering educational courseware, assessments and services, and consumer publishing through its associate interest in Penguin Random House.

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

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

These consolidated financial statements were approved for issue by the Board of Directors on 11 March 2019.

1a. Accounting policies

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

Basis of preparation

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

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

These accounting policies have been consistently applied to all years presented, unless otherwise stated.

1. Interpretations and amendments to published standards effective 2018 The following standards were adopted in 2018:

› IFRS 15 Revenue from Contracts with Customers

› IFRS 9 Financial Instruments

The impact of the adoption of these new standards is set out in notes 1b and 1c.

A number of other new pronouncements are also effective from 1 January 2018 but they do not have a material impact on the consolidated financial statements. Additional disclosure has been given where relevant.

2. Standards, interpretations and amendments to published standards that are not yet effective New accounting standards and interpretations have been published that are not mandatory for the year ended 31 December 2018. The Group has elected not to early-adopt these new standards and interpretations. The Group's assessment of the impact of these new standards is set out below.

IFRS 16 'Leases', effective for annual reporting periods beginning on or after 1 January 2019. The Group will apply IFRS 16 on 1 January 2019 using the modified retrospective approach. Under this approach, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings on 1 January 2019, with no restatement of comparative information.

IFRS 16 requires lessees to recognise right-of-use assets and lease liabilities on the balance sheet for all applicable leases with associated depreciation and interest charges recorded in the income statement together with changes to the classification of cash flows. In addition, IFRS 16 requires an intermediate lessor to assess and classify subleases as either a finance lease or an operating lease.

The Group has assessed the impact of adopting IFRS 16 with reference to its existing lease portfolio. The most significant part of the portfolio is property leases, amounting to approximately 750, together with a number of low value vehicle and equipment leases. The lease liability has been measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate at transition. The right-of-use asset is measured at its carrying amount as if the standard had been applied since the commencement of the lease, discounted using the incremental borrowing rate at transition. Where data is not available to enable this measurement to be made, the right-of-use asset is measured at an amount equal to the lease liability. Transition recognition exemptions relating to short-term and low value leases have been applied as well as practical expedients taken, where available, to simplify the transition process.

Adoption of the new standard will have a material impact on the Group. It is estimated that on transition the lease liability to be brought on balance sheet will be around £910m with the corresponding right-of-use asset valued at around £435m. In addition, certain subleases have been reclassified as finance leases resulting in an additional lease receivable of around £215m being brought on balance sheet. The net impact on the balance sheet will be a reduction of net assets of around £100m after taking into account existing liabilities relating to onerous lease provisions and lease incentives. The impact on the income statement in 2019 is expected to reduce profit before tax by approximately £10m (increasing operating profit by approximately £20m and increasing net finance costs by approximately £30m); the operating lease expense recognised under the existing standard (IAS 17) being replaced by depreciation and finance costs and finance income. There will be no impact on the Group's cash and cash equivalents.

In June 2015, the IASB issued an exposure draft ED/2015/5 'Remeasurement on a Plan Amendment, Curtailment or Settlement/ Availability of a Refund from a Defined benefit Plan (Proposed Amendments to IAS 19 and IFRIC 14)'. The proposed amendments to IFRIC 14, which may have restricted the Group's ability to recognise a pension asset in respect of pension surpluses in its UK defined benefit plan, are currently on hold with the IASB.

1a. Accounting policies continued

Basis of preparation continued

A number of other new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2019, and have not been applied in preparing these financial statements. None of these is expected to have a material impact on the consolidated financial statements.

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

Intangible assets: Goodwill
Intangible assets: Pre-publication assets
Taxation
Revenue recognition including provisions for returns
Employee benefits: Pensions
Provisions: Onerous leases

Consolidation

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

The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred in the operating expenses line of the income statement. Identifiable assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The determination of fair values often requires significant judgements and the use of estimates, and, for material acquisitions, the fair value of the acquired intangible assets is determined by an independent valuer. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill (see note 30).

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

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

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

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

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

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

4. Joint ventures and associates Joint ventures are entities in which the Group holds an interest on a long-term basis and has rights to the net assets through contractually agreed sharing of control. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Ownership percentage is likely to be the key indicator of investment classification; however, other factors, such as Board representation, may also affect the accounting classification. Judgement is required to assess all of the qualitative and quantitative factors which may indicate that the Group does, or does not, have significant influence over an investment. Penguin Random House is the Group's only material associate – see note 12 for further details on the judgements involved in its accounting classification. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at the fair value of consideration transferred.

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

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

Unrealised gains and losses on transactions between the Group and its joint ventures and associates are eliminated to the extent of the Group's interest in these entities.

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1a. Accounting policies continued

Consolidation continued

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

Foreign currency translation

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

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

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

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

ii) Income and expenses are translated at average exchange rates

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

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

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.34 (2017: $1.30) and the year-end rate was $1.27 (2017: $1.35).

Property, plant and equipment

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

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

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

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

Intangible assets

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

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

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

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

1a. Accounting policies continued

Intangible assets continued

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

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

5. Pre-publication assets Pre-publication assets represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably.

Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating lifecycle of the title, with a higher proportion of the amortisation taken in the earlier years.

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

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

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 33).

Other financial assets

Other financial assets are non-derivative financial assets classified and measured at estimated fair value.

Marketable securities and cash deposits with maturities of greater than three months are classified and subsequently measured at fair value through profit and loss.

They are remeasured at each balance sheet date by using market data and the use of established valuation techniques. Any movement in the fair value is immediately recognised in finance income or finance costs in the income statement.

Investments in the equity instruments of other entities are classified and subsequently measured at fair value through other comprehensive income. Changes in fair value are recorded in equity in the fair value reserve via other comprehensive income. On subsequent disposal of the asset, the net fair value gains or losses are reclassified from the fair value reserve to retained earnings. Any dividends received from equity investments classified as fair value through other comprehensive income are recognised in the P&L unless they represent a return of capital.

Inventories

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

Royalty advances

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

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

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

Cash and cash equivalents

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

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

Notes to the consolidated financial statements

1a. Accounting policies continued

Share capital

Ordinary shares are classified as equity.

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

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

Ordinary shares purchased under a buyback programme are cancelled and the nominal value of the shares is transferred to a capital redemption reserve.

Borrowings

Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. Accrued interest is included as part of borrowings.

Where a debt instrument is in a fair value hedging relationship, an adjustment is made to its carrying value in the income statement to reflect the hedged risk.

Where a debt instrument is in a net investment hedge relationship gains and losses on the effective portion of the hedge are recognised in other comprehensive income.

Derivative financial instruments

Derivatives are recognised at fair value and remeasured at each balance sheet date. The fair value of derivatives is determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

For derivatives in a hedge relationship, the currency basis spread is excluded from the designation as a hedging instrument and is separately accounted for as a cost of hedging, which is recognised in equity in a cost of hedging reserve.

Changes in the fair value of derivatives are recognised immediately in finance income or costs. However, derivatives relating to borrowings and certain foreign exchange contracts are designated as part of a hedging transaction.

The accounting treatment is summarised as follows:

Typical reason for designation	Reporting of gains and losses on effective portion of the hedge	Reporting of gains and losses on disposal
Net investment hedge		
The derivative creates a foreign currency liability which is used to hedge changes in the value of a subsidiary which transacts in that currency.	Recognised in other comprehensive income.	On disposal, the accumulated value of gains and losses reported in other comprehensive income is transferred to the income statement.
Fair value hedges		
The derivative transforms the interest profile on debt from fixed rate to floating rate. Changes in the value of the debt as a result of changes in interest rates are offset by equal and opposite changes in the value of the derivative. When the Group's debt is swapped to floating rates, the contracts used are designated as fair value hedges.	Gains and losses on the derivative are reported in finance income or finance costs. However, an equal and opposite change is made to the carrying value of the debt (a 'fair value adjustment') with the benefit/cost reported in finance income or finance costs. The net result should be a zero charge on a perfectly effective hedge.	If the debt and derivative are disposed of, the value of the derivative and the debt (including the fair value adjustment) are reset to zero. Any resultant gain or loss is recognised in finance income or finance costs.
Non-hedge accounted contracts		
These are not designated as hedging instruments. Typically these are short-term contracts to convert debt back to fixed rates or foreign exchange contracts where a natural offset exists.	No hedge accounting applies.	

Taxation

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

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

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

1a. Accounting policies continued

Taxation continued

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

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises tax provisions when it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are based on management's best judgement of the application of tax legislation and best estimates of future settlement amounts (see note 7). Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred tax assets and liabilities require management judgement and estimation in determining the amounts to be recognised. In particular, when assessing the extent to which deferred tax assets should be recognised, significant judgement is used when considering the timing of the recognition and estimation is used to determine the level of future taxable income together with any future tax planning strategies (see note 13).

Employee benefits

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

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

The determination of the pension cost and defined benefit obligation of the Group's defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth and longevity (see note 25).

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

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

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

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

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

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

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

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. The calculation of onerous lease provisions involves estimates of potential sublet income, lease terms including rent free periods, void periods, lease incentives and running costs.

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

Revenue recognition

The Group's revenue streams are courseware, assessments and services. Courseware includes curriculum materials provided in book form and/or via access to digital content. Assessments includes test development, processing and scoring services provided to governments, educational institutions, corporations and professional bodies. Services includes the operation of schools, colleges and universities, including sistemas in Brazil, as well as the provision of online learning services in partnership with universities and other academic institutions.

Revenue is recognised in order to depict the transfer of control of promised goods and services to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods and services. This process begins with the identification of our contract with a customer, which is generally through a master services agreement, customer purchase order, or a combination thereof. Within each contract, judgement is

Notes to the consolidated financial statements

1a. Accounting policies continued

Revenue recognition continued

applied to determine the extent to which activities within the contract represent distinct performance obligations to be delivered and the total amount of transaction price to which we expect to be entitled.

The transaction price determined is net of sales taxes, rebates and discounts, and after eliminating sales within the Group. Where a contract contains multiple performance obligations such as the provision of supplementary materials or online access with textbooks, revenue is allocated on the basis of relative standalone selling prices. Where a contract contains variable consideration significant estimation is required to determine the amount to which the Group is expected to be entitled.

Revenue is recognised on contracts with customers when or as performance obligations are satisfied which is the period or the point in time where control of goods or services transfer to the customer. Judgement is applied to determine first whether control passes over time and if not, then the point in time at which control passes. Where revenue is recognised over time judgement is used to determine the method which best depicts the transfer of control. Where an input method is used significant estimation is required to determine the progress towards delivering the performance obligation.

Revenue from the sale of books is recognised net of a provision for anticipated returns. This provision is based primarily on historical return rates, customer buying patterns and retailer behaviours including stock levels (see note 22). If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period. When the provision for returns is remeasured at each reporting date to reflect changes in estimates, a corresponding adjustment is also recorded to revenue.

The Group may enter into contracts with another party in addition to our customer. In making the determination as to whether revenue should be recognised on a gross or net basis, the contract with the customer is analysed to understand which party controls the relevant good or service prior to transferring to the customer. This judgement is informed by facts and circumstances of the contract in determining whether the Group has promised to provide the specified good or service or whether the Group is arranging for the transfer of the specified good or service, including which party is responsible for fulfilment, has discretion to set the price to the customer and is responsible for inventory risk. On certain contracts, where the Group acts as an agent, only commissions and fees receivable for services rendered are recognised as revenue. Any third party costs incurred on behalf of the principal that are rechargeable under the contractual arrangement are not included in revenue.

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

The Group has applied IFRS 15 using the cumulative effect method and therefore comparative information has not been restated and continues to be reported under IAS 18 and IAS 11. The details of accounting policies under IAS 18 and IAS 11 are disclosed separately if they are different from those under IFRS 15. A description of the changes impacting the Group as well as a quantitative impact analysis has been disclosed in note 1b.

Additional details on the Group's revenue streams are also included in note 3.

Leases

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

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

Dividends

Final 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 when paid.

Discontinued operations

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of or meets the criteria to be classified as held for sale.

Discontinued operations are presented in the income statement as a separate line and are shown net of tax.

Assets and liabilities held for sale

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

1a. Accounting policies continued

Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts. Following the adoption of IFRS 9 in 2018, provisions for bad and doubtful debts are based on the expected credit loss model. The 'simplified approach' is used with the expected loss allowance measured at an amount equal to the lifetime expected credit losses. In 2017, trade receivables are also stated after provision for anticipated future sales returns (also see Revenue recognition policy and note 1b).

1b. Change of accounting policy: IFRS 15

The Group has adopted IFRS 15 'Revenue from Contracts with Customers' at 1 January 2018 and applied the modified retrospective approach. Comparatives for 2017 have not been restated and the cumulative impact of adoption has been recognised as a decrease to retained earnings with a corresponding decrease in net assets at 1 January 2018 as follows:

All figures in £ millions	2018 1 January
Retained earnings	
Unexercised customer rights (or breakage)	(103)
Online Program Management (OPM) marketing	(38)
Administration fees	(2)
Commissions	1
Income tax	34
Total impact at 1 January 2018	**(108)**
Current assets	
Inventories	12
Trade and other receivables	133
Assets classified as held for sale	31
Non-current liabilities	
Deferred income tax liabilities	16
Current liabilities	
Trade and other liabilities	(215)
Liabilities classified as held for sale	(85)
Total impact at 1 January 2018	**(108)**

IFRS 15 has had an impact on retained earnings in four areas as outlined below. There was no net impact on any associate investments of the Group.

Unexercised customer rights (or breakage): The Group sells rights to future performance to customers which may go unexercised. While the customer has paid for future performance, usage is at the customer's discretion and those rights may expire prior to usage, or never be used. The Group maintains historical customer data to understand usage patterns over time (i.e. redemption rates). Where the Group expects to have no future obligation (based on these redemption rates), revenue has historically been recognised immediately for this portion of the sale. Under IFRS 15, where the Group previously recognised this breakage element on subscriptions, revenue is now recognised evenly over the period of use. Where breakage relates to sales of tests or vouchers, revenue is now recognised when the underlying tests are delivered. This revised treatment in respect of breakage has primarily affected the school and higher education businesses in North America and resulted in higher deferred income at adoption on 1 January 2018.

Online Program Management (OPM) marketing: Historically the OPM business recognised revenue for the pre-semester costs of marketing and recruitment as a separate performance obligation from course delivery during the semester (i.e. revenue was recognised in line with the marketing costs incurred). Under IFRS 15, revenue has been recognised on a straight-line basis over the semester with no revenue recognised up front for pre-semester recruitment and marketing costs based on management's judgement under the new standard's requirements assessing the start of the Group's contract and determining the Group's performance obligations. This revised treatment of pre-semester costs only affects the OPM business in North America and has resulted in a lower contract related asset balance at adoption on 1 January 2018.

Administration fees: This relates to non-refundable up front administration fees charged to customers which do not relate to the transfer of a promised good or service to the customer. Rather these fees are charged to cover internal costs, such as registration fees for testing candidate exams. Historically administration fees have been recognised in revenue up-front when charged. Under IFRS 15, such fees have been deferred and recognised over the period over which services are provided as they do not relate to a specific performance obligation. This revised treatment primarily affects the UK Assessments business and has resulted in higher deferred income at adoption on 1 January 2018.

Commissions: This relates to incremental costs of obtaining customer contracts, such as sales incentive plans or sales commissions specifically linked to obtaining new contracts. Historically such commissions have been charged to the profit and loss account as incurred. Under IFRS 15, sales commissions in respect of customer transactions with an accounting period of greater than one year have been capitalised and amortised over that accounting period, using practical expedients permissible under the new standard. This revised treatment affects the US Assessments business and resulted in a higher contract related asset upon adoption on 1 January 2018.

Notes to the consolidated financial statements

1b. Change of accounting policy: IFRS 15 continued

In addition to the changes above, IFRS 15 also requires that the Group's provision for sales returns is reclassified. This provision was previously netted off in trade receivables and from 1 January 2018 this is now shown in two parts as a separate sales return liability within trade and other liabilities and an inventory returns asset within inventory. The effect on transition was to increase trade and other receivables by £170m, increase trade and other liabilities by £182m and inventory by £12m. In addition, held for sale assets and liabilities were both increased by £13m. The impact of adoption on the results for 2018 is outlined below.

				2018
All figures in £ millions	**Amounts pre IFRS 15**	**Transition adjustment**	**In period adjustment**	**Amounts as reported**
Sales	4,120	–	9	**4,129**
Operating profit	544	–	9	**553**
Profit before tax	489	–	9	**498**
Income tax	94	–	(2)	**92**
Profit for the year	583	–	7	**590**
Other comprehensive income/(expense) for the year	130	–	(6)	**124**
Total comprehensive income for the year	713	–	1	**714**
Current assets				
Inventories	154	12	(2)	**164**
Trade and other receivables	1,058	133	(13)	**1,178**
Assets classified as held for sale	630	31	(13)	**648**
Non-current liabilities				
Deferred income tax liabilities	(154)	16	2	**(136)**
Current liabilities				
Trade and other liabilities	(1,193)	(215)	8	**(1,400)**
Liabilities classified as held for sale	(507)	(85)	19	**(573)**
Net assets	4,632	(108)	1	**4,525**

Had the Group been applying IFRS 15 during 2017, it is estimated that both sales and profit before tax would have been £2m higher for the full year, with the balance sheet impact at the beginning and end of the year being similar.

1c. Change of accounting policy: IFRS 9

The Group adopted IFRS 9 'Financial Instruments' at 1 January 2018 and applied the new rules in accordance with the transitional provisions. Comparatives for 2017 have not been restated. The Group has assessed the impact of adopting IFRS 9 and the only material adjustment is an increase in the provision for losses against trade debtors which was reflected as an adjustment to retained earnings at 1 January 2018 as shown below.

All figures in £ millions	2018 1 January
Retained earnings	
Provision for losses against trade debtors	(13)
Income tax	3
Total impact at 1 January 2018	(10)
Non-current assets	
Deferred income tax assets	3
Current assets	
Trade and other receivables	(12)
Assets classified as held for sale	(1)
Total impact at 1 January 2018	(10)

The adjustment arises from adoption of the expected credit loss model for impairments under IFRS 9. The adoption of this model requires the recognition of impairment provisions based on expected credit losses rather than only incurred credit losses, as is the case under IAS 39. Although there is a transition impact from adoption of the new model there was no material impact on profit before tax for 2018.

Under IFRS 9, the Group's equity financial investments continue to be recognised at fair value and the Group has elected to take the option to recognise all movements in fair value in other comprehensive income (FVOCI). Gains or losses realised on the subsequent sale of these financial assets (FVOCI investments) are no longer recycled through the profit and loss account, but are instead reclassified from the FVOCI reserve to retained earnings. There was one small disposal of these assets during 2018 resulting in a reclassification of a £2m gain.

IFRS 9 also introduced a new, simpler hedge accounting model with a principles-based approach designed to align the accounting result with the economic hedging strategy. The Group previously used fair value hedge relationships to hedge interest rate risk and currency risk on its bond borrowings and also used net investment hedging relationships to hedge currency re-translation risk on its overseas assets. The Group has confirmed that its previous hedge relationships continue to qualify as hedges under IFRS 9 in 2018.

The following table shows the original classification and measurement categories of financial assets and liabilities under IAS 39 and the new classification and measurement categories under IFRS 9 as at 1 January 2018. The effect of adopting IFRS 9 on the carrying amounts of financial assets and liabilities relates solely to the new impairment requirements as shown in the previous table, all other carrying values remained the same.

	Original classification and measurement under IAS 39	New classification and measurement under IFRS 9
Financial assets		
Investments in unlisted securities	Available for sale – fair value	Fair value through OCI
Cash and cash equivalents	Loans and receivables – amortised cost	Financial assets at amortised cost
Marketable securities	Available for sale – fair value	Fair value through profit or loss
Derivative financial instruments used for hedging	Derivatives in a hedge relationship – fair value	Fair value – hedging instrument
Other derivative financial instruments	Held for trading – fair value	Fair value through profit or loss
Trade receivables	Loans and receivables – amortised cost	Financial assets at amortised cost
Financial liabilities		
Derivative financial instruments used for hedging	Derivatives in a hedge relationship – fair value	Fair value – hedging instrument
Other derivative financial instruments	Held for trading – fair value	Fair value through profit or loss
Trade payables	Other liabilities – amortised cost	Other financial liabilities – amortised cost
Liability to purchase own shares	Other liabilities – amortised cost	Other financial liabilities – amortised cost
Bank loans and overdrafts	Other liabilities – amortised cost	Other financial liabilities – amortised cost
Finance lease liabilities	Other liabilities – amortised cost	Other financial liabilities – amortised cost
Bonds	Other liabilities – amortised cost	Other financial liabilities – amortised cost

Notes to the consolidated financial statements

2. Segment information

The primary segments for management and reporting are geographies as outlined below. In addition, the Group separately discloses the results from the Penguin Random House associate.

The chief operating decision-maker is the Pearson executive.

North America Courseware, Assessments and Services businesses in the US and Canada.

Core Courseware, Assessments and Services businesses in more mature markets including UK, Europe, Asia Pacific and North Africa.

Growth Courseware, Assessments and Services businesses in emerging markets including Brazil, India, South Africa, Hispano-America, Hong Kong and China, and the Middle East.

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

							2018
All figures in £ millions	**Notes**	**North America**	**Core**	**Growth**	**Penguin Random House**	**Corporate**	**Group**
Sales		2,784	806	539	–	–	4,129
Adjusted operating profit		362	57	59	68	–	546
Cost of major restructuring		(78)	(16)	–	(8)	–	(102)
Intangible charges		(72)	(8)	(19)	(14)	–	(113)
Other net gains and losses		4	–	226	–	–	230
UK pension GMP equalisation		–	(8)	–	–	–	(8)
Operating profit		216	25	266	46	–	553
Finance costs	6						(91)
Finance income	6						36
Profit before tax							498
Income tax	7						92
Profit for the year							590
Segment assets		4,366	1,975	536	–	636	7,513
Joint ventures	12	–	–	–	–	–	–
Associates	12	–	5	–	387	–	392
Total assets		4,366	1,980	536	387	636	7,905
Other segment items							
Share of results of joint ventures and associates	12	(4)	1	1	46	–	44
Capital expenditure	10, 11	135	25	36	–	–	196
Pre-publication investment	20	234	90	64	–	–	388
Depreciation	10	41	12	13	–	–	66
Amortisation	11, 20	344	92	89	–	–	525

Included in the North America segment above is £60m in pre-publication investment and £67m in amortisation relating to assets held for sale.

2. Segment information continued

All figures in £ millions	Notes	North America	Core	Growth	Penguin Random House	Corporate	Group
							2017
Sales		2,929	815	769	–	–	4,513
Adjusted operating profit		394	50	38	94	–	576
Cost of major restructuring		(60)	(11)	(8)	–	–	(79)
Intangible charges		(89)	(12)	(37)	(28)	–	(166)
Other net gains and losses		(3)	–	35	96	–	128
Impact of US tax reform		–	–	–	(8)	–	(8)
Operating profit		242	27	28	154	–	451
Finance costs	6						(110)
Finance income	6						80
Profit before tax							421
Income tax	7						(13)
Profit for the year							408
Segment assets		4,116	1,914	667	–	793	7,490
Joint ventures	12	–	–	3	–	–	3
Associates	12	4	3	–	388	–	395
Total assets		4,120	1,917	670	388	793	7,888
Other segment items							
Share of results of joint ventures and associates	12	5	1	1	71	–	78
Capital expenditure	10, 11	162	35	43	–	–	240
Pre-publication investment	20	218	84	59	–	–	361
Depreciation	10	56	13	21	–	–	90
Amortisation	11, 20	348	103	110	–	–	561

There were no material inter-segment sales in either 2018 or 2017.

For additional detailed information on the calculation of adjusted operating profit as shown in the above tables, see p222-225 (Financial key performance indicators).

Adjusted operating profit is shown in the above tables as it is the key financial measure used by management to evaluate the performance of the Group and allocate resources to business segments. The measure also enables investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments over time by separating out those items of income and expenditure relating to acquisition and disposal transactions, major restructuring programmes and certain other items that are also not representative of underlying performance, which are explained below and reconciled in note 8.

Cost of major restructuring In May 2017, the Group announced a restructuring programme, to run between 2017 and 2019, to drive significant cost savings. This programme began in the second half of 2017 and net costs incurred were £79m in 2017 and £102m in 2018 and relate to delivery of cost efficiencies in the enabling functions and the US Higher Education Courseware business together with further rationalisation of the property and supplier portfolio. The restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation. Included in the property rationalisation in 2018 is the impact of the consolidation of the Group's property footprint in London which resulted in a charge for onerous leases of £91m partially offset by profit from the sale of property of £81m. The costs of this restructuring programme are significant enough to exclude from the adjusted operating profit measure so as to better highlight the underlying performance (see note 4).

Intangible charges These represent charges in respect of intangible assets acquired through business combinations and the direct costs of acquiring those businesses. These charges are excluded as they reflect past acquisition activity and do not necessarily reflect the current year performance of the Group. Intangible amortisation charges in 2018 were £113m compared to a charge of £166m in 2017.

Other net gains and losses These represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets and are excluded from adjusted operating profit as they distort the performance of the Group as reported on a statutory basis. Other net gains of £230m in 2018 relate to the sale of the Wall Street English language teaching business (WSE), realising a gain of £207m, the disposal of the Group's equity interest in UTEL, the online University partnership in Mexico, realising a gain of £19m, and various other smaller disposal items for a net gain of £4m. Other net gains of £128m in 2017 relate to the sale of the test preparation business in China which resulted in a profit on sale of £44m and the part sale of the Group's share in Penguin Random House which resulted in a profit of £96m and other smaller disposal items for a net loss of £12m (see note 31).

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2. Segment information continued

UK pension GMP equalisation In 2018, also excluded is the impact of adjustments arising from clarification of guaranteed minimum pension (GMP) equalisation legislation in the UK as this relates to historical circumstances (see note 25).

Impact of US tax reform In 2017, as a result of US tax reform, the Group's share of profit from associates was adversely impacted by £8m. This amount was excluded from adjusted operating profit as it is considered to be a transition adjustment that is not expected to recur in the near future.

Corporate costs are allocated to business segments on an appropriate basis depending on the nature of the cost and therefore the total segment result is equal to the Group operating profit.

Segment assets, excluding corporate assets, consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combinations were £nil (2017: £nil) (see note 30).

The Group operates in the following main geographic areas:

	Sales		Non-current assets	
All figures in £ millions	2018	2017	2018	2017
UK	**377**	384	**900**	796
Other European countries	**246**	262	**143**	128
US	**2,627**	2,770	**2,162**	2,247
Canada	**126**	126	**250**	240
Asia Pacific	**455**	643	**146**	151
Other countries	**298**	328	**137**	184
Total	**4,129**	4,513	**3,738**	3,746

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. The geographical split of non-current assets is based on the subsidiary's country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

3. Revenue from contracts with customers

The following tables analyse the Group's revenue streams. Courseware includes curriculum materials provided in book form and/or via access to digital content. Assessments includes test development, processing and scoring services provided to governments, educational institutions, corporations and professional bodies. Services includes the operation of schools, colleges and universities, including sistemas in Brazil as well as the provision of online learning services in partnership with universities and other academic institutions.

All figures in £ millions	North America	Core	Growth	2018 Group
Sales:				
Courseware				
School Courseware	378	172	127	677
Higher Education Courseware	1,042	87	57	1,186
English Courseware	16	58	102	176
	1,436	317	286	2,039
Assessments				
School and Higher Education Assessments	332	247	23	602
Clinical Assessments	140	45	–	185
Professional and English Certification	344	150	64	558
	816	442	87	1,345
Services				
School Services	288	2	47	337
Higher Education Services	244	40	29	313
English Services	–	5	90	95
	532	47	166	745
Total	2,784	806	539	4,129

All figures in £ millions	North America	Core	Growth	2017 Group
Sales:				
Courseware				
School Courseware	394	171	139	704
Higher Education Courseware	1,146	93	63	1,302
English Courseware	20	60	102	182
	1,560	324	304	2,188
Assessments				
School and Higher Education Assessments	355	256	23	634
Clinical Assessments	146	46	–	192
Professional and English Certification	341	138	60	539
	842	440	83	1,365
Services				
School Services	274	5	54	333
Higher Education Services	253	34	32	319
English Services	–	12	296	308
	527	51	382	960
Total	2,929	815	769	4,513

Notes to the consolidated financial statements

3. Revenue from contracts with customers continued

The Group derived revenue for the year to 31 December 2018 from the transfer of goods and services over time and at a point in time in the following major product lines:

All figures in £ millions	North America	Core	Growth	Total
Courseware				
Products transferred at a point in time (sale or return)	718	313	197	**1,228**
Products transferred at a point in time (other)	–	–	35	**35**
Products and services transferred over time	718	4	54	**776**
	1,436	317	286	**2,039**
Assessments				
Products transferred at a point in time	146	65	6	**217**
Products and services transferred over time	670	377	81	**1,128**
	816	442	87	**1,345**
Services				
Products transferred at a point in time	–	26	38	**64**
Products and services transferred over time	532	21	128	**681**
	532	47	166	**745**
Total sales	2,784	806	539	**4,129**

a. Nature of goods and services

The following is a description of the nature of the Group's performance obligations within contracts with customers broken down by revenue stream, along with significant judgements and estimates made within each of those revenue streams.

Courseware

Revenue is generated from customers through the sales of print and digital courseware materials to schools, bookstores, and direct to individual learners. Goods and services may be sold separately or purchased together in bundled packages. The goods and services included in bundled arrangements are considered distinct performance obligations, except for where Pearson provides both a licence of intellectual property and an on-going hosting service. As the licence of intellectual property is only available with the concurrent hosting service, the licence is not treated as a distinct performance obligation separate from the hosting service.

The transaction price is allocated between distinct performance obligations on the basis of their relative standalone selling prices.

In determining the transaction price, variable consideration exists in the form of discounts and anticipated returns. Discounts reduce the transaction price on a given transaction. A provision for anticipated returns is made based primarily on historical return rates, customer buying patterns and retailer behaviours including stock levels (see note 22). If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period. Variable consideration as described above is determined using the expected value approach.

While payment for these goods and services generally occurs at the start of these arrangements, the length of time between payment and delivery of the performance obligations is generally short-term in nature or the reason for early payment relates to reasons other than financing, including customers securing a vendor in a longer-term arrangement or the transfer of goods or services is at the discretion of the customer. For these reasons and the use of the practical expedient on short-term financing, significant financing components are not recognised within Courseware transactions.

Revenue from the sale of physical books is recognised at a point in time when control passes. This is generally at the point of shipment when title passes to the customer, when the Group has a present right to payment and the significant risks and rewards of ownership have passed to the customer. Revenue from physical books sold through the direct print rental method is recognised over the rental period, as the customer is simultaneously receiving and consuming the benefits of this rental service through the passage of time.

Revenue from the sale of digital courseware products is recognised on a straight-line basis over the subscription period, unless hosted by a third party or representative of a downloadable product, in which case Pearson has no on-going obligation and recognises revenue when control transfers as the customer is granted access to the digital product.

Revenue from the sale of 'off-the-shelf' software is recognised on delivery or on installation of the software where that is a condition of the contract. In certain circumstances, where installation is complex, revenue is recognised when the customer has completed their acceptance procedures.

3. Revenue from contracts with customers continued

a. Nature of goods and services continued

Assessments

Revenue is primarily generated from multi-year contractual arrangements related to large-scale assessment delivery, such as contracts to process qualifying tests for individual professions and government departments, and is recognised as performance occurs. Under these arrangements, while the agreement spans for multiple years, the contract duration has been determined to be each testing cycle based on contract structure, including clauses regarding termination. While in some cases the customer may have the ability to terminate during the term for convenience, significant financial or qualitative barriers exist limiting the potential for such terminations in the middle of a testing cycle.

Within each testing cycle, a variety of service activities are performed such as test administration, delivery, scoring, reporting, item development, operational services, and programme management. While each of these service activities is capable of being distinct, they are not treated as distinct in the context of the customer contract as Pearson provides an integrated managed service offering and these activities are accounted for together as one comprehensive performance obligation.

Within each testing cycle, the transaction price may contain both fixed and variable amounts. Variable consideration within these transactions primarily relates to expected testing volumes to be delivered in the cycle. The assumptions, risks and uncertainties inherent to long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Variable consideration is measured using the expected value method, except where amounts are contingent upon a future event's occurrence, such as performance bonuses. Such event-driven contingency payments are measured using the most likely amount approach. To the extent a higher degree of uncertainty exists regarding variable consideration, these amounts are excluded from the transaction price and expensed when the uncertainty is reasonably removed.

Customer payments are generally defined in the contract through a payment schedule, which may require customer acceptance for services rendered. Pearson has a history of providing satisfactory services which are accepted by the customer. While a delay between rendering of services and payment may exist, payment terms are within 12 months and the Group has elected to use the practical expedient available in IFRS 15 and not identify a significant financing component on these transactions.

Revenue is recognised for Assessment contracts over time as the customer is benefiting as performance takes place through a continuous transfer of control to the customer. This continuous transfer of control to the customer is supported by clauses in the contracts which may allow the customer to terminate for convenience, compensate us for work performed to date, and take possession of work in process.

As control transfers over time, revenue is recognised based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgement and is based on the nature of the services provided. Revenue is recognised on a percentage completion basis calculated using the proportion of the total estimated costs incurred to date. Percentage of completion is used to recognise the transfer of control of services provided as these services are not provided evenly throughout the testing cycle and involve varying degrees of effort during the term.

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.

In Assessments contracts driven primarily by transactions directly to end users, Pearson's main obligation to the customer involves test delivery and scoring. Test delivery and scoring are defined as a single performance obligation delivered over time whether the test is subsequently manually scored or digitally scored on the day of the assessment. Customers may also purchase print and digital supplemental materials. Print products in this revenue stream are recognised at a point in time when control passes to the customer upon shipment. Recognition of digital revenue will occur based on the extent of Pearson's on-going hosting obligation.

Services

Revenue is primarily generated from multi-year contractual arrangements related to large-scale educational service delivery to academic institutions, such as schools and higher education universities. Under these arrangements, while an agreement may span for multiple years, the contract duration has been determined to be each academic period based on the structure of contracts, including clauses regarding termination. While in some cases the customer may have the ability to terminate during the term for convenience, significant financial or qualitative barriers exist limiting the potential for such terminations in the middle of an academic period. The academic period for this customer base is normally an academic year for schools and a semester for higher education universities.

Within each academic period, while a variety of services are provided such as programme development, student acquisition, education technology and student support services. While each of these services is capable of being distinct, they are not distinct in the context of the customer contract as Pearson provides an integrated managed service offering and these activities are accounted for together as a comprehensive performance obligation.

Notes to the consolidated financial statements

3. Revenue from contracts with customers continued

a. Nature of goods and services continued

Services continued

Where Services are provided to university customers, volumes and transaction price is fixed at the start of the semester. Where Services are provided to School customers, the transaction price may contain both fixed and variable amounts which require estimation during the academic period. Estimation is required where consideration is based upon average enrolments or other metrics which are not known at the start of the academic year. Variable consideration is measured using the expected value method. To the extent a higher degree of uncertainty exists regarding variable consideration, these amounts are excluded from the transaction price and recognised when the uncertainty is reasonably removed.

Customer payments are generally defined in the contract as occurring shortly after invoicing. Where there is a longer payment term offered to a customer through a payment schedule, payment terms are within 12 months and the Group has elected to use the practical expedient available in IFRS 15 and not identify a significant financing component on these transactions.

Revenue is recognised for Service contracts over time as the customer is benefiting as performance takes place through a continuous transfer of control to the customer. This continuous transfer of control to the customer is supported by clauses in the contracts which may allow the customer to terminate for convenience, compensate us for work performed to date, and take possession of work in process.

As control transfers over time, revenue is recognised based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgement and is based on the nature of the products or services provided. Within the comprehensive service obligation, the timing of services occurs relatively evenly over each academic period and as such, time elapsed is used to recognise the transfer of control to the customer on a straight-line 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.

In cases of optional or add-on purchases, institutions may purchase physical goods priced at their standalone value, which are accounted for separately and recognised at the point in time when control passes to the customer upon shipment.

b. Disaggregation of revenue

The tables in notes 2 and 3 show revenue from contracts with customers disaggregated by operating segment, geography and revenue stream. These disaggregation categories are appropriate as they represent the key groupings used in managing and evaluating underlying performance of each of the businesses. The categories also reflect groups of similar types of transactional characteristics, among similar customers, with similar accounting conclusions.

c. Contract balances

Transactions within the Courseware revenue stream generally entail customer billings at or near the contract's inception and accordingly Courseware deferred income balances are primarily related to subscription performance obligations to be delivered over time.

Transactions within the Assessments and Services revenue streams generally entail customer billings over time based on periodic intervals, progress towards milestones or enrolment census dates. As the performance obligations within these arrangements are delivered over time, the extent of accrued income or deferred income will ultimately depend upon the difference between revenue recognised and billings to date.

Refer to note 22 for opening and closing balances of accrued income. Refer to note 24 for opening and closing balances of deferred income. Revenue recognised during the period from changes in deferred income was driven primarily by the release of revenue over time from digital subscriptions.

d. Contract costs

The Group capitalises incremental costs to obtain contracts with customers where it is expected these costs will be recoverable. Incremental costs to obtain contracts with customers are considered those which would not have been incurred if the contract had not been obtained. For the Group, these costs relate primarily to sales commissions. The Group has elected to use the practical expedient as allowable by IFRS 15 whereby such costs will be expensed as incurred where the expected amortisation period is one year or less. Where the amortisation period is greater than one year, these costs are amortised over the contract term on a systematic basis consistent with the transfer of the underlying goods and services within the contract to which these costs relate, which will generally be on a ratable basis. Impairment of capitalised contract costs was £nil in 2018.

The Group does not recognise any material costs to fulfil contracts with customers as these types of activities are governed by other accounting standards.

Refer to note 22 for further details of opening and closing balances of these costs reflected within deferred contract costs.

3. Revenue from contracts with customers continued

e. Remaining transaction price

The below table depicts the remaining transaction price on unsatisfied or partially unsatisfied performance obligations from contracts with customers as at 31 December 2018.

	Sales	Deferred income	Committed sales	Total remaining transaction price	2019	2020	2021 and later
Courseware							
Products transferred at a point in time (sale or return)	1,228	1	–	1	1	–	–
Products transferred at a point in time (other)	35	–	–	–	–	–	–
Products and services transferred over time	776	679	8	687	272	131	284
Assessments							
Products transferred at a point in time	217	–	–	–	–	–	–
Products and services transferred over time	1,128	196	402	598	420	173	5
Services							
Products transferred at a point in time	64	–	–	–	–	–	–
Products and services transferred over time – subscriptions	310	17	–	17	13	3	1
Products and services transferred over time – other ongoing performance obligations	371	19	145	164	162	1	1
Total	4,129	912	555	1,467	868	308	291

Committed sales amounts are equal to the transaction price from contracts with customers excluding those amounts previously recognised as revenue and amounts currently recognised in deferred income. The total of committed sales and deferred income is equal to the remaining transaction price.

Time bands represented above represent the expected timing of when the remaining transaction price will be recognised as revenue.

4. Operating expenses

All figures in £ millions	2018	2017
By function:		
Cost of goods sold	1,943	2,066
Operating expenses		
Distribution costs	88	84
Selling, marketing and product development costs	759	896
Administrative and other expenses	1,039	1,207
Restructuring costs	90	79
Other income	(69)	(64)
Total net operating expenses	1,907	2,202
Other net gains and losses	(230)	(128)
Total	3,620	4,140

Included in other income is service fee income from Penguin Random House of £3m (2017: £3m). Included in administrative and other expenses are research and efficacy costs of £14m (2017: £14m). In addition to the restructuring costs shown above, there were major restructuring costs in relation to associates of £12m (2017: £nil).

Notes to the consolidated financial statements

4. Operating expenses continued

An analysis of major restructuring costs is as follows:

All figures in £ millions	2018	2017
By nature:		
Product costs	**12**	15
Employee costs	**56**	11
Depreciation and amortisation	**1**	13
Property and facilities	**(5)**	24
Technology and communications	**1**	2
Professional and outsourced services	**9**	12
General and administrative costs	**16**	2
Total restructuring – operating expenses	**90**	79
Share of associate restructuring	**12**	–
Total	**102**	79

The 2017-2019 restructuring programme was announced in May 2017, began in the second half of 2017 and is expected to drive significant cost savings. The costs of this programme have been excluded from adjusted operating profit so as to better highlight the underlying performance (see note 8). In 2018, property and facilities costs include gains on the disposal of properties sold as part of the restructuring programme.

All figures in £ millions	Notes	2018	2017
By nature:			
Royalties expensed		**236**	246
Other product costs		**516**	564
Employee benefit expense	5	**1,637**	1,805
Contract labour		**161**	152
Employee-related expense		**115**	127
Promotional costs		**233**	229
Depreciation of property, plant and equipment	10	**66**	90
Amortisation of intangible assets – pre-publication	20	**338**	338
Amortisation of intangible assets – software	11	**88**	85
Amortisation of intangible assets – other	11	**99**	138
Property and facilities		**147**	202
Technology and communications		**192**	218
Professional and outsourced services		**396**	322
Other general and administrative costs		**85**	140
Costs capitalised to intangible assets		**(390)**	(324)
Other net gains and losses		**(230)**	(128)
Other income		**(69)**	(64)
Total		**3,620**	4,140

4. Operating expenses continued

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

All figures in £ millions	2018	2017
The audit of parent company and consolidated financial statements	4	4
The audit of the company's subsidiaries	2	2
Total audit fees	**6**	6
Audit-related and other assurance services	1	1
Other non-audit services	–	1
Total other services	**1**	2
Total non-audit services	**1**	2
Total	**7**	8

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

All figures in £ millions	2018	2017
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	6	6
Non-audit fees	1	2
Total	**7**	8

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Included in non-audit fees is audit related work in relation to disposal transactions and other assurance work related to the audit of the Group's efficacy programme.

5. Employee information

All figures in £ millions	Notes	2018	2017
Employee benefit expense			
Wages and salaries (including termination costs)		1,421	1,567
Social security costs		112	130
Share-based payment costs	26	37	33
Retirement benefits – defined contribution plans	25	56	57
Retirement benefits – defined benefit plans	25	23	19
Other post-retirement medical benefits	25	(12)	(1)
Total		**1,637**	1,805

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

Average number employed	2018	2017
Employee numbers		
North America	14,113	16,295
Core	5,192	5,291
Growth	4,521	8,268
Other	496	485
Total	**24,322**	30,339

Notes to the consolidated financial statements

6. Net finance costs

All figures in £ millions	Notes	2018	2017
Interest payable on financial liabilities at amortised cost and associated derivatives		**(42)**	(99)
Net foreign exchange losses		**(36)**	–
Finance costs associated with transactions		**(1)**	(6)
Derivatives not in a hedge relationship		**(7)**	(5)
Derivatives in a hedge relationship		**(5)**	–
Finance costs		**(91)**	(110)
Interest receivable on financial assets at amortised cost		**18**	20
Net finance income in respect of retirement benefits	25	**11**	3
Net foreign exchange gains		**–**	44
Derivatives not in a hedge relationship		**6**	12
Derivatives in a hedge relationship		**1**	1
Finance income		**36**	80
Net finance costs		**(55)**	(30)
Analysed as:			
Net interest payable reflected in adjusted earnings		**(24)**	(79)
Other net finance income/(costs)		**(31)**	49
Total net finance costs		**(55)**	(30)

Included in interest receivable is £1m (2017: £1m) of interest receivable from related parties. There was a net movement of £nil on fair value hedges in 2018 (2017: £1m), comprising a gain of £4m (2017: gain of £37m) on the underlying bonds, offset by a loss of £4m (2017: loss of £36m) on the related derivative financial instruments.

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

7. Income tax

All figures in £ millions	Notes	2018	2017
Current tax			
Credit/(charge) in respect of current year		**92**	(121)
Adjustments in respect of prior years		**34**	(2)
Total current tax credit/(charge)		**126**	(123)
Deferred tax			
In respect of temporary differences		**(6)**	96
Other adjustments in respect of prior years		**(28)**	14
Total deferred tax (charge)/credit	13	**(34)**	110
Total tax credit/(charge)		**92**	(13)

The adjustments in respect of prior years in both 2018 and 2017 primarily arise from revising the previous year's reported tax provision to reflect the tax returns subsequently filed. This results in a change between deferred and current tax as well as an absolute benefit to the total tax charge.

7. Income tax continued

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

All figures in £ millions	2018	2017
Profit before tax	**498**	421
Tax calculated at UK rate (2018: 19%, 2017: 19.25%)	**(94)**	(81)
Effect of overseas tax rates	**(28)**	15
Joint venture and associate income reported net of tax	**8**	15
Intra-group financing benefit	**25**	26
Movement in provisions for tax uncertainties	**111**	49
Impact of US tax reform	**–**	(1)
Net expense not subject to tax	**(29)**	(39)
Benefit from change in US tax accounting treatment	**25**	–
Gains and losses on sale of businesses not subject to tax	**77**	8
Utilisation of previously unrecognised tax losses and credits	**–**	(1)
Unrecognised tax losses	**(9)**	(16)
Adjustments in respect of prior years	**6**	12
Total tax credit/(charge)	**92**	(13)
UK	**37**	(36)
Overseas	**55**	23
Total tax credit/(charge)	**92**	(13)
Tax rate reflected in earnings	**(18.5)%**	3.1%

Included in net expense not subject to tax are foreign taxes not creditable, the tax impact of share-based payments and other expenses not deductible.

Factors which may affect future tax charges include changes in tax legislation, transfer pricing regulations, the level and mix of profitability in different countries, and settlements with tax authorities.

The movement in provisions for tax uncertainties primarily reflects releases due to the expiry of relevant statutes of limitation and the reassessment of historical tax positions. The current tax liability of £72m (2017: £231m) includes £181m (2017: £280m) of provisions for tax uncertainties principally in respect of a number of issues in the US, the UK and China. The issues provided for include the allocation between territories of proceeds of historical business disposals and the potential disallowance of intra-group recharges. The Group is currently under audit in a number of countries, and the timing of any resolution of these audits is uncertain. Of the balance of £181m, £57m relates to 2014 and earlier and is mostly under audit. In most countries tax years up to and including 2014 are now statute barred from examination by tax authorities. Of the remaining balance, £66m relates to 2015, £29m to 2016, £23m to 2017 and £6m to 2018. If relevant enquiry windows pass with no audit, management believes it is reasonably possible that provision levels will reduce by an estimated £50m within the next 12 months. However the tax authorities may take a different view from management and the final liability may be greater than provided. For items currently under audit if tax authorities are successful, liabilities could increase by £25m (2017: £25m).

Notes to the consolidated financial statements

7. Income tax continued

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

All figures in £ millions	2018	2017
Profit before tax	**498**	421
Adjustments:		
Cost of major restructuring	**102**	79
Other net gains and losses	**(230)**	(128)
Intangible charges	**113**	166
Other net finance costs/(income)	**31**	(49)
UK pension GMP equalisation	**8**	–
Impact of US tax reform	–	8
Adjusted profit before tax	**522**	497
Total tax credit/(charge)	**92**	(13)
Adjustments:		
Tax benefit on cost of major restructuring	**(37)**	(26)
Tax (benefit)/charge on other net gains and losses	**(31)**	20
Tax benefit on intangible charges	**(18)**	(85)
Tax (benefit)/charge on other net finance (income)/costs	**(6)**	9
Tax benefit on UK pension GMP equalisation	**(2)**	–
Impact of US tax reform	–	1
Tax amortisation benefit on goodwill and intangibles	**29**	39
Adjusted income tax credit/(charge)	**27**	(55)
Tax rate reflected in adjusted earnings	**(5.2)%**	11.1%

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

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

All figures in £ millions	2018	2017
Net exchange differences on translation of foreign operations	**(4)**	9
Fair value gain on other financial assets	–	(4)
Remeasurement of retirement benefit obligations	**9**	(42)
	5	(37)

8. Earnings per share

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares.

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares.

All figures in £ millions	2018	2017
Earnings for the year	**590**	408
Non-controlling interest	**(2)**	(2)
Earnings attributable to equity holders of the company	**588**	406
Weighted average number of shares (millions)	**778.1**	813.4
Effect of dilutive share options (millions)	**0.6**	0.3
Weighted average number of shares (millions) for diluted earnings	**778.7**	813.7
Earnings per share		
Basic	**75.6p**	49.9p
Diluted	**75.5p**	49.9p

Adjusted

For additional detailed information on the calculation of adjusted measures, see p222-225 (Financial key performance indicators). See note 2 for details of specific items excluded from or included in adjusted operating profit in 2018 and 2017.

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

Adjusted earnings is a non-GAAP (non-statutory) financial measure and is included as it is a key financial measure used by management to evaluate the performance of the Group and allocate resources to business segments. The measure also enables investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments over time by separating out those items of income and expenditure relating to acquisition and disposal transactions, major restructuring programmes and certain other items that are also not representative of underlying performance.

Adjusted earnings per share is calculated as adjusted earnings divided by the weighted average number of shares in issue on an undiluted basis. The following items are excluded from or included in adjusted earnings:

Cost of major restructuring In May 2017, the Group announced a restructuring programme, to run between 2017 and 2019, to drive significant cost savings. This programme began in the second half of 2017 and net costs incurred were £79m in 2017 and £102m in 2018 and relate to delivery of cost efficiencies in the enabling functions and the US Higher Education Courseware business together with further rationalisation of the property and supplier portfolio. The restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation. Included in the property rationalisation in 2018 is the impact of the consolidation of the Group's property footprint in London which resulted in a charge for onerous leases of £91m partially offset by profit from the sale of property of £81m. The costs of this restructuring programme are significant enough to exclude from the adjusted operating profit measure so as to better highlight the underlying performance (see note 4).

Other net gains and losses These represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets and are excluded from adjusted earnings as they distort the performance of the Group as reported on a statutory basis.

Intangible charges These represent charges in respect of intangible assets acquired through business combinations and the direct costs of acquiring those businesses. These charges are excluded as they reflect past acquisition activity and do not necessarily reflect the current year performance of the Group. Intangible amortisation charges in 2018 were £113m compared to a charge of £166m in 2017.

Other net finance income/costs These include finance costs in respect of retirement benefits, finance costs of deferred consideration and foreign exchange and other gains and losses. Finance income relating to retirement benefits is excluded as management does not believe that the consolidated income statement presentation under IAS 19 reflects the economic substance of the underlying assets and liabilities. Finance costs associated with transactions are excluded as these relate to future earn-outs or acquisition expenses and are not part of the underlying financing. Foreign exchange and other gains and losses are excluded as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity. In 2018 and 2017, the foreign exchange gains and losses largely relate to foreign exchange differences on unhedged US dollar and euro loans, cash and cash equivalents.

Notes to the consolidated financial statements

8. Earnings per share continued

Adjusted continued

UK pension GMP equalisation In 2018, also excluded is the impact of adjustments arising from clarification of guaranteed minimum pension (GMP) equalisation legislation in the UK as this relates to historical circumstances (see note 25).

Impact of US tax reform In 2017, as a result of US tax reform, the Group's share of profit from associates was adversely impacted by £8m. This amount was excluded from adjusted earnings as it is considered to be a transition adjustment that is not expected to recur in the near future.

Tax Tax on the above items is excluded from adjusted earnings. Where relevant the Group also excludes the benefit from recognising previously unrecognised pre-acquisition and capital losses. As a result of US tax reform in 2017, the reported tax charge on a statutory basis includes a benefit from the revaluation of deferred tax balances to the reduced federal rate of £5m and a repatriation tax charge of £6m. This amount has been excluded from adjusted earnings as it is considered to be a transition adjustment that is not expected to recur in the near future. The tax benefit from tax deductible goodwill and intangibles is added to the adjusted income tax charge as this benefit more accurately aligns the adjusted tax charge with the expected rate of cash tax payments.

Non-controlling interest Non-controlling interest for the above items is excluded from adjusted earnings.

The following tables reconcile the statutory income statement to the adjusted income statement.

								2018
All figures in £ millions	Statutory income statement	Cost of major restructuring	Other net gains and losses	Intangible charges	Other net finance income/costs	UK pension GMP equalisation	Tax amortisation benefit	Adjusted income statement
Operating profit	553	102	(230)	113	–	8	–	546
Net finance costs	(55)	–	–	–	31	–	–	(24)
Profit before tax	498	102	(230)	113	31	8	–	522
Income tax	92	(37)	(31)	(18)	(6)	(2)	29	27
Profit for the year	590	65	(261)	95	25	6	29	549
Non-controlling interest	(2)	–	–	–	–	–	–	(2)
Earnings	588	65	(261)	95	25	6	29	547
Weighted average number of shares (millions)	778.1							778.1
Weighted average number of shares (millions) for diluted earnings	778.7							778.7
Earnings per share (basic)	75.6p							70.3p
Earnings per share (diluted)	75.5p							70.2p

								2017
All figures in £ millions	Statutory income statement	Cost of major restructuring	Other net gains and losses	Intangible charges	Other net finance income/costs	Impact of US tax reform	Tax amortisation benefit	Adjusted income statement
Operating profit	451	79	(128)	166	–	8	–	576
Net finance costs	(30)	–	–	–	(49)	–	–	(79)
Profit before tax	421	79	(128)	166	(49)	8	–	497
Income tax	(13)	(26)	20	(85)	9	1	39	(55)
Profit for the year	408	53	(108)	81	(40)	9	39	442
Non-controlling interest	(2)	–	–	–	–	–	–	(2)
Earnings	406	53	(108)	81	(40)	9	39	440
Weighted average number of shares (millions)	813.4							813.4
Weighted average number of shares (millions) for diluted earnings	813.7							813.7
Earnings per share (basic)	49.9p							54.1p
Earnings per share (diluted)	49.9p							54.1p

9. Dividends

All figures in £ millions	2018	2017
Final paid in respect of prior year 12.0p (2017: 34.0p)	93	277
Interim paid in respect of current year 5.5p (2017: 5.0p)	43	41
	136	318

The Directors are proposing a final dividend in respect of the financial year ended 31 December 2018 of 13.0p per share which will absorb an estimated £102m of shareholders' funds. It will be paid on 10 May 2019 to shareholders who are on the register of members on 5 April 2019. These financial statements do not reflect this dividend.

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2017	398	560	20	978
Exchange differences	(20)	(29)	(2)	(51)
Additions	26	40	24	90
Disposals	(13)	(34)	–	(47)
Disposal through business disposal	(11)	(5)	–	(16)
Reclassifications	5	8	(13)	–
Transfer to intangible assets	–	(11)	–	(11)
Transfer to assets classified as held for sale	(55)	(2)	–	(57)
At 31 December 2017	330	527	29	886
Exchange differences	11	14	1	26
Additions	32	22	12	66
Disposals	(75)	(97)	–	(172)
Reclassifications	19	(8)	(11)	–
Transfer to intangible assets	–	–	(11)	(11)
Transfer to intangible assets – pre-publication	–	–	(2)	(2)
At 31 December 2018	317	458	18	793

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2017	(229)	(406)	–	(635)
Exchange differences	12	23	–	35
Charge for the year	(35)	(55)	–	(90)
Disposals	9	26	–	35
Disposal through business disposal	6	3	–	9
Transfer to assets classified as held for sale	40	1	–	41
At 31 December 2017	(197)	(408)	–	(605)
Exchange differences	(5)	(11)	–	(16)
Charge for the year	(20)	(46)	–	(66)
Disposals	34	97	–	131
Reclassifications	(7)	7	–	–
At 31 December 2018	(195)	(361)	–	(556)
Carrying amounts				
At 1 January 2017	169	154	20	343
At 31 December 2017	133	119	29	281
At 31 December 2018	122	97	18	237

Notes to the consolidated financial statements

10. Property, plant and equipment continued

Depreciation expense of £18m (2017: £23m) has been included in the income statement in cost of goods sold and £48m (2017: £67m) in operating expenses.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £7m (2017: £9m).

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2017	2,341	798	974	353	211	600	5,277
Exchange differences	(148)	(46)	(74)	(26)	(6)	(50)	(350)
Additions – internal development	–	133	–	–	–	–	133
Additions – purchased	–	17	–	–	–	–	17
Disposals	–	(23)	–	–	–	–	(23)
Disposal through business disposal	–	(4)	(9)	(19)	–	(27)	(59)
Transfer from property, plant and equipment	–	11	–	–	–	–	11
Transfer to assets classified as held for sale	(163)	(4)	(2)	(27)	(21)	(34)	(251)
At 31 December 2017	2,030	882	889	281	184	489	4,755
Exchange differences	**74**	**32**	**39**	**(2)**	**–**	**1**	**144**
Additions – internal development	**–**	**124**	**–**	**–**	**–**	**–**	**124**
Additions – purchased	**–**	**6**	**–**	**–**	**–**	**–**	**6**
Disposals	**–**	**(94)**	**(18)**	**(12)**	**–**	**(33)**	**(157)**
Disposal through business disposal	**–**	**(2)**	**–**	**–**	**–**	**–**	**(2)**
Transfer from property, plant and equipment	**–**	**11**	**–**	**–**	**–**	**–**	**11**
Transfer from assets classified as held for sale	**7**	**–**	**–**	**–**	**–**	**–**	**7**
At 31 December 2018	**2,111**	**959**	**910**	**267**	**184**	**457**	**4,888**

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2017	–	(461)	(555)	(209)	(198)	(412)	(1,835)
Exchange differences	–	30	43	13	4	36	126
Charge for the year	–	(85)	(77)	(18)	(3)	(40)	(223)
Disposals	–	21	–	–	–	–	21
Disposal through business disposal	–	2	8	18	–	22	50
Transfer to assets classified as held for sale	–	–	1	16	19	34	70
At 31 December 2017	–	(493)	(580)	(180)	(178)	(360)	(1,791)
Exchange differences	**–**	**(23)**	**(26)**	**1**	**2**	**(10)**	**(56)**
Charge for the year	**–**	**(88)**	**(59)**	**(14)**	**(2)**	**(24)**	**(187)**
Disposals	**–**	**92**	**18**	**12**	**–**	**33**	**155**
Disposal through business disposal	**–**	**–**	**–**	**–**	–	**–**	**–**
At 31 December 2018	**–**	**(512)**	**(647)**	**(181)**	**(178)**	**(361)**	**(1,879)**
Carrying amounts							
At 1 January 2017	2,341	337	419	144	13	188	3,442
At 31 December 2017	2,030	389	309	101	6	129	2,964
At 31 December 2018	**2,111**	**447**	**263**	**86**	**6**	**96**	**3,009**

Goodwill

The goodwill carrying value of £2,111m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002, no value was ascribed to intangibles other than goodwill which was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated, then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003, value has been ascribed to other intangible assets which are amortised.

Other intangible assets

Other intangibles acquired include content, technology and software rights.

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

Amortisation of £18m (2017: £17m) is included in the income statement in cost of goods sold and £169m (2017: £206m) in operating expenses.

Notes to the consolidated financial statements

11. Intangible assets continued

Other intangible assets continued

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

Class of intangible asset	2018 Useful economic life
Acquired customer lists, contracts and relationships	3-20 years
Acquired trademarks and brands	2-20 years
Acquired publishing rights	5-20 years
Other intangibles acquired	2-20 years

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

All figures in £ millions	2018 One to five years	Six to ten years	More than ten years	Total
Class of intangible asset				
Acquired customer lists, contracts and relationships	187	66	10	263
Acquired trademarks and brands	49	27	10	86
Acquired publishing rights	5	1	–	6
Other intangibles acquired	77	19	–	96

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

Impairment tests have been carried out where appropriate as described below. Goodwill was allocated to CGUs, or an aggregation of CGUs, where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs (including Growth given the recent write down of goodwill). The recoverable amount for each unit exceeds its carrying value, therefore there is no impairment in 2018. The carrying value of the goodwill in each of the CGUs is summarised below:

All figures in £ millions	2018	2017
North America	930	1,013
Core	701	641
Growth (includes Brazil, China, India and South Africa)	–	–
Pearson VUE	480	376
Total	2,111	2,030

The recoverable amount of each aggregated CGU is based on fair value less costs of disposal. Goodwill is tested at least annually for impairment. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

11. Intangible assets continued

Key assumptions

For the purpose of estimating the fair value less costs of disposal of the CGUs, management has used an income approach based on present value techniques. The calculations use cash flow projections based on financial budgets approved by management covering a five-year period, management's best estimate about future developments and market assumptions. The fair value less costs of disposal measurement is categorised as Level 3 on the fair value hierarchy. The key assumptions used by management in the fair value less costs of disposal calculations were:

Discount rates The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average post-tax discount rates range from 7.9% to 15.8%. Discount rates are lower for those businesses which operate in more mature markets with low inflation and higher for those operating in emerging markets with higher inflation.

Perpetuity growth rates A perpetuity growth rate of 2.0% was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historical growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 3.0% and 6.5% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historical growth rates in these markets.

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

Forecast sales growth rates Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key assumptions include growth in Online Program Management, Virtual Schools and Professional Certification, stabilisation in UK Qualifications and US Assessments, and ongoing pressures in the US Higher Education Courseware market. The five-year sales forecasts use average nominal growth rates between 2% and 3% for mature markets and between (1)% and 12% for emerging markets with high inflation.

Operating profits Operating profits are forecast based on historical experience of operating margins, adjusted for the impact of changes to product costs and cost-saving initiatives, including the impact of the implementation of our cost efficiency programme.

Cash conversion Cash conversion is the ratio of operating cash flow to operating profit. Management forecasts cash conversion rates based on historical experience.

Sensitivities

Impairment testing for the year ended 31 December 2018 has identified the following CGUs, or groups of CGUs, as being sensitive to changes in assumptions. The table below shows the headroom at 31 December 2018 and the cumulative impact of changes in the assumptions used in calculating the fair value.

All figures in £ millions	Headroom at 31 December 2018	1% increase in average discount rate	5% decrease in annual contribution	10% decrease in annual contribution	1% decrease in perpetuity growth rate
Headroom/(impairment)					
North America	356	128	27	(301)	167
Core	210	67	84	(42)	83
Brazil	20	(8)	3	(14)	(4)

The above analysis is performed at the exchange rates used in the Group's strategic planning process. CGU contribution excludes fixed costs and corporate overheads. The goodwill related to the Brazil CGU was fully impaired in prior years, and the intangibles related to the Brazil CGU are amortised over their useful economic life.

Notes to the consolidated financial statements

12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2018	2017
Associates	**392**	395
Joint ventures	–	3
Total	**392**	398

The amounts recognised in the income statement are as follows:

All figures in £ millions	2018	2017
Associates	**43**	77
Joint ventures	**1**	1
Total	**44**	78

Investment in associates

The Group has the following material associates:

	Principal place of business	Ownership interest	Nature of relationship	Measurement method
Penguin Random House Ltd	UK/Global	25%	See below	Equity
Penguin Random House LLC	US	25%	See below	Equity

On 1 July 2013, Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. On 5 October 2017, Pearson sold a 22% stake in Penguin Random House to Bertelsmann, retaining a 25% share. Pearson owns its 25% interest in Penguin Random House via 25% interests in each of the two entities listed in the table above. Despite the separate legal structures of the two Penguin Random House entities, Pearson regards Penguin Random House as one combined global business. Consequently, Pearson discloses Penguin Random House as one single operating segment and presents disclosures related to its interests in Penguin Random House on a combined basis.

The shareholder agreement includes protective rights for Pearson as the minority shareholder, including rights to dividends. Management considers ownership percentage, Board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over Penguin Random House and Bertelsmann has the power to direct the relevant activities and therefore control. Following the transaction in 2017 the assessment of significant influence has not changed. Penguin Random House does not have a quoted market price.

12. Investments in joint ventures and associates continued

Investment in associates continued

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

All figures in £ millions	2018 Penguin Random House	2017 Penguin Random House
Assets		
Non-current assets	**1,043**	1,048
Current assets	**1,929**	1,758
Liabilities		
Non-current liabilities	**(1,104)**	(859)
Current liabilities	**(1,546)**	(1,579)
Net assets	**322**	368
Sales	**2,775**	2,693
Profit for the year	**185**	171
Other comprehensive income/(expense)	**13**	(60)
Total comprehensive income	**198**	111
Dividends received from associate in relation to profits	**67**	146
Re-capitalisation dividends received from associate	**50**	312

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

A reconciliation of the summarised financial information to the carrying value of the material associate is shown below:

All figures in £ millions	2018 Penguin Random House	2017 Penguin Random House
Opening net assets	**368**	1,386
Exchange differences	**18**	(18)
Profit for the year	**185**	171
Other comprehensive income /(expense)	**13**	(60)
Dividends, net of tax paid	**(262)**	(1,167)
Tax adjustments in relation to disposals	**–**	56
Closing net assets	**322**	368
Share of net assets	**80**	92
Goodwill	**307**	296
Carrying value of associate	**387**	388

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2018	2017
(Loss)/profit for the year	**(3)**	7
Total comprehensive (expense)/income	**(3)**	7

Notes to the consolidated financial statements

12. Investments in joint ventures and associates continued

Transactions with material associates

From time to time the Group loans funds to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2018 was £nil (2017: £46m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2017 was repaid in its entirety in January 2018.

The Group also has a current asset receivable of £17m (2017: £19m) from Penguin Random House and a current liability payable of £nil (2017: £3m) arising from the provision of services. Included in other income (note 4) is £3m (2017: £3m) of service fees. In addition, the Group received a further re-capitalisation dividend of £50m in April 2018, which was triggered by the Group's decision to sell a 22% stake in Penguin Random House in 2017.

Investment in joint ventures

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

All figures in £ millions	2018	2017
Profit for the year	**1**	1
Total comprehensive income	**1**	1

13. Deferred income tax

All figures in £ millions	2018	2017
Deferred income tax assets	**60**	95
Deferred income tax liabilities	**(136)**	(164)
Net deferred income tax	**(76)**	(69)

Substantially all of the deferred income tax assets are expected to be recovered after more than one year.

Deferred income tax assets and liabilities shall be offset when there is a legally enforceable right to offset current income tax assets with current income tax liabilities and where the deferred income taxes relate to the same fiscal authority. At 31 December 2018, the Group has unrecognised deferred income tax assets of £31m (2017: £32m) in respect of UK losses, £28m (2017: £18m) in respect of US losses and approximately £90m (2017: £86m) in respect of losses in other territories. The UK losses are capital losses. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years. Other deferred tax assets of £12m (2017: £12m) have not been recognised.

Deferred tax assets of £43m (2017: £75m) have been recognised in countries that reported a tax loss in either the current or preceding year. The majority arises in Brazil in respect of tax deductible goodwill. It is considered more likely than not that there will be sufficient future taxable profits to realise these assets.

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

13. Deferred income tax continued

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

All figures in £ millions	Trading losses	Returns provisions	Retirement benefit obligations	Deferred revenue	Goodwill and intangibles	Other	Total
Deferred income tax assets/(liabilities)							
At 1 January 2017	22	35	37	117	(295)	69	(15)
Exchange differences	(2)	(3)	(4)	(8)	19	(8)	(6)
Income statement (charge)/benefit	(11)	6	7	(9)	118	(1)	110
Disposal through business disposal	–	–	–	–	–	(3)	(3)
Tax benefit in other comprehensive income	–	–	(84)	–	–	(5)	(89)
Transfer to assets/(liabilities) classified as held for sale	–	(4)	–	(73)	3	8	(66)
At 31 December 2017	9	34	(44)	27	(155)	60	(69)
Adjustment on initial application of IFRS 15 (see note 1b)	–	–	–	15	–	1	16
Adjustment on initial application of IFRS 9 (see note 1c)	–	–	–	–	–	3	3
Exchange differences	–	1	1	6	(16)	(5)	(13)
Income statement (charge)/benefit	11	(4)	(21)	20	(34)	(14)	(42)
Disposal through business disposal	–	–	–	–	–	16	16
Tax charge in other comprehensive income	–	–	9	–	–	–	9
Tax charge in equity	–	–	–	–	–	4	4
At 31 December 2018	20	31	(55)	68	(205)	65	(76)

Other deferred income tax items include temporary differences in respect of share-based payments, provisions, depreciation and royalty advances.

In addition, £98m (2017: £68m asset and £2m liability) of deferred income tax assets are included in assets classified as held for sale with a charge of £8m in 2018 relating to assets and liabilities held for sale.

14. Classification of financial instruments

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

		2018					2017				
		Fair value			Amortised cost		Fair value			Amortised cost	
All figures in £ millions	Notes	FVOCI	FVTPL	Fair value – hedging instrument	Financial assets	Total carrying value	Available for sale	Derivatives held for trading	Derivatives in hedge relationship	Loans and receivables	Total carrying value
Investments in unlisted securities	15	93	–	–	–	93	77	–	–	–	77
Cash and cash equivalents	17	–	–	–	568	568	–	–	–	518	518
Cash and cash equivalents – within assets classified as held for sale	32	–	–	–	–	–	–	–	–	127	127
Marketable securities		–	–	–	–	–	8	–	–	–	8
Derivative financial instruments	16	–	4	64	–	68	–	3	137	–	140
Trade receivables	22	–	–	–	904	904	–	–	–	760	760
Trade receivables – within assets classified as held for sale		–	–	–	49	49	–	–	–	22	22
Total financial assets		93	4	64	1,521	1,682	85	3	137	1,427	1,652

The carrying value of the Group's financial assets is equal to, or approximately equal to, the market value. Following the adoption of IFRS 9 in 2018 the terminology used to describe financial assets has been changed (see note 1c).

Notes to the consolidated financial statements

14. Classification of financial instruments continued

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

All figures in £ millions	Notes	2018 FVTPL	2018 Fair value – hedging instrument	2018 Amortised cost – Other financial liabilities	2018 Total carrying value	2018 Total market value	2017 Fair value – Derivatives held for trading	2017 Fair value – Derivatives in hedge relationship	2017 Amortised cost – Other liabilities	2017 Total carrying value	2017 Total market value
Derivative financial instruments	16	–	(59)	–	(59)	(59)	–	(140)	–	(140)	(140)
Trade payables	24	–	–	(311)	(311)	(311)	–	–	(265)	(265)	(265)
Trade payables – within liabilities classified as held for sale		–	–	(22)	(22)	(22)	–	–	(20)	(20)	(20)
Liability to purchase own shares	24	–	–	–	–	–	–	–	(151)	(151)	(151)
Bank loans and overdrafts	18	–	–	(43)	(43)	(43)	–	–	(15)	(15)	(15)
Other borrowings due within one year	18	–	–	(3)	(3)	(3)	–	–	(4)	(4)	(4)
Borrowings due after more than one year	18	–	–	(674)	(674)	(663)	–	–	(1,066)	(1,066)	(1,070)
Total financial liabilities		–	(59)	(1,053)	(1,112)	(1,101)	–	(140)	(1,521)	(1,661)	(1,665)

Following the adoption of IFRS 9 in 2018 the terminology used to describe financial liabilities has been changed (see note 1c).

Fair value measurement

As shown above, the Group's derivative assets and liabilities, unlisted securities and marketable securities are held at fair value. Financial instruments that are measured subsequently to initial recognition at fair value are grouped into levels 1 to 3, based on the degree to which the fair value is observable, as follows:

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

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

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

The Group's derivative assets valued at £68m (2017: £140m) and derivative liabilities valued at £59m (2017: £140m) are classified as level 2. The Group's marketable securities valued at £nil (2017: £8m) are classified as level 2. The Group's investments in unlisted securities are valued at £93m (2017: £77m) and are classified as level 3.

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

All figures in £ millions	2018 Investments in unlisted securities	2017 Investments in unlisted securities
At beginning of year	77	65
Exchange differences	4	(4)
Acquisition of investments	13	3
Fair value movements	7	13
Disposal of investments	(8)	–
At end of year	93	77

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset, recent funding rounds and amounts realised on the sale of similar assets.

15. Other financial assets

All figures in £ millions	2018	2017
At beginning of year	77	65
Exchange differences	4	(4)
Acquisition of investments	13	3
Fair value movements	7	13
Disposal of investments	(8)	–
At end of year	**93**	77

Other financial assets comprise unlisted securities of £93m (2017: £77m) that are classified at fair value through other comprehensive income (FVOCI). The assets, which are not held for trading, relate to the Group's interests in new and innovative educational ventures across the world. These are strategic investments and the Group considers the classification as FVOCI to be more relevant. None of the investments are individually significant to the financial statements. In 2018, equities held at a fair value of £8m (2017: £nil) were disposed. The cumulative gain on disposal was £nil and £2m was recycled from the fair value reserve to retained earnings.

16. Derivative financial instruments and hedge accounting

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

			2018			2017
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	404	13	–	799	23	–
Interest rate derivatives – not in a hedge relationship	362	3	–	429	3	–
Cross-currency rate derivatives – in a hedge relationship	577	51	(35)	1,522	114	(140)
FX forwards and collars – in a hedge relationship	434	–	(24)	–	–	–
Other derivatives – not in a hedge relationship	473	1	–	–	–	–
Total	**2,250**	**68**	**(59)**	2,750	140	(140)
Analysed as expiring:						
In less than one year	771	1	(23)	–	–	–
Later than one year and not later than five years	795	22	(1)	1,638	65	(95)
Later than five years	684	45	(35)	1,112	75	(45)
Total	**2,250**	**68**	**(59)**	2,750	140	(140)

The Group's fixed rate USD debt is held as fixed rate instruments at amortised cost.

The majority of the Group's fixed rate euro debt is converted to a floating rate exposure using interest rate and cross-currency swaps. The Group receives interest under its euro debt related swap contracts to match the interest on the bonds (ranging from a receipt of 1.375% on its euro 2025 notes to 1.875% on its euro 2021 notes) and, in turn, pays either a floating US dollar or sterling variable rates of GBP Libor + 0.81% and US Libor + 1.36%.

GBP and USD Interest rate swaps are subsequently used to fix an element of the interest charge. The all-in rates (including the spread above Libor) that the Group pays are between 2.2% and 3.8%. At 31 December 2018, the Group had interest rate swap contracts to fix £361m of debt and a further £256m of outstanding fixed rate bonds bringing the total fixed rate debt to £617m. These pay fixed interest rate derivatives are not in designated hedging relationships. Additionally the group uses FX derivatives including forwards, collars and cross currency swaps to create synthetic USD debt as a hedge of its USD assets and to achieve certainty of USD currency conversion rates, in line with the Group's FX hedging policy. Outstanding contracts as at 31 December 2018 were held at an average GBP/USD rate of 1.39. These derivatives are in designated net investment hedging relationships. Outstanding contracts on the cross currency swaps at 31 December 2018 were held at an average EUR/GBP rate of 0.79. These derivatives are in designated fair value hedging relationships.

At the end of 2018, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross currency rate derivatives, was US dollar £(185)m, sterling (215)m and euro £432m (2017: US dollar £(869)m, sterling £12m and euro £857m).

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

Notes to the consolidated financial statements

16. Derivative financial instruments and hedge accounting continued

Fair value hedges

The group uses Interest Rate Swaps and Cross Currency Swaps as Fair value hedges of the Groups euro issued debt.

Interest rate exposure arises from movements in the fair value of the Group's euro debt attributable to movements in euro interest rates. The hedged risk is the change the euro bonds fair value attributable to interest rate movements. The hedged items are the Group's euro bonds which are issued at a fixed rate. The hedging instruments are fixed to floating euro interest rate swaps where the Group receives fixed interest payments and pays three month Euribor.

As the critical terms of the interest rate swaps match the bonds such there is an expectation that the value of the hedging instrument and the value of the hedged item move in the opposite direction as a result of movements in the zero coupon Euribor curve. The hedge ratio is 100%. Sources of hedge ineffectiveness are a reduction or modification in the hedged item or a material change in the credit risk of swap counterparties.

A foreign currency exposure arises from foreign exchange fluctuations on translation of the Group's euro debt into GBP. The hedged risk is the risk of changes in the GBPEUR spot rate that will result in changes in the value of the euro debt when translated into GBP. The hedged items are a portion of the Group's euro bonds. The hedging instruments are floating to floating cross currency swaps which creates an exposure to euro strengthening against GBP within the hedge item. The final exchange on the cross currency swap creates an exposure to euro weakening against GBP.

As the critical terms of the cross currency swap match the bonds there is an expectation that the value of the hedging instrument and the value of the hedged item move in the opposite direction as a result of movements in the EURGBP exchange rate. The hedge ratio is 100%. Sources of hedge ineffectiveness are a reduction or modification in the hedged item or a material change in the credit risk of swap counterparties.

At December 2018, the Group held the following instruments to hedge exposures to changes in interest rates and foreign currency risk associated with borrowings.

All figures in £ millions	Carrying amount of hedging instruments	Change in fair value of hedging instrument used to determine hedge ineffectiveness	Nominal amounts of hedging instruments
Interest rate risk			
Financial assets – derivative financial instruments	13	(7)	404
Currency risk			
Financial assets – derivative financial instruments	51	3	404

The amounts at the reporting date relating to items designated as hedge items were as follows:

All figures in £ millions	Carrying amount of hedged items	Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount	Change in fair value of hedged item used to determine hedge ineffectiveness	Hedge ineffectiveness	Line item in profit or loss that includes hedge ineffectiveness
Interest rate risk					
Financial liabilities – borrowings	(416)	(9)	7	–	n/a
Currency risk					
Financial liabilities – borrowings	(416)	n/a	(3)	–	n/a

Hedge of net investment in a foreign operation

A foreign currency exposure arises from the translation of the Group's net investments in its subsidiaries which have USD and euro functional currencies. The hedged risk is the risk of changes in the GBPUSD and GBPEUR spot rates that will result in changes in the value of the group's net investment in its USD and euro assets when translated into GBP. The hedged items are a portion of the Group's assets which are denominated in USD and euro. The hedging instruments are debt and derivative financial instruments, including Cross Currency Swaps, FX Forwards and FX Collars which creates an exposure to USD and euro weakening against GBP.

It is expected that the change in value of each of these items will mirror each other as there is a clear and direct economic relationship between the hedge and the hedged item in the hedge relationship.

Hedge ineffectiveness would arise if the value of the hedged items fell below the value of the hedging instruments however this is unlikely as the value of the group's assets denominated in USD and euro are significantly greater than the proposed net investment programme.

16. Derivative financial instruments and hedge accounting continued

The amounts related to items designated as hedging instruments were as follows:

All figures in £ millions	Carrying amount of hedged instruments	Change in value of hedging instrument used to determine hedge ineffectiveness	Nominal amounts of hedging instruments	Hedging gains/(losses) recognised in OCI	Hedge ineffectiveness recognised in profit or loss
Financial liabilities – derivative financial instruments	(59)	(22)	607	(22)	–
Financial liabilities – borrowings	(256)	(10)	(256)	(10)	–

In addition to the above, £15m of hedging losses were recognised in OCI in relation to derivative financial instruments that matured during the year.

Offsetting arrangements

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

			2018			2017
All figures in £ millions	Gross derivative assets	Gross derivative liabilities	Net derivative assets/ liabilities	Gross derivative assets	Gross derivative liabilities	Net derivative assets/ liabilities
Counterparties in an asset position	67	(44)	23	103	(78)	25
Counterparties in a liability position	1	(15)	(14)	37	(62)	(25)
Total as presented in the balance sheet	68	(59)	9	140	(140)	–

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

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty.

The Group has no material embedded derivatives that are required to be separately accounted for in accordance with IFRS 9 'Financial Instruments'.

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2018	2017
Cash at bank and in hand	533	361
Short-term bank deposits	35	157
	568	518
Cash at bank and in hand – within assets classified as held for sale	–	127
	568	645

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

At the end of 2018, the currency split of cash and cash equivalents was US dollar 18% (2017: 36%), sterling 30% (2017: 8%), Canadian dollar 14% (2017: 2%), euro 6% (2017: 7%), renminbi 3% (2017: 20%) and other 29% (2017: 27%). At the end of 2017, a significant proportion of the renminbi cash related to assets held for sale.

Cash and cash equivalents have fair values that approximate to their carrying value due to their short-term nature. Cash and cash equivalents include the following for the purpose of the cash flow statement:

All figures in £ millions	2018	2017
Cash and cash equivalents	568	518
Cash and cash equivalents – within assets classified as held for sale	–	127
Bank overdrafts	(43)	(15)
	525	630

The Group has certain cash pooling arrangements in US dollars, sterling, euro and Canadian dollars where both the company and the bank have a legal right of offset. Offsetting amounts are presented gross in the balance sheet. Offset arrangements in respect of derivatives are shown in note 16.

Notes to the consolidated financial statements

18. Financial liabilities – borrowings

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

All figures in £ millions	2018	2017
Non-current		
1.875% euro notes 2021 (nominal amount €250m; 2017 nominal amount €500m)	233	463
3.75% US dollar notes 2022 (nominal amount $117m)	92	85
3.25% US dollar notes 2023 (nominal amount $94m)	74	69
1.375% euro notes 2025 (nominal amount €300m; nominal amount €500m)	273	445
Finance lease liabilities	2	4
	674	1,066
Current		
Due within one year or on-demand:		
Bank loans and overdrafts	43	15
Finance lease liabilities	3	4
	46	19
Total borrowings	720	1,085

Included in the non-current borrowings above is £6m of accrued interest (2017: £10m). Included in the current borrowings above is £nil of accrued interest (2017: £nil).

The maturities of the Group's non-current borrowings are as follows:

All figures in £ millions	2018	2017
Between one and two years	1	3
Between two and five years	400	549
Over five years	273	514
	674	1,066

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

			2018			2017
All figures in £ millions	Effective interest rate	Carrying value	Market value	Effective interest rate	Carrying value	Market value
Bank loans and overdrafts	n/a	43	43	n/a	15	15
1.875% euro notes 2021	2.04%	233	233	2.04%	463	467
3.75% US dollar notes 2022	3.94%	92	91	3.94%	85	87
3.25% US dollar notes 2023	3.36%	74	71	3.36%	69	67
1.375% euro notes 2025	1.44%	273	266	1.44%	445	445
Finance lease liabilities	n/a	5	5	n/a	8	8
		720	709		1,085	1,089

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

The carrying amounts of the Group's borrowings before the effect of derivatives (see notes 16 and 19 for further information on the impact of derivatives) are denominated in the following currencies:

All figures in £ millions	2018	2017
US dollar	188	172
Sterling	23	1
Euro	506	911
Other	3	1
	720	1,085

18. Financial liabilities – borrowings continued

The Group has $1.75bn (£1.4bn) of undrawn capacity on its committed borrowing facilities as at 31 December 2018 (2017: $1.75bn (£1.3bn) undrawn). In addition, there are a number of short-term facilities that are utilised in the normal course of business. All of the Group's borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

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

All figures in £ millions	2018	2017
Finance lease liabilities – minimum lease payments		
Not later than one year	**3**	4
Later than one year and not later than two years	**1**	3
Later than two years and not later than three years	**1**	1
Later than three years and not later than four years	**–**	–
Later than four years and not later than five years	**–**	–
Later than five years	**–**	–
Future finance charges on finance leases	**–**	–
Present value of finance lease liabilities	**5**	8

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

All figures in £ millions	2018	2017
Not later than one year	**3**	4
Later than one year and not later than five years	**2**	4
Later than five years	**–**	–
	5	8

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

19. Financial risk management

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

Treasury policy

Pearson's treasury policies set out the group's principles for addressing key financial risks including capital risk, liquidity risk, foreign exchange risk and interest rate risk and sets out measurable targets for each. The Audit Committee receive quarterly reports incorporating compliance with these measurable targets and review and approve the treasury policies annually.

The treasury function is permitted to use derivatives where their use reduces a risk or allows a transaction to be undertaken more cost effectively. Derivatives permitted include swaps, forwards and collars to manage foreign exchange and interest rate risk, with foreign exchange swap and forward contracts the most commonly executed. Speculative transactions are not permitted.

Capital risk

The Group's objectives when managing capital are:

› To maintain a strong balance sheet and a solid investment grade rating;

› To continue to invest in the business;

› To have a sustainable and progressive dividend policy, and;

› To return surplus cash to our shareholders where appropriate.

The Group aims to maintain net debt at a level less than 1.5 times EBITDA before the adoption of IFRS 16 and less than 2.2 times EBITDA after the adoption of IFRS16. This is consistent with a solid investment grade rating (assuming no material deterioration in trading performance) and provides comfortable headroom against covenants.

The Group is currently rated BBB (negative outlook) with Standard and Poor's and Baa2 (stable outlook) with Moody's.

Notes to the consolidated financial statements

19. Financial risk management continued

Net debt

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

All figures in £ millions	2018	2017
Cash and cash equivalents	**568**	645
Marketable securities	**–**	8
Derivative financial instruments	**9**	–
Bank loans and overdrafts	**(43)**	(15)
Bonds	**(672)**	(1,062)
Finance lease liabilities	**(5)**	(8)
Net debt	**(143)**	(432)

Interest and foreign exchange rate management

The Group's principal currency exposure is to the US dollar which represents more than 60% of the Group's sales.

The Group's long-term debt is primarily held in US dollars to provide a natural hedge of this exposure, which is achieved through issued US dollar debt or converting euro debt to US dollars using cross-currency swaps, forwards and collars. As at 31 December 2018, £617m of the Group's debt is held at fixed rates (2017: £674m), with £103m held at floating rates (2017: £411m), partially offset by US dollar cash balances which attract floating rate interest.

See note 16 for details of the Group's hedging programme which addresses interest rate risk and foreign currency risk.

Overseas profits are converted to sterling to satisfy sterling cash outflows such as dividends at the prevailing spot rate at the time of the transaction. To the extent the Group has sufficient sterling, US dollars may be held as dollar cash to provide a natural offset to the Group's debt or to satisfy future US dollar cash outflows.

The Group does not have significant cross border foreign exchange transactional exposures.

As at 31 December 2018, the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in unlisted securities	93	–	–	(7)	9
Cash and cash equivalents	568	–	–	(36)	45
Derivative financial instruments	9	(3)	3	1	(1)
Bonds	(672)	17	(17)	61	(74)
Other borrowings	(48)	–	–	2	(3)
Other net financial assets	620	–	–	(51)	62
Total financial instruments	570	14	(14)	(30)	38

The table shows the sensitivities of the fair values of each class of financial instrument to an isolated change in either interest rates or foreign exchange rates. Other net financial assets comprises trade receivables less trade payables. A significant proportion of the movements shown above would impact equity rather than the income statement due to the location and functional currency of the entities in which they arise and the availability of net investment hedging.

The Group's income statement is reported at average rates for the year while the balance sheet is translated at the year-end closing rate. Differences between these rates can distort ratio calculations such as debt to EBITDA and interest cover. Adjusted operating profit translated at year-end closing rates would be £28m higher than the reported figure of £546m at £574m. EBITDA translated at year-end closing rates would be £32m higher than the reported figure of £698m at £730m.

Liquidity and re-financing risk management

The Group regularly reviews the level of cash and debt facilities required to fund its activities. This involves preparing a prudent cash flow forecast for the next three to five years, determining the level of debt facilities required to fund the business, planning for shareholder returns and repayments of maturing debt, and identifying an appropriate amount of headroom to provide a reserve against unexpected outflows.

At 31 December 2018, the Group had cash of £0.5bn and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75bn (£1.4bn). At 31 December 2017, the Group had cash of £0.6bn and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75bn (£1.3bn).

19. Financial risk management continued

The $1.75bn facility contains interest cover and leverage covenants which the Group has complied with for the year ended 31 December 2018. The maturity of the carrying values of the Group's borrowings and trade payables are set out in notes 18 and 24 respectively.

At the end of 2018, the currency split of the Group's trade payables was US dollar £178m, sterling £57m and other currencies £98m (2017: US dollar £137m, sterling £58m and other currencies £90m) . Trade payables are all due within one year (2017: all due within one year).

The following table analyses the Group's bonds and derivative assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. Short dated derivative instruments have not been included in this table. The amounts disclosed in the table are the contractual undiscounted cash flows (including interest) and as such may differ from the amounts disclosed on the balance sheet.

	Analysed by maturity				Analysed by currency			
All figures in £ millions	Greater than one month and less than one year	Later than one year but less than five years	Five years or more	Total	USD	GBP	Other	Total
At 31 December 2018								
Bonds	**14**	**431**	**277**	**722**	**189**	**–**	**533**	**722**
Rate derivatives – inflows	**(20)**	**(288)**	**(343)**	**(651)**	**(40)**	**(167)**	**(444)**	**(651)**
Rate derivatives – outflows	**23**	**289**	**341**	**653**	**254**	**390**	**9**	**653**
FX forwards – inflows	**(251)**	**(35)**	**–**	**(286)**	**–**	**(286)**	**–**	**(286)**
FX forwards – outflows	**275**	**37**	**–**	**312**	**312**	**–**	**–**	**312**
Total	**41**	**434**	**275**	**750**	**715**	**(63)**	**98**	**750**
At 31 December 2017								
Bonds	20	601	533	1,154	184	–	970	1,154
Rate derivatives – inflows	(38)	(975)	(684)	(1,697)	(53)	(751)	(893)	(1,697)
Rate derivatives – outflows	48	1,060	667	1,775	1,003	751	21	1,775
FX forwards – inflows	–	–	–	–	–	–	–	–
FX forwards – outflows	–	–	–	–	–	–	–	–
Total	30	686	516	1,232	1,134	–	98	1,232

Financial counterparty and credit risk management

Financial counterparty and credit risk arises from cash and cash equivalents, favourable derivative financial instruments and deposits with banks and financial institutions, as well as credit exposures to customers, including outstanding receivables.

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

Cash deposits and derivative transactions are made with approved counterparties up to pre-agreed limits. To manage counterparty risk associated with cash and cash equivalents, the Group uses a mixture of money market funds as well as bank deposits. As at 31 December 2018, 85% of cash and cash equivalents was held with investment grade bank counterparties, 7% with AAA money market funds and 8% held with non-investment grade bank counterparties. As at 31 December 2018, the Group had a net exposure of £33m with investment grade counterparties for derivative transactions.

For trade receivables and contract assets the Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, risk associated with the industry and country in which customers operate may also influence the credit risk. The credit quality of customers is assessed by taking into account financial position, past experience and other relevant factors. Individual credit limits are set for each customer based on internal ratings. The compliance with credit limits is regularly monitored by the Group. A default on a trade receivable is when the counterparty fails to make contractual payments within the stated payment terms. Trade receivables and contract assets are written off when there is no reasonable expectation of recovery. The carrying amounts of financial assets, trade receivables and contract assets represent the maximum credit exposure.

Trade receivables and contract assets are subject to impairment using the expected credit loss model. The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected credit loss allowance for all trade receivables and contract assets. To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. See note 22 for further details about trade receivables and contract assets including movements in provisions for bad and doubtful debts.

Notes to the consolidated financial statements

20. Intangible assets – pre-publication

All figures in £ millions	2018	2017
Cost		
At beginning of year	**1,854**	2,417
Exchange differences	**70**	(168)
Additions	**328**	362
Disposal through business disposal	**–**	(1)
Disposals	**(158)**	(248)
Transfer from property, plant and equipment	**2**	–
Transfer to assets classified as held for sale	**–**	(508)
At end of year	**2,096**	1,854
Amortisation		
At beginning of year	**(1,113)**	(1,393)
Exchange differences	**(53)**	109
Charge for the year	**(271)**	(338)
Disposals	**158**	248
Transfer to assets classified as held for sale	**–**	261
At end of year	**(1,279)**	(1,113)
Carrying amounts		
At end of year	**817**	741

Included in the above are pre-publication assets amounting to £577m (2017: £504m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold.

In addition to the above £242m (2017: £247m) of pre-publication assets are included in assets classified as held for sale (see note 32) with a charge of £67m and additions of £60m in 2018 relating to assets and liabilities held for sale.

21. Inventories

All figures in £ millions	2018	2017
Raw materials	**5**	4
Work in progress	**–**	2
Finished goods	**149**	142
Returns asset	**10**	–
	164	148

The cost of inventories recognised as an expense and included in the income statement in cost of goods sold amounted to £375m (2017: £324m). In 2018 £39m (2017: £38m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

Included within the inventory balance is the estimation of the right to receive goods from contracts with customers via returns (see note 1b). The value of the returns asset is measured at the carrying amount of the assets at the time of sale aligned to the Group's normal inventory valuation methodology less any expected costs to recover the asset and any expected reduction in value. Impairment charges against the inventory returns asset are £nil in 2018. The returns asset all relates to finished goods.

22. Trade and other receivables

All figures in £ millions	2018	2017
Current		
Trade receivables	**874**	739
Royalty advances	**5**	8
Prepayments	**103**	82
Deferred contract costs	**1**	–
Accrued income	**2**	1
Other receivables	**193**	280
	1,178	1,110
Non-current		
Trade receivables	**30**	21
Royalty advances	**21**	20
Prepayments	**13**	15
Deferred contract costs	**1**	–
Accrued income	**10**	10
Other receivables	**25**	37
	100	103

Accrued income represents contract assets which are unbilled amounts generally resulting from assessments and services revenue streams where revenue to be recognised over time has been recognised in excess of customer billings to date. Impairment charges on accrued income assets are £nil in 2018. The carrying value of the Group's trade and other receivables approximates its fair value. Trade receivables are stated net of provisions for bad and doubtful debts. Trade and other receivables includes the impact of adoption of IFRS 15 in 2018 (see note 1b). This impact increased trade and other receivables as a result of the transfer of the sales return liability of £173m to trade and other liabilities that was previously netted in trade receivables. Comparatives have not been restated.

The movements in the provision for bad and doubtful debts are as follows:

All figures in £ millions	2018	2017
At beginning of year	**(116)**	(112)
Adjustment on initial application of IFRS 9 (see note 1c)	**(12)**	–
Exchange differences	**2**	7
Income statement movements	**(1)**	(38)
Utilised	**31**	21
Disposal through business disposal	**–**	1
Transfer to assets classified as held for sale	**–**	5
At end of year	**(96)**	(116)

Concentrations of credit risk with respect to trade receivables are limited due to the Group's large number of customers, who are internationally dispersed.

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

All figures in £ millions	2018	2017
Within due date	**606**	661
Up to three months past due date	**172**	187
Three to six months past due date	**72**	48
Six to nine months past due date	**16**	18
Nine to 12 months past due date	**24**	13
More than 12 months past due date	**14**	3
Total trade receivables	**904**	930
Less: sales return liability	**–**	(170)
Net trade receivables	**904**	760

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historical payment profiles. Management believes all the remaining receivable balances are fully recoverable.

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23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2018	45	3	11	21	80
Exchange differences	**2**	**–**	**–**	**–**	**2**
Charged to income statement	**–**	**103**	**–**	**3**	**106**
Released to income statement	**–**	**(2)**	**–**	**(5)**	**(7)**
Utilised	**(5)**	**(2)**	**(5)**	**(3)**	**(15)**
Disposal through business disposal	**–**	**–**	**(1)**	**–**	**(1)**
At 31 December 2018	**42**	**102**	**5**	**16**	**165**

Analysis of provisions:

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
					2018
Current	**6**	**2**	**5**	**7**	**20**
Non-current	**36**	**100**	**–**	**9**	**145**
	42	**102**	**5**	**16**	**165**
					2017
Current	5	1	11	8	25
Non-current	40	2	–	13	55
	45	3	11	21	80

Deferred consideration primarily relates to the formation of a venture in North America in 2011. The provision will be utilised over a number of years as payments are based on a royalty rate. The provision above represents management's best estimate of the liability, however, the maximum that could be payable is £84m. Property provisions predominantly relate to restructuring and onerous leases. The main provisions relate to the consolidation of London properties and are expected to be utilised from 2020. Uncertainties around property provisions relate to prevailing market conditions including potential sublet income, lease terms including rent free periods, void periods, lease incentives and running costs. Disposals and closures include liabilities related to recent disposals and are expected to be utilised in 2019. Legal and other includes legal claims, contract disputes and potential contract losses with the provisions utilised as the cases are settled. Also included in legal and other are other restructuring provisions that are generally utilised within one year.

24. Trade and other liabilities

All figures in £ millions	2018	2017
Trade payables	**311**	265
Sales return liability	**173**	–
Social security and other taxes	**16**	21
Accruals	**397**	447
Deferred income	**387**	322
Interest payable	**46**	45
Liability to purchase own shares	**–**	151
Other liabilities	**225**	224
	1,555	1,475
Less: non-current portion		
Accruals	**15**	26
Deferred income	**66**	35
Other liabilities	**74**	72
	155	133
Current portion	**1,400**	1,342

The carrying value of the Group's trade and other liabilities approximates its fair value. The deferred income balance comprises contract liabilities in respect of advance payments in assessment, testing and training businesses; subscription income in school and college businesses; and obligations to deliver digital content in future periods. Trade and other liabilities includes the impact of adoption of IFRS 15 in 2018 (see note 1b). This impact increased trade and other liabilities as a result of the transfer of the sales return liability of £173m that was previously netted in trade receivables and deferred income by £28m at 31 December 2018. Comparatives have not been restated. The liability to purchase own shares in 2017 relates to a buyback agreement for the purchase of the company's own shares (see note 27).

25. Retirement benefit and other post-retirement obligations

Background

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

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

A ruling in the Lloyds Bank High Court case in October 2018 provided clarity on how pension plans should equalise guaranteed minimum pensions (GMP) between males and females. The case ruling resulted in a past service charge in the income statement of £8m and an additional liability of £8m which has been incorporated into the valuation of the UK Group plan defined benefit obligation. This charge has been excluded from the Group's adjusted earnings as this relates to historical circumstances (see note 8). The charge is an estimate based on available data and revisions to these estimates in future years will be treated as assumption changes and recorded in other comprehensive income rather than the income statement.

At 31 December 2018, the UK Group plan had approximately 24,000 members, analysed in the following table:

All figures in %	Active	Deferred	Pensioners	Total
Defined benefit	1	25	35	61
Defined contribution	9	30	–	39
Total	10	55	35	100

The other major defined benefit plans are based in the US. These are also final salary pension plans which provide benefits to members in the form of a guaranteed pension payable for life, with the level of benefits dependent on length of service and final pensionable pay. The majority of the US plans are funded.

The Group also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans. In 2018, changes made to the US PRMB have resulted in a curtailment gain of £11m being recognised in the income statement.

The defined benefit schemes expose the Group to actuarial risks, such as life expectancy, inflation risks, and investment risk including asset volatility and changes in bond yields. The Group is not exposed to any unusual, entity-specific or plan-specific risks.

The defined contribution section of the UK Group plan operates a Reference Scheme Test (RST) pension underpin for its members. Where a member's fund value is insufficient to purchase the RST pension upon retirement, the UK Group plan is liable for the shortfall to cover the member's RST pension. In 2017, the UK Group plan revised its approach to securing the RST underpin by converting a member's fund value into a pension in the UK Group plan rather than purchasing an annuity with an insurer. A liability of £23m (2017: £32m) in respect of the underpin is included in the UK Group plan's defined benefit obligation, calculated as the present value of projected payments less the fund value. The UK Group plan's conversion factors are lower than the respective insurer annuity values and this drove a reduction in the underpin liability, resulting in an actuarial gain through other comprehensive income and an increase in the surplus at 31 December 2017. From 1 January 2018, members who have sufficient funds to purchase an RST pension are able to convert their fund value into a pension in the UK Group plan as an alternative to purchasing an annuity with an insurer. The Group does not recognise the assets and liabilities for members of the defined contribution section of the UK Group plan whose fund values are expected to be sufficient to purchase an RST pension without assistance from the UK Group plan. The defined contribution section of the UK Group plan had gross assets of £453m at 31 December 2018.

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25. Retirement benefit and other post-retirement obligations continued

Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

All figures in %	2018 UK Group plan	2018 Other plans	2018 PRMB	2017 UK Group plan	2017 Other plans	2017 PRMB
Inflation	**3.3**	**1.6**	**1.5**	3.2	1.6	1.5
Rate used to discount plan liabilities	**2.8**	**4.0**	**4.1**	2.5	3.0	3.0
Expected rate of increase in salaries	**3.8**	**2.9**	**3.0**	3.7	3.0	3.0
Expected rate of increase for pensions in payment and deferred pensions	**2.1 to 5.1**	**–**	**–**	2.1 to 5.1	–	–
Initial rate of increase in healthcare rate	**–**	**–**	**7.0**	–	–	6.5
Ultimate rate of increase in healthcare rate	**–**	**–**	**5.5**	–	–	5.0

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities.

The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.3% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.3% has been used.

The expected rate of increase in salaries has been set at 3.8% for 2018.

For the UK Group plan, the mortality base table assumptions have been updated and are derived from the SAPS S2 for males and females, adjusted to reflect the observed experience of the plan, with CMI model improvement factors. A 1.5% long-term rate improvement on the CMI model is applied for both males and females.

For the US plans, the mortality table (RP – 2018) and 2018 improvement scale (MP – 2018) with generational projection for male and female annuitants has been adopted.

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows:

All figures in years	UK 2018	UK 2017	US 2018	US 2017
Male	**23.8**	23.6	**20.7**	20.8
Female	**24.5**	25.7	**22.7**	22.8

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

All figures in years	UK 2018	UK 2017	US 2018	US 2017
Male	**25.4**	25.7	**22.3**	22.5
Female	**26.3**	27.9	**24.2**	24.4

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

25. Retirement benefit and other post-retirement obligations continued

Financial statement information

The amounts recognised in the income statement are as follows:

All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
						2018
Current service cost	7	2	9	56	(1)	64
Past service cost	8	–	8	–	–	8
Curtailments	–	–	–	–	(11)	(11)
Administration expenses	6	–	6	–	–	6
Total operating expense	21	2	23	56	(12)	67
Interest on plan assets	(82)	(5)	(87)	–	–	(87)
Interest on plan liabilities	68	6	74	–	2	76
Net finance (income)/expense	(14)	1	(13)	–	2	(11)
Net income statement charge	7	3	10	56	(10)	56

All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
						2017
Current service cost	8	1	9	57	(1)	65
Administration expenses	9	1	10	–	–	10
Total operating expense	17	2	19	57	(1)	75
Interest on plan assets	(84)	(5)	(89)	–	–	(89)
Interest on plan liabilities	77	7	84	–	2	86
Net finance (income)/expense	(7)	2	(5)	–	2	(3)
Net income statement charge	10	4	14	57	1	72

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
				2018				2017
Fair value of plan assets	3,240	141	–	3,381	3,337	155	–	3,492
Present value of defined benefit obligation	(2,671)	(158)	(19)	(2,848)	(2,792)	(161)	(20)	(2,973)
Net pension asset/(liability)	569	(17)	(19)	533	545	(6)	(20)	519
Other post-retirement medical benefit obligation				(49)				(67)
Other pension accruals				(13)				(11)
Net retirement benefit asset				471				441
Analysed as:								
Retirement benefit assets				571				545
Retirement benefit obligations				(100)				(104)

Notes to the consolidated financial statements

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

The following gains have been recognised in other comprehensive income:

All figures in £ millions	2018	2017
Amounts recognised for defined benefit plans	16	175
Amounts recognised for post-retirement medical benefit plans	6	–
Total recognised in year	**22**	**175**

The fair value of plan assets comprises the following:

	2018			2017		
All figures in %	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
Insurance	28	1	29	29	–	29
Equities	1	1	2	1	1	2
Bonds	–	2	2	–	3	3
Property	7	–	7	8	–	8
Pooled asset investment funds	44	–	44	44	–	44
Other	16	–	16	14	–	14

The plan assets do not include any of the Group's own financial instruments, or any property occupied by the Group. The table below further disaggregates the plan assets into additional categories and those assets which have a quoted market price in an active market and those that do not:

	2018		2017	
All figures in %	Quoted market price	No quoted market price	Quoted market price	No quoted market price
Insurance	29	–	29	–
Non-UK equities	–	2	–	2
Fixed-interest securities	2	–	3	–
Property	–	7	–	8
Pooled asset investment funds	44	–	44	–
Other	–	16	–	14
Total	**75**	**25**	**76**	**24**

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

All figures in %	2018	2017
Liquid – call <1 month	51	50
Less liquid – call 1–3 months	–	–
Illiquid – call >3 months	49	50

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

Changes in the values of plan assets and liabilities of the retirement benefit plans are as follows:

All figures in £ millions	2018 UK Group plan	2018 Other plans	2018 Total	2017 UK Group plan	2017 Other plans	2017 Total
Fair value of plan assets						
Opening fair value of plan assets	**3,337**	**155**	**3,492**	3,339	158	3,497
Exchange differences	**–**	**4**	**4**	–	(8)	(8)
Interest on plan assets	**82**	**5**	**87**	84	5	89
Return on plan assets excluding interest	**(45)**	**(13)**	**(58)**	(140)	10	(130)
Contributions by employer	**6**	**1**	**7**	234	8	242
Benefits paid	**(140)**	**(11)**	**(151)**	(188)	(18)	(206)
Other	**–**	**–**	**–**	8	–	8
Closing fair value of plan assets	**3,240**	**141**	**3,381**	3,337	155	3,492
Present value of defined benefit obligation						
Opening defined benefit obligation	**(2,792)**	**(181)**	**(2,973)**	(3,181)	(205)	(3,386)
Exchange differences	**–**	**(3)**	**(3)**	–	13	13
Current service cost	**(7)**	**(2)**	**(9)**	(8)	(1)	(9)
Past service cost	**(8)**	**–**	**(8)**	–	–	–
Administration expenses	**(6)**	**–**	**(6)**	(9)	(1)	(10)
Interest on plan liabilities	**(68)**	**(6)**	**(74)**	(77)	(7)	(84)
Actuarial gains/(losses) – experience	**(49)**	**(2)**	**(51)**	126	6	132
Actuarial gains/(losses) – demographic	**(12)**	**–**	**(12)**	133	1	134
Actuarial gains/(losses) – financial	**131**	**6**	**137**	44	(5)	39
Contributions by employee	**–**	**–**	**–**	–	–	–
Other	**–**	**–**	**–**	(8)	–	(8)
Benefits paid	**140**	**11**	**151**	188	18	206
Closing defined benefit obligation	**(2,671)**	**(177)**	**(2,848)**	(2,792)	(181)	(2,973)

The weighted average duration of the defined benefit obligation is 16.1 years for the UK and 7.1 years for the US.

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25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

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

All figures in £ millions	2018	2017
Opening defined benefit obligation	**(67)**	(77)
Exchange differences	**(2)**	5
Current service cost	**1**	1
Curtailments	**11**	–
Interest on plan liabilities	**(2)**	(2)
Actuarial gains/(losses) – experience	**4**	1
Actuarial gains/(losses) – demographic	**–**	1
Actuarial gains/(losses) – financial	**2**	(2)
Benefits paid	**4**	6
Closing defined benefit obligation	**(49)**	(67)

Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group in trust. The trustee of the plan is required to act in the best interest of the plan's beneficiaries. The most recent triennial actuarial valuation for funding purposes was completed as at 1 January 2018 and this valuation revealed a technical provisions funding surplus of £163m. The plan expects to be able to provide benefits (in accordance with the plan rules) with a very low level of reliance on future funding from the Group.

Assets of the plan are divided into two elements: matching assets, which are assets that produce cash flows that can be expected to match the cash flows for a proportion of the membership, and include a liability-driven investment mandate (UK bonds, interest rate/inflation swaps and other derivative instruments), Pensioner buy-in insurance policies, inflation-linked property and infrastructure; and return seeking assets, which are assets invested with a longer-term horizon to generate the returns needed to provide the remaining expected cash flows for the beneficiaries, and include diversified growth funds, property and alternative asset classes. The plan's long-term investment strategy allocates 85% to matching assets and 15% to return seeking assets.

In February 2019, the UK Group plan purchased a further pensioner buy-in policy valued at approximately £500m with Legal & General. This is in addition to the previous buy-in policies with Aviva and Legal & General totalling £1.2bn which were purchased in 2017. As a result of this latest transaction, 95% of the UK Group plan's pensioner liabilities are now matched with buy-in policies. These transfer significant longevity risk to Aviva and Legal & General, reducing the pension risks being underwritten by the Group and providing additional security for members.

Regular contributions to the plan in respect of the defined benefit sections are estimated to be £3m for 2019.

Sensitivities

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

	2018	
All figures in £ millions	1% increase	1% decrease
Effect:		
(Decrease)/increase in defined benefit obligation – UK Group plan	**(386)**	**522**
(Decrease)/increase in defined benefit obligation – US plan	**(11)**	**13**

25. Retirement benefit and other post-retirement obligations continued

Sensitivities continued

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

All figures in £ millions	2018 One year increase	2018 One year decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	143	(138)
Increase/(decrease) in defined benefit obligation – US plan	7	(8)

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

All figures in £ millions	2018 0.5% increase	2018 0.5% decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	129	(114)
Increase/(decrease) in defined benefit obligation – US plan	–	–

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

26. Share-based payments

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

All figures in £ millions	2018	2017
Pearson plans	37	33

The Group operates the following equity-settled employee option and share plans:

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

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

Long-Term Incentive Plan The plan was first introduced in 2001, renewed again in 2006 and again in 2011. The plan consists of restricted shares. The vesting of restricted shares is normally dependent on continuing service over a three-to five-year period, and in the case of executive directors and senior management upon the satisfaction of corporate performance targets over a three-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to executive directors in May 2018 and September 2017 vest dependent on relative total shareholder return, return on invested capital and adjusted earnings per share growth. Restricted shares awarded to senior management in March 2017 vest dependent on adjusted earnings per share growth. Other restricted shares awarded in 2018 and 2017 vest depending on continuing service over periods of up to three years.

Management Incentive Plan The plan was introduced in 2017 combining the Group's Annual Incentive Plan and Long-Term Incentive Plan for senior management. The number of shares to be granted to participants is dependent on Group performance in the calendar year preceding the date of grant (on the same basis as the Annual Incentive Plan). Subsequently, the shares vest dependent on continuing service over a three year period, and additionally in the case of Pearson Executive Management upon satisfaction of non-market based performance criteria as determined by the Remuneration Committee. Restricted shares awarded as part of the 2017 Management Incentive Plan were granted in April 2018. Restricted shares awarded as part of the 2018 Management Incentive Plan will be granted in April 2019.

Notes to the consolidated financial statements

26. Share-based payments continued

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

	2018		2017	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	2,981	6.84	2,978	8.14
Granted during the year	729	5.80	1,619	5.50
Exercised during the year	(70)	6.57	(9)	7.00
Forfeited during the year	(668)	7.58	(1,451)	8.04
Expired during the year	(244)	8.19	(156)	9.09
Outstanding at end of year	2,728	5.76	2,981	6.84
Options exercisable at end of year	169	11.31	350	8.18

Options were exercised regularly throughout the year. The weighted average share price during the year was £8.45 (2017: £6.71). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

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

	2018		2017	
Range of exercise prices £	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
5–10	2,553	2.29	2,697	2.52
>10	175	0.29	284	1.24
	2,728	2.16	2,981	2.40

In 2018 and 2017, options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black–Scholes option pricing model.

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

	2018 Weighted average	2017 Weighted average
Fair value	£1.88	£1.24
Weighted average share price	£7.49	£6.83
Weighted average exercise price	£5.80	£5.50
Expected volatility	35.78%	34.75%
Expected life	3.7 years	3.7 years
Risk-free rate	0.87%	0.20%
Expected dividend yield	5.21%	7.61%
Forfeiture rate	3.2%	3.2%

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

The following shares were granted under restricted share arrangements:

	2018		2017	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	2,907	7.55	6,453	6.61
Management Incentive Plan	2,035	7.45	–	–

26. Share-based payments continued

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

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

27. Share capital and share premium

	Number of shares 000s	Share capital £m	Share premium £m
At 1 January 2017	822,127	205	2,597
Issue of ordinary shares – share option schemes	923	–	5
Purchase of own shares	(20,996)	(5)	–
At 31 December 2017	802,054	200	2,602
Issue of ordinary shares – share option schemes	**864**	**1**	**5**
Purchase of own shares	**(21,840)**	**(6)**	–
At 31 December 2018	**781,078**	**195**	**2,607**

The ordinary shares have a par value of 25p per share (2017: 25p per share). All issued shares are fully paid. All shares have the same rights.

The £300m share buyback programme announced in October 2017 was completed on 16 February 2018. In 2017, the Group's brokers purchased 21m shares at a value of £153m of which £149m had been cancelled at 31 December 2017. Cash payments of £149m had been made in respect of the purchases with the outstanding £4m settlement made at the beginning of January 2018. This £4m together with the remaining value of the buyback programme of £147m was recorded as a liability at 31 December 2017 (see note 24). A further 22m shares were purchased under the programme in 2018 (see note 37). The shares bought back have been cancelled and the nominal value of these shares transferred to a capital redemption reserve. The nominal value of shares cancelled at 31 December 2018 was £11m (2017: £5m).

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

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

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

28. Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2017	7,719	79
Purchase of treasury shares	–	–
Release of treasury shares	(1,725)	(18)
At 31 December 2017	5,994	61
Purchase of treasury shares	–	–
Release of treasury shares	**(2,769)**	**(28)**
At 31 December 2018	**3,225**	**33**

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 0.4% (2017: 0.8%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £0.8m (2017: £1.5m). Dividends on treasury shares are waived.

At 31 December 2018, the market value of Pearson plc treasury shares was £30m (2017: £44m).

Notes to the consolidated financial statements

29. Other comprehensive income

All figures in £ millions	Attributable to equity holders of the company					2018
	Fair value reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
Items that may be reclassified to the income statement						
Net exchange differences on translation of foreign operations – Group	–	91	–	91	–	91
Net exchange differences on translation of foreign operations – associates	–	(1)	–	(1)	–	(1)
Currency translation adjustment disposed	–	(4)	–	(4)	–	(4)
Attributable tax	–	–	(4)	(4)	–	(4)
Items that are not reclassified to the income statement						
Fair value gain on other financial assets	8	–	–	8	–	8
Attributable tax	–	–	–	–	–	–
Remeasurement of retirement benefit obligations – Group	–	–	22	22	–	22
Remeasurement of retirement benefit obligations – associates	–	–	3	3	–	3
Attributable tax	–	–	9	9	–	9
Other comprehensive income/(expense) for the year	8	86	30	124	–	124

All figures in £ millions	Attributable to equity holders of the company					2017
	Fair value reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total
Items that may be reclassified to the income statement						
Net exchange differences on translation of foreign operations – Group	–	(158)	–	(158)	–	(158)
Net exchange differences on translation of foreign operations – associates	–	(104)	–	(104)	–	(104)
Currency translation adjustment disposed	–	(51)	–	(51)	–	(51)
Attributable tax	–	–	9	9	–	9
Items that are not reclassified to the income statement						
Fair value gain on other financial assets	13	–	–	13	–	13
Attributable tax	–	–	(4)	(4)	–	(4)
Remeasurement of retirement benefit obligations – Group	–	–	175	175	–	175
Remeasurement of retirement benefit obligations – associates	–	–	7	7	–	7
Attributable tax	–	–	(42)	(42)	–	(42)
Other comprehensive income/(expense) for the year	13	(313)	145	(155)	–	(155)

30. Business combinations

There were no significant acquisitions in 2018 or 2017. There were no material adjustments to prior year acquisitions. The net cash outflow relating to acquisitions in the year is shown below.

All figures in £ millions	2018	2017
Cash flow on acquisitions		
Deferred payments for prior year acquisitions and other items	**(5)**	(11)
Net cash outflow	**(5)**	(11)

31. Disposals

In March 2018, the Group completed the sale of its Wall Street English language teaching business (WSE) resulting in a pre-tax profit on sale of £207m. Tax on the disposal is estimated at £6m. WSE was classified as held for sale on the balance sheet at 31 December 2017 (see note 32). In May 2018 the Group disposed of the equity interest in UTEL, the online University partnership in Mexico realising a gain of £19m before tax of £2m.

					2018	2017
All figures in £ millions	Notes	WSE	UTEL	Other	Total	Total
Disposal of subsidiaries and associates						
Property, plant and equipment		**(17)**	**–**	**–**	**(17)**	(7)
Intangible assets		**(15)**	**–**	**(2)**	**(17)**	(9)
Investments in joint ventures and associates		**–**	**(3)**	**–**	**(3)**	(352)
Net deferred income tax assets		**–**	**–**	**–**	**–**	(3)
Intangible assets – pre-publication		**(8)**	**–**	**–**	**(8)**	(1)
Inventories		**(1)**	**–**	**–**	**(1)**	(2)
Trade and other receivables		**(30)**	**–**	**–**	**(30)**	(16)
Current income tax receivable		**–**	**–**	**–**	**–**	(5)
Cash and cash equivalents (excluding overdrafts)		**(119)**	**–**	**–**	**(119)**	(13)
Net deferred income tax liabilities		**16**	–	–	**16**	–
Trade and other liabilities		**171**	**–**	**1**	**172**	34
Provisions for other liabilities and charges	23	**–**	**–**	**1**	**1**	–
Cumulative currency translation adjustment	29	**4**	**–**	**–**	**4**	51
Net (assets)/liabilities disposed		**1**	**(3)**	**–**	**(2)**	(323)
Cash received		**212**	**22**	**9**	**243**	468
Deferred proceeds		**–**	**–**	**2**	**2**	–
Fair value of financial asset acquired		**–**	**–**	**3**	**3**	–
Costs		**(6)**	**–**	**(10)**	**(16)**	(17)
Gain on disposal		**207**	**19**	**4**	**230**	128

Notes to the consolidated financial statements

31. Disposals continued

All figures in £ millions	2018	2017
Cash flow from disposals		
Cash – current year disposals	**243**	468
Cash and cash equivalents disposed	**(119)**	(13)
Costs and other disposal liabilities paid	**(23)**	(25)
Net cash inflow	**101**	430
Analysed as:		
Cash inflow/ from sale of subsidiaries	**83**	19
Cash inflow from sale of joint ventures and associates	**18**	411

32. Held for sale

Held for sale assets and liabilities in 2018 relate to the K12 school courseware business in the US (K12). Following the decision in 2017 to sell both the Wall Street English language teaching business (WSE) and the K12 business, the assets and liabilities of those businesses were classified as held for sale on the balance sheet at 31 December 2017. During 2018 WSE was sold and the K12 business remains on the balance sheet as a held for sale asset prior to the disposal announced in February 2019 (see note 37).

		2018	2017
All figures in £ millions	Notes	Total	Total
Non-current assets			
Property, plant and equipment		**–**	16
Intangible assets		**168**	181
Deferred income tax assets		**98**	68
Trade and other receivables		**25**	27
		291	292
Current assets			
Intangible assets – pre-publication		**242**	247
Inventories		**55**	46
Trade and other receivables		**60**	48
Cash and cash equivalents (excluding overdrafts)	17	**–**	127
		357	468
Assets classified as held for sale		**648**	760
Non-current liabilities			
Deferred income tax liabilities		**–**	(2)
Other liabilities		**(371)**	(284)
		(371)	(286)
Current liabilities			
Trade and other liabilities		**(202)**	(302)
		(202)	(302)
Liabilities classified as held for sale		**(573)**	(588)
Net assets classified as held for sale		**75**	172

Goodwill is allocated to the held for sale businesses on a relative fair value basis where these businesses form part of a larger cash generating unit (CGU). The goodwill allocated to the K12 business was reassessed at 31 December 2018.

33. Cash generated from operations

All figures in £ millions	Notes	2018	2017
Profit		**590**	408
Adjustments for:			
Income tax		**(92)**	13
Depreciation	10	**66**	90
Amortisation and impairment of acquired intangibles and goodwill	11	**99**	138
Amortisation of software	11	**88**	85
Net finance costs	6	**55**	30
Charges relating to GMP equalisation		**8**	–
Share of results of joint ventures and associates	12	**(44)**	(78)
Profit on disposal of subsidiaries, associates, investments and fixed assets		**(315)**	(116)
Net foreign exchange adjustment from transactions		**28**	(26)
Share-based payment costs	26	**37**	33
Pre-publication		**(37)**	(35)
Inventories		**(10)**	24
Trade and other receivables		**(15)**	133
Trade and other liabilities		**35**	6
Retirement benefit obligations		**(9)**	(232)
Provisions for other liabilities and charges		**63**	(11)
Net cash generated from operations		**547**	462
Dividends from joint ventures and associates		**117**	458
Re-capitalisation dividends from Penguin Random House		**(50)**	(312)
Purchase of property, plant and equipment		**(70)**	(82)
Purchase of intangible software assets		**(130)**	(150)
Proceeds from sale of property, plant and equipment and intangible software assets		**128**	–
Finance lease principal payments		**(4)**	(5)
Special pension contribution		**–**	227
Net (proceeds from) /cost paid re major restructuring		**(25)**	71
Operating cash flow		**513**	669
Operating tax paid		**(43)**	(75)
Net operating finance costs paid		**(22)**	(69)
Operating free cash flow		**448**	525
Special pension contribution		**–**	(227)
Net proceeds from/(cost paid) re major restructuring		**25**	(71)
Free cash flow		**473**	227
Dividends paid (including to non-controlling interests)		**(137)**	(318)
Net movement of funds from operations		**336**	(91)
Acquisitions and disposals		**92**	416
Re-capitalisation dividends from Penguin Random House		**50**	312
Loans repaid/(advanced) (including to related parties)		**46**	(13)
New equity		**6**	5
Buyback of equity		**(153)**	(149)
Other movements on financial instruments		**(6)**	14
Net movement of funds		**371**	494
Exchange movements on net debt		**(82)**	166
Total movement in net debt		**289**	660

Notes to the consolidated financial statements

33. Cash generated from operations continued

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

Operating cash flow, operating free cash flow and total free cash flow are non-GAAP (non-statutory) measures and have been disclosed and reconciled in the above table as they are commonly used by investors to measure the cash performance of the Group. In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

All figures in £ millions	2018	2017
Net book amount	**41**	12
Profit/(loss) on sale of property, plant and equipment	**87**	(12)
Proceeds from sale of property, plant and equipment	**128**	–

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

All figures in £ millions	2017	Financing cash flows	Foreign exchange movements	Fair value and other movements	2018
Financial liabilities					
Non-current borrowings	1,066	(441)	10	8	**643**
Current borrowings	4	(1)	22	–	**25**
Total	1,070	(442)	32	8	**668**

Non-current borrowings include bonds, derivative financial instruments and finance leases. Current borrowings include loans repayable within one year and finance leases, but exclude overdrafts classified within cash and cash equivalents.

34. Contingencies

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

As previously reported, on 24 November 2017 the European Commission published an opening decision that the United Kingdom controlled foreign company group financing partial exemption ("FCPE") constitutes State Aid. No final decision has yet been published, and may anyway be challenged by the UK tax authorities. The Group has benefited from the FCPE in 2018 and prior years by approximately £116m. At present the Group believes no provision is required in respect of this issue.

35. Commitments

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

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £128m (2017: £178m).

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

All figures in £ millions	2018	2017
Not later than one year	**143**	156
Later than one year and not later than two years	**130**	139
Later than two years and not later than three years	**115**	121
Later than three years and not later than four years	**101**	100
Later than four years and not later than five years	**91**	86
Later than five years	**595**	599
	1,175	1,201

In the event that the Group has excess capacity in its leased offices and warehouses it will enter into sub-lease contracts in order to offset costs. The future aggregate minimum sub-lease payments expected to be received under non-cancellable sub-leases are as follows:

All figures in £ millions	2018	2017
Not later than one year	**51**	45
Later than one year and not later than two years	**44**	45
Later than two years and not later than three years	**41**	40
Later than three years and not later than four years	**39**	35
Later than four years and not later than five years	**35**	33
Later than five years	**124**	138
	334	336

36. Related party transactions

Joint ventures and associates

Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12.

Key management personnel

Key management personnel are deemed to be the members of the Pearson executive (see p13). It is this Committee which had responsibility for planning, directing and controlling the activities of the Group in 2018. Key management personnel compensation is disclosed below:

All figures in £millions	2018	2017
Short-term employee benefits	**6**	12
Retirement benefits	**1**	1
Share-based payment costs	**7**	2
Total	**14**	15

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

37. Events after the balance sheet date

On 18 February 2019, the Group announced the sale of the US K12 courseware business to Nexus Capital Management LP for headline consideration of $250m comprising an initial cash payment of $25m and an unconditional vendor note for $225m expected to be repaid in three to seven years. Following the repayment of the vendor note, the Group is entitled to 20% of all future cash flows to equity holders and 20% of net proceeds if the business is sold. The transaction is expected to complete in the first half of 2019.

Also in February 2019, the UK Group pension plan purchased a further pensioner buy-in policy valued at approximately £500m with Legal & General. As a result of this latest transaction, 95% of the UK Group plan's pensioner liabilities are now matched with buy-in policies which significantly reduces longevity risk of the Group. The buy-in will be accounted for in 2019 and is expected to reduce the retirement benefit asset on the balance sheet but is not expected to have a material impact on the income statement.

On 6 March 2019, the Group announced a tender offer for up to €75m of its €500m 1.875% notes due 2021 of which €250m were outstanding at 31 December 2018. In addition, the Group also announced the refinancing of its bank facility, with a new $1.19bn Revolving Credit Facility due to mature in February 2024.

38. Accounts and audit exemptions

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

	Company number
Aldwych Finance Limited	04720439
Edexcel Limited	04496750
Education Development International plc	03914767
Longman Group (Overseas Holdings) Limited	00690236
Major123 Limited	05333023
Pearson Affordable Learning Fund Limited	08038068
Pearson Australia Finance Unlimited	05578463
Pearson Books Limited	02512075
Pearson Brazil Finance Limited	08848874
Pearson Canada Finance Unlimited	05578491
Pearson Dollar Finance plc	05111013
Pearson Dollar Finance Two Limited	06507766
Pearson Education Holdings Limited	00210859
Pearson Education Investments Limited	08444933
Pearson Education Limited	00872828
Pearson Funding Four plc	07970304

	Company number
Pearson International Finance Limited	02496206
Pearson Loan Finance No. 3 Limited	05052661
Pearson Loan Finance No. 4 Limited	02635107
Pearson Loan Finance Unlimited	05144467
Pearson Management Services Limited	00096263
Pearson Overseas Holdings Limited	00145205
Pearson Pension Trustee Services Limited	10803853
Pearson PRH Holdings Limited	08561316
Pearson Real Estate Holdings Limited	09768242
Pearson Services Limited	01341060
Pearson Shared Services Limited	04623186
Pearson Strand Finance Limited	11091691
TQ Catalis Limited	07307943
TQ Clapham Limited	07307925
TQ Global Limited	07802458

Company balance sheet

As at 31 December 2018

All figures in £ millions	Notes	2018	2017
Assets			
Non-current assets			
Investments in subsidiaries	2	**6,710**	6,691
Amounts due from subsidiaries		**2,269**	3,118
Financial assets – derivative financial instruments	6	**67**	140
		9,046	9,949
Current assets			
Amounts due from subsidiaries		**361**	209
Amounts due from related parties		**–**	46
Current income tax assets		**28**	–
Cash and cash equivalents (excluding overdrafts)	4	**50**	119
Financial assets – derivative financial instruments	6	**1**	–
		440	374
Total assets		**9,486**	10,323
Liabilities			
Non-current liabilities			
Amounts due to subsidiaries		**(2,944)**	(3,530)
Financial liabilities – derivative financial instruments	6	**(36)**	(140)
		(2,980)	(3,670)
Current liabilities			
Amounts due to subsidiaries		**(2,007)**	(1,739)
Financial liabilities – borrowings	5	**(11)**	(3)
Current income tax liabilities		**–**	(4)
Other liabilities		**(8)**	(158)
Financial liabilities – derivative financial instruments	6	**(23)**	–
		(2,049)	(1,904)
Total liabilities		**(5,029)**	(5,574)
Net assets		**4,457**	4,749
Equity			
Share capital	7	**195**	200
Share premium	7	**2,607**	2,602
Treasury shares	8	**12**	(16)
Capital redemption reserve		**11**	5
Special reserve		**447**	447
Retained earnings – including loss for the year of £160m (2017: loss of £163m)		**1,185**	1,511
Total equity attributable to equity holders of the company		**4,457**	4,749

These financial statements have been approved for issue by the Board of Directors on 11 March 2019 and signed on its behalf by

Coram Williams
Chief Financial Officer

Company statement of changes in equity

Year ended 31 December 2018

	Equity attributable to equity holders of the company						
All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Special reserve	Retained earnings	Total
At 1 January 2018	200	2,602	(16)	5	447	1,511	4,749
Loss for the year	–	–	–	–	–	(160)	(160)
Issue of ordinary shares under share option schemes*	1	5	–	–	–	–	6
Buyback of equity	(6)	–	–	6	–	(2)	(2)
Purchase of treasury shares	–	–	–	–	–	–	–
Release of treasury shares	–	–	28	–	–	(28)	–
Dividends	–	–	–	–	–	(136)	(136)
At 31 December 2018	195	2,607	12	11	447	1,185	4,457

	Equity attributable to equity holders of the company						
All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Special reserve	Retained earnings	Total
At 1 January 2017	205	2,597	(34)	–	447	2,310	5,525
Loss for the year	–	–	–	–	–	(163)	(163)
Issue of ordinary shares under share option schemes*	–	5	–	–	–	–	5
Buyback of equity	(5)	–	–	5	–	(300)	(300)
Purchase of treasury shares	–	–	–	–	–	–	–
Release of treasury shares	–	–	18	–	–	(18)	–
Dividends	–	–	–	–	–	(318)	(318)
At 31 December 2017	200	2,602	(16)	5	447	1,511	4,749

The capital redemption reserve reflects the nominal value of shares cancelled in the Group's share buyback programme. The special reserve represents the cumulative effect of cancellation of the company's share premium account.

Included within retained earnings is an amount of £162m (2017: £162m) relating to profit on intra-Group disposals that is not distributable.

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

Company cash flow statement

Year ended 31 December 2018

All figures in £ millions	Notes	2018	2017
Cash flows from operating activities			
Net loss		**(160)**	(163)
Adjustments for:			
Income tax		**(26)**	70
Net finance costs		**107**	26
Disposals, liquidations and impairment charges		**57**	790
Amounts due from/(to) subsidiaries		**302**	(748)
Net cash generated from/(used in) operations		**280**	(25)
Interest paid		**(68)**	(21)
Tax (paid)/received		**(7)**	9
Net cash generated from/(used in) operating activities		**205**	(37)
Cash flows from investing activities			
Loans repaid by/(advanced to) related parties		**46**	(13)
Interest received		**4**	7
Net cash received from/(used in) investing activities		**50**	(6)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	7	**6**	5
Buyback of equity		**(153)**	(149)
Repayment of borrowings		**(44)**	(243)
Dividends paid to company's shareholders		**(136)**	(318)
Net cash used in financing activities		**(327)**	(705)
Effects of exchange rate changes on cash and cash equivalents		**(5)**	10
Net decrease in cash and cash equivalents		**(77)**	(738)
Cash and cash equivalents at beginning of year		**116**	854
Cash and cash equivalents at end of year	4	**39**	116

Notes to the company financial statements

1. Accounting policies

The financial statements on p209-219 comprise the separate financial statements of Pearson plc.

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

The company has no employees.

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

Investments

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

Lending to/from subsidiaries is considered to be an operating activity and any movements are classified as cash flows from operating activities in the cash flow statement.

New accounting standards

The following standards were adopted in 2018:

› IFRS 15 Revenue from Contracts with Customers

› IFRS 9 Financial Instruments

Adoption of these standards has not had a material impact on the company financial statements.

2. Investments in subsidiaries

All figures in £ millions	2018	2017
At beginning of year	**6,691**	7,441
Subscription for share capital in subsidiaries	**–**	164
Disposals/liquidations	**–**	(430)
Impairments	**(57)**	(360)
Currency revaluations	**76**	(124)
At end of year	**6,710**	6,691

In 2018, impairments relate to the carrying value of intermediate holding company investments. In 2017, impairments, disposals and liquidations relate to restructuring of intermediate holding companies and were largely offset by dividends received.

The recoverability of investments is considered annually and significant estimation is required to determine the recoverable amount. Recoverability is based upon financial information related to the subsidiaries including cash flow projections in conjunction with the goodwill impairment analysis performed by the Group (see note 11 of the Group financial statements).

3. Financial risk management

The company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments, current borrowings and in 2017 a liability to purchase own shares (included within other liabilities). Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost, which approximates fair value. The company's approach to the management of financial risks is consistent with the Group's treasury policy, as discussed in note 19 to the consolidated financial statements. The company believes the value of its financial assets to be fully recoverable.

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in an £3m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £3m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £149m, while a 10% weakening in the value of sterling would increase the carrying value by £184m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

3. Financial risk management continued

The following table analyses the company's derivative assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows (including interest) and as such may differ from the amounts disclosed on the balance sheet.

	Analysed by maturity				Analysed by currency			
All figures in £ millions	Greater than one month and less than one year	Later than one year but less than five years	Five years or more	Total	USD	GBP	Other	Total
At 31 December 2018								
Rate derivatives – inflows	**(20)**	**(288)**	**(343)**	**(651)**	**(40)**	**(167)**	**(444)**	**(651)**
Rate derivatives – outflows	**23**	**289**	**341**	**653**	**254**	**390**	**9**	**653**
FX forwards – inflows	**(251)**	**(35)**	**–**	**(286)**	**–**	**(286)**	**–**	**(286)**
FX forwards – outflows	**275**	**37**	**–**	**312**	**312**	**–**	**–**	**312**
Total	**27**	**3**	**(2)**	**28**	**526**	**(63)**	**(435)**	**28**
At 31 December 2017								
Rate derivatives – inflows	(38)	(975)	(684)	(1,697)	(53)	(751)	(893)	(1,697)
Rate derivatives – outflows	48	1,060	667	1,775	1,003	751	21	1,775
FX forwards – inflows	–	–	–	–	–	–	–	–
FX forwards – outflows	–	–	–	–	–	–	–	–
Total	10	85	(17)	78	950	–	(872)	78

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the company net settles these amounts wherever possible.

Fair value hedge accounting

A foreign currency exposure arises from foreign exchange fluctuations on translation of the company's investments in subsidiaries denominated in USD into GBP. The hedged risk is the risk of changes in the GBPUSD spot rate that will result in changes in the value of the USD investments when translated into GBP. The hedged items are a portion of the company's equity investment in subsidiares denominated in USD. The hedging instruments are a portion of the company's intercompany loans due from subsidiaries which are denominated in USD.

It is expected that the change in value of each of these items will mirror each other as there is a clear and direct economic relationship between the hedge and the hedged item in the hedge relationship. The hedge ratio is 100%. Hedge ineffectiveness would arise if the value of the hedged items fell below the value of the hedging instruments however this is unlikely as the value of the company's investments denominated in USD are significantly greater than the proposed fair value hedge programme.

The value of the hedged items and the hedging instruments are £1.4bn and the change in value during the year which was used to assess hedge ineffectiveness was £76m. There was no hedge ineffectiveness.

Credit risk management

The company's main exposure to credit risk relates to lending to subsidiaries. Amounts due from subsidiaries are stated net of provisions for bad and doubtful debts. The credit risk of each subsidiary is influenced by the industry and country in which they operate, however, the company considers the credit risk of subsidiaries to be low as it has visibility of, and the ability to influence, their cash flows.

4. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2018	2017
Cash at bank and in hand	**50**	2
Short-term bank deposits	**–**	117
	50	119

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates. At the end of 2018 the currency split of cash and cash equivalents was US dollar 0% (2017: 82%), sterling 79% (2017: 17%) and other 21% (2017: 1%).

Notes to the company financial statements

4. Cash and cash equivalents (excluding overdrafts) continued

Cash and cash equivalents have fair values that approximate their carrying amounts due to their short-term nature. Cash and cash equivalents include the following for the purpose of the cash flow statement:

All figures in £ millions	2018	2017
Cash and cash equivalents	**50**	119
Bank overdrafts	**(11)**	(3)
	39	116

5. Financial liabilities – borrowings

All figures in £ millions	2018	2017
Current		
Due within one year or on demand:		
Bank loans and overdrafts	**11**	3
	11	3
Total borrowings	**11**	3

Current borrowings in both years are classified within cash and cash equivalents and do not give rise to financing cash flows. The carrying amounts of the company's borrowings is equal to, or approximately equal to, the market value.

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

All figures in £ millions	2018	2017
US dollar	**11**	–
Sterling	**–**	3
	11	3

6. Derivative financial instruments

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

	2018			2017		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives	**766**	**16**		1,228	26	–
Cross-currency rate derivatives	**577**	**51**	**(35)**	1,389	114	(140)
FX forwards and collars	**434**	**–**	**(24)**	–	–	–
Other derivatives	**473**	**1**	**–**	–	–	–
Total	**2,250**	**68**	**(59)**	2,617	140	(140)
Analysed as expiring:						
In less than one year	**771**	**1**	**(23)**	–	–	–
Later than one year and not later than five years	**795**	**22**	**(1)**	1,545	64	(97)
Later than five years	**684**	**45**	**(35)**	1,072	76	(43)
Total	**2,250**	**68**	**(59)**	2,617	140	(140)

The carrying value of the above derivative financial instruments equals their fair value. Derivatives are categorised as Level 2 on the fair value hierarchy. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

7. Share capital and share premium

	Number of shares 000s	Share capital £m	Share premium £m
At 1 January 2017	822,127	205	2,597
Issue of ordinary shares – share option schemes	923	–	5
Purchase of own shares	(20,996)	(5)	–
At 31 December 2017	802,054	200	2,602
Issue of ordinary shares – share option schemes	**864**	**1**	**5**
Purchase of own shares	**(21,840)**	**(6)**	–
At 31 December 2018	**781,078**	**195**	**2,607**

7. Share capital and share premium continued

The ordinary shares have a par value of 25p per share (2017: 25p per share). All issued shares are fully paid. All shares have the same rights.

The £300m share buyback programme announced in October 2017 was completed on 16 February 2018. In 2017, the Group's brokers purchased 21m shares at a value of £153m of which £149m had been cancelled at 31 December 2017. Cash payments of £149m had been made in respect of the purchases with the outstanding £4m settlement made at the beginning of January 2018. This £4m together with the remaining value of the buyback programme of £147m was recorded as a liability at 31 December 2017. A further 22m shares were purchased under the programme in 2018. The shares bought back have been cancelled and the nominal value of these shares transferred to a capital redemption reserve. The nominal value of shares cancelled at 31 December 2018 was £11m (2017: £5m).

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2017	7,719	34
Release of treasury shares	(1,725)	(18)
At 31 December 2017	5,994	16
Release of treasury shares	**(2,769)**	**(28)**
At 31 December 2018	**3,225**	**(12)**

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £0.8m (2017: £1.5m). At 31 December 2018, the market value of the company's treasury shares was £30m (2017: £44m). The gross book value of the shares at 31 December 2018 amounts to £33m. This value has been netted off with contributions received from operating companies of £45m, resulting in a net credit value of £12m.

9. Contingencies

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

10. Audit fees

Statutory audit fees relating to the company were £35,000 (2017: £35,000).

11. Related party transactions

Subsidiaries

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

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £105m (2017: £122m) and interest receivable from subsidiaries for the year of £105m (2017: £111m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £59m (2017: £42m). Management fees receivable from subsidiaries in respect of centrally provided services amounted to £35m (2017: £69m). Dividends received from subsidiaries were £nil (2017: £701m).

Associates

Amounts due from related parties, disclosed on the face of the company balance sheet, relate to loans to Penguin Random House, an associate of the Group. These loans are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2018 was £nil (2017: £46m). The loans are provided under a working capital facility and fluctuate during the year.

Key management personnel

Key management personnel are deemed to be the members of the Pearson executive.

It is this committee which had responsibility for planning, directing and controlling the activities of the company in 2018. Key management personnel compensation is disclosed in note 36 to the consolidated financial statements.

Notes to the company financial statements

12. Group companies

In accordance with section 409 of the Companies Act 2006 a full list of subsidiaries, partnerships, associates, joint ventures and joint arrangements, the country of incorporation, the registered address and the effective percentage of equity owned, as at 31 December 2018 is disclosed below. Unless otherwise stated, the shares are all indirectly held by Pearson plc. Unless otherwise stated, all wholly-owned and partly-owned subsidiaries are included in the consolidation and all associated undertakings are included in the Group's financial statements using the equity method of accounting. Principal Group companies are identified in **bold**.

Wholly-owned subsidiaries

Registered company name	Country of Incorp.	Reg office
Addison Wesley Longman, Inc.	US	3
Addison-Wesley Educational Publishers Inc.	US	4
AEL (S) PTE Limited	SG	5
Aldwych Finance Limited	UK	1
America's Choice, LLC	US	4
ATI Professional Development LLC	US	4
Atkey Finance Limited	IE	7
Axis Finance Inc.	US	4
Camsaw, Inc.	US	4
CAMSAWUSA, Inc.	US	11
Casapsi Livraria e Editora Ltda	BR	12
Centro Cultural Americano Franquias e Comércio Ltda.	BR	16
Century Consultants Ltd.	US	14
Certiport China Holding, LLC	US	4
Certiport, Inc.	US	4
Cogmed Systems AB	SE	15
Connections Academy of Arkansas, LLC	US	18
Connections Academy of Florida, LLC	US	22
Connections Academy of Iowa, LLC	US	26
Connections Academy of Maine, LLC	US	30
Connections Academy of Maryland, LLC	US	31
Connections Academy of Minnesota, LLC	US	32
Connections Academy of Missouri, LLC	US	33
Connections Academy of Nevada, LLC	US	34
Connections Academy of New Jersey, LLC*	US	14
Connections Academy of New Mexico, LLC	US	35
Connections Academy of New York, LLC*	US	36
Connections Academy of Oregon, LLC	US	40
Connections Academy of Pennsylvania LLC	US	41
Connections Academy of Tennessee, LLC	US	43
Connections Academy of Texas LLC	US	44
Connections Education LLC	US	4
Connections Education of Florida, LLC	US	22
Connections Education, Inc.	US	4
CTI Education Group (Pty) Limited	ZA	50
Dominie Press, Inc.	US	19
Dorian Finance Limited	IE	7
Dorling Kindersley Australasia Pty Limited	AU	51
EBNT Canada Holdings ULC	CA	61
EBNT Holdings Limited	CA	60
EBNT USA Holdings Inc.	US	4
eCollege.com	US	4
Edexcel Limited†	UK	52
Edexcel South Africa Pty Ltd*	ZA	50
Éditions Du Renouveau Pédagogique Inc.	CA	53
Education Development International Plc†	UK	1
Education Resources (Cyprus) Limited	CY	54
Educational Management Group, Inc.	US	55
Embanet ULC	CA	47
Embanet-Compass Knowledge Group Inc.	US	22
Embankment Finance Limited*	UK	6

Registered company name	Country of Incorp.	Reg office
English Language Learning and Instruction System, Inc.	US	57
Escape Studios Limited*	UK	6
Falstaff Holdco Inc.	US	4
Falstaff Inc.	US	58
FBH, Inc.	US	4
George (Shanghai) Commercial Information Consulting Co., Ltd	CN	23
Global George I Limited	KY	8
Global George II limited	CN	56
Globe Fearon Inc.	US	19
Guangzhou Crescent Software Co., Ltd	CN	64
Heinemann Education Botswana (Publishers) (Proprietary) Limited	BW	65
Icodeon Limited*	UK	6
IndiaCan Education Private Limited	IN	2
Integral 7, Inc.	US	4
INTELLIPRO, INC.	US	14
J M Soluções Exportação e Importação Ltda	BR	67
K12 Learning Services LLC	US	4
Kagiso Education Pty Ltd*	ZA	50
Knowledge Analysis Technologies, LLC	US	20
LCCI International Qualifications (Malaysia) Sdn. Bhd.*	MY	68
LCCIEB Training Consultancy., Ltd	CN	69
LessonLab, Inc.	US	19
Lignum Oil Company	US	4
Linx Brasil Distribuidora Ltda.	BR	13
Longman (Malawi) Limited	MW	70
Longman Australasia Pty Ltd	AU	71
Longman Group(Overseas Holdings) Limited	UK	1
Longman Indochina Acquisition, L.L.C.	US	4
Longman Kenya Limited	KE	72
Longman Mocambique Ltda	MZ	45
Longman Romania S.R.L.	RO	25
Longman Swaziland (Pty) Limited	SZ	73
Longman Tanzania Limited*	TZ	74
Longman Zambia Educational Publishers Pty Ltd	ZM	75
Longman Zambia Limited	ZM	75
Longman Zimbabwe (Private) Ltd	ZW	76
Longmaned Ecuador S.A.	EC	77
Major123 Limited	UK	1
MeasureUp, LLC	US	4
Modern Curriculum Inc.	US	19
Multi Treinamento e Editora Ltda	BR	17
National Computer Systems Japan Co. Ltd	JP	80
NCS Information Services Technology (Beijing) Co Ltd	CN	81
NCS Pearson Pty Ltd	AU	51
NCS Pearson Puerto Rico, Inc.	PR	82
NCS Pearson, Inc.	US	32
Ordinate Corporation	US	19

Registered company name	Country of Incorp.	Reg office
Pearson (Beijing) Management Consulting Co., Ltd.	CN	83
Pearson (Guizhou) Education Technology Co., Ltd.	CN	84
Pearson Affordable Learning Fund Limited	UK	1
Pearson America LLC	US	4
Pearson Amsterdam B.V.	NL	85
Pearson Australia Finance Unlimited	UK	1
Pearson Australia Group Pty Ltd	AU	51
Pearson Australia Holdings Pty Ltd	AU	51
Pearson Australia Pty Ltd	AU	51
Pearson Benelux B.V.	NL	85
Pearson Books Limited†	UK	1
Pearson Brazil Finance Limited	UK	1
Pearson Business Services Inc.	US	4
Pearson Canada Assessment Inc	CA	86
Pearson Canada Finance Unlimited	UK	1
Pearson Canada Holdings Inc	CA	86
Pearson Canada Inc.	CA	86
Pearson Central Europe Spółka z ograniczoną odpowiedzialnością	PL	42
Pearson College Limited	UK	1
Pearson DBC Holdings Inc.	US	4
Pearson Desarrollo y Capacitación Profesional Chile Limitada	CL	87
Pearson Deutschland GmbH	DE	88
Pearson Digital Learning Puerto Rico, Inc.	PR	82
Pearson Dollar Finance plc†	UK	1
Pearson Dollar Finance Two Limited	UK	1
Pearson Educacion de Chile Limitada	CL	87
Pearson Educacion de Colombia S A S	CO	90
Pearson Educacion de Mexico, S.A. de C.V.	MX	91
Pearson Educacion de Panama SA	PA	92
Pearson Educacion de Peru S.A.	PE	93
Pearson Educacion SA	ES	94
Pearson Education (Singapore) Pte Ltd	SG	5
Pearson Education Africa (Pty) Ltd	ZA	50
Pearson Education Asia Limited	CN	56
Pearson Education Botswana (Proprietary) Limited	BW	65
Pearson Education do Brasil S.A	BR	63
Pearson Education Hellas SA	GR	28
Pearson Education Holdings Limited†	UK	1
Pearson Education Indochina Limited	TH	95
Pearson Education Investments Limited	UK	1
Pearson Education Korea Limited	KR	96
Pearson Education Limited	UK	1
Pearson Education Namibia (Pty) Limited	NA	97
Pearson Education Publishing Limited	NG	98
Pearson Education S.A.	UY	99
Pearson Education SA	AR	100
Pearson Education South Africa (Pty) Ltd	ZA	50
Pearson Education South Asia Pte. Ltd.	SG	5

Registered company name	Country of Incorp.	Reg office
Pearson Education Taiwan Ltd	TW	101
Pearson Education, Inc.	US	4
Pearson Educational Measurement Canada, Inc.	CA	39
Pearson Educational Publishers, LLC	US	4
Pearson Egitim Cozumleri Tikaret Limited Sirketi	TR	102
Pearson Falstaff (Holdings) Inc.	US	4
Pearson Falstaff Holdco LLC	US	4
Pearson France	FR	103
Pearson Funding Five plc†	UK	1
Pearson Funding Four plc†	UK	1
Pearson Funding Two Limited*†	UK	6
Pearson Holdings Inc.	US	4
Pearson Holdings Southern Africa (Pty) Limited	ZA	50
Pearson in Practice Holdings Limited*	UK	6
Pearson in Practice Skills Based Learning Limited*	UK	6
Pearson in Practice Technology Limited*	UK	6
Pearson India Education Services Private Limited	IN	2
Pearson India Support Services Private Limited	IN	2
Pearson Institute of Higher Education	ZA	50
Pearson International Finance Limited†	UK	1
Pearson Investment Holdings, Inc.	US	4
Pearson IOKI Spółka z ograniczoną odpowiedzialnością	PL	104
Pearson Italia S.p.A	IT	105
Pearson Japan KK	JP	106
Pearson Lanka (Private) Limited	LK	107
Pearson Learning China (HK) Limited	CN	56
Pearson Lesotho (Pty) Ltd	LS	66
Pearson Loan Finance No. 3 Limited	UK	1
Pearson Loan Finance No. 4 Limited	UK	1
Pearson Loan Finance No.2 Unlimited*	UK	6
Pearson Loan Finance Unlimited	UK	1
Pearson Longman Uganda Limited	UG	108
Pearson Malaysia Sdn. Bhd.	MY	62
Pearson Management Services Limited†	UK	1
Pearson Management Services Philippines Inc.	PH	109
Pearson Maryland Inc.	US	11
Pearson Netherlands B.V.	NL	85
Pearson Netherlands Holdings B.V.	NL	85
Pearson Nominees Limited†	UK	1
Pearson Online Tutoring LLC	US	4
Pearson Overseas Holdings Limited†	UK	1
Pearson PEM P.R., Inc.	PR	21
Pearson Pension Nominees Limited	UK	1
Pearson Pension Property Fund Limited	UK	1
Pearson Pension Trustee Limited	UK	1
Pearson Pension Trustee Services Limited†	UK	1
Pearson PRH Holdings Limited	UK	1
Pearson Professional Assessments Limited	UK	1
Pearson Real Estate Holdings Inc.	US	4
Pearson Real Estate Holdings Limited†	UK	1
Pearson Schweiz AG	CH	37
Pearson Services Limited†	UK	1
Pearson Shared Services Limited†	UK	1
Pearson Strand Finance Limited†	UK	1

Registered company name	Country of Incorp.	Reg office
Pearson Sweden AB	SE	15
Pearson VUE Philippines, Inc.	PH	111
Penguin Capital, LLC	US	4
Phumelela Publishers (Pty) Ltd*	ZA	50
PN Holdings Inc.	US	4
ProctorCam, Inc.	US	110
PT Efficient English Services	ID	89
Reading Property Holdings LLC	US	79
Rebus Planning Associates, Inc.	US	10
Reston Publishing Company, Inc.	US	4
Rycade Capital Corporation	US	4
Shanghai AWL Education Software Ltd	CN	78
Silver Burdett Ginn Inc.	US	4
Skylight Training and Publishing Inc.	US	55
Smarthinking, Inc.	US	4
Sound Holdings Inc.	US	4
Spear Insurance Company Limited†	BM	48
Stark Verlag GmbH	DE	88
Sunnykey International Holdings Limited (BVI)	VG	29
The Financial Times (I) Pvt Ltd	IN	24
The Learning Edge International pty Ltd	AU	71
The Waite Group Inc	US	19
TQ Catalis Limited	UK	1
TQ Clapham Limited	UK	1
TQ Education and Training Limited	UK	1
TQ Education and Training Limited	SA	59
TQ Global Limited	UK	1
TQ Group Limited	UK	1
TQ Holdings Limited	UK	1
Trio Parent Holdings LLC	US	4
US Learning Services LLC	US	4
USLS Holdings LLC	US	4
Vue Testing Services Israel Ltd	IL	49
Vue Testing Services Korea Limited	KR	38
Wall Street Institute Kft.	HU	27
Williams Education GmbH	DE	88

* In liquidation

† Directly owned by Pearson plc

Subsidiary addresses

The following list includes all Pearson registered offices worldwide. Please see wholly-owned subsidiaries list opposite for each subsidiary's registered office code.

	Registered office address
1	80 Strand, London, WC2R 0RL, England
2	4th Floor Software Block, Elnet Software City, TS 140 Block 2 & 9, Rajiv Gandhi Salai, Taramani, Chennai, TN, 600113, India
3	C T Corporation System, 155 Federal St., Suite 700, Boston, MA, 02110, United States
4	The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle, DE, 19801, United States
5	9, #13-05/06, North Buona Vista Drive, The Metropolis Tower One, 138588, Singapore
6	Acre House, 11-15 William Road, London, NW1 3ER, England
7	1st Floor Riverview House, 21/23 City Quay, Dublin, D02FP21, Ireland
8	Maples Corporate Services Limited P.O. Box 309, Ugland House, South Church Street, George Town, Grand Cayman, KY1-1104, Cayman Islands
9	3F, Building R2 China Merchants Tower, No.118 Jianguo Road, Chaoyang District, Beijing, China
10	The Corporation Company, 40600 Ann Arbor Rd E Suite 201, Plymouth, MI, 48170, United States
11	The Corporation Trust Company, 2405 York Road, Suite 201, Lutherville Timonium, MD, 21093, United States
12	No 15000, Francisco Matarazzo Avenue, Cj. 51 – Bloco 1 – Edificio New York, City of São Paulo, São Paulo, 05001-100, Brazil
13	Comendador Aladino Selmi Avenue, 4630, Galpão 1, Sala 1, Parque Cidade Campinas, City of Campinas, São Paulo 13069-036, Brazil
14	820, Bear Tavern Road, West Trenton, Mercer, NJ, 08628, United States
15	Gustavslundsvägen 137, 167 51 Bromma, Stockholm, Sweden
16	Comendador Aladino Selmi Avenue, 4630, Galpão 1, Sala 3, Parque Cidade Campinas, City of Campinas, São Paulo 13069-036, Brazil
17	Comendador Aladino Selmi Avenue, 4630, Galpão 1, e2, Sala 10, Parque Cidade Campinas, City of Campinas, São Paulo 13069-036, Brazil
18	The Corporation Company, 124 West Capitol Avenue, Suite 1900, Little Rock, AR, 72201, United States
19	C T Corporation System, 818 West Seventh Street, Suite 930, Los Angeles, CA, 90017, United States
20	The Corporation Company, 7700 E Arapahoe Rd Suite 220, Centennial, CO, 80112-1268, United States
21	Edificio Ochoa 500 Calle de la Tanoa, Suite 401, San Juan, Puerto Rico 00901-1969
22	1200, South Pine Island Road, Plantation, FL, 33324, United States
23	Room 1658, Suites 1604-06, 16/F, 588 Dalian Road, Yangpu District, Shanghai, China
24	Plot No. 3, Bharti Colony Vikas Marg, New Dehli, DL 110092, India
25	Sector de Bucarest 2, calle C.A., Rosett1, n.17, oficina 009RESCO-WORK03, Romania
26	C T Corporation System, 400 E Court Ave, Des Moines, IA, 50309, United States
27	Hermina út 17. 8th floor, Budapest, 1146, Hungary
28	21, Amfitheas Avenue, Paleo Faliro Athens, 17564, Greece
29	Commerce House, Wickhams Cay 1, P.O. Box 3140, Road Town, Tortola, British Virgin Islands
30	C T Corporation System, 128 State St #3, Augusta, ME, 04330, United States

Notes to the company financial statements

Registered office address	
31	7 St. Paul Street, Suite 1660, Baltimore, MD, 21202, United States
32	C T Corporation System Inc., 1010 Dale Street North, St Paul, MN, 55117-5603, United States
33	120, South Central Avenue, Clayton, MO, 63105, United States
34	The Corporation Trust Company of Nevada, 701 S Carson St, Suite 200, Carson City, NV, 89701, United States
35	C T Corporation System, 206 S Coronado Ave, Espanola, NM, 87532-2792, United States
36	CT Corporation, 111 Eighth Avenue, New York, NY 10011, United States
37	Chollerstrasse 37, 6300 Zug, Switzerland
38	21, Mugyo-ro Jung-gu, Seoul, Republic of Korea
39	199 Bay Street, Commerce Court West, Suite 2800, Toronto, ON, M5L1A9, Canada
40	C T Corporation System, 780 Commercial St SE Ste 100, Salem, OR, 97301, United States
41	C T Corporation System, 116 Pine Street, Suite 320, Harrisburg, Dauphin, PA, 17101, United States
42	Ulica Szamocka 8 01-748, Warszawa, Poland
43	C T Corporation System, 800 S Gay St, Suite 2021, Knoxville, TN, 37929-9710, United States
44	CT Corporation System, 1999 Bryan Street, Suite 900, Dallas, TX, 75201, United States
45	Numero 776, Avenida 24 de Julho, Maputo, Mozambique
46	C T Corporation System, 4701 Cox Road, Suite 285, Glen Allen, Henrico, VA, 23060-0000, United States
47	3500, 855 – 2nd Street, S.W., Calgary, AB, T2P 4K7, Canada
48	Thistle House, 4 Burnaby Street, Hamilton, HM11, Bermuda
49	Derech Ben Gurion 2, BSR Building 9th Floor, Ramat Gan, 52573, Israel
50	Auto Atlantic, 4th Floor, Corner Hertzog Boulevard and Heerengracht, Cape Town, 8001, South Africa
51	707 Collins Street, Docklands, Melbourne, VIC, 3008, Australia
52	190, High Holborn, London, WC1V 7BH, England
53	1611, Boul. Cremazie Est, 10th Floor, Montréal, PQ, H2M 2P2, Canada
54	195, Archbishop Makarios III Avenue, Neocleous House, Limassol, 3030, Cyprus
55	Illinois Corporation Service Company, 700 S 2nd Street, Springfield, IL, 62703, United States
56	28/F, 1063 King's Road, Quarry Bay, Hong Kong
57	C/o Corporation Service Company, 251 Little Falls Drive, Wilmington, Delaware, 19808, United States
58	111, 13th Floor, Eighth Avenue, New York, NY, 10011, United States
59	King Fahad Road, Olaya, Riyadh, 58774, 11515, Saudi Arabia

Registered office address	
60	44 Chipman Hill, Suite 1000, Saint Jon, NB, E2L 4S6, Canada
61	Suite 2600, Three Bentall Centre, P.O. Box 49314, 595 Burrard Street, Vancouver, BC, V7X 1L3, Canada
62	Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No 8, Jalan Kerinchi, 59200 Kuala Lumpur, Malaysia
63	Comendador Aladino Selmi Avenue, 4630, Galpão 1, Mezanino, Sala 5, Parque Cidade Campinas, City of Campinas,São Paulo, 13069-036, Brazil
64	Suite 1201 (site: self-made No. 1219), No. 85 Huacheng Avenue, Tianhe District, Guangzhou, China
65	Plot 50371, Fairground Office Park, Gaborone, Botswana
66	C/o Du Preez, Llebetrau & Co, 252 Kingsway, Next to USA Embassy, Maseru, Lesotho
67	João Scarparo Netto Avenue, 84, Bloco B, Ground Floor, Sala 44, Ed Unique Village Offices, Loteamento Center Santa Genebra, City of Campinas, São Paulo, 13080-655, Brazil
68	Unit 621, 6th Floor, Block A, Kelana Centre Point. No 3, Jalan SS7/9, Kelana Jaya 47301 Petaling Jaya, Selangor Darul Ehsan, Malaysia
69	Room 305, Building 2, 6555 Shangchuan Road, Pudong District, Shanghai, China
70	Parkway House, Hannover Avenue, Blantyre, Malawi
71	707 Collins Street, Docklands, Melbourne, VIC, 3008, Australia
72	Queensway House, Kaunda Street, Nairobi, Kenya
73	Robinson Bertram, 3rd Floor, Sokhzmlilio Bldg, Mbabane, Swaziland
74	P O Box 45, IPS Building, Maktaba Street, Dar es Salaam, Tanzania
75	Mlungushi Conference Centre, Centre Annex, Great East Road, Lusaka, Zambia
76	Stand 1515, Cnr Tourle Road/Harare Drive, Ardbennie, Harare, Zimbabwe
77	Andalucía y cordero E12-35. Edificio CYEDE piso 1, Oficina 11, Sector "La Floresta", Quito, Pichincha, Ecuador
78	Suite 302-9,Block 3, No. 333 Weining Road, Changning District, Shanghai, China
79	C/O Pearson Education, 501 Boylston St, Boston, MA, 02116, United States
80	Teikoku Hotel Tower 18F, 1-1-1 Uchi Saiwai-Cho, Chiyoda-ku, Tokyo, Japan
81	Suite 1201, Tower 2, No. 36 North Third Ring East Road, Dongcheng District, Beijing, China
82	268 Munoz Rivera Avenue, Suite 1400, San Juan, 00918, Puerto Rico
83	Suite 1208, 12/F, Tower 2, No. 36 North Third Ring East Road, Dongcheng District, Beijing, China
84	Suites 3-28 (2:3), Shi Guang Jun Yuan, No. 89 Hubin Road, Goden Sun Technology Industrial Park, High Technical & Industrial Development District, Guiyang City, Guizhou Province, China

Registered office address	
85	Gatwickstraat 1, Amsterdam, 1043 GK, Netherlands
86	26 Prince Andrew Place, Don Mills, Toronto, ON, M3C 2T8, Canada
87	Oficina N°117, edificio Casa Colorada, calle Merced N°838-A Santiago Centro, Santiago, Chile
88	2, Lilienthalstrasse, Hallbergmoos, 85399, Germany
89	30th Floor, Ratu Plaza Office Tower, Jl. Jend. Sudirman Kav 9, Jakarta, 10270, Indonesia
90	Carrera 7 Nro 156 – 68, Piso 26, Bogota, Colombia
91	Calle Antonio Dovali jaime #70, Torre B, Piso 6, Col. Zedec ed Plaza Santa Fe, del. Álvaro Obregon, Ciudad de Mexico, CP 01210, Mexico
92	Punta Pacifica, Torres de las Americas, Torre A Piso 15 Ofic. 1517, Panama, 0832-0588, Panama
93	Cal. Los Halcones, no. 275, Urb. Limatombo, Lima, Perú
94	28, Ribera del Loira, Madrid, 28042, Spain
95	87/1 Capital Tower Building, All Seasons Place unit 1604 – 6 16th floor, Wireless Road, Lumpini, Pathumwan, Bangkok, Thailand
96	6F Kwanjeong Building, 35, Cheonggyecheon-Ro, Jongno-gu, Seoul, 03188, Republic of Korea
97	Unit 7 Kingland Park, 98 Nickel Street, Prosperita, Windhoek, Namibia
98	8, Secretariat Road, Obafemi Awolowo Way, Alausa, Ikeja, Lagos State, Nigeria
99	Juan Benito Blanco 780 – Plaza Business Center Montevideo, Uruguay
100	Humboldt 1509 piso 6 (C1414CTM), Ciudad Autonoma de Buenos Aires, Argentina
101	No 219, Room D, 11F, Sec 3, Beixin Road, New Taipei City, Xindian District, 23143, Taiwan
102	Barbaros Bulvarı. No:149, Dr. Orhan Birman İş Merkezi Kat:3, Gayrettepe Beşiktaş, Istanbul, 34349, Turkey
103	3-15, Immeuble Terra Nova II, Rue Henri Rol Tanguy, Montreuil, 93100, France
104	Ulica Jana Henryka Dąbrowskiego 77A 60-529, Poznań, Poland
105	16, Corso Trapani, Turin, 10100, Italy
106	1-5-15, Kanda-Sarugakucho, Chiyoda-ku, Tokyo, Japan
107	Orion City, Irgel Building #752, Colombo, 09, Sri Lanka
108	Plot 8, Berkley Road, Old Kampala, Uganda
109	7/F North Tower, Rockwell Business Center COR. Sheridan & United Street, Brgy. Highway Hills, Mandaluyong, Philippines
110	National Registered Agents, inc., 160 Greentree Dr Ste 101, Dover, Kent, DE, 19904, United States
111	27/F Trident Tower, 312 Sen. Gil Puyat Avenue, Makati City, Metro Manila, Philippines

Partly-owned subsidiaries

Registered company Name	Country of Incorp.	% Owned	Reg office
Certiport China Co Ltd	CN	50.69	1
Educational Publishers LLP	UK	85	2
GED Domains LLC	US	70	3
GED Testing Service LLC	US	70	4
Heinemann Publishers (Pty) Ltd	SA	75	5
Maskew Miller Longman (Pty) Limited	SA	75	5
Pearson Education Achievement Solutions (RF) (Pty) Limited	SA	97.3	5
Pearson South Africa (Pty) Ltd	SA	75	5

Associated undertakings

Registered company Name	Country of Incorp.	% Owned	Reg office
ACT Aspire LLC	US	50	6
Avanti Learning Centres Private Limited‡	IN	23.27	7
eAdvance Proprietary Limited‡	ZA	35.11	8
Institute for Private Education & Training KSCC*	KU	49.02	9
Karadi Path learning Company Private Limited‡	IN	24.91	11
Learn Capital Special Opportunities Fund I, L.P.‡	US	99.59	16
Learn Capital Venture Partners II, L.P.‡	US	72.93	16
Learn Capital Venture Partners IIIA, L.P.‡	KY	99.00	10
Learn Capital Venture Partners, L.P.‡	US	99.15	16
Omega Schools Franchise Limited	GH	49.05	12
Peking University Pearson (Beijing) Cultural Development Co., Ltd	CN	45	13
Penguin Random House Limited	UK	25	2
Penguin Random House LLC	US	25	6
Tenyi Education Company Limited	CN	49	17
The Egyptian International Publishing Company-Longman	EG	49	14
Zaya Learning Labs Private Limited‡	IN	20	15

* In liquidation
‡ Accounted for as an 'Other financial asset' within non-current assets

Partly-owned subsidiaries & associated undertakings company addresses

	Registered office address
1	Suite 1804, No.99 Huichuan Road, Changning District, Shanghai City, China
2	80 Strand, London, WC2R 0RL, England
3	C T Corporation System, 4701 Cox Road, Suite 285, Glen Allen, Henrico, VA, 23060-0000, United States
4	The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle, DE, 19801, United States
5	Auto Atlantic, 4th Floor, Corner Hertzog Boulevard and Heerengracht, Cape Town, 8001, South Africa
6	C/o Corporation Service Company, 251, Little Falls Drive, Wilmington, Delaware, 19808, United States
7	16 Paschimi Marg, Vasant Vihar, New Delhi, DL, India
8	Office 201, Parktown Quarter, Corner 3rd & 7th Avenue, Parktown North, Johannesburg, 2193. South Africa
9	P.O. Box No. 6320, 32038 Hawalli, Kuwait City, Kuwait
10	Campbells Corporate Services Limited, Floor 4, Willow House, Cricket Square, Grand Cayman, KY1-9010, Cayman Islands
11	3A Dev Regency II, First Main Road, Gandhinagar, Adyar, Chennai, TN, India
12	2nd Floor OTS Building, off Accra-Winneba Road, Kasoa second, Kasoa P.O. Box WJ973, Weija, Accra. Ghana
13	Suite 216, No. 127-1 Zhongguancun North Street, Haidian District, Beijing, China
14	10a Hussein Wassef St, Midan Missaha, Dokki Giza, 12311, Egypt
15	Unit No. 404, New Udyog Mandir 2, Mogul Lane, Mahim(West), Mumbai, MH, 400016, India
16	Incorporating Services, Ltd. 3500 S Dupont Way, Dover, Kent DE, 19901 United States
17	28/F, 1063 King's Road, Quarry Bay, Hong Kong

Five-year summary

All figures in £ millions	2014	2015	2016	2017	2018
Sales: By geography					
North America	2,906	2,940	2,981	2,929	**2,784**
Core	910	815	803	815	**806**
Growth	724	713	768	769	**539**
Continuing	4,540	4,468	4,552	4,513	**4,129**
Discontinued	343	312	–	–	**–**
Total sales	4,883	4,780	4,552	4,513	**4,129**
Adjusted operating profit: By geography					
North America	444	480	420	394	**362**
Core	122	105	57	50	**57**
Growth	32	(3)	29	38	**59**
Penguin Random House	69	90	129	94	**68**
Continuing	667	672	635	576	**546**
Discontinued	55	51	–	–	**–**
Total adjusted operating profit	722	723	635	576	**546**

All figures in £ millions	2014	2015	2016	2017	2018
Operating margin – continuing	14.7%	15.0%	13.9%	12.8%	**13.2%**
Adjusted earnings					
Total adjusted operating profit	722	723	635	576	**546**
Net finance costs	(64)	(46)	(59)	(79)	**(24)**
Income tax	(118)	(105)	(95)	(55)	**27**
Non-controlling interest	1	–	(2)	(2)	**(2)**
Adjusted earnings	541	572	479	440	**547**
Weighted average number of shares (millions)	810.9	813.3	814.8	813.4	**778.1**
Adjusted earnings per share	66.7p	70.3p	58.8p	54.1p	**70.3p**

Prior periods have not been restated to reflect the adoption of IFRS 15 and IFRS 9 in 2018.

All figures in £ millions	2014	2015	2016	2017	2018
Cash flow					
Operating cash flow	649	435	663	669	**513**
Operating cash conversion	90%	60%	104%	116%	**94%**
Operating free cash flow	413	255	549	525	**448**
Operating free cash flow per share	50.9p	31.4p	67.4p	64.5p	**57.6p**
Free cash flow	413	152	310	227	**473**
Free cash flow per share	50.9p	18.7p	38.0p	27.9p	**60.8p**
Net assets	5,985	6,418	4,348	4,021	**4,525**
Net debt	1,639	654	1,092	432	**143**
Return on invested capital					
Total adjusted operating profit	722	723	635	576	**546**
Operating tax paid	(163)	(129)	(63)	(75)	**(43)**
Return	559	594	572	501	**503**
Gross basis:					
Average invested capital	9,900	10,317	11,464	11,568	**10,672**
Return on invested capital	5.6%	5.8%	5.0%	4.3%	**4.7%**
Net basis:					
Average invested capital	9,835	9,422	7,906	8,126	**7,544**
Return on invested capital	5.7%	6.3%	7.2%	6.2%	**6.7%**
Dividend per share	51.0p	52.0p	52.0p	17.0p	**18.5p**

Financial key performance indicators

The following tables and narrative provide further analysis of the financial key performance indicators which are described in the financial review of the annual report on p44-50 , are shown within the key performance indicators on p2 of the annual report and shown in notes 2 and 8 of the notes to the consolidated financial statements.

Adjusted performance measures

The annual report and accounts reports results and performance on a headline basis which compares the reported results both on a statutory and on a non-GAAP (non-statutory) basis. The Group's adjusted performance measures are non-GAAP (non-statutory) financial measures and are also included in the annual report as they are key financial measures used by management to evaluate performance and allocate resources to business segments. The measures also enable investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income and expenditure relating to acquisition and disposal transactions, major restructuring programmes and certain other items that are also not representative of underlying performance.

The Group's definition of adjusted performance measures may not be comparable to other similarly titled measures reported by other companies. A reconciliation of the adjusted measures to their corresponding statutory measures is shown below.

Sales

Underlying sales movements exclude the effect of exchange, the impact of portfolio changes arising from acquisitions and disposals and the impact of adopting new accounting standards that are not retrospectively applied. Portfolio changes are calculated by taking account of the additional contribution (at constant exchange rates) from acquisitions made in both the current year and the prior year. For acquisitions made in the prior year the additional contribution is calculated as the sales made in the period of the current year that corresponds to the pre-acquisition period in the prior year. Sales made by businesses disposed in either the current year or the prior year are also excluded. Constant exchange rates are calculated by assuming the average exchange rates in the prior year prevailed throughout the current year. These non-GAAP measures enable management and investors to track more easily, and consistently, the underlying sales performance of the Group.

All figures in £ millions	North America	Core	Growth	Total
Statutory sales 2018	2,784	806	539	**4,129**
Statutory sales 2017	2,929	815	769	**4,513**
Statutory sales decrease	(145)	(9)	(230)	**(384)**
Comprising:				
Underlying (decrease)/increase	(43)	3	6	**(34)**
Portfolio changes including the impact of adopting new accounting standards (IFRS 15 see note 1b)	(11)	(7)	(198)	**(216)**
Exchange differences	(91)	(5)	(38)	**(134)**
Statutory sales decrease	(145)	(9)	(230)	**(384)**
Statutory decrease	(5)%	(1)%	(30)%	**(9)%**
Constant exchange rate decrease	(2)%	–	(25)%	**(6)%**
Underlying (decrease)/increase	(1)%	–	1%	**(1)%**

Adjusted operating profit

Adjusted operating profit excludes the cost of major restructuring; other net gains and losses on the sale of subsidiaries, joint ventures, associates and other financial assets; intangible charges, including impairment, relating only to goodwill and intangible assets acquired through business combinations and the direct costs of acquiring those businesses; the impact of UK pension GMP equalisation in 2018; and the impact of US tax reform in 2017. Further details are given below under 'Adjusted earnings per share'. Underlying adjusted operating profit movements exclude the effect of exchange, the impact of portfolio changes arising from acquisitions and disposals and the impact of adopting new accounting standards that are not retrospectively applied. Portfolio changes are calculated by taking account of the additional contribution (at constant exchange rates) from acquisitions made in both the current year and the prior year.

For acquisitions made in the prior year the additional contribution is calculated as the operating profit made in the period of the current year that corresponds to the pre-acquisition period in the prior year. Operating profit made by businesses disposed in either the current year or the prior year is also excluded. Constant exchange rates are calculated by assuming the average exchange rates in the prior year prevailed throughout the current year. This non-GAAP measure enables management and investors to track more easily, and consistently, the underlying operating profit performance of the Group.

All figures in £ millions	2018	2017
Operating profit	**553**	451
Cost of major restructuring	**102**	79
Other net gains and losses	**(230)**	(128)
Intangible charges	**113**	166
UK pension GMP equalisation	**8**	–
Impact of US tax reform	**–**	8
Adjusted operating profit	**546**	576

All figures in £ millions	North America	Core	Growth	PRH	Total
Adjusted operating profit (decrease)/increase	(32)	7	21	(26)	**(30)**
Comprising:					
Underlying increase	2	5	30	6	**43**
Portfolio changes including the impact of adopting new accounting standards (IFRS 15 see note 1b)	(16)	(1)	(2)	(33)	**(52)**
Exchange differences	(18)	3	(7)	1	**(21)**
Adjusted operating profit (decrease)/increase	(32)	7	21	(26)	**(30)**
Constant exchange rate (decrease)/increase	(4)%	8%	74%	(29)%	**(2)%**
Underlying increase	1%	10%	97%	10%	**8%**

Adjusted earnings per share

Adjusted earnings includes adjusted operating profit and adjusted finance and tax charges. Adjusted earnings is included as a non-GAAP measure as it is used by management to evaluate performance and allocate resources to business segments and by investors to more easily, and consistently, track the underlying operational performance of the Group over time. Adjusted earnings per share is calculated as adjusted earnings divided by the weighted average number of shares in issue on an undiluted basis.

The following items are excluded from adjusted earnings:

Cost of major restructuring In May 2017, the Group announced a restructuring programme to run between 2017 and 2019 to drive significant cost savings. The costs of this restructuring programme are significant enough to exclude from the adjusted operating profit measure so as to better highlight the underlying performance (see note 4).

Other net gains and losses These represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets and are excluded from adjusted earnings as they distort the performance of the Group as reported on a statutory basis.

Intangible charges These represent charges in respect of intangible assets acquired through business combinations and the direct costs of acquiring those businesses. These charges are excluded as they reflect past acquisition activity and do not necessarily reflect the current year performance of the Group.

Financial key performance indicators

Other net finance income/costs These include finance costs in respect of retirement benefits, finance costs of deferred consideration and foreign exchange and other gains and losses. Finance income relating to retirement benefits are excluded as management does not believe that the consolidated income statement presentation under IAS 19 reflects the economic substance of the underlying assets and liabilities. Finance costs relating to acquisition transactions are excluded as these relate to future earn outs or acquisition expenses and are not part of the underlying financing. Foreign exchange and other gains and losses are excluded as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity.

UK pension GMP equalisation In 2018 the impact of adjustments arising from clarification of guaranteed minimum pension (GMP) equalisation legislation in the UK, as outlined in note 25 of the notes to the consolidated financial statements, has also been excluded as this relates to historical circumstances.

Impact of US tax reform In 2017, as a result of US tax reform, the Group's share of profit from associates was adversely impacted by £8m. This amount has been excluded from adjusted earnings as it is considered to be a transition adjustment that is not expected to recur in the near future.

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

All figures in £ millions	2018	2017
Profit for the year	**590**	408
Non-controlling interest	**(2)**	(2)
Cost of major restructuring	**102**	79
Other net gains and losses	**(230)**	(128)
Intangible charges	**113**	166
Other net finance income/(costs)	**31**	(49)
UK pension GMP equalisation	**8**	–
Impact of US tax reform	**–**	8
Tax	**(65)**	(42)
Adjusted earnings	**547**	440
Weighted average number of shares (millions)	**778.1**	813.4
Adjusted earnings per share	**70.3p**	54.1p

Return on invested capital

Return on invested capital (ROIC) is included as a non-GAAP measure as it is used by management and investors to track investment returns and by management to help inform capital allocation decisions within the business. ROIC is calculated as adjusted operating profit less operating cash tax paid expressed as a percentage of average invested capital. Invested capital includes the original unamortised goodwill and intangibles. Average values for total invested capital are calculated as the average monthly balance for the year. ROIC is also presented on a net basis after removing impaired goodwill from the invested capital balance. The net approach assumes that goodwill which has been impaired is treated consistently to goodwill disposed as it is no longer being used to generate returns.

All figures in £ millions	2018 Gross	2017 Gross	2018 Net	2017 Net
Adjusted operating profit	**546**	576	**546**	576
Operating tax paid	**(43)**	(75)	**(43)**	(75)
Return	**503**	501	**503**	501
Average goodwill	**6,675**	7,236	**3,547**	3,794
Average other non-current intangibles	**2,438**	2,606	**2,438**	2,606
Average intangible assets – pre-publication	**999**	995	**999**	995
Average tangible fixed assets and working capital	**560**	731	**560**	731
Average invested capital	**10,672**	11,568	**7,544**	8,126
Return on invested capital	**4.7%**	4.3%	**6.7%**	6.2%

Operating cash flow

Operating cash flow is calculated as net cash generated from operations before the impact of items excluded from the adjusted income statement plus dividends from joint ventures and associates (less the re-capitalisation dividends from Penguin Random House); less capital expenditure on property, plant and equipment and intangible software assets; plus proceeds from the sale of property, plant and equipment and intangible software assets; less finance lease principal payments; plus special pension contributions paid; and plus cost of major restructuring paid. Operating cash flow is included as a non-GAAP measure in order to align the cash flows with the corresponding adjusted operating profit measures.

All figures in £ millions	2018	2017
Net cash generated from operations	**547**	462
Dividends from joint ventures and associates	**117**	458
Re-capitalisation dividends from Penguin Random House	**(50)**	(312)
Purchase of property, plant and equipment	**(70)**	(82)
Purchase of intangible software assets	**(130)**	(150)
Proceeds from sale of property, plant and equipment and intangible software assets	**128**	–
Finance lease principal payments	**(4)**	(5)
Special pension contribution	**–**	227
Net (proceeds from)/ cost paid re major restructuring	**(25)**	71
Operating cash flow	**513**	669

For information, cash conversion, calculated as operating cash flow as a percentage of adjusted operating profit, is also shown as a non-GAAP measure as this is used by management and investors to measure underlying cash generation by the Group.

All figures in £ millions	2018	2017
Adjusted operating profit	**546**	576
Operating cash flow	**513**	669
Cash conversion	**94%**	116%

For information, operating cash flow, operating free cash flow and total free cash flow, which are non-GAAP measures, are disclosed and reconciled in note 33 of the notes to the consolidated financial statements as they are commonly used by investors to measure the cash performance of the Group.

Net debt and earnings before interest, tax, depreciation and amortisation (EBITDA)

For information, the net debt/EBITDA ratio is shown as a non-GAAP measure as it is commonly used by investors to measure balance sheet strength. EBITDA is calculated as adjusted operating profit less depreciation on property, plant and equipment and less amortisation on intangible software assets.

All figures in £ millions	2018	2017
Adjusted operating profit	**546**	576
Depreciation (excluding items included in 'cost of major restructuring')	**66**	80
Amortisation on intangible software assets (excluding items included in 'cost of major restructuring')	**87**	82
EBITDA	**699**	738
Cash and cash equivalents	**568**	518
Marketable securities	**–**	8
Derivative financial instruments	**9**	–
Bank loans and overdrafts	**(43)**	(15)
Bonds	**(672)**	(1,062)
Finance lease liabilities	**(5)**	(8)
Total	**(143)**	(559)
Cash and cash equivalents classified as held for sale	**–**	127
Net debt	**(143)**	(432)
Net debt/EBITDA ratio	**0.2x**	0.6x

Glossary of major products and services

AcceleratED pathways: a corporate education benefit, where Pearson partners with companies to improve employee development by focusing on the educational needs of a specific business and its people, helping to strategically align educational assistance spending to the talent objectives of the organisation.

ACCUPLACER®/MyFoundationsLab®: this all-in-one diagnostics and intervention programme combines The College Board's assessment programme with Pearson's proven online intervention solution. It identifies the areas where a student needs work and then takes a personalised learning path that helps them work on their individual skills deficit. Last year alone, Pearson delivered 9.2M tests on the ACCUPLACER® platform.

Artificial intelligence (AI): describes machines that can sense and interact with environments in a perception-planning-action cycle, or with other machines, without explicit programming. This is typically accomplished through Machine Learning (ML) which is the development, and application of algorithms that improve their performance (inference) at some task based on experience (training). Pearson takes a human-centric perspective of AI that considers the entire learning ecosystem when developing AI capabilities including ethics, privacy, appropriate uses and user needs.

Bug Club: a core reading programme for 4-11 year olds, which has everything needed to deliver the 2014 UK primary curriculum and includes over 590 finely levelled titles, available in print and eBook format and a unique online learning platform with in-built assessment.

BTEC: taught in colleges, schools and university throughout the world, a BTEC gives learners of all levels and ages the knowledge and skills they need for career success, now and into the future. The unique experience BTEC learners get of having to apply the knowledge and skills they've learned to real-life scenarios means more employers and learners are choosing BTEC.

› **BTEC Level 1/Level 2 Firsts:** BTEC Firsts allow level 2 learners to develop knowledge and understanding by applying their learning and skills in real-life scenarios. Combined with other qualifications, they enable learners to progress to further study, an apprenticeship, or into employment.

› **BTEC Level 1/Level 2 Tech Awards:** studied alongside GCSE, BTEC Tech Awards provide a great introduction to a professional sector where students learn transferable skills they'll use if they progress to further study, and in their future career.

› **BTEC Level 2 Technicals:** designed in collaboration with employers and industry professionals, BTEC Level 2 Technicals provide career-focused, applied courses for post-16 level 2 learners in a specialist occupational area. They support progression to an apprenticeship, to further technical study, or into the workplace.

› **BTEC Level 3 Nationals:** allow level 3 learners to apply their learning in real-life scenarios to develop the specialist knowledge and skills they need to progress towards their chosen career path, whether that is through further or higher education, an apprenticeship or directly into the workplace.

› **BTEC Higher Nationals:** available at levels 4 and 5, BTEC Higher Nationals are internationally recognised, career-focused higher education courses which are the same level as the first and second years of a degree course. Co-designed with employers and representing the most up-to-date professional standards, they support learners to develop the real-world knowledge, skills and behaviours needed to succeed, allowing them to move on to complete degree and progress in their chosen career path.

Clinical Assessment: our Clinical Assessment business provides assessments to help professionals improve lives by providing valuable information that can identify and manage an individual learner's strengths and weaknesses and learning barriers. For example, AimsWeb Plus provides universal screening, benchmarking, and progress monitoring assessments to give educators the reliable data they need to improve students' maths and reading skills.

The Clinical Assessment portfolio also offers a range of assessments serving a diverse audience of professionals including Psychologists, Speech Language Pathologists, Occupational Therapists and more. These professionals rely on leading measures like the Wechsler Scales of Intelligence, which assess an individual's cognitive strengths and weaknesses or the Minnesota Multiphasic Personality Inventory (MMPI), a world renowned measure of psychopathology and personality.

Other examples of our Clinical products include:

› **Behaviour Assessment System for Children:** a comprehensive set of rating scales and forms to help children thrive in their school and home environments through effective behaviour assessment. BASC provides a complete picture of child and adolescent behaviour. School and clinical psychologists have depended on BASC for more than 20 years.

› **Goldman-Fristoe Test of Articulation-Third Edition (GFTA-3):** a systematic means of assessing an individual's ability to pronounce different speech sounds of Standard American English in order to diagnose different disorders which can inhibit an individual's articulation. It provides information about an individual's speech sound ability by sampling both spontaneous and imitative sound production in single words and connected speech.

Connections Academy: The Connections Academy online school programme for grades K12 is a comprehensive collection of online learning products and school support services for online public schools across the US, most of which carry the Connections Academy name. In addition, International Connections Academy is a private online school for grades K12 and serves students worldwide.

Digitally–enabled learning: learning that is enabled through digital media, tools or technology.

Edexcel GCSE/A level: AS and A levels – sometimes called General Certificates of Education (GCE) or Advanced levels – are normally studied after level 2 in a BTEC or GCSEs. They mainly involve studying the theory of a subject, combined with some investigative work, and are usually studied full time over two years at school or college. AS and A levels are at level 3 on the National Qualifications Framework.

English Benchmark: a motivating English test for young learners aged 6-13, which proves students' English abilities to parents, monitors learning progress, and ensures teaching targets the right skills. English Benchmark measures students' speaking, listening, reading, and writing skills, through fun and interactive tablet-based activities, and uses AI-based automated scoring to provide immediate detailed reports for teachers and parents that include students' strengths, suggestions for improvement, and recommended activities to improve their skills.

ePen: an assessment scoring tool with various features designed for use by a variety of education stakeholders, including Education Agency officials, educators, independent contractors, and Pearson employees.

GED: GED Testing Service is a joint venture between Pearson and the American Council on Education, and is part of a programme which measures proficiency in language arts, maths, science and social studies. It allows learners to obtain their high school equivalency credential, be placed in college courses, and even earn college credit. In addition to the actual GED test, Pearson VUE also offers a suite of products and services to help people prepare for this assessment, including GED Ready, a predictive practice test that provides learners with a detailed score report, which outlines areas of strength and those that need more attention and gives learners the tools they need to be successful.

Global Learning Platform (GLP): ultimately Pearson's single product platform that will leverage best-in-class technology to deliver the future generation of global digital learning experiences. The GLP is not a product, but it will change the way we design and deliver products, providing a modern, reliable consumer grade experience across all devices in all geographies. Products built on GLP will deliver improved outcomes and provide a user-centered, globally consistent, locally optimised, learning experience for our customers.

Inclusive Access: provides all US college students with equal and affordable access to course materials by their first day of class eliminating key hurdles to their academic success. Inclusive Access can also provide institutions a valuable tool to help increase retention by lowering the withdraw and fail rates caused by the lack of students preparedness. By utilising Inclusive Access institutions can drive down the overall cost of attendance for students by realising savings in using digital course materials rather than new print materials.

Intelligent Essay Assessor (IEA): a suite of capabilities for evaluating written responses for both content and quality of writing. IEA can score and provide immediate feedback on different types of written responses, both essay length and short answer, across a variety of content subject areas including English Language Arts, science, social studies, and text-based maths.

Learning Catalytics: a web-based and interactive student response tool, accessible via smartphones, tablets, and laptops, which encourages team-based learning and allows students to take part in a variety of interactive tasks and thinking.

Longman English+: an app that provides personalised English language learning for learners in China.

MyLab/Mastering: reaching over 10 million learners globally, MyLab/Mastering is a collection of online homework, tutorial, and assessment products designed for personalised learning experiences that engage students and improve their academic performance. These teaching and learning platforms empower instructors to reach every student. For example, in a study conducted at five higher education institutions in the US, it was found an increase of 18 attempts on MyLab Math homework was associated with a fivefold increase in the probability of passing a Developmental Math course.

MePro: a complete, blended service solution for English language learning, which provides a personalised learning experience through courseware & assessment linked to the Global Scale of English (GSE), remediation and stretch content for personalised learning, professional development for teachers and a parent app.

MyPedia: an integrated learning programme which aims to transform how education is delivered in schools by bringing together all learning and teaching tools – including publishing resources, digital content and assessments – to help improve foundational skills in literacy and numeracy in pre-primary to grade 8 children.

Online Program Management (OPM): a market in which Pearson is a provider by partnering with colleges and universities around the world to bring their degrees and short courses online, helping students gain skills for the changing world of work. Pearson provides the upfront capital and infrastructure that institutions need, as well as providing services such as student enrolment and retention, course design and development, and market research and insights.

Partner Print Rental: a partnership with campus bookstores and other online retailers that offer a "rent only" option of high-demand print products at a lower cost to students.

Pearson Affordable Learning Fund (PALF): invests 'patient capital' in independently run, for-profit, education start-ups using innovative approaches to improving learner outcomes and increasing access at scale. By investing in new educational ventures, Pearson helps to increase the quality of education for millions of learners, identify what's next in the world's largest growth markets, and generate attractive financial returns.

Pearson College London: a not-for-profit, alternative degree provider, offering a university education that's powered by industry experience.

Pearson Institute of Higher Education: Pearson Institute of Higher Education (Pty) Ltd. (formerly Midrand Graduate Institute and CTI Education Group) is registered with the Department of Higher Education and Training as a private higher education institution under the Higher Education Act, 101, of 1997. We have 12 campuses across South Africa. Our campuses engage in a range of employability initiatives in order to enhance students success in the workplace. We have over 8000 students and over 35 different nationalities on our campuses. We have over 25 qualifications and programmes across a range of faculties, all equipping students with the skills they need in the workplace. We use an optimal combination of technology-enhanced and traditional learning methods, as well as practical application, to prepare students for the technology-driven and fast-changing work environment of the 21st century. Producing employable graduates is a priority for Pearson Institute.

Pearson Test of English Academic (PTE Academic): is an English language test that enables people to prove their English skills when applying to study in English or to migrate to Australia or New Zealand. The test is completed on a computer in a secure test centre and measures the candidate's speaking, listening, reading, and writing skills. Unlike competitor tests, PTE Academic uses AI-based automated scoring to provide a more accurate and reliable result with most test takers receiving scores within two days during 2018.

Glossary of major products and services

Pearson VUE: Pearson VUE is a comprehensive computer-based testing company that develops and delivers millions of certification and licensure exams each year for the most highly regarded exam owners in every industry from academia and admissions to IT and healthcare. Pearson VUE is the global leader in exam development and psychometric services, programme management tools and services, and diverse delivery options, including online proctoring and anywhere proctoring, as well as a network of 20,000 highly secure global test centres.

Q-Interactive: a digital system for administering and scoring tests in a one-on-one setting between an examiner and examinee. Testing takes place on two iPads with an app called Assess. The simplicity of the system improves accuracy and speed in providing real-time scoring and allows for greater flexibility.

Remote proctoring: in our Pearson VUE business, remote proctoring is when a proctor and a test-taker are not physically located in the same room. In most cases, the person takes their entire exam on a computer while the proctor watches through an online video camera.

Revel: replaces traditional texts with an engaging learning experience that prepares students for class. It presents an affordable, seamless blend of author-created digital text, media, and assessment based on learning science. Students can read, practice, and study anywhere, anytime, and on any device. With assignment and tracking tools, Revel also allows instructors to gauge student understanding and engagement with the material inside and outside the classroom, empowering them to spend class time on meaningful instruction. For example, each additional five hours a student spent on Revel Psychology readings was associated with an increase of 2.19 (±1.10) percentage points on unit exams.

Sistemas: a complete package of products and services for private and public K12 schools in Brazil. With a single price per student, we provide courseware, educational assistance, professional development, management consulting, and marketing support, as well as digital content.

Smarthinking: expert online tutoring and writing review that gives students 24x7 access to academic help from live professional educators and uses a proven, problem-solving approach to help students learn, gain confidence, and handle future assignments on their own. Complementing Pearson content and technology solutions, Smarthinking's human delivered services have 30 years of experience improving student performance, course persistence, and overall retention. Karen Reilly, Campus Dean of Learning Support at Valencia College, said that "The results of our analysis show that Smarthinking is an important component in our overall academic support programme; it is essential that students have access to tutoring assistance after hours and on weekends – whenever a learning moment is happening."

Speak Out: part of our English Language Teaching product portfolio, Speak Out is an English language course that includes video content from the BBC to engage students and make teaching easier by exposing students to a wide array of words and accents, familiarising students with English as it is spoken. By watching many such videos, students learn proper pronunciation, expand their vocabulary bank and reinforce their English-language confidence.

TestNav: an innovative online test delivery platform that is part of Pearson's comprehensive assessment solution. TestNav delivers millions of secure, high-stakes state and national tests in K12 schools every year. Secure, scalable, and reliable, TestNav provides engaging and interactive testing to students who learn and play in a digital environment.

The Enabling Programme (TEP): one of Pearson's largest business transformation projects. Its aim is to make us a simpler organisation, with globally consistent ways of working across HR, finance, procurement, supply chain, and rights and royalties.

Top Notch: part of our English Language Teaching product portfolio, Top Notch is a communicative English course that prepares students to communicate in English with an emphasis on cultural fluency that enables students to navigate the social, travel and business situations that they will encounter in their lives. Top Notch makes English unforgettable through the right input of language, intensive practice, and systematic recycling using a diverse array of speakers around the world who have a wide range of native and non-native accents.

Wiz.me: an English language learning app within Wizard schools that gives students the opportunity to continue to learn and practice their skills outside the classroom.

Wizard: a franchise of language-learning schools that offers eight different language courses and uses the international certification, TOEIC, as a teaching mode. TOEIC is the Test of English for International Communication (TOEIC®), an examination for international communication, which measures the English proficiency of a foreigner in everyday situations, and especially in situations related to the job market.

In the **US Higher Education landscape**, we partner and provide products and services to a diverse array of educational institutions including:

- **Community College:** sometimes called junior colleges, are two-year schools that provide affordable postsecondary education as a pathway to a four-year degree.
- **Private Not For Profit:** a private foundation that is engaged in social or public benefit activities and is registered as such with the IRS. It derives its revenue from a small group of donors without any intention of earning income for its owners. All the profits and donations of a not-for-profit organisation are used in operating the organisation as per its objectives (i.e., charity or public service).
- **4 Year Public Universities:** a university offering a Bachelor's degree that is predominantly funded by public means through a national or subnational government, as opposed to private universities.
- **For-Profit Universities:** a university that is owned and run by a private organisation or corporation.

US School Assessment Business: helps young children and students reach their educational aspirations through meaningful feedback. Testing plays an integral role in determining educator and student success, and we are the largest provider of educational assessment services in the US. We partner with departments of education and educators to develop new and personalised ways of learning through effective, scalable assessments that measure 21st century skills and inform instruction throughout the school year. Examples of the tests we support include:

- **SAT:** an entrance exam used by most colleges and universities to make admissions decisions. It is a multiple-choice, pencil-and-paper test with the purpose to measure a high school student's readiness for college, and provide colleges with one common data point that can be used to compare all applicants.
- **National Assessment of Educational Progress (NAEP):** The National Assessment of Educational Progress (NAEP) is the largest nationally representative and continuing assessment of what America's students know and can do in various subject areas.
- **ACT:** The ACT® test is the nation's most popular college entrance exam accepted and valued by all universities and colleges in the United States.

Shareholder information

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

Corporate website

The investors' section of our corporate website www.pearson.com/corporate/investors.html provides a wealth of information for shareholders. It is also possible to sign up to receive e-mail alerts for reports and press releases relating to Pearson at www.pearson.com/corporate/news/media/email-alert-signup.html

Shareholder information online

Shareholder information can be found on our website www.pearson.com/corporate/investors.html

Our registrar, Equiniti, also provides a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at www.shareview.co.uk. For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA. Telephone 0371 384 2233* or, for those shareholders with hearing difficulties, textphone number 0371 384 2255*.

Information about the Pearson share price

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

2018 dividends

	Payment date	Amount per share
Interim	14 September 2018	5.5 pence
Final[1]	10 May 2019	13 pence

1 Subject to approval by shareholders at the Annual General Meeting.

2019 financial calendar

Ex-dividend date	**4 April**
Record date	**5 April**
Last date for dividend reinvestment election	**16 April**
Annual General Meeting	**26 April**
Payment date for dividend and share purchase date for dividend reinvestment	**10 May**

Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0371 384 2043*.

Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0371 384 2268*.

Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to www.shareview.co.uk/dealing or call customer services on 0345 300 0430*.

Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact their telephone dealing helpline on 03456 037 037* or, for online dealing, log on to www.shareview.co.uk/dealing. You will need your shareholder reference number as shown on your share certificate.

A postal dealing service is also available through Equiniti. Please telephone 0371 384 2248* for details or log on to www.shareview.co.uk to download a form.

* Lines open 8.30 am to 5.30 pm Monday to Friday (excluding UK public holidays).

ShareGift

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

American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact Bank of New York Mellon, Shareholder Correspondence (ADR), PO Box 505000, Louisville, KY 40233-5000, telephone 1 (866) 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively, you may e-mail shrrelations@cpushareownerservices.com

Voting rights for registered ADR holders can be exercised through Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

Shareholder information

Share register fraud: protecting your investment

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

For more information, please log on to our website at www.pearson.com/corporate/investors/managing-your-shares/share-register-fraud.html

Tips on protecting your shares

› Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation

› Inform our registrar, Equiniti, promptly when you change address

› Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or, better still, make arrangements to have the dividend paid directly into your bank account

› Consider holding your shares electronically in a CREST account via a nominee.

Reliance on this document

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

Forward-looking statements

This document includes forward-looking statements concerning Pearson's financial condition, business and operations and its strategy, plans and objectives. In particular, all statements that express forecasts, expectations and projections, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing, anticipated cost savings and synergies and the execution of Pearson's strategy, are forward-looking statements.

By their nature, forward-looking statements involve known and unknown risks and uncertainties because they relate to events and depend on circumstances that may occur in the future. They are based on numerous expectations, assumptions and beliefs regarding Pearson's present and future business strategies and the environment in which it will operate in the future. There are various factors which could cause Pearson's actual financial condition, results and development to differ materially from the plans, goals, objectives and expectations expressed or implied by these forward-looking statements, many of which are outside Pearson's control. These include international, national and local conditions, as well as the impact of competition. They also include other risks detailed from time to time in Pearson's publicly-filed documents and, in particular, the risk factors set out in this document, which you are advised to read. Any forward-looking statements speak only as of the date they are made and, except as required by law, Pearson gives no undertaking to update any forward-looking statements in this document whether as a result of new information, future developments, changes in its expectations or otherwise. Readers are cautioned not to place undue reliance on such forward-looking statements.

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