Pearson

Annual report and accounts 2019

Focused on digital, lifelong learning

Who we are
We are the world's learning company, operating in 70 countries around the world, with more than 22,500 employees. 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 lifelong employability prospects.

We aim to support learners throughout their lifetime for every moment that matters – whether this is exam preparation and success, graduating from university, getting a new job, studying for a postgraduate degree, changing career, or looking for a new challenge.

Our purpose 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.

Our commitment to sustainability and learning outcomes

Across our operations, we are committed to a new **2030 Sustainability Strategy** to unleash untapped talent – helping everyone to reach their full potential and shape a brighter future.

Read more about our Sustainability Strategy on p16

The outcomes that are being demanded of education are evolving. The next generation of **Efficacy** builds on what we have learned, to create the tools Pearson needs to be a trusted guide to lifelong learning, with the aspiration of improving learning outcomes.

Read more about our approach to Efficacy on p27

In this report

Our reporting structure
From 2020, we will be operating within a new structure. This is outlined on p12. In this annual report, the 'Strategy' section follows our new structure. The 'Financial review' and 'Operating performance review' sections continue to use our geographical reporting structure – North America, Core and Growth – as these relate to our 2019 performance. Next year's reporting will use our new operating structure throughout.

Strategic report
The strategic report, up to and including p50, is formed of three sections: 'Overview', 'Our strategy' and 'Our performance', and was approved for issue by the Board on 6 March 2020 and signed on its behalf by:

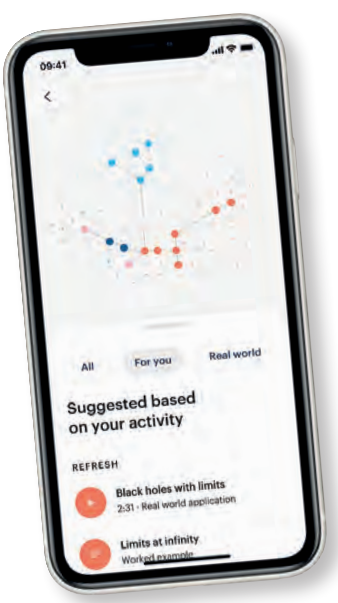
Coram Williams
Chief Financial Officer

Unleashing a world of talent

AIDA

Aida helps students learn calculus and apply it in the real world.

p35



BTEC

I want to be a director who makes a change.

p20

VIRTUAL SCHOOLS

I have the flexibility to work with others to make STEM less intimidating.

p39

Key performance indicators

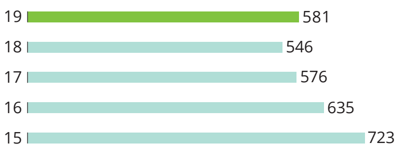
Financial measures

Sales
£million R

£3,869m

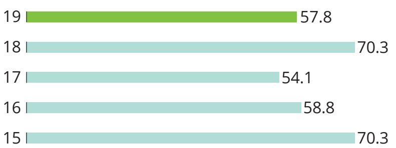
Adjusted operating profit[1]
£million R

£581m



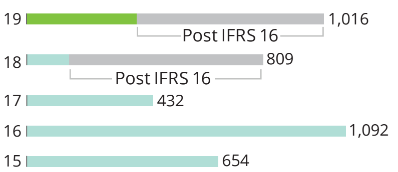
Adjusted earnings per share[1]
pence R

57.8p



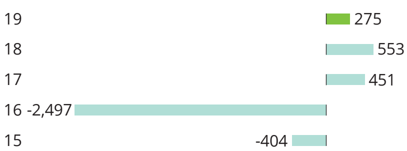
Net debt[2]
£million

£1,016m



Operating profit/loss[3]
£million

£275m

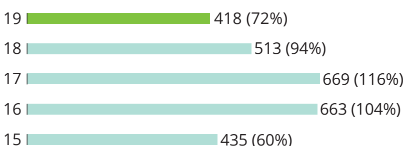


Basic earnings per share[3]
pence

34.0p

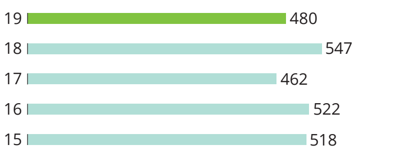
Operating cash flow and cash conversion[1] £million R

£418m



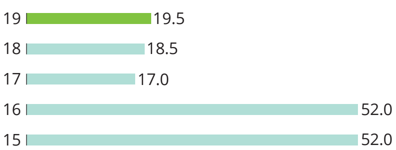
Net cash generated from operations[3]
£million

£480m



Dividend per share
pence

19.5p



Total shareholder returns[4] R

-30.55%	1-year TSR
-34.28%	5-year TSR
+6.42%	10-year TSR

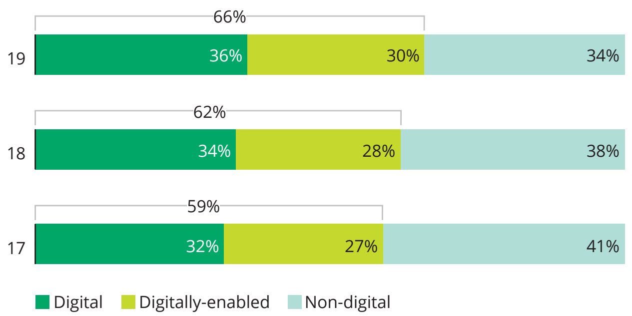
1 See p30–32 for an explanation of these alternative performance measures.
2 2019 includes impact of IFRS 16 (see note 1b to the consolidated financial statements). 2018 is presented on a post IFRS 16 basis for comparability.
3 Equivalent statutory measure.
4 Source: Datastream.

Note: See p201–204 for full reconciliation of the alternative performance measures to the equivalent statutory measure.

R See how we link strategy to management reward on p84

Business measures

Digital revenue[1]



1 Excludes GEDU, Wall Street English (WSE) and US K12 Courseware. GEDU was sold in 2017, WSE was sold in 2018; US K12 Courseware was held for sale in 2018 and was sold in 2019.

Digital platforms

- Launch of the Pearson Learning Platform (PLP)
  - Revel launched commercially with 17 titles in 2019
- Launch of AI-enabled calculus app, Aida

Simplification

In-year incremental cost savings achieved in 2019	£130m
Annualised cost savings achieved from simplification programme	£335m
Percentage of revenue on one Enterprise Planning Resource (ERP) system	c.80%

Business growth in our key businesses

Virtual Schools	
Underlying revenue	+6%
Full Time Equivalent (FTE) students in continuing partner schools	+5%
Global Online Program Management	
Underlying revenue	+10%
Enrolments	+6%
Professional Certification (Pearson VUE)	
Underlying revenue	+10%
Test volume	+8%
US Student Assessment	
Underlying revenue	(1)%
Digital/print test volume %	57%/43%
English	
English Courseware underlying revenue	+3%
PTE Academic test volume	+17%
UK Assessments & Qualifications	
Underlying revenue	+6%
US Higher Education Courseware	
Underlying revenue	(12)%
Digital/print revenue split %	63%/37%

Non-financial measures

Talent and employee engagement

p21

Active Employee Resource Groups	50
Employee Engagement Network meetings connecting employees with the Board	2

Reduce our carbon footprint

	2019	vs. 2018
Global greenhouse gas emissions (tCO_2e)	80,421	(14)%

Improve gender diversity

	2019	2018
Female Board members	33%	30%
Female senior managers[2]	34%	31%
Female employees	59%	62%
GB median gender pay gap	12%	14%

2 Two reporting lines from the Chief Executive.

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

Chair's introduction

Pearson is transforming to succeed

Sidney Taurel
Chair

Dear shareholders,
In a year of significant change for Pearson, the Board and the Executive Management team continued to work together to lay the foundations to create a sustainable, profitable, digitally-enabled organisation which helps millions of learners make progress through their lives.

Progress and performance

We entered 2019 with a determination to return to growth on our top line and deliver increased profit. However, despite a strong performance across 76% of Pearson, a disappointing performance in our US Higher Education Courseware business, driven by a much quicker decline in print textbooks, meant underlying Group revenue was flat. Underlying adjusted operating profit was up 6% on 2018, in line with the bottom of our guidance range. We acknowledge there are still challenges to overcome and we remain focused on building on the progress we have made so far – Pearson is now a leaner, more efficient and more digital company with a strong balance sheet and this gives us a platform from which we can address these challenges.

Technology is disrupting every industry and education is no exception. The US Higher Education Courseware market is experiencing fundamental structural shifts as students swap expensive textbooks for more affordable, digital options. There is an increasing focus on employability and reskilling or upskilling for different careers in a lifetime. There is a greater demand for lifelong learning and the digital tools and services required to fulfil this demand. A key tenet of our strategy has been the steady investment in digital innovation and technology, which places us in an advantageous position to meet these changing demands, and ultimately to deliver sustainable growth in earnings and dividends over the long-term.

Succession planning and leadership changes

In December 2019, we announced that John Fallon had informed the Board of his intention to retire from his role as Chief Executive. John has been in role for seven years. In that time, he has worked tirelessly to lead Pearson through a period of significant change, and has been successful in transforming it from a media conglomerate to a single-focused learning company. Under his leadership, Pearson has become a simpler, more digitally-focused business, underpinned by a stronger balance sheet and better positioned to deliver a sustainable and healthy future.

Such a transformation and shift in the ways a company operates is never an easy change, and the Board and I would like to thank John for his significant contribution during his tenure. A succession process is under way that will consider both external and internal candidates.

In January 2020, we announced that Coram Williams, our Chief Financial Officer (CFO), had informed the Board that he will be leaving Pearson to take on a comparable role elsewhere. On behalf of the Board, I would like to thank Coram for the fundamental role he has played in the company's achievements over the last five years. We wish him all the best in his new role.

Sally Johnson, our current Deputy CFO, will succeed Coram when he leaves Pearson at our AGM in April. At that point, Sally will become the CFO and an Executive Director on the Board. Sally is exceptionally well-qualified to be the new CFO of Pearson. She has a deep understanding of the company and the markets we operate in. She will be a strong addition to the Board, bringing a focused, analytical and commercial perspective.

Simplifying Pearson

2019 saw continued progress in our planned simplification programme initiated in 2017. The programme is on track to deliver ahead of both our initial and upwardly revised targets for cost savings, with total annualised cost savings of £335m by the end of 2019.

We also continued to simplify the portfolio to enable us to focus on the biggest opportunities in education, and we completed the disposal of our US K12 Courseware business. In December, we announced an agreement to sell our remaining 25% stake in Penguin Random House to Bertelsmann for approximately $675m. The formation of Penguin Random House in 2013 created the first truly global consumer book publishing company and has created significant value for Pearson shareholders, generating c.£1.9bn in net disposal proceeds and dividends. The disposal is enabling us to return capital to you, our shareholders, through a £350m share buyback which commenced in January 2020.

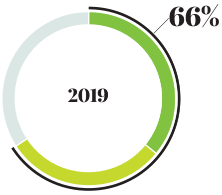
You can read more about these accomplishments in the Chief Executive's overview that follows.

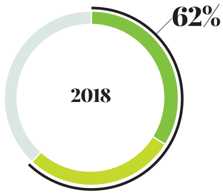
Maintaining financial strength while looking to Pearson's longer-term future

The Board remains confident about Pearson's medium and long-term prospects and our growth opportunities are significant. Our immediate focus is on improving financial and operational performance and continuing to grow the 76% of the business that represents the future growth drivers of Pearson. Our longer-term vision is to deliver lifelong learning to customers, leading to increased employability and work-related skills – all as part of a wider ecosystem of delivery partners and stakeholders.

Our capital allocation policy is 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, as evidenced through the two share buybacks we have launched. While our focus is generally on organic investment, we have recently completed two small but interesting acquisitions – Lumerit Education and Smart Sparrow. You can read more about these in the Chief Executive's overview that follows. Thanks to the strength of our balance sheet, we now have optionality for more should we see a good strategic opportunity. Our strategy is clearer than ever, and due to management's work to modernise the company, any potential future acquisitions can now be integrated quickly and seamlessly.

Pearson digital revenue[1]





	2019	2018
Digital	**36%**	34%
Digitally-enabled	**30%**	28%
Non-digital	**34%**	38%

1 Excludes WSE and US K12 Courseware.

Progress over the last three years

	2019	2018	2017
Adjusted operating profit	**£581m**	£546m	£576m
Dividend per share	**19.5p**	18.5p	17p
Net debt	**£1,016m**	£143m	£432m

This includes the impact of IFRS 16. Excluding this, and on a like for like basis, 2019 net debt is £374m.

As we navigate through a period of significant change, both within Pearson and across the industry as a whole, our financial strength provides a firm foundation for our business transformation, and our continuing investment in the company to grow shareholder value through the prudent allocation of capital.

We have proposed a final 2019 dividend of 13.5p resulting in a full year dividend of 19.5p, an increase of 5%. This is consistent with underlying profit growth in 2019 and reflects the Board's continued confidence in the future growth of the business and our sustainable and progressive dividend policy.

Corporate governance and engagement with stakeholders

In 2019, our Board continued to engage with, and encourage participation from employees, educators, learners, community and thought leaders, as well as other stakeholders to ensure the company is contributing to wider society. My fellow Board members and I attended and spoke at various events with employees and other stakeholders in London and in the US. In addition we held meetings with a broad range of stakeholders to understand the challenges and opportunities they faced with digital teaching and learning in schools, higher education and industry.

Furthermore, the Board and I spent time throughout the year with many of our shareholders to ensure we maintained an open, transparent dialogue on our strategy and progress.

Nourishing talent and focusing on sustainability

As always, I would like to thank all colleagues in the business for their efforts towards our achievements in 2019. All of our employees are lifelong learners – and our biggest asset. We want to make Pearson the employer of choice. We know that we must continue to do for employees what we do for people all over the world: help them make progress in their lives and careers. That starts by enabling our employees to grow and develop using the world's very best learning and assessment tools made by us.

In addition, the Board continues to focus on having a corporate culture that is inclusive, innovative, meritocratic and aligned with the company's purpose, values and strategy. Part of this means ensuring that all Directors act with integrity, lead by example and promote the desired culture.

In December, my fellow Board members and I identified a diverse pipeline of 'ready later' emerging talent both at the Executive management level and other key roles, and plans have been put in place to accelerate their path to succession where possible.

As a company with a clear purpose, our sustainability footprint is increasingly becoming more integrated into our core business and operations. In 2020, I am pleased that we are launching our 2030 Sustainability Strategy, in line with the UN Sustainable Development Goals (SDGs). We are committed to embedding Environmental, Social and Governance (ESG) principles more deeply across our business. We are focused on leveraging our products and partnerships to advance equity in learning for under-represented groups and equip learners with the skills they need to build a more sustainable future for all. We will continue to scale up our initiatives to respect human rights and minimise environmental impact across our value chain. The Board has been very engaged on this topic because integrating ESG across the company is an important way to drive growth, manage risk and reduce costs. You can read more about our approach in our Sustainability section on p16 and Governance section on p51

Board composition

We made two important additions to the Board in 2019. I would like to officially welcome Graeme Pitkethly, the CFO of Unilever PLC and NV, and Sherry Coutu, angel investor and entrepreneur. We are benefiting from Graeme's financial expertise, global overview and deep understanding of consumer behaviour, particularly as we look to build more direct relationships with learners. Sherry's expertise in building fast-growth, entrepreneurial businesses, focused on technology and education, is already proving invaluable, as we target digital-first, high-growth business models.

The Board benefits from a wide range of backgrounds, skills and experience spanning key areas for the future of Pearson, such as digital technology, sustainability, international regulatory affairs and entrepreneurship. We are also passionate about supporting diversity and promoting diverse talent internally, as part of our company goal to unleash our world of talent.

To this effect, I am delighted with the appointment of Sally Johnson. My fellow Board members and I aim to further support the talent pipeline. You can read more about our employee engagement and talent initiatives in the Governance sections which begins on p51

The world's learning company

Our purpose is to empower people to progress in their lives through learning. Our vision is to enable that to happen through a direct relationship with tens of millions of learners who we will support through a lifetime of learning, helping them link their education to better employment. 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.

The Board remains confident about Pearson's longer-term prospects and resilience to near term challenges and we are excited about the opportunities to build 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

Chief Executive's strategic overview

We are pioneering new forms of digital learning

John Fallon
Chief Executive

Dear fellow shareholders,
After over seven years as Chief Executive, and more than 22 years with the company, I will be retiring from Pearson later this year. I'd love to be retiring with the flags flying high, and the share price performing well. Sadly, that's not currently the case. I do believe, however, that, in time, we will all see the benefits of the huge amount that has been achieved over the last few years – and that the company is increasingly well placed to capitalise on what is proving to be a long and difficult transformation.

The power and the purpose of digital learning

Pearson's purpose is as strong and powerful as at any point in the company's 175-year history. Our business model – to grow and prosper as a company by enabling millions of people around the world to grow and prosper throughout their own lives by providing a digital platform that makes learning engaging, rewarding and affordable – is highly sustainable.

In one of my first Chief Executive reports, I argued that digital learning would be one of the great global growth opportunities of the next 20 years. I believe that even more strongly today. The exponential pace of digital change – and the impact of artificial intelligence and machine learning on the world of work – will require all of us to acquire fresh knowledge and learn new skills throughout an ever-longer working life.

One important way to meet this need is by combining relevant content with assessment, powered by technology, to make learning more adaptive, personalised and accessible. As the world's digital learning company – 66% of our £3.9bn in annual revenues last year were digital or digitally-enabled – Pearson is better placed than anyone to do this.

The challenge and the opportunity in US Higher Education Courseware

In the short term, however, our progress has been overshadowed by the fact that, as America's leading college publisher, we have first had to work our way through arguably one of the most challenging of analogue to digital disruptions yet faced by any part of the media sector. We will survive it with our market leadership intact, and, with an overwhelmingly digital business, well placed to grow again. But it is proving to be a very painful journey to get there.

The 24% of Pearson that is still in US Higher Education Courseware declined last year by 12%, more than we guided to at the start of the year, as students embraced digital over print much more quickly. Digital revenue grew, but textbook sales fell close to 30%.

In 2010, we had a $2bn US Higher Education Courseware business, split 75:25 between print and digital. By 2022, we expect to have an almost fully-digital[1] US Higher Education Courseware business well set to grow again.

Every industry is being disrupted in some way by technology, and ours is no exception. 10 years ago, we sold 21m textbooks to American college students; last year, we sold fewer than 4m. The college textbook has not been disaggregated in the way that the music album was – which saw music revenues decline significantly from peak to valley before now starting to grow again. It has not been displaced by 'free' models of the sort that has reduced newspaper advertising revenues dramatically and ensured analogue dollars become digital cents. Nor have we suffered a Kodak 'moment', pushed into obsolescence by the digital revolution.

This year, a third of all courses taught in American Universities will use our content and homework tools, just as they did a decade ago. In fact, use of these resources is greater now than it ever was. We have 8m platform subscriptions a year for our digital courses, which enable students to complete assignments and receive feedback, 35% more than a decade ago. In addition, students use over 2m eTexts, with all the rich content and pedagogy of our textbooks, at a cheaper price and a fraction of the weight. The level of engagement – in faculty use and student feedback – is greater than ever. And, students are willing to pay – $80 for a fully adaptive platform-based course; $40 for an eText.

So, why has our US Higher Education Courseware revenue halved in ten years? If our digital products are now deeply embedded in the workflow of our customers,

Laying the foundations for growth

Deconstructing decades of complexity to build the foundations for Pearson's transformation into a platform-based company, to become the winner in digital learning.

Legacy

Simplification

Global property portfolio reduced by net **30** properties
c.2,500 applications decommissioned
81 data centres closed
1 ERP system running 80% of Group revenue

c.£1bn of costs removed since 2013

Platform-based

Pearson

1 The core US Higher Education Courseware business is expected to be almost entirely digital. We also have an Advanced Placement business selling higher education content into US schools. This, together with several other smaller, non-college channels, comprises roughly c.$200m of print revenue which has been broadly stable.

shouldn't we have largely seen print migrate to digital on an orderly 1:1 basis? The answer lies in a number of factors that are specific to this market. Whilst professors decide what courseware to adopt, it is the students who buy them. This means that many of our sales go through thousands of campus stores, as well as through Amazon and specialist online retailers. And, whilst the physical textbook has an edition cycle of three to five years, a student often needs it for no more than a single four-month semester.

These market conditions proved fertile for the emergence of a highly disruptive trend – a large secondary market in the analogue product, the print textbook, enabled by technology. College textbooks have been bought and sold second-hand for decades. What technology changed was the nature of it: from some students selling back their books to the campus store at the end of the semester, to most students choosing to rent on a term-by-term basis. And, the scale of it: in 2010, the secondary market was a fraction of the size of the primary one; by last year, it had overtaken it.

Salvation rests in our own hands. The disruption has come to the analogue past, not the digital future, of US Higher Education Courseware. The future of learning will be digital, and consumer-defined. Experience, outcomes and affordability will all matter. The new Pearson Learning Platform – on which we are now launching our first products – will be the platform on which this future of learning will be built. It will enable engaging, immersive, learning experiences, that are personalised, diagnostic and adaptive. It will be fast, flexible and secure, enabling better learning outcomes at lower prices. A digital-first approach to updating features, content and tools – made for the benefit of the teacher and the learner, so the digital product is never out of date. A digital-first approach to pricing, in which students share in the financial benefits of a much more scalable, platform-based model.

Building on those 8m platform subscriptions, and 2m eTexts, Pearson will be well placed to start to regain share from secondary sales of its own textbooks – and do it in a sustainable and purposeful way.

A simpler, more efficient company

For many years, Pearson as a whole was overly dependent for profits from the US Higher Education Courseware business. The fact that we've been able to survive disruption on this scale is due to all that we have done to make Pearson as a whole a much simpler, more efficient and modern company. Over the last six years, we've reduced the cost base by around £1bn, and headcount by around 20,000, due to divestitures and restructuring. We've decommissioned around 2,500 applications, closed 81 data centres, and implemented 16 new global, scalable, cloud-based platforms. 80% of the company runs on one ERP system today – which includes our major businesses in the US, UK and Canada. We plan to start the roll out across further markets in 2020.

As a result, benchmarking the costs of running Pearson against other large companies, we are now much more efficient than we were a few years ago. It will take some time yet to fully bed in all these new systems but, as we do so, they will give us the ability to both achieve further efficiencies and provide the data by which we can engage more deeply with our learners and support them at key moments of learning throughout their lives.

Investment, innovation and growth

As a simpler, more efficient company, we are able to invest more organically – significantly more than we were investing five years ago – and we're starting to see the benefits. In spite of those ongoing challenges in US Higher Education Courseware, in 2019, Pearson as a whole was able to match prior year underlying sales for the first time since 2014. That's because the broader 76% of Pearson grew by 4% in aggregate. Our growth businesses – Pearson VUE, Virtual Schools, OPM and PTE Academic – grew by 8%. We also performed well across our wider assessment and courseware businesses, where the majority have stabilised or grown.

Innovation and investment have come in many forms across the company in the last year:

- We launched Aida, the world's first AI-inspired calculus app to help maths students across the globe to apply calculus into the real world, breaking the unseen barrier to STEM (Science, Technology, English and Maths) careers.
- We exported our highly regarded UK vocational qualifications overseas through our work growing the BTEC brand in markets such as the UAE, Turkey and Sri Lanka.
- We supported the Egyptian government to digitally transform its national assessment system for high school students – Pearson's biggest assessment commercial agreement by test volume to date.
- We developed a commercial agreement with the UK Home Office for the UK Secure English Language Test (SELT), which will drive future growth in our English business.
- We agreed a partnership with Oxford University to offer new short courses for learners.

These growth businesses will continue to grow in 2020, as we invest in new forms of online education, in better, smarter, online assessments, in new AI-inspired direct-to-learner apps, and in shifting Pearson's focus to link education and employability with the workplace.

This shift will be helped by a small, bolt-on acquisition – Lumerit Education – we made last year, our first in five years. You can read a case study on Lumerit Education in the Governance report on p61. Lumerit Education helps address the issues of college degree completion and affordability. It uses data and analytics to match learner profiles to academic programmes and will support the growth of our nascent 'Accelerated Pathways' business. Accelerated Pathways works with major corporates to maximise the value of their employee tuition assistance programmes and offer education as an employee benefit, which we see as a major new growth opportunity.

A second small acquisition – Smart Sparrow, an ed-tech company which specialises in the creation of rich, interactive content – will help our Pearson eText to become much more of an engaging, interactive and personalised learning experience. The strength of our balance sheet – which our CFO, Coram Williams, talks about on p30 – means that we are able to complement increased organic investment with bolt-on acquisitions that enable us to expand into faster-growing markets more quickly. And, the work we've done to simplify the company means we can now integrate these acquisitions much more quickly and seamlessly.

A fully-focused learning company

For almost 50 years, Pearson has been proud to play our part in the publishing and commercial success of first Penguin, and then more recently Penguin Random House. At the end of 2019, we announced that we are planning to sell our remaining 25% stake to our partner, Bertelsmann, for approximately $675m, which is expected to close in the first half of 2020. Using the proceeds, we launched a £350m share buyback programme in early 2020. Our total stake in Penguin Random House has generated c.£1.9bn in net disposal proceeds and dividends for Pearson. We know the company is in good hands and we wish our colleagues and authors every future

Chief Executive's strategic overview

success. This enables Pearson now to be completely focused on being the world's digital learning company.

Efficacy 2.0 – designing better learning outcomes and greater impact

We can be more confident in the positive impact our increased investment will have on learning outcomes because of all the work we've done over the last seven years to design efficacy into our new products and services. In 2013, we committed to publicly reporting on the efficacy of some of our largest products. We have made good progress on this journey and on improving outcomes, based on what we learned. The next generation of Efficacy builds on this to take this important work much further.

We aim to improve our impact on learning outcomes, support company growth, build public trust, and ensure our products, assessments, services and solutions are known worldwide for their positive impact for customers. You can read more about this on p27

A more sustainable and prosperous company

I see this commitment to efficacy – to holding ourselves to account publicly for the learning outcomes we help enable – as fundamental to ensuring the long-term sustainability of the business. It is one of the key means by which we align our business with the UN Sustainable Development Goals (SDGs), particularly goal 4 on quality education, goal 8 on decent jobs and economic growth, and goal 10 on reducing inequality. As I noted earlier, at its very core, Pearson is a company driven by a sense of purpose – we exist to empower people to progress in their lives through learning. The deeper we integrate sustainability into our business and strategy, the bigger and more positive will be the impact we have on society – and the more likely we are to prosper over time. We are publishing our new 2030 Sustainability Strategy with this annual report, building on our focus of identifying, supporting and developing people so they can reach their full potential and create a better world for us all. You can read more on our 2030 Sustainability Strategy on p16 and throughout the strategic report.

Developing our own world of talent

As we saw again last year, the power of our purpose is one of the things that sustains so many talented and committed colleagues through some challenging times for the company. I am proud of the fact that, in all the major changes we've had to make, we've stayed true to our values of being brave, imaginative, decent and accountable.

In times of great change and disruption, it is especially important, in retaining the engagement and support of colleagues, to be as open and transparent as possible – to acknowledge when mistakes have been made and lessons learned, to provide a forum in which colleagues can challenge decisions and help us make better ones as a result.

So, I'm pleased that we've strengthened the extensive ways in which we already engage with colleagues across the company with the launch of an Employee Engagement Network. This small group of cross-functional employees has been created to enable the Board and Executive team to hear perspectives on what is working and what can improve across Pearson.

We have become much more structured and deliberate in how we make Pearson a more diverse and inclusive company. We are doing this through a collaboration model, including our new Global Diversity & Inclusion (D&I) council, which I chair, a network of Employee Resource Groups, as well as a D&I advocate network underpinned by a community of practice. People come to Pearson to learn, and to grow personally and professionally. Our goal is to be the number one company in the world for learning and development. And, we are doing this by offering dedicated learning time to all of our people and access to our own world-class learning products and services.

On a personal note, I'd like to thank Coram Williams who has led the finance function with great intelligence, integrity and grit through these challenging times. He has made big strides in improving the clarity and transparency of our financial reporting. He has also been fundamental in making Pearson a simpler and more efficient company, in strengthening the balance sheet and in enabling us to invest in the future growth of the company. His key partner in that work has been Sally Johnson, our Deputy CFO. She knows the company and our markets exceptionally well, is highly regarded across the company and she is going to make a brilliant CFO.

What the future holds

Although it may not yet be obvious externally, I believe we are now on the cusp of the next phase in the Pearson transformation. One of the biggest issues the world faces today is the exponential pace of digital disruption – through AI, machine learning and automation. Indeed, this year we published our first Global Learner Survey, which not only gauges the views of learners around the world, but also gives great insights in the shifting sands of education as learners look for new ways to consume education in a digital age (read more on p9)

All this brings great opportunities, but it brings great challenges too. The disruption is hollowing out many middle-skill jobs, it risks bringing much greater economic and social inequality, and it demands that society embraces lifelong learning.

This gives Pearson a very special opportunity. The world needs a learning company willing to hold itself to account for the learning outcomes its products enable. It needs a company with the relationships around the world – the emergent ecosystem – to have an impact at scale. And, it needs a company that defines lifetime value to help influence millions of people through a lifetime of learning.

An exciting future is in store, where we are empowered to make a direct connection with tens of millions of learners at a key moment in their lives and become their trusted partner. We now have the balance sheet, cost base, platform, capabilities – and the product pipeline – to go after that future very aggressively, and that's what we are going to do. We have invested the proceeds of our simplification programme in digital learning. Now, we must unleash its full power.

As the company enters this next phase, I think it will benefit from a new leader, with a fresh perspective, which is why I've decided to retire by the end of 2020, once the Board has appointed a new Chief Executive, and after an appropriate transition. In the meantime, of course, I will continue to do everything I can to help bring the full benefits of digital learning into view as quickly as possible.

As this is my last annual report before I retire, I would like to thank all my colleagues, past and present, our partners and shareholders for their support throughout the years. Pearson is a very special company, which I have been enormously privileged to lead. There is a lot still to do, but I'm confident that, with the platform we've built, better days lie ahead.

John Fallon
Chief Executive

Trends shaping our market

Global Learner Survey

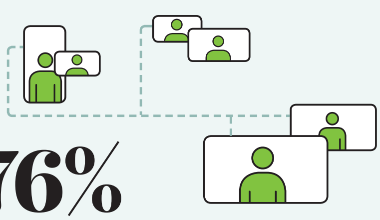
In September 2019, we released the results of our inaugural **Global Learner Survey**, the first of its kind study that gauges the opinions of learners worldwide. This new study captured the collective voice of **11,000 learners** in **19 countries** to get a full picture on how people are learning. The findings show that now, more than ever, people are taking charge of their education, and technology matters.

Lifelong learning is not just a philosophy, it's the new reality

Globally, there is wide agreement that people need to keep learning throughout their career to stay up-to-date in their careers.

In the next decade, digital and virtual learning will be the new normal

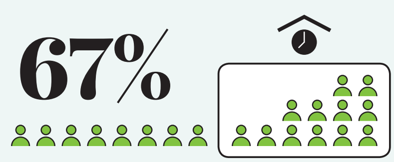
Expectations of online learning



76%

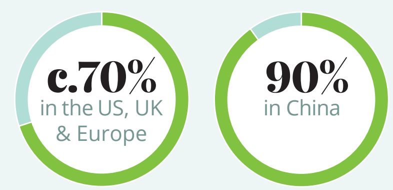
of people believe that more college students will be attending school virtually within 10 years.

67%



believe more primary and secondary students will too.

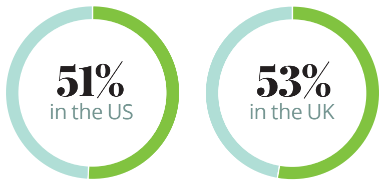
Expectations of AI



believe that AI will have a positive impact on education.

Half of Gen Z in the US, UK and Australia think you can be successful without a traditional college education

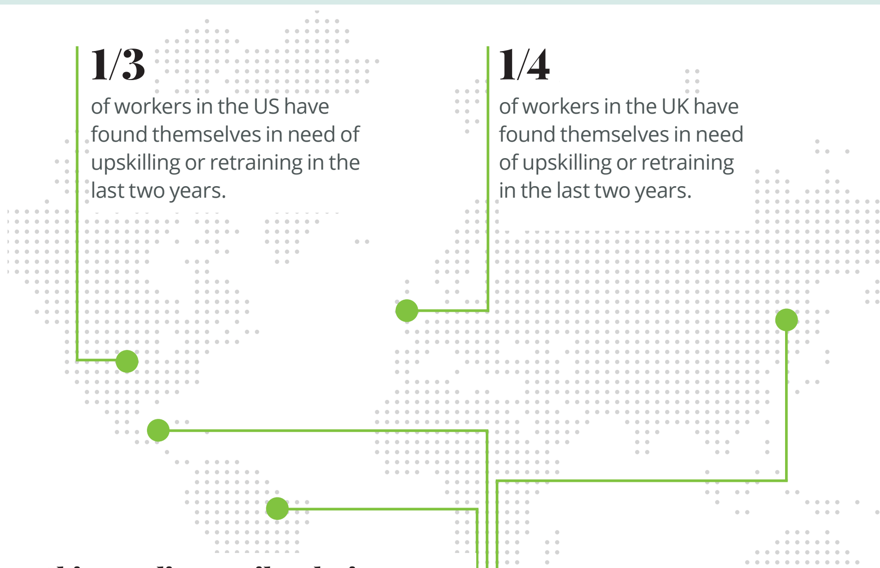
Despite statistics showing higher lifetime earnings with a college degree...



of Gen Z learners think you can do 'ok' in life without it.

68%

of learners think you can do just as well with an education from a vocational or trade school.



1/3

of workers in the US have found themselves in need of upskilling or retraining in the last two years.

1/4

of workers in the UK have found themselves in need of upskilling or retraining in the last two years.

China, India, Brazil and Hispano America are outpacing the US and UK in the upskilling race and defining a new global economy

More than anywhere else in the world, people in these markets believe education is driving the global economy.

2/3rds

or more of people in China, Brazil, Hispano-America and India have identified the need to upskill or retrain and are doing so.

Our strategic model

Building a digital, platform-based business centred on the learner

Our strategic advantages

Insights and capabilities

We partner with world-class authors, institutions, government and regulatory bodies, as well as employers to develop our content, assessment and service capabilities. 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 supports 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 and globally deployed, with local expertise and capabilities ensuring success.

Our new operating structure in 2020

We are refining the structure of our business to better reflect the shift towards more digital learner-centred products.

Key businesses in our new structure

Global Online Learning
- Virtual Schools
- Online Program Management

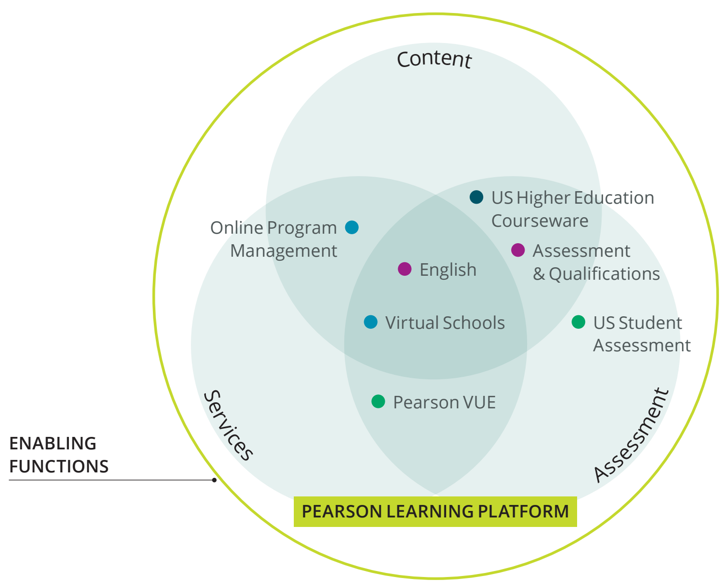
Global Assessment
- Pearson VUE
- US Student Assessment

International
- English
- Assessment & Qualifications

North American Courseware
- US Higher Education Courseware

Interdependencies in our key businesses across our core capabilities

We have three core capabilities – content, assessment and services. Our key businesses share interdependencies across them, powered by the Pearson Learning Platform, all of which is supported by our Enabling Functions.



Our 2030 Sustainability Strategy

- Advance equity in learning
- Build skills for sustainable futures
- Lead by example

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

We are **the world's learning company**

Our long-term strategy

We are shifting from a product-centred approach to a learner-centred model. This means our portfolio of products can now be integrated around the learner, meeting their needs throughout their learning life.

This relentless focus on learner needs is driving a new approach to how we deliver learning. The new Pearson Learning Platform will be the platform on which the future of learning will be built. This will be an engaging, immersive learning experience that is highly personalised.

From this...

Product-centred

Individual products delivered to learners who are currently 'unknown' to us.

To this...

Learner-centred platform

An integrated, multi-product learning experience, with a 'known' customer base enabling lifelong learning, and creating lifetime value for Pearson and the learner.

Delivering long-term value for all stakeholders

Customer experience and learning outcomes

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 work, we are helping increase access to quality education for more people around the world, equip people with the technical skills, knowledge, creativity and resilience needed to achieve the UN SDGs, and consider human rights and the environment across our value chain.

Read more about the value we create for our stakeholders on p14

Capital allocation

- Maintain a strong balance sheet
- Maintain an investment grade credit rating
- Organic investment and acquisitions
- Return capital via a sustainable and progressive dividend
- Return any excess capital via special returns where appropriate

Our businesses

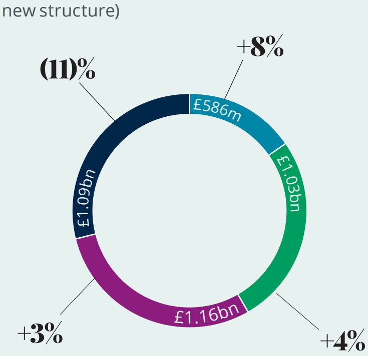
Our new reporting structure in 2020

We are changing the structure of our business to better reflect the shift towards more digital learner-centred products, with effect from 1 January 2020. Our four reporting segments with their constituent businesses are shown to the right. We will also be presenting our Enabling Functions costs, which include corporate functions.

We highlight 2019 revenue and revenue growth vs. 2018, as well as profit contribution for the year, by our new reporting structure, as follows:

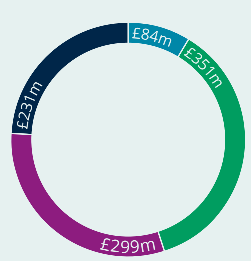
Revenue and underlying revenue growth in 2019

(by new structure)



Contribution in 2019

(by new structure)



- Global Online Learning
- Global Assessment
- International
- North American Courseware

This information is provided for illustrative purposes. It is not intended to supersede the segmental information presented in the financial review and operating performance review or in the consolidated financial statements, which reflects the way in which the business was managed, monitored and reported through 31 December 2019.

We now go into more detail on key businesses in our new structure.

	Global Online Learning	Global Assessment
	Two large digital businesses, Virtual Schools and Online Program Management (OPM) Revenue **£586m** Contribution **£84m**	**The largest businesses are Pearson VUE and US Student Assessment. Also includes Clinical Assessment** Revenue **£1,031m** Contribution **£351m**
OUTLOOK	› Revenue growth of mid to high-single digits	› Revenue growth of low to mid-single digits
MARKETS	› Virtual Schools – global market size is c.$2bn[1] › OPM – global market size is $3.5bn[1] › Both growing 8–10%[1] and further upside in evolving markets › Entering the corporate learning segment	› US Student Assessment – market size is c.$1.15bn[1], stable › Global Certification – market size is c.$1.8bn[1], faster growing
GROWTH DRIVERS	› Increased demand for online education › In Virtual Schools: scale up in existing states to increase penetration; target states with high-growth potential › In OPM: improve conversion rates through portfolio and product innovation; optimise portfolio › In corporate learning: target large learner base available at corporates to upskill and retain employees	› In US Student Assessment: move to fewer, smarter, digital tests with further opportunities for AI scoring; converting PARCC states to custom assessment through digital solutions › In Pearson VUE: increased regulation in licence to practice and demand for certification
COMPETITIVE ADVANTAGE	› Flexibility, personalisation and market responsiveness › Pearson courseware, assessment and platform capabilities › Capability to match learning needs in the workplace with providers › Deep knowledge of education › Operational scale	› In US Student Assessment: flexible model to offer print or digital-based tests and proven record of secure, reliable and accurate test administration › In Pearson VUE: high operational leverage, scalable model; 450+ credential partners showing strength of our brand and breadth of relationships; network of 20,000 test centres
KEY CUSTOMERS	› Students of all ages in schools, higher education and corporate segments › Key partners include universities and charter school boards	› In US Student Assessment: state and institutional partners, as well as other assessment players › In Pearson VUE: governments, academia and employers across the professional, IT and regulatory sectors
DIGITAL PROGRESS	› Fully digital, scalable model › Invested in platform to improve learner experience	› Digitally-enabled, scalable model with leading platforms › AI scoring already in use

1 Pearson estimates.

International

Businesses including Assessment, English, Schools and Higher Education

Revenue **£1,161m**
Contribution **£299m**

OUTLOOK

- Revenue growth of low to mid-single digits

GROWTH DRIVERS

- English: expected growth of PTE (Pearson Test of English) after UK Home Office recognition; target recognition in other comparable markets including Canada; English Language Learning as a driver of employability
- Assessment: opportunity to deliver national, high-stakes digital assessments at scale in emerging markets
- Vocational qualifications: technological change, with AI driving major shifts in work; continued need for reskilling and upskilling is growing demand for the vocational and assessment market

COMPETITIVE ADVANTAGE

- Deep knowledge of market capabilities and deep customer relationships
- PTE Academic provides a world-class and convenient learner experience. AI scoring leads to unbiased results, with quick response time
- Pearson VUE test centres providing breadth of network
- Unique status – leading provider and owner of vocational qualifications and content (BTEC)

KEY CUSTOMERS

- English: adult professionals (B2C), franchisees, schools and universities
- Employability opportunities: national and regional governments, regional training providers, private school chains and employability partners

DIGITAL PROGRESS

- Expanding our digital courseware
- PTE Academic is the only English assessment of its type that combines a fully digital experience with AI scoring

North American Courseware

US Higher Education Courseware is key business with Canadian Courseware also in the segment

Revenue **£1,091m**
Contribution **£231m**

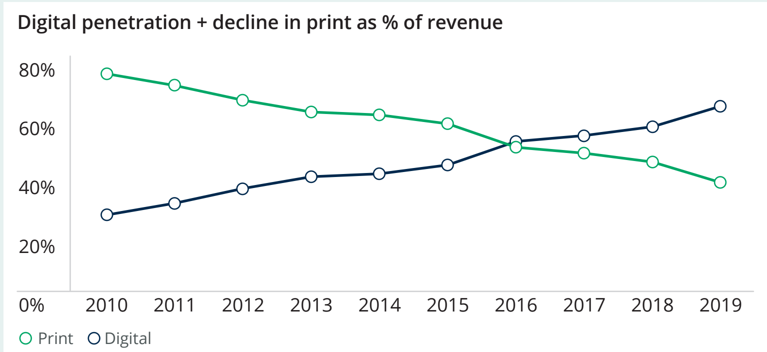
OUTLOOK

- In US Higher Education Courseware, we expect the trends we saw in 2019 to continue, with significant declines in print partially offset by modest growth in digital, as we add more products to the Pearson Learning Platform
- We plan to accelerate our product release schedule from the end of 2020 onwards, and digital growth will also accelerate

STRUCTURAL CHANGES

- **In 2010**, Pearson had a $2bn US Higher Education Courseware business, selling 21m textbooks a year
- **By 2022**, we expect US Higher Education Courseware to be an almost completely digital business[2] – increasingly based on the Pearson Learning Platform.

Shift from print to digital in US Higher Education Courseware



DIGITAL PROGRESS

The Pearson Learning Platform will drive digital growth through:

- Share gains with better experiences and outcomes
- Expanding the platform segment with new product models
- Recapturing sales from the secondary market
- Direct-to-learner relationships

2 The core US Higher Education Courseware business is expected to be almost entirely digital. We also have an Advanced Placement business selling higher education content into US schools. This, together with several other smaller, non-college channels, comprises roughly c.$200m of print revenue which has been broadly stable.

Creating value for our stakeholders

In a digital world, we are a driving force behind change. Our focus is on providing better access, affordability and learning outcomes

Education is evolving to meet the changing demands of today's learners. In a 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.

For Pearson, engaging with stakeholders always takes place through the lens of sustainability, which informs and influences our approach across our global operations. In order to ensure that our new 2030 Sustainability Strategy is focused on the areas that are most important to our stakeholders, an Engagement Strategy was a cornerstone of the process. Read more on p16

	Learners	Employees	Shareholders
STAKEHOLDER GROUP	Pearson helps tens of millions of learners across the world make progress in their lives.	Our purpose-driven employees are key to the sustainable success of Pearson.	We have a broad range of investors who entrust their capital with us.
	88% of people globally agree that education doesn't stop at college/university and believe that you need to keep learning to stay relevant in your career	**2** Employee Engagement Network meetings connecting employees with the Board	**477** investor meetings with **284** institutions in 2019
HOW WE SERVE & ENGAGE	We regularly gauge the views of learners to understand how people are incorporating learning into their lives beyond the traditional classroom. This enables us to put learners at the centre of what we do, build world-class digital products delivering amazing experiences, and help people to learn and thrive in the talent economy.	We are focused on creating a healthier company, encouraging and enabling more people to progress. We are working to develop talent, drive more diversity, ensure greater employee engagement, drive innovation, support accessibility and inclusion efforts, and improve best practice sharing across Pearson.	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.
KEY CONCERNS	Our inaugural Global Learner Survey shows that around the world education is still highly valued. But, people are redefining when, how and what they learn, relying less on traditional institutions and adopting a do-it-yourself approach, learning on their own terms.	Our people want better tools to help them manage more effectively and develop their own careers. They want to feel more closely connected to leadership, be supported through our digital transformation and have more access to Pearson's products and services.	Our shareholder base has a diverse range of views covering financial, environmental and ESG-related issues.
OUR RESPONSE	We are helping meet learners' needs through working with institutions, employers and governments to increase options for virtual learning, online degrees, stackable credentials for adults and on-demand learning for everyone. See the strategy section on p10 for more about how we are becoming a learner-centric business.	In 2019, we introduced a more flexible approach to performance management, developed a new behaviours framework, and launched 'Managers' Corner' to help managers guide their teams better. We created our first Employee Engagement Network and launched 'Pearson Products for Pearson People' as part of our commitment to help our employees prosper. See how this approach helps create long term value in our strategy section on p10	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. We also respond to surveys and questionnaires to provide information about our ESG practices.

Read more on our interconnected approach to stakeholder engagement, and how the Board engages with our stakeholders, in the Governance report, on p62

	Educational Institutions & Educators	Employers	Governments & Regulators	Business Partners
STAKEHOLDER GROUP	We work with teachers, instructors and educators across all stages of education.	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 thrive.	We partner with governments to ensure learners have access to high-quality instruction, materials and assessments linked to beneficial outcomes, including building workforce skills.	From technology providers to suppliers, channel partners to our authors, we have a broad range of partners across our global business.
	91% of educators in the US and UK believe technology in education gives people more freedom, flexibility, choice and convenience in their education options	**84%** of UK employers we surveyed plan to maintain or increase their investment in adult education and training in the year ahead	**50** US states and a wide range of global markets in which Pearson works with government stakeholders	**c.80%** Pearson global spend derives from c.600 suppliers
HOW WE SERVE & ENGAGE	We collaborate with educators and provide them with the tools they need in order to help the next generation of learners to be successful in their education and make progress in their lives.	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.	These learning opportunities address learners' needs, close skills gaps and meet workforce demands. Governments and regulators also set policy to help drive sustainable growth and ensure learners have access to affordable education.	We are focused on building successful business partnerships across the education ecosystem to ensure joint success and growth.
KEY CONCERNS	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.	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.	Governments are looking for effective approaches to better connect education and training to employer needs, improving learner outcomes.	We share similar goals with our partners – from driving business transformation to developing world-class products; enhancing customer experience, adherence to data privacy and IT security processes; managing risk; developing talent and more. We expect partners to share our values.
OUR RESPONSE	We aim to provide more engaging ways to connect students with lifelong learning opportunities, 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 to learners to understand how we future-proof our products and services for the learning journeys of the next generation of learners.	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.	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 learner access, affordability and success.	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.

Sustainability

Talent is the world's most valuable resource – we're working to unleash it

We are pleased to announce our new 2030 Sustainability Strategy

The world is facing exciting, unprecedented opportunities and challenges. We need everyone to reach their full potential and help shape a brighter future. By leveraging our capabilities and partnering with others, we can help develop lifelong learning opportunities that enable people around the world to create better lives for themselves, their families and generations to come.

Our focus is identifying, supporting and developing people so they can reach their full potential and supporting the UN Sustainable Development Goals (SDGs) particularly goal 4 on quality education, goal 8 on decent jobs and economic growth, and goal 10 on reducing inequality.

The focus areas of our strategy are below. Later this year, we will release our targets and more detail about how we will advance these objectives.

Materiality analysis

Our new sustainability framework was developed based on a materiality analysis that considered how Pearson's business priorities and stakeholder expectations have changed and are likely to evolve. Our materiality assessment was undertaken with Forum for the Future, a well-respected sustainability charity.

As we approached this work, we have taken several key considerations into account:

- Engaging with our stakeholders: we engaged with key stakeholders to understand the issues most important to them and where they expect Pearson to play a role.
- Identifying current and future trends: we conducted futures research to help identify the social, environmental and economic issues that will influence learning, our ecosystem of partners and Pearson's business in the years to come.
- Linking to business priorities: our process was designed to align with and support our corporate strategy and brand strategy.
- Supporting global goals: we will continue our commitment to advancing the UN SDGs and leverage their targets and indicators in our goal-setting.

Active, ongoing input and engagement from internal and external stakeholders is key to ensuring the achievement of our new 2030 Sustainability Strategy. Our key stakeholder groups include:

- employees;
- shareholders;
- learners;
- educational institutions & educators;
- employers;
- governments & regulators;
- business partners & suppliers; and
- international, non-governmental & non-profit organisations.

In addition to Pearson's other stakeholders, to inform our Sustainability Strategy, we listen carefully to the insights of international, non-governmental & non-profit organisations working to improve education for vulnerable and marginalised groups, advocating for the UN SDGs and looking at the impact of business in society.

We conducted internal and external interviews, focus groups and workshops to identify high-impact issues.

To download more information about our materiality analysis, complete ESG data, our Global Reporting Initiative (GRI) and UN Global Compact Index, visit pearson.com/sustainability

Our new 2030 Sustainability Strategy

Pearson sees a world of talent

Talent is the world's most valuable resource. We want to unleash it.

Our Sustainability Strategy has three main pillars:

Advance equity in learning

We have the role and responsibility to help overcome barriers to lifelong learning, from socio-economic hurdles to equity and health challenges.

Build skills for sustainable futures

We will use our skills, assets and partnerships to equip people with the technical skills, knowledge, creativity and resilience needed to achieve the UN SDGs.

Lead by example

Our 2030 strategy will continue to focus on building the foundations for a sustainable business, such as our commitments to respect human rights and minimise environmental impacts across our value chain.

Taking stock of our 2020 Sustainability Plan

We are approaching the end of Pearson's 2020 Sustainability Plan, which is focused on three pillars: 1) reaching more learners; 2) shaping the future of learning; and 3) being a trusted partner and supporting our commitment to the UN SDGs. Pearson has made good progress across the pillars of our plan.

Reach more learners

Improve access to and affordability of products and services

We have built strong foundations to reach more learners from disadvantaged backgrounds and support them to overcome barriers through products and services. See examples on p17, 20, 36, 37 and 38

Collaborate to reach underserved learners

Through partnerships involving non-governmental organisations, teachers, education experts, governments and others, we are also tackling some of the biggest education challenges.

Read more about our partnership with Save the Children on p18 and CAMFED on p18

Shape the future of learning

Build skills that foster employability and inclusive economic growth

We are better preparing students to progress in learning, work and life through a range of products and services. For example, 'Pearson's Career Success' programme, which has reached 135,000 learners since 2018, helps students set career goals, fill skills gaps and prepare for employment.

Promote education for sustainable development

We are increasingly integrating and promoting sustainability content and skills, including in our BTEC qualifications and US Higher Education Courseware products. We also released a white paper with Arizona State University, Business Fights Poverty and the UN Principles for Responsible Management Education on how to scale up and partner on opportunities to advance learning and skills for sustainable development. Read more on p18–19

Engage in multi-stakeholder research, dialogue and collective action to solve global challenges

We are active participants in multi-stakeholder, collective action initiatives that aim to strengthen global education systems, explore the role of the private sector in global education and development, and advance the UN SDGs. See organisations on p26

Be a trusted partner

Respect and support our people, customers and communities

We successfully achieved our goals to develop and implement an Editorial Policy to ensure content is appropriate (see p19) and report on Pearson's GB gender pay.

In 2018 and 2019, we also reported on Pearson's GB gender pay and continue to take actions to further reduce the gap.

Protect our natural environment

We met our 2020 targets to reduce our operational Greenhouse Gas emissions by 50% (using 2009 as the base year) and reduce energy use in our buildings on an absolute basis by 50% (using 2013 as the base year) early. Read more on p22–23

Build a sustainable supply chain

We have taken a number of steps to continuously improve how we consider social and environmental issues in our supply chain and procurement. Read more on p23–25

Progress in 2019

Advancing equity in learning

We have built a foundation to scale how our products and services can help more under-represented learners from diverse backgrounds make better progress. Helping improve access to quality education for a broader spectrum of learners contributes to growing our business, stimulating innovation and advancing the UN SDGs. Some of the underserved and underrepresented groups we have focused on to date include adult learners without degrees, underprepared learners in US higher education, people with disabilities, women and girls, and refugees.

As one example, within the assessment business in the US, the computer-based GED allows adult learners to prepare for college, career training programmes or better-paying jobs. By supporting adults who have faced barriers completing their high school education, it is a key piece of our sustainability objective to advance equity in education.

Other examples of products that are helping learners overcome barriers include Accelerated Pathways (see p36) and BTEC qualifications (see p18 and 37)

Accessibility

Pearson is committed to continual improvement to increase the accessibility of our products. Our Global Accessibility Steering Group drives support for people with disabilities through the intentional integration of accessibility standards into product development. Our Pearson Able Employee Resource Group has a remit to improve company practice in the support of learners and employees with diverse needs.

Pearson has joined the Valuable 500, a global movement to put disability on the business leadership agenda. As part of our membership, we have committed to publicly disclose a policy framework for product accessibility as well as to build, develop and share a market-leading approach to mentoring people with disabilities.

In 2019, the Assessment business drafted an internal policy for accessibility, provided 25 virtual accessibility training sessions for employees, and designed an external accessibility website with tools and guidance. The team also designed a three-year tactile graphics study and completed Phase 1. The study's advisory board includes representatives from the National Federation of the Blind, the Braille Authority of North America, Braille production vendors,

Sustainability

certified Braille transcribers, students, parents and teachers of the visually impaired.

In 2019, the Global Product business revised an existing internal policy on accessibility and laid the foundations to update all guidelines from Web Content Accessibility Guidelines (WCAG) 2.0 to 2.1, in line with increasingly global customer requirements. The team also signed agreements with a number of new channel partners to ensure the widest and most convenient possible access to our products.

Every Child Learning

Since 2015, Pearson has joined forces with Save the Children to deliver the multilateral Every Child Learning programme to support Syrian refugee and host community girls and boys in Jordan, aged 9–12 years, in Grades 4, 5 and 6. The programme helps improve their learning and build their resilience, whilst making their learning environments safer.

To achieve this ambition, the partnership has focused on researching and integrating new programmatic and digital educational solutions – including the creation of the innovative classroom mobile learning tool, the 'Space Hero' (Batl Al Fada'a) maths app.

The programme was successfully expanded from three to 19 schools during the academic year 2018–19, working collaboratively with children, parents, teachers, school leadership and the Jordanian Ministry of Education. Over 10,000 children used the Space Hero app through the programme, and over 2,000 participated in Arabic remedial classes to help them catch up with their peers through the programme.

To support educators, we developed and tested a user dashboard complementing the 'Space Hero' app, which includes features to help teachers follow up on their students' progress and tailor future classes. The partners published 'The Space Hero Manual' and distributed it to maths teachers in schools. In addition, over 300 school staff members were trained on academic subjects and providing psychosocial support.

CAMFED

Since 2013, Pearson has partnered with international NGO CAMFED (Campaign for Female Education) to help girls from low-income communities in sub-Saharan Africa stay in school, learn and develop key skills for life and work. The project is funded by the UK Department for International Development's Girls' Education Challenge, and supported by national Ministries of Education. Together, we developed a life skills curriculum and learning resources used by young women 'Learner Guides' in supporting vulnerable children studying in rural schools. We also created a customised BTEC qualification to recognise the skills, experience and achievements of Learner Guides and enhance their employability prospects. As of December 2019, we have awarded 2,880 BTECs to young women from marginalised backgrounds in Zimbabwe, Tanzania, Ghana and Malawi, against a target of 5,000.

In 2019, Pearson and CAMFED adapted the BTEC qualification to make it accessible to all the young women acting as volunteer guides in CAMFED's programme: not just guides working in schools but also those supporting girls as they graduate from school, and those mentoring young women to set up and grow local enterprises. The revisions also reflect a greater emphasis on employability skills, and new content has been introduced on topics such as sexual and reproductive health and information technology. The revised BTEC qualification was launched in Zimbabwe, Tanzania and Zambia during 2019 and is projected to reach a further 4,500 candidates over the next three years.

Pearson Ventures

Pearson Ventures invests in companies building new market opportunities using innovative business models, future technologies and new educational experiences. In December 2019, the initiative made investments in its first two startups, Springboard and Knowledge to Practice (K2P), which are focused on lifelong learning and employability. The investments total $4.2m with Springboard at $2.2m and K2P at $2m.

Volunteering

Pearson sponsored a 2019 North America Volunteer Day to support the philanthropic interests of its employees and make a difference in communities across the US and Canada. Over 500 colleagues participated in a variety of impactful activities including book drives, reading to classrooms, food drives, Habitat for Humanity, mentoring at the Boys & Girls Club, park clean-ups and trips to local animal shelters.

Building skills for sustainable futures

We want our learners to be equipped with the skills and capabilities they need to build careers and communities, navigate uncertainty, address the world's biggest sustainable development challenges and thrive in the 21st century and beyond.

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 UN SDGs and inspiring the next generation to improve their world.

Supporting Syrian refugee and host community girls and boys

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.

Leading by example

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.

Human rights

Our goal is to respect and promote human rights, including the right to education, throughout our operations and with our customers, employees, contractors and supply chain. 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 respect the rights of our employees to freedom of association and representation through trade unions, works councils or any other appropriate forum wherever local laws allow. We work to prevent discriminatory, illegal and inhumane labour practices including child labour, forced labour, slavery and human trafficking. We use our influence with our suppliers to improve standards for their employees. Read more about supporting our suppliers and our work to prevent modern slavery in the supply chain on p23–25

Our Human Rights Statement outlines the priority human rights risks and opportunities for Pearson that our programme is taking steps to address. Our approach to human rights covers five areas: learners, content, employees, partnerships (see responsible sourcing, p23–25), and privacy and data (see risk section, p47–48)

Learners

Through our human rights impact assessment, we determined that Pearson's greatest opportunity to advance human rights is supporting underserved and vulnerable learners through its products and services. On p17 we describe our approach and examples of products that are helping learners overcome barriers, such as the GED (see p17), Accelerated Pathways (see p36) and BTEC qualifications (see p18 and 37)

To protect learners from harm, we are committed to safeguarding wherever we operate, and particularly in schools, training and learning centres, and teaching facilities. More detail on our approach appears on p45. We have undertaken work to strengthen our processes for learners to raise concerns about harassment or abuse, including by integrating recommendations from the UN Guiding Principles on Business and Human Rights into relevant safeguarding risk assessment frameworks. We have completed a gap analysis of current processes and identified areas of improvement to take forward in 2020.

Content: Pearson's Editorial Policy

To ensure that the content within our products is aligned to Pearson's values, and to prevent inappropriate content from being published, our Global Editorial Policy acts as a guide for content developers to create products that are relevant, appropriate and inclusive.

Our policy is based on principles in the following areas:

1. Respecting human rights including freedom from discrimination and bias
2. Creating content that embeds an awareness for and the promotion of Diversity & Inclusion
3. Demonstrating support for learning that is based on evidence and facts
4. Aligning with legal and ethical obligations of content creation and production
5. Ensuring content respects regional laws and is not locally inappropriate or offensive

The policy is applied across all markets and business units, and is overseen by a cross-regional and functional steering committee, chaired by a member of our Executive team. 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.

In 2019, we incorporated the Policy into Pearson's Code of Conduct. An online learning module is automatically assigned to new starters in content-facing and support functions and, for external providers, as part of our vendor onboarding process. To date, over 6,000 employees and 1,500 external providers have completed our Global Editorial Policy training. Policy checkpoints are included in our product development processes, and a Policy review of published titles has also been established in some business units.

In our Global Product unit, key D&I discipline leads have completed training on content review, and we have released internal guidelines to integrate best practices and escalate issues. Moving into 2020, we will launch additional training and certification on reviewing content for D&I and scale up our efforts in this area.

“I want the female African perspective to be heard and film is a powerful tool to express my ideas. **I want to be a director who makes a change.**”

Josephine Kiaga,
BTEC Student of the Year 2019

CASE STUDY BTEC

Creative and inspirational

BTEC Student of the Year 2019, Josephine Kiaga, is both a creative and an inspirational voice for her peers and the wider community.

She took a BTEC Subsidiary Diploma in Creative Media Production (Film and Television), as well as a BTEC Diploma in Performing Arts (Acting) at Braeburn International School Arusha in Tanzania, to support her ambitions to become a director.

Josephine sets her sights high: “I want the female African perspective to be heard and film is a powerful tool to express my ideas. I want to be a director who makes a change and who creates with a purpose.”

Josephine is a powerful leader. She was an ambassador of human rights at the East African Model United Nations (EAMUN) conference and she co-organised a ‘Girls’ Empowerment’ day for local girls in the community where they ran workshops regarding entrepreneurship, female hygiene and more. She has also achieved distinctions in public speaking enabling her to teach London Academy of Music and Dramatic Art (LAMDA) classes assisting fellow students.

As BTEC Student of the Year, Josephine is a future creative leader and a powerful advocate for women and her country. Her energy and passion for the creative arts will take her far.

About Pearson’s BTEC qualifications

Over 1m learners every year choose a BTEC course through c.6,000 approved BTEC centres in 60 countries around the globe. Learners choose BTECs because they are high-quality, hands-on qualifications grounded in the real world of work.

Students learn by doing, and develop valuable employability skills that they will use throughout their future career or for progression into university and to make a positive impact on the world. We know that this has a positive effect on students: research from the UK Department for Education shows that, for pupils in state-funded mainstream schools, taking a Technical Award, such as a BTEC Tech Award, is associated with pupils having lower absence rates, lower permanent exclusion rates and lower fixed exclusion rates, when compared with similar pupils who did not take a Technical Award.

Our priority growth markets are China, ASEAN, Middle East, Central/Eastern Europe and North Africa. The key strategic industry sectors that we are focused on to address the skills demand are engineering, construction, digital/tech, travel and tourism, as well as health and care.

This is an example of how we are designing products to have an impact on key learning outcomes such as employability skills and promoting education to advance the UN SDGs as part of our 2030 Sustainability Strategy.

Learn more about Efficacy on p27
Learn more in our Sustainability section on p16

Employees

Our employees are key to helping us fulfill our vision of helping far more people prosper throughout a lifetime of learning. As such, we play a crucial role in creating a working environment that enables our employees to grow, develop and succeed. This strategic report describes the various ways in which the company engages with, invests in and rewards its employees. The remuneration report also describes the remuneration philosophy which applies to the company as a whole.

Employee engagement

This year, we have enabled engagement with a range of opportunities for employees at all levels of the organisation.

On the back of our successful Innovation Jam in 2018, we formed Tiger Teams to support implementing ideas and solutions. The Tiger Teams have been directly involved with introducing a more flexible approach to performance management, including a new behaviours framework, and they have been instrumental in shaping our learning strategy for 2020.

We launched the 'Managers' Corner' community in January 2019 to streamline communications for our managers. The purpose is to help our managers understand what they need to know, need to do and need to talk about with their teams. This is a critical channel for ensuring all employees are aware of key matters of concern, including financial and economic factors affecting our business. Our 'We are Pearson' campaign launched in October 2019 with the celebration of Pearson's 175th birthday. The activity was focused on reinvigorating the hearts and minds of our employees across the globe virtually and through 59 in-person local birthday celebrations in 25 countries.

In response to the UK Corporate Governance Code, we are excited to take part in strengthening the voice of our workforce with the creation of our Employee Engagement Network (read more on p64)

Investing in and supporting our talent

This year, we launched 'Pearson Products for Pearson People', as part of our commitment to help our employees prosper. We introduced GEDWorks™, an opportunity for regular employees and their families in the US to earn a GED credential for free (read more about the GED on p17), and free access to Pearson's eText titles through the VitalSource Bookshelf.

We implemented changes to our performance management approach to shift our focus from an annual backward-looking conversation to regular conversations over the year, giving employees the opportunity to continuously learn, grow and improve performance. The relationship between pay and performance has not changed, to ensure that employees are rewarded for their contribution and impact. Managers have more flexibility to differentiate their reward decisions.

We offer benefit programmes that make our employees' lives easier, simpler and more rewarding. Our programmes vary globally and include health insurance, disability coverage, retirement savings matching, employee share purchase options, commuter benefits, tuition reimbursement, and programmes that support wellbeing and work-life balance.

This year, we implemented US policy changes designed to give our employees more time with family when needed. Maternity leave and Parental & Serious Illness in the Family Leave (PSIL) were extended and the Financial Aid for Adoption Policy was modified to expand reimbursement benefits to offset surrogacy expenses.

Pearson maintains its accreditation by the Living Wage Foundation and has committed to paying employees and regularly contracted staff working in our buildings across the UK and in London the real Living Wage.

Labour practices

We respect the right of our employees to freedom of association and representation through trade unions, works councils or any other appropriate forum wherever local laws allow. We have policies and processes in place to prevent discriminatory, illegal or inhumane labour practices, including child labour, forced labour, slavery and human trafficking, in our places of business, as well as to address violations when they occur. Representation takes many forms. We support the right to unionise in the UK.

Employee learning and development

Our culture is centred around helping people unlock their futures through learning and a range of diverse work experiences.

To become a digital-first company, we recognise the importance of helping our employees build their own digital skills. 'Digital Learning Live' launched this year as an interactive webinar series to provide all employees with practical digital skills that can be used across Pearson. The Help Me kNow hub provides a large library of videos, activities and lessons to help our employees feel more comfortable with the new digital tools introduced company-wide this year.

We are introducing a Senior Vice President (SVP)–Employee Experience role which will bring together our HR Centres of Expertise to integrate our approach from recruitment to retirement in a more meaningful way for employees.

Managing organisational changes

Pearson experienced continued change this year, through consolidation and headcount reduction, as we work to achieve our digital-first strategy. We continue to support our employees with regular communication. In the UK, we follow a legally prescribed consultation process and undertake a minimum period of 45 days.

We are also in the early stages of implementing predictive analytics to help us identify variations in employee turnover globally. As we mature in this space, we will be better positioned to develop targeted strategies that increase retention.

In 2019, the Pearson Alumni Network supported a community of past and current engagement with employees through quarterly newsletters, a 'Leaders in Learning' podcast, the 'Career Coach' to share job opportunities from around the sector, and the 'Alumni Learning Series'.

Sustainability

Key performance indicators: women in Pearson

Among our seven D&I priorities is a goal to improve gender representation at the top two levels of the company. At Board level, 33% of our members were female as at the end of 2019. 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 and in our Senior Leadership Group by 2020. The table below sets out our female representation over the past three years. The final column on the right represents actual numbers.

	2018	2019	2019
Board of Directors	30%	**33%**	**4**
Senior leadership[1]	31%	**34%**	**34**
All employees[2]	62%	**59%**	**13,022**

1 Two reporting lines from the Chief Executive.

2 Total employee figures for female composition of workforce are based on a snapshot of employees as at 31 December 2019. Average annual figures for 2019 are used elsewhere in this report and differ due to including seasonal employees at peak periods in our assessment businesses, as well as those who may no longer be employed by the Group at 31 December 2019 due to the simplification programme.

Key performance indicators: global Greenhouse Gas emissions data

Metric tonnes of CO_2e	2009[1]	2018	2019
Combustion of fuel and operation of facilities (GHG Protocol Scope 1)	44,649	13,057	**13,251**
Electricity (GHG Protocol Scope 2 – location based)	130,395	49,920	**47,384**
Electricity (GHG Protocol Scope 2 – market based)[2]	–	4,583	**418**
Emissions relating to air and rail travel, electricity transmission, waste and water (GHG Protocol Scope 3)	35,262	30,022[3]	**19,786**
Total – location based	210,306	92,999	**80,421**
Total – market based		39,312	**33,454**

	2013[1]	2018	2019
Total energy used in buildings (MWh)	285,590	127,083	**129,717**
Intensity ratios			
tCO_2e per employee (scope 1, 2 & 3)	6.8	3.48	**3.57**
tCO_2e/sales revenue (scope 1, 2 & 3)		20.50	**20.79**

1 2009 is a baseline year for carbon reduction and 2013 is a baseline year for energy reduction.

2 For nine of our key markets we buy renewable energy through green energy tariffs or renewable energy certificates (RECs) in the country of consumption. This accounts for 97% of our electricity use. We buy RECs regionally for the remaining 3% in those markets where we have a small presence.

3 A new, enhanced data source was employed in 2019. We have updated and rebased our estimated emissions as a result.

Methodology: We have reported on all of the emission sources required under the Companies Act 2006. The method we have used to calculate GHG emissions is the GHG Protocol Corporate Accounting and Reporting Standard (revised edition), using the Scope 2 dual reporting methodology, 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.

Diversity & 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 other factors – as set out in our Diversity & Inclusion Statement. At Pearson, we value a diverse workforce and a workplace which reflects our learners – the customers we serve around the world.

Last year, Pearson designed and adopted a new strategic framework for diversity and inclusion practice. Our charter is to capitalise on different perspectives and leverage diversity to spur innovation and growth through an inclusive culture and working environment. Our approach includes:

› a Global Diversity & Inclusion (D&I) 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 Employee Resource Groups.

› a set of seven priorities which guide our action planning and major initiatives.

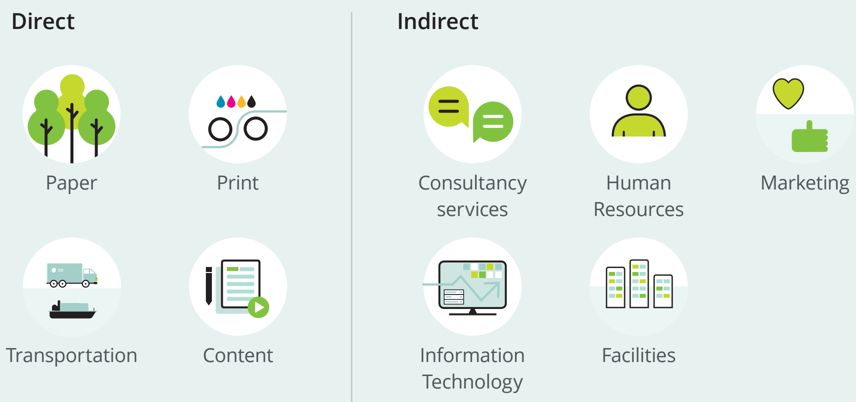
› a global network of D&I Advocates who provide support to advance our practice in their businesses and geographic locations.

› a plan to help our ten employee resource groups at Pearson evolve and mature. The networks are for women, women in technology, parents, veterans, Latinos, the LGBT+ community, generational differences, people with disabilities, employees of black and/or African ancestry, and a group representing black, Asian and minority ethnic people.

› a D&I dashboard review and goal-setting session held with each business and function leadership team. This was a new introduction in 2019.

Disability is an important part of our wider commitment to Diversity & Inclusion. 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. Our Pearson ABLE employee resource group helps improve practice by bringing together people with disabilities in Pearson and accessibility advocates.

What goes into our products?



In 2019, Pearson received a number of D&I awards (see p26) and was recognised as fostering an inclusive culture through our leaders. The Managing Director of Pearson Canada was named on the 2019 HERoes Women Role Model Executives list, which celebrates women driving change to increase gender diversity in the workplace. Also, our SVP-BTEC and Apprenticeships has been recognised in the 2019 EMpower list of the top 100 ethnic minority business leaders.

Pearson continues to report on GB gender pay in line with UK regulations. Our work to extend our reporting on gender pay to cover our global operations by 2020 continues and is on track.

Our environmental impact

We are committed to reducing our impact on the environment. Responsible environmental stewardship helps to create a healthy and sustainable planet for our learners and all of society. Our biggest direct impacts are carbon emissions from our use of energy, so we need to ensure we manage our own operations responsibly.

We continue to do our part to address the global challenges of climate change. In 2019, we calculated our Scope 3 GHG emissions and developed a proposal for the Science Based Target Initiative to establish our new long-term goal for carbon emissions in 2020.

We met our 2020 GHG and energy reduction targets achieving:

- 62% reduction in total (location based) GHG emissions (vs target of 50% reduction against 2009 baseline).
- 55% reduction in energy use in our buildings (vs target of 50% vs 2013 baseline).

In 2019, we installed LED lighting in three of our UK properties.

- We maintained our commitment to using 100% renewable electricity and offset our emissions from our energy and fuel consumption and business travel (through an Indonesian forestry conservation project and an Indian renewable energy project, both of which are certified to the VCS standard).

In 2019, we maintained our ISO 14001 certification, the environmental management standard in the UK and Australia. This standard incorporates both internal and external audits.

Responsible sourcing

At Pearson, we believe in doing business with partners who share our commitment to human rights and the environment – strengthening our supply chain through shared values and commitments.

In 2019, Pearson purchased over £2.35bn of goods and services from third parties, from large multinationals to smaller specialist companies and sole traders. Around 80% of Pearson's global spend is represented by 605 suppliers.

The majority of products and services Pearson purchases are sourced from suppliers in OECD countries, predominantly in North America and Europe. Our relationships with suppliers are guided by our commitments to international standards for human rights and environmental responsibility. We are committed to the UN Global Compact and other human rights standards including the Universal Declaration of Human Rights, the International Labour Organization's declarations on fundamental principles and rights at work, and the UN Guiding Principles on Business and Human Rights (see p19 for more on our commitments). The UK Modern Slavery Act also guides our approach, and our Modern Slavery Statement is available at: https://www.pearson.com/legal-information/our-policies/modern-day-slavery.html

We are a founding member of the Book Chain Project, a partnership between publishers to enhance industry standards relating to labour standards and human rights, product safety, and paper sourcing.

Sourcing policies

Our policies help ensure Pearson's values are reflected and shared with everyone we do business with. The Business Partner Code of Conduct (Partner Code) clarifies the responsibilities and expectations we have of our business partners (which includes joint venture partners, vendors, franchisees, distributors, suppliers, contractors, consultants and agents) for ethical and responsible business practices.

Sustainability

The Partner Code sets out our support for environmental stewardship, universal human rights (including equal employment, freedom of speech and of association, and cultural, economic and social wellbeing), good labour practices, and decent working conditions. It also sets out expectations that our supply partners, and their subcontractors, oppose discriminatory, illegal, or inhumane labour practices, including slavery and human trafficking. The Partner Code is present in new contracts and is included when contracts are renewed or updated. Compliance with the principles in our code is a minimum standard of behaviour outlined in contracts.

Our Business Terms of Reference, specific to Pearson supply chain contracts, set out the terms and conditions for purchase of goods and services, and are agreed prior to engaging suppliers. This provides Pearson with the power of audit and right to terminate a relationship if we find issues of non-compliance, ensuring our responsible purchasing principles are contractually enforceable.

When working with schools and campuses, suppliers must have an acceptable safeguarding policy which meets or exceeds Pearson's own (see p45 for more on safeguarding). Suppliers are also subject to Pearson's Anti-Bribery and Corruption Policy (see p49 and p77) and Gifts and Hospitality Policy.

Direct supply chain
While we have a growing technology-enabled supply chain reflecting our increasing shift to digital, our traditional paper-based products continue to be a key area of focus. Our Supply Chain function manages our purchases of paper for books, as well as our contracts with printers and works with distributors and shippers who bring our products to market.

> “**We are committed** to reducing our impact on the environment.”

US Higher Education Courseware supply chain
Pearson does not directly manage paper procurement, print manufacturing, warehousing and distribution operations for our US Higher Education Courseware business. These activities are outsourced to LSC Communications, which is subject to our Business Partner Code of Conduct.

Paper sourcing
Pearson has a longstanding Responsible Paper Sourcing Policy that sets out our approach to managing risks related to human rights and environmental practices in our direct supply chain. This policy sets out our preference for paper suppliers which hold Forest Stewardship Council (FSC) certification, and we also recognise the Programme for the Endorsement of Forest Certification (PEFC) system of certification.

In 2019, we purchased over 100,000 tonnes of paper globally. To help to reduce our impact, we have retained Chain of Custody accreditation from the FSC in the UK, which enables Pearson products to carry the FSC logo. Of the more than 12,000 tonnes of paper we purchased in the UK, 86% was certified to an environmental standard, such as FSC or PEFC.

Print production
We rely on third-party suppliers to print our textbooks and course materials. Globally, we have over 200 print suppliers representing approximately £200m in spend.

In the UK, we require suppliers rated as high risk and with spend of over £100,000 to undertake an independent third-party audit before being approved as a supplier, and to agree to regular review audits at least once every two years. We rate suppliers as medium or high risk based on a Book Chain tool designed specifically to help publishers identify labour and environmental risks in the supply chain. The audits are carried out by third-party auditors and shared via the Book Chain platform.

Our due diligence process also includes visiting suppliers around the world to assess compliance with our standards, and to ensure suppliers address non-compliance. These visits provide a valuable opportunity to reinforce our commitments to eliminating all forms of child, forced and compulsory labour, as well as promoting environmental stewardship.

In our UK business, we had £26m in spend with 46 suppliers in total. Of these, we have identified four suppliers, representing £6.6m in spend, as high-risk based on country of operation (China and Malaysia), guidance from the Book Chain Project and meeting our £100,000 materiality threshold. All four were visited in 2019 and have a valid audit in place.

Indirect procurement

Following deployment of systems in the UK, US and Canada, new supplier requests are tracked and pass through audited approval actions before being confirmed for onboarding into Pearson systems. Suppliers submit information directly and securely through our platform, governed by SOX control standards, where risk assessment concerns are tested across: conflict of interest, trade sanctions, sanctioned countries, sustainability, physical security, diversity, and business continuity.

Our 2020 supplier risk initiatives will focus on: a reduction in the number of 'active' suppliers available for the business users to purchase against (therefore reducing our risk landscape); risk assessment of incumbent suppliers; and improvement of Pearson's supplier risk assessment enabled by technology and partnerships.

Contingent workers

Allegis Global Solutions (AGS) is the major partner supporting Pearson's relationships with our contingent workforce population. Our contingent workers frequently fill roles such as engineers, developers, exam graders and project managers.

AGS, and our other partners, help Pearson ensure our contingent workers receive detailed information outlining how Pearson's people policies apply to them, and help to hold contingent worker agencies accountable for ensuring that workers are informed of these policies.

Supplier diversity

Our supplier diversity programme focuses on local, small, diverse businesses – such as underutilised, or women-, minority-, LGBT- or veteran-owned. Building close partnerships with diverse suppliers helps make us more competitive and drive innovation. In 2019, the Global Supplier Diversity team contributed to 37 proposals with supplier diversity requirements, whose total potential contract value exceeds ~£400m.

A roadmap for the future

In 2019, we undertook a project with sustainability advisers, BSR, to assess our existing approach to human rights in our supply chain, ensure we meet global standards and stakeholder expectations, identify any gaps, and develop a roadmap to improve our approach. Based on the project's findings, Pearson plans to improve spend data, facilitate better measurement and reporting of KPIs, and continue to inform both buyers and suppliers on human rights issues to Pearson's standards.

Through our Procurement Function, Pearson will continue to contribute to our corporate social responsibility and sustainability targets by influencing our sourcing methodologies to promote spend with qualifying suppliers. We are putting processes in place to: increase our diverse spend; include supplier diversity language in our requests for proposals; and work with non-diverse suppliers to incorporate supplier diversity goals into their procurement process.

Governance

Our strong governance structures and internal systems are key to managing risks and embedding sustainability, responsibility and ethics across our business. Key areas include our organisational risk management (see p40–50), compliance and anti-bribery process (see p49), public policy (see p45) and tax (see p47)

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 p72

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 leaders from across the business. We updated the membership and terms of reference in 2019 to oversee and support the integration of our updated sustainable business priorities.

Code of Conduct

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.

Our Code of Conduct was revised and refreshed in 2019, and the course included a focus on raising concerns, a certification to the Code and an overview of our Global Conflicts of Interest Policy and disclosure process. We make sure all Pearson employees are aware of our Code and confirm they understand and will comply with it. In 2019, we achieved our target of 100% employee completion and acknowledgement of the Code by all employees. The Code is also assigned as part of the onboarding process for all new Pearson employees.

Raising concerns

We operate a free, confidential telephone helpline and website for anyone who wants to raise a concern, and we have a clear Raising Concerns and Anti-Retaliation Policy in place to encourage honesty and openness. Cases that pose significant risks to our business are reported to the Pearson Audit Committee with ultimate ownership by the Board.

Sustainability

Recognition and multi-stakeholder engagement

Awards

Initiatives

Non-financial information statement & more information

The following table outlines where the key contents requirements of the non-financial information statement (as required by sections 414CA and 414CB of the Companies Act 2006) can be found in this document.

Please visit our website for a complete set of our environmental, social and governance performance data and information about how we are aligning with the UN Global Compact principles, Global Reporting Initiative and Carbon Disclosure Project.

Reporting requirement	Pearson policies and procedures	Section of annual report
Environmental matters	Environmental Policy Paper Purchasing Policy	Our environmental impact, p22–23
Employees	Code of Conduct Human Rights Statement Raising Concerns and Anti-Retaliation Policy Health & Safety Statement Diversity & Inclusion Statement	Our employees, p21–22
Human rights	Human Rights Statement Editorial Policy Modern Slavery Statement Safeguarding Principles	Human rights, p19 Editorial Policy, p19 Our employees, p21–22
Social matters	Human Rights Statement	Our 2030 strategy, p6 Advance equity in learning, p17 Build skills for sustainable futures, p18–19
Anti-corruption and bribery	Code of Conduct Anti-Bribery and Corruption (ABC) Policy Raising Concerns and Anti-Retaliation Policy	Legal and compliance, p48–49
Policy embedding, due diligence and outcomes		Organisational risk management, p40–50 Sustainability, p16–26
Description of principal risks and impact of business activity		Organisational risk management, p40–50
Description of business model		Our strategic model, p10–11
Non-financial key performance indicators		Sustainability, p16–26

Publicly available policies in the list above can be found at:
www.pearson.com/corporate/our-policies.html

Efficacy

Efficacy is the science behind how Pearson designs learning experiences to impact learning

In 2013, we made a commitment to measuring our impact on some of the outcomes that matter most to learners, such as achievement in exams. The next generation of efficacy takes what we have learned and evolves our approach by putting a stronger focus on designing products to have a measurable impact on delivering employability and lifelong learning outcomes as well.

Although our approach is rigorous, the concept underlying it is simple: we use evidence and research to design products and solutions to help learners achieve the outcomes that matter to them. Then, we measure the impact the use of our products has, publicly and transparently report on that impact, and use what we learn to help learners and ourselves continuously improve.

We aspire in our commitment to efficacy to give learners a reason to believe in Pearson, as the trusted guide to lifelong learning, as they navigate a changing world of work. The era of one job or career for life is gone. The talent economy is now driving the need for a lifetime of learning. Automation is changing the world of work, STEM jobs are on the rise and in many places, jobs outnumber workers for the first time in decades. Skills that are hard to automate, like personal and social capabilities such as communication and critical thinking, are becoming more important than ever. To equip themselves to make the most of this new world of work, people must continuously grow, demonstrate their skills and adapt their talents.

In this talent-driven world, to support people to make the necessary progress, we must also refocus and redesign learning to support the development of key skills needed to thrive in the future of work.

First, we must help people to understand what it means to be employable. Based on research with c.14,000 employers, educators, and learners across the world into the outcomes that matter most, we have identified the range of competencies and skills that go into making an individual employable. This includes the foundations, such as learning to learn, to securing levels of achievement in core academic areas like the STEM disciplines, to the skills needed to continuously learn throughout life in order to remain successful over a whole career. These are the skills needed for jobs that don't even exist yet. The skills fall into four broad categories as visualised below.

Reflecting this, our aspiration to be a trusted guide is built on demonstrating to learners we can help them grow, show and continuously evolve their talents through a lifetime of learning.

Our ongoing commitment to demonstrating our impact via transparent, publicly audited efficacy reporting sets us apart from our competitors. Two of the efficacy reports we are releasing this spring focus on products designed to support individuals to be successful in their careers:

- Watson-Glaser assesses critical thinking for higher education placement and employee hiring and success.
- BTEC Level 3 Health and Social Care equips students with the specialist knowledge, practical skills and understanding they need to progress along their chosen learning and career path.

Learn more about BTEC on p20

Additional reports will be released later in 2020 on our Virtual Schools business, and on our US Higher Education Courseware products. All of our reports are accessible at: www.pearson.com/corporate/efficacy-and-research.html

As pioneers in applying efficacy in education, we are committed to keeping on pushing the boundaries of the returns learners deserve from learning experiences: guiding learners through a lifetime of learning and, in doing so, building public trust in the business of learning.

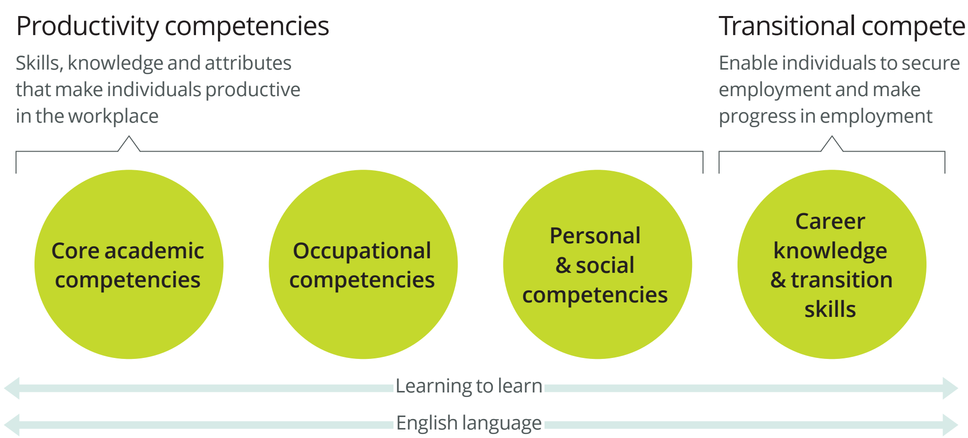
Designing innovations for impact

Aida is the world's first AI-enabled mobile calculus tutor designed to support students to pass calculus and in doing so contribute to increasing STEM retention rates.

To achieve this outcome, the design was informed by our learning science and design expertise. Aida analyses learners' paper-based calculations, identifying incorrect steps, gives feedback and uses authentic examples to more actively engage learners and improve motivation.

No matter how advanced the technology is, our focus on efficacy keeps our product development grounded in design, based on decades of evidence of what works to enable learning, measure impact and continuously improve.

Learn more about Aida on p35



Directors' duties statement

The Directors of Pearson plc – and those of all UK companies – must act in accordance with a set of general duties. These duties are detailed in the Companies Act 2006 and include in Section 172 a duty to promote the success of the company (see inset, right).

As part of their induction at Pearson, the Directors are briefed on their duties and they can access professional advice on these – either through the company or, if they judge it necessary, from an independent provider. Typically, in large and complex businesses such as Pearson, the Directors fulfil their duties partly through a governance framework that delegates day-to-day decision-making to employees of the Group.

The Board recognises that such delegation needs to be much more than a simple financial authority and, throughout this document, we have summarised: our governance framework; the values and behaviours expected of our employees and business partners, including the standards to which they must adhere; how we engage with stakeholders, including to understand and take into account their views and concerns; and how the Board looks to ensure that we have a robust system of control and assurance processes in place.

In this annual report, we provide examples of how the Directors take into account the likely consequences of decisions in the long term, build relationships with stakeholders, engage with employees, understand the impact of Pearson's operations on communities and the environment, and attribute importance to behaving as an ethical and responsible business. In particular, you are encouraged to read the following sections of this report which illustrate how the Directors, with the support of the wider business, consider these matters in the course of their duties, although this is not intended to be an exhaustive list as such matters are integrated throughout this report:

› Creating value for our stakeholders (p14), which summarises our stakeholder groups, how we serve and engage with them, their key concerns and our response.

› The Board's disclosure, Engagement with stakeholders (p62), which summarises:

  – how Directors have engaged with employees and had regard to employees' interests; and

  – how Directors have had regard to the need to foster the company's business relationships with suppliers, customers and others. Pearson considers its key customer groups to be Learners, Educators and Educational Institutions, and describes its suppliers as Business Partners – we have categorised our engagement with these groups accordingly.

› Sustainability (p16), which describes:

  – how stakeholders were consulted in the development of our new 2030 Sustainability Strategy, which is ongoing and is overseen by our Reputation & Responsibility Committee;

  – the ways in which we engage in respect of the social, environmental and economic issues that will influence learning;

  – initiatives through which we strive to improve access to quality education for underserved and underrepresented groups;

  – the ways in which Pearson strives to be the best partner we can be to customers such as learners and educators, suppliers and communities: living our values through how we do business, treat people and protect the environment.

A continued understanding of the key issues affecting stakeholders is an integral part of the Board's decision-making process and the insights which the Board gains through engagement mechanisms form an important part of the context for all of the Board's discussions and decision-making processes. The case study on Pearson's recent acquisition of Lumerit Education (p61) provides an illustrative example of how the Board takes stakeholder views, and the impact on stakeholders, into account in its decision-making.

Section 172 of the Companies Act

In summary, as required by Section 172 of the Companies Act 2006, a director of a company must act in the way he considers, in good faith, would most likely promote the success of the company for the benefit of its shareholders. In doing this, the director must have regard, amongst other matters, to:

› the likely consequences of any decisions in the long term;

› the interests of the company's employees;

› the need to foster the company's business relationships with suppliers, customers and others;

› the impact of the company's operations on the community and environment;

› the company's reputation for high standards of business conduct; and

› the need to act fairly as between members of the company.

Financial review

In 2019, underlying sales were flat and adjusted operating profit was up 6%

Coram Williams
Chief Financial Officer

Profit and loss statement

In 2019, sales decreased by £260m in headline terms to £3,869m (2018: £4,129m) with portfolio changes reducing sales by £347m and currency movements increasing revenue by £97m. Stripping out the impact of portfolio and currency movements, revenue was flat in underlying terms. Underlying revenue in North America declined 3%, Core was up 5% and Growth was up 4%.

The 2019 adjusted operating profit of £581m (2018: £546m) reflects a £130m year-on-year benefit from restructuring, £19m benefit from other operational factors, a benefit of £15m from currency movements, and a £25m benefit from the adoption of IFRS 16 Leases (see note 1b to the consolidated financial statements) offset by £37m of portfolio changes, £50m of inflation, and a £67m decrease from trading. Excluding the impact of currency movements and portfolio changes, underlying adjusted operating profit grew 6%.

Net interest payable was £41m, compared to £24m in 2018. The increase is due to the adoption of IFRS 16, which resulted in an additional £34m of net interest payable in 2019. After excluding the impact of IFRS 16, there was a reduction in net interest payable due to lower levels of net debt together with favourable movements in interest on tax and the absence of one-off costs from the redemption of bonds.

The effective tax rate on adjusted earnings in 2019 was a charge of 16.5% compared to a credit of 5.2% in 2018. The increase in tax rate reflects the lower level of one-off benefits in 2019 compared with 2018, including provision releases, due to the expiry of relevant statutes of limitation and the reassessment of historical positions.

Adjusted earnings per share of 57.8p (2018: 70.3p) reflects all the elements above.

Cash generation

Operating cash flow was £418m in 2019 (2018: £513m) with cash conversion at 72% (2018: 94%). This was impacted by the timing of the disposal of our US K12 Courseware business, a mismatch between cash and accrued incentive compensation and challenging trading in US Higher Education Courseware. These factors more than offset a modest benefit from the adoption of IFRS 16.

The equivalent statutory measure, net cash generated from operations, was £480m in 2019 compared to £547m in 2018, for the reasons noted above, as well as higher net restructuring payments of £111m. 2018 had £25m restructuring cash inflow due to proceeds from the rationalisation of our property portfolio.

Financial summary

Business performance

£ millions	2019	2018	Headline growth	CER growth	Underlying growth
Sales	**3,869**	4,129	(6)%	(9)%	0%
Adjusted operating profit	**581**	546	6%	4%	6%
Operating cash flow	**418**	513			
Adjusted earnings per share	**57.8p**	70.3p			
Dividend per share	**19.5p**	18.5p			
Net debt	**(1,016)**	(143)[1]			

Statutory results

£ millions	2019	2018	Headline growth	CER growth	Underlying growth
Sales	**3,869**	4,129	(6)%	(9)%	0%
Operating profit	**275**	553			
Profit for the year	**266**	590			
Cash generated from operations	**480**	547			
Basic earnings per share	**34.0p**	75.6p			

Throughout this section: a) Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and changes related to the adoption of IFRS 16. b) 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 p201–204

1 Net debt pre-IFRS 16. Net debt adjusted for IFRS 16 in 2018 would have been £809m.

Financial review

Statutory results

Our statutory operating profit was £275m in 2019, compared to £553m in 2018. The decrease in 2019 is largely due to the decrease in gains on disposals, together with increased intangible and restructuring charges, which more than offset the increase in adjusted operating profit.

Capital allocation

Our capital allocation policy is to maintain a strong balance sheet and a solid investment grade rating, to continue to invest in the business and through acquisitions, to have a sustainable and progressive dividend policy, and to return surplus cash to our shareholders. Given the strength of the balance sheet and, with the simplification of our back office largely complete, this gives us more scope for inorganic investment.

Balance sheet

Net debt to adjusted EBITDA was 1.3x on a post-IFRS 16 basis. On a post-IFRS 16 basis, net debt rose from £809m in 2018 to £1,016m in 2019, reflecting lower operating free cash flow, dividends, additional capital invested in Penguin Random House, the acquisitions of Smart Sparrow and Lumerit Education and outflows from the disposal of the US K12 Courseware business.

In March 2019, the Group repurchased €55m of its remaining €500m Euro 1.875% notes due May 2021, to leave €195m outstanding. The Group also refinanced its revolving credit facility (RCF) in February 2019, extending the maturity to February 2024 and reducing the size to $1.19bn. Borrowings at 31 December 2019 included drawings on the Group's RCF of £230m (2018: £nil).

Pension plan

The overall surplus on UK pension plan of £571m at the end of 2018 has decreased to a surplus of £429m at the end of 2019. The decrease has arisen principally due to the unfavourable impact from changes in discount rate assumptions.

Dividend

In line with our policy, the Board is proposing a final dividend of 13.5p (2018: 13p), an increase of 4%, which results in an overall dividend of 19.5p (2018: 18.5p), up 5% on prior year, and subject to shareholder approval. This will be payable on 7 May 2020.

Share buyback

In January 2020, the Group commenced a £350m share buyback programme, in connection with the announcement in December 2019 of the sale of its remaining 25% interest in Penguin Random House. As of 3 March 2020, being the latest practicable date before the publication of this report, we have completed £105m of the share buyback so far.

Businesses held for sale

In December 2019, the Group announced the agreement to sell its remaining 25% interest in Penguin Random House to Bertelsmann, generating net proceeds of approximately $675m.

At the end of December, our share of the assets of Penguin Random House has been classified as held for sale on the balance sheet.

Businesses disposed of

Following the decision to sell the US K12 Courseware business, the assets and liabilities of that business were classified as held for sale on the balance sheet at the end of 2018. In March 2019, the Group completed the sale, resulting in a pre-tax profit on sale of £13m.

2020 outlook

In 2019, we delivered flat underlying revenue, achieved adjusted operating profit growth, made good progress on our simplification programme and laid the foundations for growth. Our guidance for 2020 is for adjusted operating profit between £410m and £490m and adjusted earnings per share of 38.0p to 47.0p. This reflects our portfolio excluding Penguin Random House, exchange rates as at 31 December 2019 and the following factors:

Inflation and other operational factors

Our 2020 guidance incorporates cost inflation of c.£30m which reflects a lower cost base and the benefits of our simplification drive, other operational factors of £45m predominantly due to the reinstatement of staff incentives, as well as continued investment in our strategic growth areas.

Trading

Trading is expected to impact profit between flat and £(80)m with the decline in US Higher Education Courseware offset by growth in the rest of the business.

Restructuring benefits

We expect incremental in-year benefits from the 2017–2019 restructuring programme of £60m in 2020.

Disposals

We expect a negative impact of £55m on adjusted operating profit, from portfolio changes, including £65m from the sale of Penguin Random House.

Interest and tax

We expect a 2020 net interest charge of c.£50m and a tax rate of c.21%, excluding Penguin Random House.

Currency

In 2019, Pearson generated approximately 62% of its sales in the US, 3% in Greater China, 5% in the Eurozone, 3% in Brazil, 3% in Canada, 4% in Australia, 2% in South Africa and 2% in India and our guidance is based on exchange rates at 31 December 2019.

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

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 p201–204

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 2018 or 2019. A reconciliation of the statutory measure to the adjusted measure is shown below:

£ millions	2019	2018
Operating profit	275	553
Add back: cost of major restructuring	159	102
Add back: other net (gains) and losses	(16)	(230)
Add back: intangible charges	163	113
Add back: impact of GMP equalisation	–	8
Adjusted operating profit	581	546

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 costs incurred 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 2019 relate predominantly to staff redundancies, whilst the restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation, including the net impact of our consolidation of the property footprint in London.

These major restructuring costs are analysed below:

£ millions	2019	2018
Further efficiency improvements in Enabling Functions through back office change programmes in Human Resources, Finance and Technology	(94)	(48)
Adjusting the cost base in our US Higher Education Courseware business	(34)	(21)
Further rationalisation of property, vendor and supplier agreements	(29)	(21)
Associate restructuring	(2)	(12)
Total	(159)	(102)

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. This is because 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 included in operating profit of £16m in 2019 mainly relate to the profit on sale of the US K12 Courseware business. Other net gains of £230m in 2018 relate to the sale of the Wall Street English language teaching business (WSE), a gain of £207m, the disposal of our equity interest in UTEL, the online university partnership in Mexico, a gain of £19m, and various other smaller disposal items.

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. Intangible amortisation and impairment charges in 2019 were £163m compared to a charge of £113m in 2018, as although acquisition activity has reduced in recent years, there was an additional £65m impairment charge in 2019 relating to acquired intangibles in the Brazil business, following a reassessment of the relative risk in that market (see also note 11 to the financial statements).

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

Underlying growth rates

Sales decreased on a headline basis by £260m, or 6%, from £4,129m in 2018 to £3,869m in 2019, and adjusted operating profit increased by £35m, or 6%, from £546m in 2018 to £581m in 2019. The headline basis simply compares the reported results for 2019 with those for 2018. We also present sales and adjusted operating profit on an underlying basis, which exclude the effects of exchange, the effect of portfolio changes arising from acquisitions and disposals, and the impact of adopting new accounting standards that are not retrospectively applied. Our portfolio change is calculated by taking account of the contribution from acquisitions and by excluding sales and profits made by businesses disposed in either 2018 or 2019. Portfolio changes mainly relate to the sale of our US K12 Courseware business in 2019 and the sale of our WSE language teaching business in the first half of 2018. Acquisition contribution was not significant in either 2018 or 2019.

In 2019, our underlying basis excludes the impact on adjusted operating profit of IFRS 16 ‘Leases’. This new standard was adopted on 1 January 2019 but the comparative figures for 2018 have not been restated. The impact in 2019 was to increase adjusted operating profit by £25m.

On an underlying basis, sales were flat in 2019, compared to 2018, and adjusted operating profit increased by 6%. Currency movements increased sales by £97m and adjusted operating profit by £15m. Portfolio changes decreased sales by £347m, and together with the impact of IFRS 16 (as noted above), decreased adjusted operating profit by £12m.

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	2019	2018
Profit for the year	266	590
Non-controlling interest	(2)	(2)
Add back: cost of major restructuring	159	102
Add back: other net gains	(16)	(230)
Add back: intangible charges	163	113
Add back: other net finance costs	2	31
Add back: impact of GMP equalisation	–	8
Tax benefit relating to items added back	(123)	(65)
Adjusted earnings	449	547
Weighted average number of shares (millions)	777.0	778.1
Adjusted earnings per share	57.8p	70.3p

Financial review

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 are 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 earnouts 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 2019, the total of these items excluded from adjusted earnings was a charge of £2m compared to a charge of £31m in 2018. Finance income relating to retirement benefits increased from £11m in 2018 to £13m in 2019, reflecting the comparative funding position of the plans at the beginning of each year. The remainder of the decrease was largely driven by a reduction in foreign exchange losses on unhedged cash and cash equivalents in 2019 compared to 2018.

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	2019	2018
Net cash generated from operations	**480**	547
Dividends from joint ventures and associates	**64**	67
Capital expenditure on property, plant, equipment and software (including leased assets)	**(257)**	(204)
Proceeds from sale of property plant, equipment and software (including disposal of leased assets)	**18**	128
Investment income	**2**	–
Add back: costs paid/(proceeds from) major restructuring projects	**111**	(25)
Operating cash flow	**418**	513

Operating cash flow decreased on a headline basis by £95m from £513m in 2018, to £418m in 2019. The decrease results from increased investment in pre-publication assets and other increases in net working capital, including the impact of reduced staff incentives and the absence of a contribution from the US K12 Courseware business, following its disposal in the first half of the year. These factors more than offset a positive impact from the adoption of IFRS 16.

Restructuring cash inflow of £25m in 2018 included proceeds from the sale of property primarily associated with the rationalisation of the property footprint in London and in 2019 restructuring cash outflow was £111m. The restructuring payments made in 2019, together with the impact of the adoption of IFRS 16 (see section below 'Adoption of new accounting standards in 2019') largely explain the reduction in provisions and other liabilities on the balance sheet when comparing 2019 and 2018.

Other financial information

Net finance costs

£ millions	2019	2018
Net interest payable	**(41)**	(24)
Finance income in respect of retirement benefits	**13**	11
Other net finance costs	**(15)**	(42)
Net finance costs	**(43)**	(55)

Net interest payable in 2019 was £41m, compared to £24m in 2018. The increase is due to the adoption of IFRS 16, which resulted in an additional £34m of net interest payable in 2019. After excluding the impact of IFRS 16, there was a reduction in net interest payable due to lower levels of average net debt, together with favourable movements in interest on tax, and the absence of one-off costs relating to the redemption of bonds.

As detailed in the adjusted earnings per share section, finance income in respect of retirement benefits, and other net finance costs are excluded from adjusted earnings.

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 organically and through acquisitions;
- 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	2019	2018
Cash and cash equivalents	437	568
Investment in finance leases	196	–
Derivative financial instruments	15	9
Bank loans and overdrafts	(3)	(43)
Revolving credit facility	(230)	–
Bonds	(593)	(672)
Lease liabilities	(838)	(5)
Net debt	(1,016)	(143)

The Group's net debt increased from £143m at the end of 2018, to £1,016m at the end of 2019. The adoption of IFRS 16 added £666m of debt on transition, with the remainder of the increase principally due to treasury share purchases, additional capital invested in Penguin Random House and outflows from the US K12 Courseware business disposal transaction, which outweighed the normal cash inflow from operations after taking account of interest, tax and dividend payments.

Liquidity and funding

The Group had a strong liquidity position at 31 December 2019, with over £400m of cash and a significant proportion undrawn on its Revolving Credit Facility due in 2024 of $1.19bn (at 31 December 2018, the Group had cash of over £500m and was undrawn on the Revolving Credit Facility).

Taxation

The effective tax rate on adjusted earnings in 2019 was a charge of 16.5%, compared to an effective rate credit of 5.2% in 2018. The increase is mainly due to: the lower level of one-off benefits present in 2019 compared to 2018, including the release of provisions due to the expiry of relevant statutes of limitation; 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 expenses.

The reported tax charge on a statutory basis in 2019 was a credit of £34m (14.7%), compared to a credit of £92m (18.5%) in 2018. The statutory tax credit in 2019 was primarily due to US tax losses generated on the disposal of the US K12 Courseware business.

Operating tax paid in 2019 was £9m. This was impacted by a refund received in the US relating to historical periods together, with no US tax being paid in relation to 2019 as a result of the tax loss on the sale of our US K12 Courseware business. Non-operating tax paid of £21m in 2019 relates to tax paid to the Chinese tax authorities, following the disposal of WSE during 2018, and New York state and city taxes paid in the US as a result of a settlement with the tax authorities relating to past disposals. Deferred tax liabilities reduced from £136m in 2018 to £48m in 2019, mainly due to the generation of tax losses in the US as noted above. Deferred tax assets and current tax liabilities remained relatively consistent year on year. There are contingent liabilities in relation to tax as outlined in note 34 to the financial statements.

The Group adopted IFRIC 23 'Uncertainty over Income Tax Treatments' on 1 January 2019, resulting in a reduction of £5m in provisions for uncertain tax positions. The cumulative effect of applying this adjustment has been applied to retained earnings at 1 January. The impact of adopting IFRIC 23 on the income statement for 2019 was not material.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The loss on translation of £115m in 2019 compares to a gain in 2018 of £90m. The loss in 2019 mainly arises from the weakness of the US dollar compared to sterling. A significant proportion of the Group's operations are based in the US and the US dollar weakened in 2019 from an opening rate of £1:$1.27 to a closing rate at the end of 2019 of £1:$1.32. At the end of 2018 the US dollar had strengthened from an opening rate of £1:$1.35 to a closing rate of £1:$1.27 and this movement was the main reason for the gain in 2018.

Also included in other comprehensive income in 2019 is an actuarial loss of £149m in relation to retirement benefit obligations of the Group and our share of the retirement benefit obligations of Penguin Random House. The loss arises from the unfavourable impact of changes in the assumptions used to value the liabilities in the plans and in particular movements in the discount rate. The value of assets was also impacted following the UK plan's purchase of insurance buy-in policies in the first half of 2019. The loss in 2019 compares to an actuarial gain in 2018 of £25m.

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 2019 (2018: £56m) of which a charge of £69m (2018: £67m) was reported in adjusted operating profit and income of £13m (2018: £11m) was reported against other net finance costs. The small increase in the operating charge in 2019 is largely explained by the absence of material past service items, which in 2018 included a credit of £11m relating to changes in the US post-retirement medical plan, and a charge of £8m relating to guaranteed minimum pension (GMP) equalisation.

The overall surplus on UK Group pension plans of £571m at the end of 2018 has decreased to a surplus of £429m at the end of 2019. The decrease has arisen principally due to the actuarial loss noted above in the other comprehensive income section. In total, our worldwide net position in respect of pensions and other post-retirement benefits decreased from a net asset of £471m, at the end of 2018, to a net asset of £337m at the end of 2019.

Adoption of new accounting standards in 2019

The adoption of IFRS 16 'Leases' has impacted both the income statement, as described above, and has had an impact on certain lines in the balance sheet. The lease liability (classified as financial liabilities – borrowings) brought onto the balance sheet at transition was £881m, with the corresponding right-of-use asset (classified within property, plant and equipment) valued at £424m. In addition, certain subleases have been reclassified as finance leases resulting in an additional lease receivable (classified as other receivables) of £215m being brought on balance sheet. The net impact on the balance sheet is a reduction of net assets of £83m, after taking into account existing liabilities relating to onerous lease provisions (reducing provisions for other liabilities and charges by £101m), lease incentives, prepayments, adjustments to tax and the net impact on associates. The full impact of the adoption of this standard is outlined in note 1b to the consolidated financial statements.

Financial review

The impact of adopting IFRIC 23 'Uncertainty over Income Tax Treatments' had a small impact on the current tax balance but has not materially impacted the income statement (see note 1c to the consolidated financial statements).

The impact of adopting Amendments to IFRS 9 and IFRS 7 has not had a material impact on the financial statements (see note 1d to the consolidated financial statements).

Dividends

The dividend accounted for in our 2019 financial statements totalling £147m represents the final dividend in respect of 2018 (13.0p) and the interim dividend for 2019 (6.0p). We are proposing a final dividend for 2019 of 13.5p bringing the total paid and payable in respect of 2019 to 19.5p. This final 2019 dividend, which was approved by the Board in February 2020, is subject to approval at the forthcoming AGM and will be charged against 2020 profits. For 2019, the dividend is covered 3.0 times by adjusted earnings.

Businesses held for sale

Following the decision to sell the US K12 Courseware business, the assets and liabilities of that business were classified as held for sale on the balance sheet at the end of 2018. In March 2019, the Group completed the sale of its US K12 Courseware business, resulting in a pre-tax profit on sale of £13m. Total gross proceeds were £200m including £180m of deferred proceeds, which include the fair value of an unconditional vendor note for $225m, an entitlement to 20% of future cash flows to equity holders, and 20% of net proceeds in the event of a subsequent sale.

The cash outflow in the year relating to the disposal of subsidiaries was £101m, mainly reflecting the deferral of proceeds for the US K12 Courseware business and the seasonal level of cash reflecting deferred revenue in the business at the disposal date.

Tax on the disposal of the US K12 Courseware business is estimated to be a benefit of £51m. The benefit arises as the transaction gives rise to a loss for tax purposes mainly due to the differing treatment of deferred revenue disposed in the tax computation. In addition to the tax on the US K12 Courseware business there were £17m of tax credits relating to adjustments following settlement of tax relating to prior year disposals.

In December 2019, the Group announced the sale of its remaining 25% interest in Penguin Random House. At the end of December, our share of the assets of Penguin Random House has been classified as held for sale on the balance sheet.

Acquisitions and disposals

During 2019, the Group made some small acquisitions for total consideration of £40m. There were no significant acquisitions in 2018.

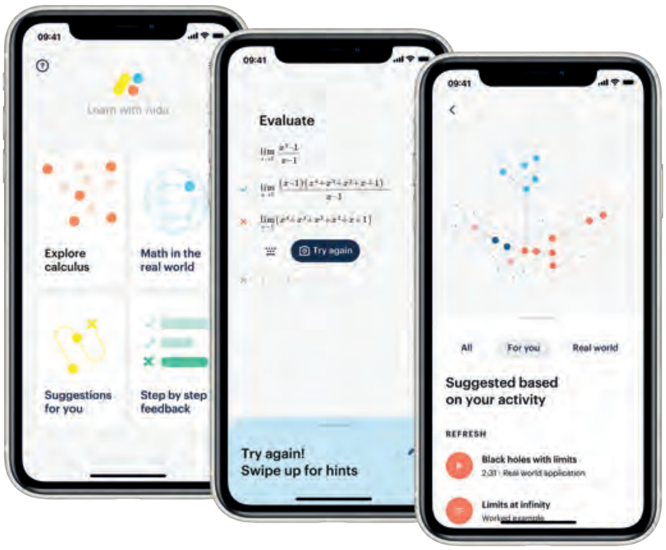
The main disposal in 2019 was the US K12 Courseware business as noted above. In 2018, the Group disposed of the Wall Street English language teaching business (WSE), realising a gain of £207m, and the equity interest in UTEL, the online university partnership in Mexico, realising a gain of £19m. Various other smaller disposal items resulted in a net gain of £4m in 2018.

Related party transactions

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

Post balance sheet events

In January 2020, the Group commenced a £350m share buyback programme in connection with the announcement in December 2019 of the sale of its remaining 25% interest in Penguin Random House.



> **Aida is a first in education.** By using multiple types of AI to tutor students, we can teach them how to learn calculus and apply it in the real world.
>
> Milena Marinova,
> SVP-AI Products & Solutions

CASE STUDY AIDA

Aida – the world's first AI-inspired calculus app

The biggest economic revolution of our time is unfolding around us: the talent economy. Technology, AI and automation are shoving all of us off a one-track career.

The future of work is moving faster than any of us. The talent economy is the new patchwork of dream jobs, gigs, freelancing, and any other way we earn a living from what makes us unique. In this new talent-driven world, we'll never catch up or leap ahead unless we redesign how people learn. Everything about our future hinges on this redesign of learning.

It's no longer enough to sit in a classroom and soak in knowledge. Learning has to happen wherever you are, whenever you need it and across your lifetime – tuned to the skills for the job you do today and the job you don't even know about yet.

Educators and schools always decided when and how people learned. Now, people are telling us how they want it done, personalised like the other content and products we all consume in a digital world.

But this is a bigger deal than the next film someone watches or an online purchase. If we want to get to the new internet, or the answer to climate change, we need more data analysts, engineers, doctors and scientists.

Ten years from now the US will have half a million more IT jobs. In 15 years, 5G will create almost 22m jobs globally. Think about that.

We can't even find workers for the 2.4m unfilled STEM jobs we have now and we'll have to find more.

And, there's a major, unseen barrier standing in the way. Calculus.

Almost all STEM fields require it and almost one-third of students drop or fail it. Just imagine a world where we could plug that leak in the STEM pipeline.

We have.

Meet Aida. The world's first AI-enabled mobile calculus tutor. Aida is a first in education. By using multiple types of AI to tutor students, we can teach them how to learn calculus and apply it in the real world. Aida gives feedback tailored to everyone. Aida is designed based on evidence of the most effective ways to teach and learn calculus. It's a highly personalised learning approach for a highly personalised world.

It's not the only answer to the STEM shortage. But Aida is a new way to teach people how to learn, and ultimately how to adapt to this new economy. It's about redesigning learning to create the economists, doctors, designers, coders and the new jobs we haven't even dreamed up yet for the future of everything.

This is an example of how we are designing products to have an impact on key learning outcomes in STEM and promoting education to advance the UN SDGs as part of our 2030 Sustainability Strategy.

Learn more about Efficacy on p27
Learn more about Sustainability on p16

FAST COMPANY
MOST INNOVATIVE COMPANIES 2020
2020 Honoree

In 2020, Pearson has been named in the prestigious **Fast Company's Most Innovative Companies List**.

Operating performance review

North America

Market summary

Our largest market includes all 50 US states and Canada.

Sales

£2,534m

Adjusted operating profit

£361m

SUSTAINABILITY IN ACTION

Accelerated Pathways

Accelerated Pathways partners with employers to implement educational benefits programmes that provide our clients' employees with lifelong learning opportunities. These solutions may include foundational education skills (including reading, writing, English, core job and work skills), pathway to a GED, college advising, accredited courses, degrees and industry or trade certifications. It drives our sustainability objective to advance equity by addressing many of the unique challenges adult learners without educational opportunities face. Programmes are online and optimised for mobile delivery, so employees can learn anytime, anywhere. A mix of funding sources can reduce or remove the cost barrier for participation.

In 2019, Accelerated Pathways grew both through new clients, including Manpower, and the acquisition of Lumerit Education, an ed-tech company that helps address the issues of college degree completion and affordability. Preliminary results from new client programmes include an average reduction of 89% for high-turnover roles, saving clients in recruitment and replacement costs, as well as increased employee engagement and confidence.

Read more about Pearson's Sustainability Strategy on p16

Advance equity in learning

Build skills for sustainable futures

Revenue declined 3% in underlying terms, primarily due to US Higher Education Courseware declining 12%, and Student Assessment, which declined slightly. Offsetting that, we saw good growth in Virtual Schools, OPM and Professional Certification (VUE) revenue. Headline revenue decreased due to disposals, partly offset by FX gains.

Adjusted operating profit declined 3% in underlying terms, due to the impact of lower sales, inflation and other operating factors partially offset by restructuring savings. Headline profit was flat on last year, with the impacts on adjusted operating profit offset by the benefits of FX and IFRS 16 adoption.

Courseware

In US Higher Education Courseware, a revenue decline of 12%, with print declining close to 30%, was partially offset by modest growth in digital. In 2019, the weaker performance was driven by a number of factors:

- Unbundling of premium-priced print and digital products for digital-only formats. Sales of bundle units declined 45% during 2019.
- Campus bookstores buying less physical inventory due to changing student behaviour, with over 50% of learners now preferring an eBook to a physical text. This trend led to eBook growth of 18% during 2019.
- Modest adoption share loss caused by the delivery issues due to the implementation of the new ERP system in H2 2018 as well as the reorganisation of our sales force.

We are focused on regaining share over time as we build traction from the rollout of our next wave of digital products on the Pearson Learning Platform, which launched in September. 60% of all Revel fall subscriptions will migrate onto the Pearson Learning Platform by the end of the year enhancing the faculty and student experience.

We are also launching a direct-to-learner Pearson eText in 2020, with enhanced features.

US Higher Education Courseware digital registrations, including eBooks, declined 2%. Good registration growth in Revel, up 9%, was offset by continued market pressure in Developmental Mathematics and the planned retirement and deprioritisation of long-tail products.

We continue to make good progress with Inclusive Access signing 162 new institutions in 2019, taking the total not-for-profit and public institutions served to 779. Including 80 longer-standing contracts with for-profit colleges, we now have direct relationships with over 850 institutions.

In 2019, we served 1.8m Inclusive Access enrolments up from 1.4m in 2018, making up 9% of 2019 US Higher Education Courseware revenue, up 19% on 2018 on a like-for-like basis, excluding the 80 for-profit colleges.

Assessment

In US Student Assessment, underlying revenue declined slightly in 2019 with continued contraction in revenue associated with PARCC and ACT-Aspire multi-state contracts and contract losses, which were partially offset by new contract wins.

During 2019, Pearson won new contracts or signed renewals in several key incumbent states including Kentucky, Maryland, Colorado and New Jersey, as well as the federal NCES contract for delivering the National Assessment of Educational Progress (NAEP). Pearson also won back the testing contract in the state of Tennessee.

Automated scoring continues to be a competitive strength for Pearson. In 2019, we scored 39m responses with AI, up 8% from 2018.

In Professional Certification (VUE), global test volume rose 8% to c.16.5m. Revenue in North America was up a high single-digit percentage, mostly driven by the IT sector with increased demand for cloud technology certifications through Microsoft and Amazon, and volume growth in an education contract launched at the end of 2018, which is now operating at its full run rate.

We signed over 40 new contracts in 2019, including the Project Management Institute (PMI) and our renewal rate on existing contracts continues to be over 95%.

In Clinical Assessment, underlying revenue declined as demand for new product only partially offset normal declines in products in the later stages of their lifecycle.

Services

School Services (Virtual Schools) grew revenue 6% and served 76,000 Full Time Equivalent (FTE) students through 42 continuing full-time virtual partner schools in 28 states, up 5% on last year.

Six new full-time, online, state-wide partner schools opened in the 2019–20 school year in the states of Oregon, Washington, Tennessee, Minnesota and California, while a contract was exited in North Carolina.

Higher Education Services (including OPM and Learning Studio) grew revenue 4%, due to growth in OPM, partially offset by a small drag from Learning Studio revenue, a learning management system, which was fully retired in 2019.

In OPM, revenue grew 9%, with growth in course registrations of 5% and new programmes launched more than offsetting programmes terminated. Our overall active programme count grew to 347 from 325 in 2018.

During 2019, we continued to optimise our portfolio and reduce the number of partners to 25 from 35. This will allow us to shift towards enterprise models where we have a number of programmes with a single partner and can benefit from economies of scale in marketing and recruitment. We are also working to integrate more content and assessment services into our partnerships.

Core

Market summary

Our international business in established and mature education markets.

Sales

£838m

Adjusted operating profit

£92m

SUSTAINABILITY IN ACTION

BTEC

BTEC qualifications support progression to higher or further education, apprenticeships or directly into employment. Across England as a whole, 44% of white working-class students who make it to higher education have at least one BTEC. 48% of black British students accepted to higher education have at least one vocational qualification.

We are committed to increasing the number of BTEC registrations outside the UK, particularly in markets where vocational education is developing. In 2018, the Group had 33,403 registrations outside of the UK, which increased to 43,906 registrations in 2019 (an increase of 31%).

BTEC also helps to build skills for a sustainable future. Sustainability is embedded within 31% of BTEC qualifications across sectors, including engineering, logistics, construction, health, health and social care, science and IT.

We recently launched our first sustainability-backed loan, linking to our progress in increasing access to quality vocational education to learners in international markets.

Read more about Pearson's Sustainability Strategy on p16

Advance equity in learning

Build skills for sustainable futures

Revenue was up 5% in underlying terms and 4% in headline terms, with growth in Student Assessment and Qualifications, including the delivery of a new digital assessment contract in Egypt, PTE Academic, OPM and Professional Certification (VUE), all partially offset by declines in Courseware.

Adjusted operating profit increased 58% in underlying terms and 61% in headline terms due to trading growth and restructuring savings.

Courseware

Courseware revenue declined moderately. Declines in School Courseware in the UK and Australia offset growth in Italy. In Higher Education Courseware, revenue declines in the UK and Europe more than offset growth in Australia.

Assessment

In Student Assessment and Qualifications, revenue grew strongly, due to price and volume increases for A levels and GCSEs and the delivery of a new digital assessment contract in Egypt. This was partially offset by continued market declines in Apprenticeships.

We successfully delivered the National Curriculum Test (NCT) for 2019, marking 3.8m scripts, up slightly from 2018. The NCT will be delivered by another provider in 2020.

In Professional Certification (VUE), revenue was up due to good growth in the DVSA test in the UK, additional exam series added to the ICAEW contract and good growth in the MOI (French driving test) which launched in late 2017.

Clinical Assessment sales declined primarily in France and the Netherlands due to an absence of new major product introductions.

PTE Academic saw continued strong growth in test volumes in Australia and New Zealand, up 14% from 2018. This was driven by its use to support visa applications to the Australian Department of Home Affairs, as well as good growth in New Zealand. We recently announced the win of the UK Secure English Language Test (SELT) contract with the UK Home Office, which we expect to drive future growth.

Services

In Higher Education Services (OPM), revenue growth was driven by course enrolment growth in the UK. During the year, we also announced new OPM partnerships in Australia with the University of Adelaide and University of Wollongong.

Operating performance review

Growth

Market summary

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

Sales

£497m

Adjusted operating profit

£63m

SUSTAINABILITY IN ACTION

China

We have taken action to assist learners as the COVID-19 epidemic has taken hold in China. As schools across China have been closed down to prevent the further spread of the illness, Pearson has made dozens of online products and courses available for free to students unable to attend school.

Both students and teachers have welcomed these resources. For example, there were over 60,000 applicants to International Connections Academy and almost 200,000 people are using free AI learning resources on the Longman English Plus WeChat Platform, known as 'Longman Xiaoying.'

Read more about Pearson's Sustainability Strategy on p16

Advance equity in learning

Build skills for sustainable futures

Revenue grew 4% in underlying terms due to strong growth in China and good growth in Brazil and the Middle East, partially offset by declines in South Africa. Headline revenue declined due to disposals.

Adjusted operating profit increased 24% in underlying terms, reflecting higher revenue together with the benefits of restructuring. In headline terms, adjusted operating profit increased 7% with the impact of disposals more than offset by trading and restructuring savings.

Courseware

Courseware revenue was flat in underlying terms, with growth in English Language Courseware in China and School Courseware in the Middle East and Hispano America, offset by declines in Higher Education Courseware in South Africa following a change in government funding.

Assessment

Professional Certification (VUE) revenue grew well due to a large ICT infrastructure certification contract, and a number of new smaller contract launches in China.

PTE Academic saw strong growth in revenue with test volumes up 25% in India and China.

Services

In English Services, underlying revenue grew slightly in our English Language School franchise in Brazil due to new product launches.

In School Services, underlying revenue grew slightly due to price increases and new product launches in our sistemas in Brazil.

In Higher Education Services, enrolments grew 3% at the Pearson Institute of Higher Education (formerly CTI), however revenue declined modestly due to changes in mix.

Penguin Random House

Penguin Random House

Adjusted operating profit

£65m

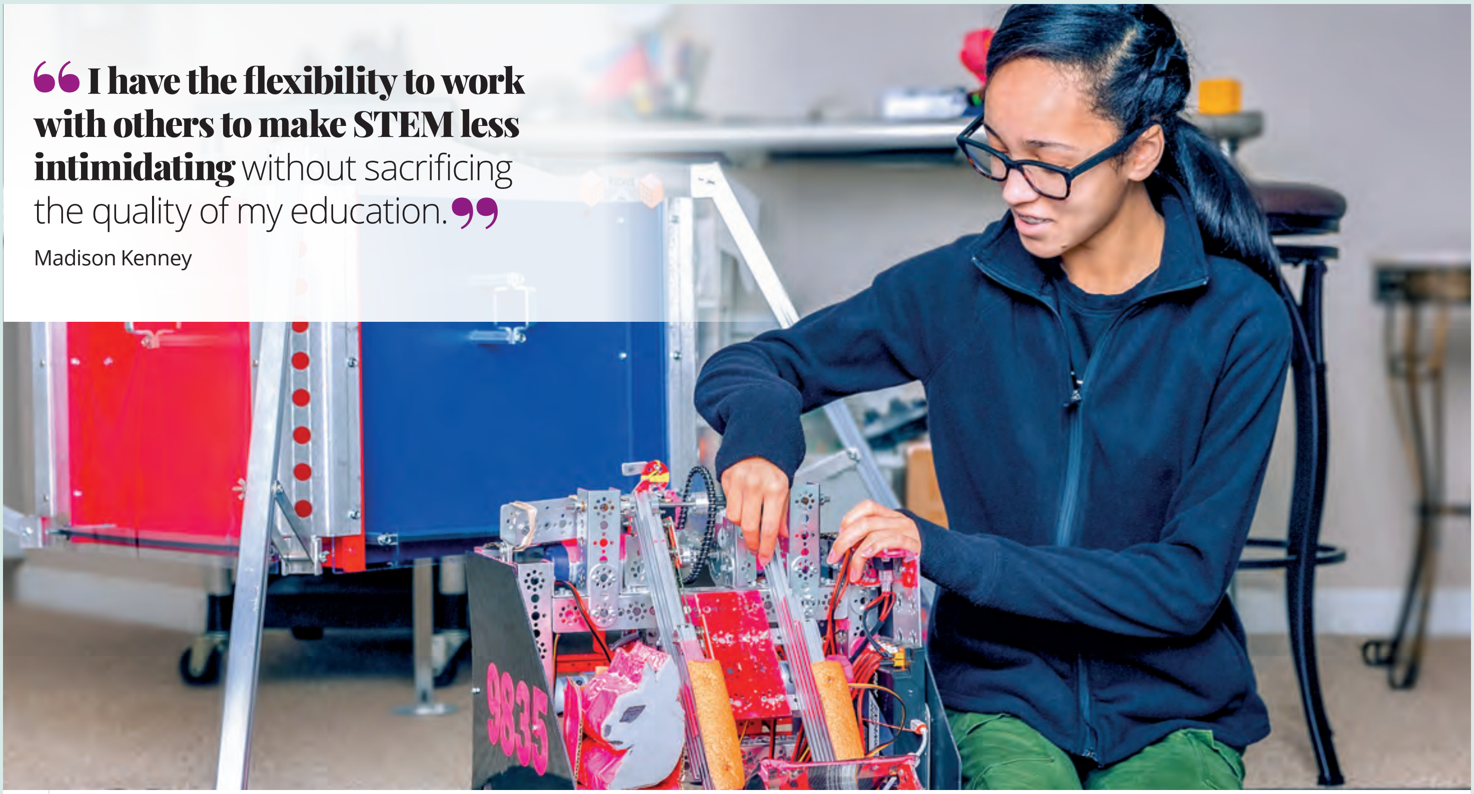
Pearson owns 25% of Penguin Random House, the first truly global consumer book publishing company.

Penguin Random House performed solidly with underlying revenue growth from a rise in audio sales, stable print sales, and the industry's top bestsellers, including *Where the Crawdads Sing* by Delia Owen, *Becoming* by Michelle Obama, and bestselling books by Margaret Atwood, Tara Westover, Lee Child, Jamie Oliver, Jeff Kinney, and Dr. Seuss.

We announced the sale of the remaining 25% in Penguin Random House on 18 December 2019. The transaction is expected to close in H1 2020.

I have the flexibility to work with others to make STEM less intimidating without sacrificing the quality of my education.

Madison Kenney



CASE STUDY VIRTUAL SCHOOLS

Online school provides opportunity for young students to pursue passions and achieve their dreams

Read the 2018 efficacy report:
www.pearson.com/corporate/efficacy-and-research/reports/connections-academy.html

Madison Kenney has a passion for STEM and wants to share that enthusiasm with other young female students. STEM is often intimidating and Madison has made it her mission to work with female students to make STEM more approachable. To allow Madison to spend more time on this mission, her mother enrolled her in Connections Academy, Pearson's Virtual Schools programme for students in K12.

"I was first introduced to robotics at a Girl Scout Expo and immediately knew that this is what I wanted to do," says Madison. "Attending Connections Academy gives me the flexibility to work with others to make STEM less intimidating without sacrificing the quality of my education."

Madison keeps a busy schedule coaching FIRST Lego League and Seaperch, and has earned several awards for STEM excellence, including the Prudential Spirit of Community Award and the President's Volunteer Service Award, among others.

Madison is also a full-time, dual-enrolled student at Kennesaw State University, and hopes to pursue a career as a mechatronics engineer for NASA. Madison says, "Online learning helped prepare me for college as it has made me an independent and motivated learner."

Efficacy research shows that Connections Academy students like Madison can receive the same quality of education as that offered at their local public school, while simultaneously taking advantage of the benefits offered to them by virtual schools.

Pearson and Virtual Schools

Pearson delivers K12 online education to schools and students across the US and internationally. 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.

This is an example of how we are designing products to have an impact on key learning outcomes and promoting education to advance the UN SDGs as part of our 2030 Sustainability Strategy. We will release a new Efficacy Report on Virtual Schools later in 2020.

Learn more about Efficacy on p27
Learn more about Sustainability on p16

Organisational risk management

Our risk management process is used to identify and mitigate our exposures and, where possible, turn risks into business opportunities.

The focus of our risk management process, which we call 'organisational risk management', is on identifying, analysing, managing and mitigating risks, with our goal to support Pearson in meeting its strategic and operational objectives.

Our risk approach 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, also enabling us to adapt to any required changes in approach.

The risk reporting process is carried out biannually and reviewed by the Audit Committee and the Board. During the year, the Audit Committee and Board conduct deep dives into selected principal risks.

Principal risks and uncertainties

In 2019, the Board of Directors undertook a robust assessment of the current principal and emerging risks facing Pearson, in accordance with provision 28 of the 2018 UK Corporate Governance Code.

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.

Brexit

The UK exited the EU on 31 January 2020. Given the prolonged negotiation process during 2019, we continued our mitigation planning, led by a Steering Committee chaired by the CFO. We worked to identify and mitigate any potential impact on our principal risks, including supply chain and operations (covered in the customer experience risk), tax and data privacy, treasury, workforce mobility and more. 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; and we have plans in place to ensure we continue with business as usual.

Coronavirus (COVID-19)

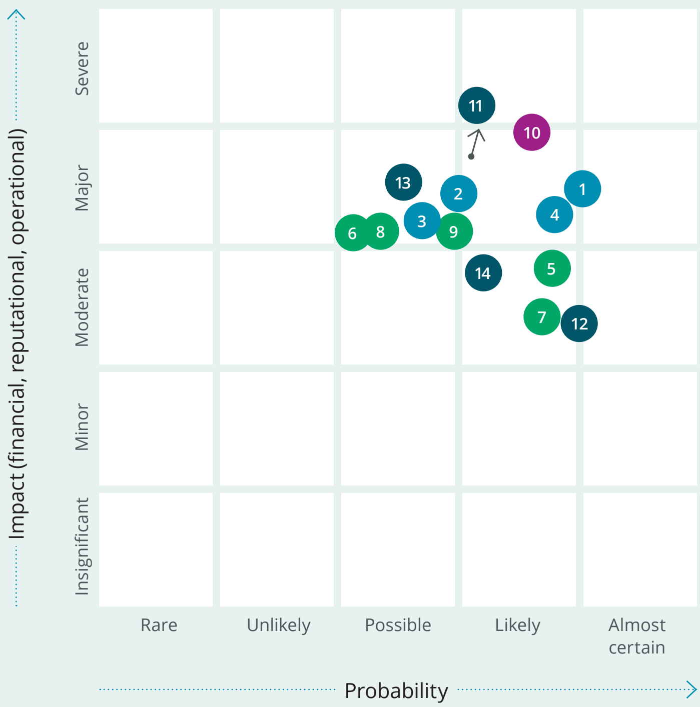
At the time of publication of our annual report, the COVID-19 outbreak in China and globally is an emerging risk that is being closely monitored on a day-by-day basis. Our primary focus is on ensuring the safety and well-being of our employees, customers and learners. We have invoked our business resilience plans to help support our customers and maintain our business operations. At this time, we do not believe that COVID-19 will have a material adverse impact on Pearson's financial results. We are actively continuing to monitor the situation.

Mitigation and controls

Throughout all 14 principal risks, Pearson adopts mitigation activities in the form of internal controls, as part of regular internal meetings and external consultations. These include reporting to the Board, reporting to Pearson's Executive management team, and monitoring compliance with Pearson policies, international regulations and standards.

The following principal risks also relate to the material issues considered in the Sustainability section of this report on p16: products and services, testing failure, political and regulatory, information security and data privacy, customer experience, and safety and security.

Principal risks: status and 2019 change



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 2019

For more information see principal risks and uncertainties tables on the following pages.

Risks are categorised into four main areas:

Category	Description	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
		2 **Products and services**	President – North American Courseware & Global Product
		3 **Talent**	Chief Human Resources Officer
		4 **Political and regulatory risk**	Chief Corporate Affairs Officer Chief Strategy Officer
Operational	Involving people, systems and processes.	5 **Testing failure**	President – Global Assessment President UK & Global Online Learning
		6 **Safety, safeguarding and corporate security**	Chief Financial Officer Chief Human Resources Officer
		7 **Customer experience**	President – North American Courseware & Global Product Chief Technology and Operations Officer
		8 **Business resilience**	Chief Financial Officer General Counsel
		9 **Data**	President – North American Courseware & 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

Principal risks and uncertainties

Strategy and change

Risk description	2019 activity	2020 plans
1 Business transformation and change		
The accelerated pace and scope of our transformation initiatives increase our risk to execution timelines and to the business's adoption of change.	› During 2019, planned headcount reductions were completed, allowing the delivery of annualised savings as expected of the programme. › A range of additional transformation initiatives were successfully completed, with further ones identified for completion in H1 2020. See the Audit Committee update on business transformation on p74 for more details.	› Deliver the Business Value Realisation (BVR) Plan, that will continue to further stabilise operations, resources and existing governance models. › Continue to review and make recommendations on further optimisation programme opportunities. › Create a key performance indicator (KPI) scorecard to reflect stabilisation activities. › Progress rest of world phase of TEP.
2 Products and services		
Failure to successfully invest, develop and deliver innovative, market-leading global products and services that will have the biggest impact on learners and drive growth.	› Product innovation: we made progress across key markets in implementing product portfolio management to ensure our products are aligned to our strategy to achieve target revenue and profitability. We also made significant progress understanding the competitive and structural threats, especially to our US Higher Education Courseware business, and made progress mitigating these. › Product and investment portfolio: we improved visibility into how our products and services contribute to Pearson's overall growth, and are using that as an input for the future investment allocation process. We continued to build our employability capabilities and further clarified our investment priorities. › Competition: market share competition remained high, especially due to pricing pressure from low cost competitors, including, in US Higher Education Courseware, open educational resources (OER). The proposed Cengage & McGraw Hill merger, if it proceeds, will consolidate our two largest competitors in this market. The impact of this remains unknown. However, we believe we have the right strategy in place with our Inclusive Access (IA) programme to tackle affordability and keep ahead of the consumer trend to digital.	› Build on the 2019 launch of the Pearson Learning Platform (PLP): 60% of all Revel fall subscriptions on PLP by the end of the year; over 100 MyLab and Mastering titles on PLP in 2021. › Launch a new Pearson eText, with an expanded catalogue and enhanced features that differentiate it from a conventional third-party eReader. › Continue efforts to embed the product lifecycle framework into our decision-making processes. › Use the results of the US Higher Education Courseware baseline survey we did in 2019 to inform and design new ways of working. › Improve our ability to horizon scan the market and customer behaviours, which will provide improved trend analysis and agility to respond to trends.

Strategy and change

Risk description	2019 activity	2020 plans
3 Talent		
Failure to attract and retain the talent we need and to create the conditions in which our people can perform to the best of their ability.	**People development** › We continued with the development of our VP and Director levels, with the *Lead to Succeed* programme, which aims to support succession planning. › We refreshed our *Manager Fundamentals* training across the company, with tools and resources that are shared with line managers each month. › We continued targeted learning with our internal learning and development platform, Pearson U, with career development workshops. **Diversity & Inclusion (D&I)** › We conducted D&I assessments and dashboard reviews with Executive team members and their leadership teams. › We continued mentoring programmes for female talent, with Board members mentoring SVP women and Executive team members mentoring VP women. **Employee engagement** › Internal teams with global employees were created to address company-wide issues (e.g. silo-busting, performance management, employee learning). › An Employee Engagement Network was created with cross-functional, top talent employees to provide an employee voice for strategic input at Pearson. › We completed research, gathered insights, delivered messaging workshops for the Employee Value Proposition which aims to improve recruiting outcomes and increase talent retention. › We launched the *Pearson Proud* campaign intended to empower employees as Pearson advocates. **Structure and approach** › Created the SVP-Learning position reporting to the Chief Human Resources Officer (CHRO) which is responsible for scaling Pearson products to all employees. › Centralised HR centres of expertise that make up our employee experience under a newly created SVP-Employee Experience role. › Refreshed performance management tool for employees with quarterly check-ins that focus on feedback, development and to improve performance outcomes.	› Work with each Pearson Executive team member and their teams to make progress on the 2019 actions from the 2018 Organisational Health Index, to improve decision-making and role clarity, as well as driving innovation and learning. › Roll out the 'new employee value proposition' programme. › Reskill/upskill employees as teams restructure and new roles are created. Assess and refine the HR global strategy. › Continue with the work under way on our recruitment marketing platform. This will help Pearson to attract and convert passive candidates to become employees and build our brand in the technology sector. › Look to update Pearson's remuneration philosophy to align with our five-year strategy and provide flexibility to adapt remuneration policies for business and talent needs as we continue to build on our digital transformation.

Principal risks and uncertainties

Strategy and change

Risk description	2019 activity	2020 plans
4 Political and regulatory risk		
Changes in governments, policy and/or regulations have the potential to impact business models and/or decisions across all markets.	In our two biggest markets, the UK and the US, progress in 2019 was as follows: › In the UK, we continued to build Pearson's position as a leader, expert and innovator in general qualifications, technical/vocational education and assessment. › In the US, we positioned Pearson as an innovator in the education and workforce space, among both parties, in state capitals, on Capitol Hill and with the Trump administration. › We maintained fair market access through national and state partnerships, as well as direct lobbying. › With the bipartisan National Governors Association, we shaped the Chair's workforce initiative which was shared with all governors, informing state policies. › We continued to monitor trade actions and sanctions that could impact business goals.	The Government relations team will continue to monitor and advise on: › Online learning legal and regulatory challenges. › Instructional material market risks that arise when Governments mandate the use of state-produced instructional materials and/or content (China, Hong Kong, South Africa and India). › Implications of being a US/UK company in the current global geopolitical environment.

Operational

Risk description	2019 activity	2020 plans
5 Testing failure		
Failure to deliver tests and assessments (e.g. for Pearson UK, Schools and VUE) and other related contractual requirements because of operational or technology issues, resulting in negative publicity impacting our brand and reputation.	› In 2019, there was a GCE (A level) Maths security breach which was managed as a significant incident. We have since reviewed, analysed and strengthened our security options, in conjunction with other awarding bodies. › A complete review, with improvements was delivered to our test fraud investigations processes, in partnership with our key UK clients. › Development was completed for an improved process enabling more secure access to live test materials for centres, rather than manual provision via email or secure file transfer. › An improved VQ system monitoring was introduced and we reduced the frequency and volume of unconfirmed bookings (i.e. test provision failure). › All School Assessment customer-facing products were successfully migrated to the cloud, resulting in greater scalability, reliability, efficiency and security.	› Utilise technology, moving systems to more stable and secure platforms in the cloud. Work continues to ensure that any technology changes are fully factored into all of Pearson's business continuity activities and adjustments are made to relevant certifications and regulatory frameworks. › Work with our security technology teams to further develop systems and partnerships towards fraud detection analytic models, AI and machine learning analysis. › Ensure assurance will continue to extend ISO activity across products and geographies. We will also further mature our business continuity measures by improving integration of Disaster Recovery (DR) and Business Continuity (BC) activities. Additional certifications are under way to further strengthen our security and technology resilience. › Ensure that our service plans will continue to develop a technology-based solution to reduce or eliminate manual Test Publishing Quality Assurance (TPQA) processes.

Operational

Risk description	2019 activity	2020 plans
6 Safety, safeguarding and corporate security		
A variety of risks that can cause harm to our people, assets and reputation continue to evolve as our company does. While some risk has reduced due to outsourcing and divestiture, the diverse nature of our people's activities require continued focus, resource and improvement to reduce the potential for harm.	**Health & Safety and wellbeing** › In 2019, two serious and separate incidents occurred, at the same Pearson printing facility. Both highlighted the continued need by staff and managers at a local/regional level for focus and improvement. › Continued to implement all outstanding audit actions, meeting or exceeding targets for follow-up action closure. › Mental health awareness has been included in high impact events sessions and was extensively rolled out in APAC, as part of the *R U OK?* Campaign. › We continued to monitor implementation of our Health & Safety Statement, which sets out our commitment to protecting the health, safety and welfare of all our employees and anyone else who comes into contact with our operations around the world, including our learners, customers and other partners. We also migrated from BS OHSAS 18001 to the new ISO 45001 standard covering Pearson Management Services in our UK Head Office. **Safeguarding** › There were stronger engagements across relevant Pearson business lines and fresh development of safeguarding policies in PIHE in South Africa and Pearson College London. › Productive conversations and future knowledge was developed with the UK's Internet Commissioner. › An advisory review was undertaken with our businesses in Brazil, which will continue to support safeguarding practice in the franchise businesses, and consider how we integrate safeguarding in our future product offerings. › At Pearson College London, we published policies that offer advice and guidance on sexual harassment, self harm and suicide. **Corporate security** There was one catastrophic incident involving Dieter Kowalski, a Pearson IT manager, who sadly lost his life while on business travel to Colombo, Sri Lanka. Dieter was a victim of the Easter Sunday terror attacks. › Travel security continues to grow in support of more travellers and new countries and cities and is no longer limited solely to higher-risk locations. › Security reviews for higher-risk locations were conducted in new locations. › High impact events (HIE) awareness continued across key locations.	**Health & Safety and wellbeing:** › Continue to further develop the analysis of occupational health data to ensure proactive and reactive intervention strategies are aligned for the promotion of employee wellbeing. › Implement a global solution to report, escalate, investigate and action Health & Safety incidents (including near misses). › Continue to focus on risk controls in high-risk activities while improving local oversight of relevant risks in lower-risk environments (emergency planning, ergonomics, stress and wellbeing). › Deliver wellbeing and mental health awareness and training across North America. **Safeguarding** › Continue to develop best practice and policy in regard to online safeguarding/harm. › Continue discussions with external consultants towards ensuring compliance with best practice and developing legislation. › Work towards the global implementation of the programme and effective support for learners. › Continue to develop our incident reporting, analysis and assurance plans. › Integrate diversity into our safeguarding practices. **Corporate security** › Continue to identify key risks when selecting properties across the globe, and particularly for higher-risk locations. › Work towards 'secure by design' in our new/refurbished offices. › Deliver further high impact events (HIE) awareness. › Work with those markets which do not have a dedicated travel provider, thus reducing risk and improving our response capabilities. › Continue to develop our current intelligence and information third-party relationships for better sharing of the risk horizon across Pearson.

Principal risks and uncertainties

Operational

Risk description	2019 activity	2020 plans
7 Customer experience		
Failure of either our current, (or future) 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 of our higher education business (direct to consumer business model and online presence).	› In 2019, our UK back to school period went well, with improved fulfilment rates and all Service Level Agreements (SLAs) being met. In addition, our helpline call volumes were down. › We continued to see improvements in forecast accuracy in the UK with the deployment and adoption of new systems. › We successfully implemented our Brexit contingency plans with our existing channel partner, providing warehousing and logistics services to UK-based customers. › In North America, we improved capabilities within the team and implemented improved processes. Warehouse fulfilment rates exceeded the SLA. › Our US Customer Experience team launched a modern digital experience for learners in the US and Canada. The new Pearson website provides the first global experience that merges content and commerce. › Customer Support teams continued to make progress in product improvement, self-help strategy and assisted support improvements. › Our focus remained on the performance and stability of all product platforms.	**Customer experience** › Onboard additional portfolios to redefine the user experience – e.g. ITPro, Pearson eText; which will rollout in our UK higher education market. › Work with customer service teams to establish a 24/7 support model for learners. › Enable new commercial models e.g. Buy Now Pay Over Time. › Expand the Voice of Customer (VOC) programme for BVR initiatives. **Customer service and support** › Continue with core platform deployment across all lines of business to enable modern support experiences. › Continue to work with technology on business cases for increased efficiencies. › Continue partnering with business owners to introduce more differentiated services to drive loyalty and growth.
8 Business resilience		
Failure to plan for, recover, test or prevent incidents involving any of our products, customers and our businesses' locations. Incident management and technology disaster recovery plans may vary in ability/ comprehensiveness across the Group.	› Direct and prolonged incident management support to key office locations following the Easter Sunday attack in Sri Lanka. › Resiliency visits made to workforces, landlords and critical suppliers in the US, South Africa, India and the Philippines, to assure local coordinated incident and business continuity readiness, including media management. Incident response teams created where none existed in critical areas. › Work continued on the delivery of a Facility Manager bundled service in North America. › Improved capabilities to respond to incidents across Pearson globally. › Continue to drive the risk message as prevention rather than reaction, towards a change focused on agile resilience.	› Continue with global process owners to embed business continuity planning within their processes. › Respond appropriately to major incidents. Resilience resources will continue to develop local, high-quality teams and plans. › Ensure critical vendors have mature response plans which are annually resilience-assured. › Continue to invest time in all critical vendors to ensure KPIs can be met during a range of disruptions. › As of February 2020, the COVID-19 outbreak in China is a new emerging risk to the wider economy across mainland China, Hong Kong, and a growing number of countries around the world. We have invoked our business resilience plans to help ensure the safety and well-being of our staff while enhancing our ability to support our customers and maintain our business operations.

Operational

Risk description	2019 activity	2020 plans
9 Data		
Inability to utilise our data to achieve market intelligence and increase productivity and efficiency, while managing market risk impacts arising from customer concerns around use of student data, may significantly affect management of our core operations and achievement of our strategy objectives.	› Defined our data governance and toolset. › Our data orchestration programme saw a solution director assigned to commence scoping work and future structures. › Initiated four work streams: – data privacy – data governance – data catalogue – data KPIs › Initiated product, customer, supplier and employee governance work streams.	› Introduce a governance operating model to become operational with an initial focus on the customer and product, followed by employees and suppliers. › Introduce a data maturity model enabling continuous improvements to be made as we progress with Pearson's digital transformation.

Financial

Risk description	2019 activity	2020 plans
10 Tax		
Legislative change caused by the OECD Base Erosion and Profit Shifting initiative, the UK exit from the EU, or other domestic governments' initiatives, including in response to the European Commission State Aid decision regarding the UK CFC exemption, results in a significant change to the effective tax rate, cash tax payments, double taxation and/or negative reputational impact.	› State Aid – the Group appealed against the Commission's decision and continues to work through the implications of the decision with support from external advisers. › Reputational risk – the third annual tax report has been published. Pearson has signed up to the B-Team tax principles and is actively participating in the B-Team tax working group. › Legislative changes – the Group continued to assess and monitor proposed changes in the international tax framework, including proposals to address the tax challenges arising from the digitalisation of the economy.	› State Aid risk – the specific next steps depend on the response from HMRC and any update on the EC legal case, and are likely to include the requirement for a payment on account. However, we will continue to confer with external advisors to protect the Group's position. › Tax legislation – work continues to mitigate the impacts of changes in the international tax environment and to monitor the ongoing OECD work.

Principal risks and uncertainties

Legal and compliance

Risk description	2019 activity	2020 plans
11 Information security and data privacy		
We have from time to time experienced, and may continue to experience in the future, security breaches of our systems despite our best efforts to prevent them. We also risk failure to comply with data privacy regulations and standards. The above could result in damage to the customer experience, our reputation, and a breach of regulations and financial loss.	**Information security** › For our people, refreshed security awareness training and policies were launched to ensure all employees understand their responsibilities for securing information. › We enhanced account access controls through Multi Factor Authentication and Privilege User Management. › Pearson continued to evolve our security controls to enable IT simplification and other transformation programmes.	**Information security** › Our people will have access to role-based security training and resources to further influence our security culture. › We will complete roll-out of enhanced laptop and mobile security controls, to track best practices. › Information Security resources, tooling and practices will continue to be embedded in our learning, enterprise and infrastructure platforms to ensure comprehensive security by design. › We will enhance our ability to detect and respond to potential security incidents through development of automated security tools in our Security Operations Centre.
	Data privacy › In 2019, we put plans in place to ensure that we were appropriately prepared for the California Consumer Privacy Act, including updates to privacy notices, execution of relevant vendor terms, implementation of processes to respond to user right requests and extensive training and guidance. › Held privacy summits with key product and tech teams focused on embedding privacy by design. › Notified affected customers of unauthorised access to school and university AIMSweb 1.0 accounts. See www.pearson.com/news-and-research/announcements/2019/07/pearson-customer-notification.html	**Data privacy** › Globally assess new laws and regulations coming into force and prepare for their implementation. › Expand scope of processes to address new user/data subject right requirements in additional jurisdictions. › Work with product teams to review and update retention schedules. › Continue to engage with relevant teams to drive privacy by design in product development.
12 Intellectual property		
Failure to adequately manage, procure, protect and/or enforce intellectual property rights (including trademarks, patents, trade secrets and copyright) in our brands, content and technology may impair the value of our core assets, or reduce profits.	› Continued to reduce our multiple brand identities, streamline and strengthen Pearson's brand and patent key strategic technology assets (PLP, Aida, etc). › Expanded internal governance and best practices to ensure effective rights management and mitigation of infringement risks across IP. › Targeted IP enforcement against key third party infringers of Pearson copyright (piracy), brands and patents.	› Continue 2019 activities with focus on improving IP practices and governance across growth geographies and reorganised product groups. › Monitor increasing risks posed by local legislation and global treaties aimed at reducing copyright protection of educational content and partner with local associations to resist these policy shifts.

Legal and compliance

Risk description	2019 activity	2020 plans
13 Compliance		
Failure to effectively manage risks associated with compliance (principally ABC and sanctions risk), including failure to vet third parties, resulting in reputational harm, Anti-Bribery and Corruption (ABC) liability, or sanctions violations.	› Completed the rollout of a third-party due diligence programme globally and over 32,000 third parties have undergone ABC and sanctions due diligence. › Created and launched a learning course for third-party due diligence in the UK, US and Canada. This will be rolled out to the rest of the world in 2020. › Our annual Code of Conduct rollout achieved 100% completion in record time, and we implemented a global conflict of interest policy as part of that launch. › We launched our *SpeakUp* campaign in certain key markets, and incorporated it into the Code of Conduct. As a result, reports into the PearsonEthics.com portal have increased by 69%.	› Focus on sanctions compliance best practice in 2020 in light of the 2019 US Department of Treasury guidance. › Continue ABC risk assessments to monitor implementations of our ABC and sanctions compliance programme policies and procedures, as well as to identify areas of continuous improvement. › Evaluate a prospective interactive Code of Conduct, for potential launch in 2021. › Finalise any legacy third-party due diligence efforts.
14 Competition law		
Failure to comply with antitrust and competition legislation could result in costly legal proceedings and fines of up to 10% of global revenue; other financial consequences such as class actions, damages, void contracts; and could adversely impact our reputation.	› Continued holding training and refresher sessions for our employees. › Formed a working group in the Lawyers Network, dedicated to performing an in-depth assessment on Pearson employees involved in industry association groups. › Set up a working group to assess on resale price maintenance risk in all countries where Pearson is active, to match the recent trend of enforcers to target this type of infringement. › Launched eLearning modules on information-exchange risk.	› Develop our approach to industry associations and information-exchange, which will include work on specific training and monitoring levels of awareness. › Continue efforts on resale price maintenance with the working group to assess risk and issue recommendations. › Raise awareness via the efforts of our Antitrust Lawyers Network. › Convey and encourage compliance measures to all teams, as part of our antitrust compliance programme, as recognised by enforcers.

Principal risks and uncertainties

Risk assessment of prospects and viability

This section should be read together with the full viability statement on p107

Pearson's principal risks and our ability to manage them as outlined in this section 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 for 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 three year 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 strategic model and businesses are discussed in more detail on p10–13

The key assumptions which underpin our three-year plan to December 2022 are as follows:

- there are further declines in enrolments and other downwards pressure in the US Higher Education Courseware market.
- OPM grows, driven by global enrolment in undergraduate and postgraduate online courses.
- Virtual Schools grows, driven by increased enrolments in new and existing schools.
- other growth businesses, including Professional Certification (VUE) and English show good growth.
- the remaining Pearson business shows modest growth.
- our 2017-2019 cost efficiency programme is completed and additional cost savings are achieved in 2020.
- our investment in the product technology platform accelerates the shift to digital and enhances courseware service capabilities.
- investment continues in our growth businesses and the Pearson Brand in order to drive growth.
- our stake in Penguin Random House is sold and no additional share of profits are recorded.

In assessing the company's viability for the three years to December 2022, the Board analysed a variety of downside scenarios, including a scenario where the company is impacted by all principal risks from 2020. The primary modelling overlaid a 'severe but plausible' downside scenario onto the base case three-year plan for the Group, focusing on the impact of the following assumptions and key risks:

- the benefits of our 2017–2019 cost efficiency programme are not sustainable;
- further declines in US Higher Education Courseware, with digital growth failing to take hold;
- failure to accelerate our digital transformation in the wider Pearson Group;
- our growth businesses including OPM and Virtual Schools do not deliver despite increased investment; and
- the Group is required to make significant cash tax payments in respect of a negative ruling on UK CFC exemption (EU State Aid). Other contingencies are not expected to crystallise in the period to December 2022.

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 2022, based on this assessment, is included alongside the going concern statement on p107

Governance report

In this section

Letter from the Chair

Chair
Sidney Taurel

Dear shareholders,

As I have said elsewhere in this report, 2019 has been a significant year of change for Pearson, and the Board's role in laying the foundations for sustainable, profitable growth is critical. 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 stakeholder engagement.

The 2018 edition of the UK Corporate Governance Code (the Code) came into effect for Pearson at the start of 2019. Building upon the solid preparatory work we had undertaken for the new Code during 2018, the Nomination & Governance Committee steered the implementation of various new or revised practices at Board level to reflect changes in the external governance landscape. The Board considers that Pearson has a strong corporate governance framework in place but nevertheless we recognised that the new Code presented a timely opportunity to review and benchmark our approach to ensure that we remain committed to the highest standards of governance. You can read more about our corporate governance framework, processes and activities during 2019 on the pages that follow.

Pearson recognises the increasing focus on the importance of all stakeholders in running a sustainable company – a view taken not just by regulators but by global business leaders, investor communities and society. Engaging with, and understanding the views of, our stakeholders is imperative to developing and delivering educational products which meet the needs of learners, educators, governments and employers. As a Board, we aim to incorporate opportunities to meet stakeholder groups whenever our schedule permits, and our Reputation and Responsibility Committee oversees Pearson's wider stakeholder engagement activity on our behalf. You can read more about the Board's engagement with stakeholders on p62 and about the importance of stakeholders to our business as a whole on p14

Board leadership and company purpose

Over the past several years, the Board's focus has been on Pearson's three strategic priorities – accelerating the digital transformation of our traditional courseware and assessment businesses; growing our 'structural growth' opportunities – exciting businesses such as Virtual Schools, OPM, English and Pearson VUE; and becoming a simpler, more efficient and sustainable business. As we reach the end of our simplification programme, we have now created the foundations to become a platform-based company well placed to succeed in the digital age. As such, our strategy is now evolving, building on the work we have done over the last few years and driving our efforts to be a learner-centric company focused on employability and lifelong learning.

The Board regularly receives a dashboard which allows Directors to monitor progress on Pearson's financial and strategic priorities, enabled by critical discussion of these matters at each Board meeting and supported by agreed indicators and milestones which the Board and management have identified as key measures of performance. Through this, we maintain oversight of digital transformation initiatives such as the Pearson Learning Platform, growing market opportunities such as online learning, and simplification programmes such as The Enabling Programme and Business Value Realisation.

During the year, the Board considered Pearson's portfolio strategy, with the aim of ensuring that Pearson focuses on retaining or acquiring businesses of which it is the best owner. These discussions enabled the Board to identify opportunities for inorganic growth, resulting in the acquisition of Lumerit Education, a US-based ed-tech company, as part of our Accelerated Pathways business, and Smart Sparrow, a small ed-tech company which specialises in the creation of rich, interactive content – Pearson's first acquisitions in five years. Our portfolio discussions also led to the agreement to dispose of our remaining 25% stake in Penguin Random House, to our partner in that venture, Bertelsmann – a transaction which is expected to complete in the first half of 2020. Taking account of the expected proceeds from this disposal, and bearing in mind Pearson's capital allocation policy, the Board agreed to return £350m of capital to shareholders by commencing a share buyback programme in January 2020.

The Board continues to focus on engendering a corporate culture that is inclusive, innovative and meritocratic, and on ensuring that this aligns with the company's purpose, values and strategy. In doing so, all Directors are committed to acting with integrity and leading by example. This report illustrates how the Board has monitored Pearson's culture throughout the year, including through the launch of our Employee Engagement Network and the implementation of successful talent initiatives, as well as considering the results of our latest organisational health survey and discussing the actions which management planned in response.

Composition, succession and evaluation

Crucial to successful delivery of our strategy is 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 & Inclusion form a continuing thread throughout the Board's and Committees' sessions.

Succession planning is a key responsibility for the Board, supported by the Nomination & Governance Committee, and effective executive succession planning is key to ensuring continuity within the business. In December 2019, Pearson's Chief Executive, John Fallon, announced his intention to retire from the company during the coming year after seven years as Chief Executive and 22 years in total serving Pearson. As Chair, I routinely consider the matter of Chief Executive succession and it was a frequent theme of my discussions with Non-Executive Directors during the year, recognising the length of Mr Fallon's tenure in the role. When John advised the Board of his intentions, I accelerated the succession process promptly with the assistance of the Nomination & Governance Committee, and Committee members and I discuss developments on a regular basis as our search and interview process moves forward.

In January 2020, Pearson's CFO, Coram Williams, announced his intention to step down from the Board and leave the company. The Board and I are delighted that Pearson's Deputy CFO, Sally Johnson, has agreed to take on the position of CFO, and shareholders will be invited to vote on Sally's appointment to the Board at the AGM on 24 April, at which point Coram will step down from the Board.

Pearson has a fully engaged Board, including a strong Non-Executive team with a breadth of experience and perspectives. We were pleased to welcome Sherry Coutu and Graeme Pitkethly to the Pearson Board, following their appointments as Non-Executive Directors with effect from 1 May 2019. Sherry's experience in building fast-growth, entrepreneurial businesses, focused on technology and education, and Graeme's financial expertise, global overview and deep understanding of consumer behaviour have further strengthened our capabilities in these areas, and I am pleased to confirm that each is already making a valuable contribution to our deliberations as a Board and to the Committees which they have joined.

In the coming year, we will say goodbye to Josh Lewis, a Non-Executive Director of Pearson since 2011, who intends to step down from the Board at the forthcoming AGM in April 2020, in line with our normal practice for Non-Executive Directors to remain on the Board for a maximum of nine years. The Board joins me in thanking both Coram and Josh for their commitment and contributions to Pearson during these years of change for the company.

The 2019 Board evaluation, which was led by our Senior Independent Director, Vivienne Cox, found the Board to be well-functioning, with a good quality of relationships between members of the Board and an appropriate level of challenge and support provided to management. There was recognition by the Board of how much has been achieved by Pearson and its employees in recent years, and of the energy and effort which this journey has required from all concerned. More detail on our 2019 Board evaluation can be found on p66. Progress on recommendations arising from our annual Board evaluation is reported at each Nomination & Governance Committee meeting until such recommendations are complete or embedded to the Committee's satisfaction.

Audit, risk and internal control

The Board of Directors is 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 compliance and risk management processes, providing independent oversight of our external audit and internal control programmes, accounting policies and business transformation projects, and in assisting the Board in reporting in a fair, balanced and understandable manner to our shareholders.

Remuneration

In 2019, the Remuneration Committee has reviewed and updated Pearson's remuneration philosophy and developed a set of principles to underpin its updated remuneration policy which will be put to shareholder vote at the 2020 AGM. These principles will inform how Pearson develops remuneration strategy for the whole organisation and give the business flexibility to deliver on its strategy and digital transformation. Pearson's current approach to Executive remuneration is explained in more detail in the remuneration section of this report on p84

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

The UK Corporate Governance Code

The principles set out in the UK Corporate Governance Code (the Code) emphasise the value of good corporate governance to the long-term sustainable success of listed companies. These principles, and their supporting provisions, cover five broad themes and the Pearson Board is responsible for ensuring that the Group has in place appropriate frameworks to comply with the Code's requirements.

The five themes are covered in particular on the following pages of the Governance report, with additional information contained in the Strategic report.

- Board leadership and company purpose; Division of responsibilities; and Composition, succession and evaluation on p54–73
- Audit, risk and internal control on p74–83
- Remuneration on p84–106

This year, we are reporting against the 2018 edition of the Code. The Board believes that during 2019 the company was in full compliance with all applicable principles and provisions of the Code, save that as noted on p87 the Company continues to work to align pension contributions for Executive Directors to those available to the workforce. This Governance report and the Strategic report set out how Pearson has applied the principles of the Code throughout the year.

The Code can be found on the Financial Reporting Council'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.

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.

Key to Committees

A Audit

N Nomination & Governance

RR Reputation & Responsibility

R Remuneration

Committee chair

Current notable commitments reflect other listed company directorships and full-time or executive roles.

Chair

Sidney Taurel Chair
aged 71, appointed 1 January 2016 N R

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)

Executive Directors

John Fallon Chief Executive
aged 57, 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. John is also President of the London Chamber of Commerce & Industry (LCCI).

John has announced his intention to retire from Pearson during 2020.

Coram Williams Chief Financial Officer
aged 46, 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.

Coram will be stepping down from the Board and his role as Chief Financial Officer at the Annual General Meeting on 24 April 2020.

Executive Director-elect

Sally Johnson
Chief Financial Officer-elect
aged 46, to be appointed 24 April 2020

Sally joined Pearson in 2000, and has held various finance and operations roles across The Penguin Group, the education business and at a corporate level. She brings to the Board extensive commercial and strategic finance experience as well as transformation, treasury, tax, risk management, business and financial operations, investor relations and M&A expertise. She has held various senior level roles across the business, most recently as Deputy CFO of Pearson. Sally is a member of the Institute of Chartered Accountants in England and Wales and trained at PricewaterhouseCoopers. She was also a Trustee for the Pearson Pension Plan from 2012 to 2018.

Non-Executive Directors

Dame Elizabeth Corley, DBE
Non-Executive Director A N R
aged 63, 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 was a senior adviser to the firm until the end of December 2019. 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 is a member of the Committee of 200. She was appointed Dame Commander of the Order of the British Empire in the Queen's Birthday Honours in 2019 for her services to the economy and financial services.

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

Sherry Coutu, CBE Non-Executive Director
aged 56, appointed 1 May 2019 N R

Sherry has extensive experience in the technology industry. She is the Chairman of Founders4Schools and founder of the Scaleup Institute. Previously, she was CEO of Interactive Investor International plc, served on the board of Bloomberg New Energy Finance and the London Stock Exchange plc. In education, she was SID and Remuneration Committee Chair of RM plc, on the board of Cambridge University, Cambridge Assessment and Cambridge University Press, and Chesterton Community College. Sherry has started and or invested in over 60 technology businesses and served on the boards of Zoopla plc, Raspberry Pi, NESTA, and the Advisory boards of the National Gallery, Royal Society and Linkedin. She was appointed Commander of the British Empire in the 2013 New Year Honours for her services to entrepreneurship.

Vivienne Cox, CBE
Senior Independent Director A N RR
aged 60, 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, and a Non-Executive Director at pharmaceutical company GlaxoSmithKline plc. She serves as Chair of the Rosalind Franklin Institute and Vice Chair of the Saïd Business School (part of Oxford University). 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)

Josh Lewis Non-Executive Director
aged 57, appointed 1 March 2011 N R

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)

Linda Lorimer Non-Executive Director
aged 67, appointed 1 July 2013 A RR

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 and is a trustee of Hollins University. She also remains on several consequential advisory committees at Yale University.

Michael Lynton Non-Executive Director
aged 60, appointed 1 February 2018 A RR

Michael served as CEO of Sony Entertainment from 2012 until 2017, overseeing Sony's global entertainment businesses. He was also 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., Schrödinger, Inc. and Warner Music, and currently serves on the boards of IEX and Ares Management Corporation LLC.

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

Board of Directors

Non-Executive Directors continued

Graeme Pitkethly Non-Executive Director
aged 53, appointed 1 May 2019 A RR

Graeme joined Unilever in 2002 and, prior to being appointed CFO and Board member, was responsible for Unilever's UK and Ireland business. Previously, he had held a number of senior financial and commercial roles within Unilever and spent the earlier part of his career in senior corporate finance roles in the telecommunications industry. Graeme served as Vice President of Financial Planning and Vice President of Corporate Development at FLAG Telecom and started his career at PricewaterhouseCoopers. Graeme is a Vice Chair of the Task Force on Climate Related Financial Disclosures and is a Chartered Accountant.

Current notable commitments: Unilever plc and Unilever NV (Chief Financial Officer)

Tim Score Non-Executive Director
aged 59, appointed 1 January 2015 A N R

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 serves as Chairman of The British Land Company plc, a role to which he was appointed in July 2019, a non-executive director of HM Treasury, and 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 (Chairman)

Lincoln Wallen Non-Executive Director
aged 59, appointed 1 January 2016 A RR

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)

Governance at Pearson

Board of Directors

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)

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
- President – UK & Global Online Learning
- President – International
- President – Global Assessment
- President – North American Courseware & Global Product
- General Counsel & Chief Legal Officer

see opposite

FLOW OF INFORMATION

Pearson Executive Management

Tim Bozik President – North American Courseware & Global Product

Tim Bozik has extensive experience in product development and higher education. Tim joined Pearson in 1983 as a sales representative and has since held leadership roles in product and general management.

Rod Bristow President – UK & Global Online Learning

Rod is a Trustee for the Education and Employers Taskforce, a Fellow of the Royal Society of Arts, and Governor for Harlow College and the BMAT multi-academy trust.

Jonathan Chocqueel-Mangan Chief Strategy Officer

Jonathan was formerly Chief Strategy and Transformation Officer at Kantar Consumer Insights. Jonathan has professional qualifications in Consulting and Coaching for Change from the Saïd Business School and a Doctor of Business Administration in Organisational Behaviour from the University of Surrey.

Gio Giovannelli President – International

Gio was previously CEO of Grupo Multi, which was acquired by Pearson in 2013. He has also held three other CEO positions in Brazil, across different sectors. Gio is a former board member of Natura and of CVC Viagens, both listed in the São Paulo Stock Exchange.

Albert Hitchcock Chief Technology & Operations Officer

Albert has been Chief Technology & Operations Officer since March 2014. Previously, Albert was Group CIO at Vodafone and prior to this was Global CIO at Nortel Networks. Albert is a Chartered Engineer and a Fellow of the Institute of Engineering & Technology.

Deirdre Latour Chief Corporate Affairs Officer

Deirdre has been Chief Corporate Affairs Officer since January 2019. She brings over 20 years of experience in corporate communications and issues management. Previously, Deirdre was the Chief Communications Officer for GE and worked for the global public relations firm Edelman.

Bjarne Tellmann General Counsel & Chief Legal Officer

Bjarne previously worked across Europe, Asia and the US in various capacities with The Coca-Cola Company, most recently as Associate General Counsel. He has also held legal positions at Kimberly-Clark and the law firms of Sullivan & Cromwell LLP and White & Case LLP.

Anna Vikström Persson Chief Human Resources Officer

Anna has been Chief Human Resources Officer since February 2018. She has over 20 years of international HR experience. Previously, Anna served as EVP & Head of Group Human Resources for Sandvik, and similarly for SSAB. She was also VP, HR & Organisation for Ericsson.

Bob Whelan President – Global Assessment

Bob has significant expertise in assessment and has driven Pearson's growth as a global leader in computer-based assessments since 2000. Bob leads Pearson's combined assessment businesses including US Student Assessment, Clinical Assessment, as well as Pearson VUE.

Corporate governance review

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 CFO, Coram Williams and nine independent Non-Executive Directors. Sherry Coutu and Graeme Pitkethly were appointed as Non-Executive Directors on 1 May 2019.

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 and provide advice. He also ensures that shareholders' views are communicated to the Board.

Chair's significant commitments There were no changes to the Chair's significant commitments during 2019.

Independence of Chair In accordance with the UK Corporate Governance Code (the Code), Sidney Taurel was considered to be independent upon his appointment as Chair on 1 January 2016.

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, he promotes Pearson's culture and standards, and is the main representative of the company to its external stakeholders.

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.

Division of responsibilities There is a defined split of responsibilities between the Chair and the executive leadership of Pearson. The roles and responsibilities of the Chair, Chief Executive and the Senior Independent Director 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.

Independence of Directors All of the Non-Executive Directors who served during 2019 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 the Code.

Directors' commitments and conflicts of interest Under the Companies Act 2006 (the Act), the 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 an established 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.

Additionally, in response to Provision 15 of the Code, Pearson has developed 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.

Once notified to the company, any potential conflicts and commitments are considered for authorisation by the Board at its next scheduled meeting or, where necessary in the interests of timeliness, by a Committee comprising the Chair, Senior Independent Director and Company Secretary. In particular, the Board or Committee considers the type of role, expected time commitment and any impact which this may have on the Director's duties to Pearson, as well as any relationships between Pearson and the external organisation. The interested Director is not permitted to vote, or be counted in the quorum, for any resolution relating to his/her commitments, conflict or potential conflict. The Board reviews any authorisations granted on an annual basis.

During 2019, the Board approved two new significant commitments for existing Directors. Firstly, the appointment of Lincoln Wallen as Chief Technology Officer of Improbable, a technology start-up company. The Board was of the opinion that this additional appointment was acceptable as the time commitment expected of Mr Wallen in his new role would be no greater than his previous executive role at the time he joined the Pearson Board. Secondly, the appointment of Tim Score as Chairman of The British Land Company plc (British Land). The Board was of the opinion that this appointment was acceptable as Mr Score holds no other directorships of listed companies apart from Pearson and British Land, therefore it was deemed that the additional time commitment would not impact on Mr Score's duties to Pearson. Additionally, in the cases of both Mr Wallen and Mr Score, the Board believes that the experience gained by Directors through their other commitments can bring valuable perspectives to the Pearson Board. There were no other new commitments of Directors during 2019 which the Board considered to be significant in nature.

Early in 2020, Michael Lynton informed the Chair that two of the companies in which he holds non-executive positions intended to list during the course of the year, namely Schrödinger and Warner Music. Once those companies are listed, Mr Lynton would then be serving on five listed company boards. Mindful of Pearson's own internal guidance, and shareholder sentiment in relation to Directors' commitments, Mr Lynton and the Chair have agreed to review this situation over the course of 2020, once there is absolute clarity regarding Mr Lynton's future intentions. To date there has been no impact on Mr Lynton's ability to commit to the Pearson Board, and he has demonstrated a full attendance record at Pearson since his appointment in 2018.

It should be noted that, should this position not change during the course of 2020, Mr Lynton has agreed with the Chair that he will not stand for re-election to the Pearson Board at the 2021 AGM.

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.

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.

A schedule of formal matters reserved for the Board's decision and approval is available on our website, at www.pearson.com/governance.

Culture, purpose and values

Pearson's core values – to be brave, imaginative, decent and accountable – go to the heart of our purpose: to help people make progress in their lives and careers, and the Board and employees are committed to demonstrating these characteristics throughout their work and deliberations. The Board endorses Pearson's culture of innovation, fostering talent and inclusivity at all levels and demonstrated this during the year by engaging with employees from across Pearson through a variety of in-person and virtual events. The Board monitors the culture and organisational health of the company with the assistance of its Committees, including through regular updates from the Chief Human Resources Officer on talent, D&I and Pearson's values as well as considering Group-wide programmes such as Code of Conduct, compliance, Health & Safety, and training initiatives. Building on discussions during 2019 and with the help of the Chief Human Resources Officer, we aim to introduce a dashboard drawing together key cultural indicators from across the Group, which will add quantitative metrics to augment the Board's existing oversight of culture and organisational health.

Strategic planning and decision-making

The Board spends considerable time in assessing that any proposed transaction aligns with the strategy and future prospects for the business. In addition, an annual strategy session enhances the Board's decision-making in shaping the company's strategic and financial plans.

The Board and Committees receive timely, regular and necessary financial, management and other information to fulfil their 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. The Directors can obtain independent professional advice, at the company's expense, in the performance of their duties. All Directors have access to the advice and services of the Company Secretary, whose appointment and removal is a matter reserved for the full Board.

The Directors recognise their duties towards the shareholders and other stakeholders of the company as set out in Section 172 of the Act, and a continued understanding of the key issues affecting stakeholders is an integral part of the Board's decision-making process. You can read more on the pages that follow about the Board's engagement with stakeholders and an illustrative example of how it takes stakeholder views into account in its decision-making.

Board meetings

The Board held seven scheduled meetings in 2019, with discussions and debates focused on the key strategic issues facing the company. Major items covered by the Board in 2019 are shown in the table on p60. In addition to its scheduled meetings, the Board meets in person or by telephone as necessary to consider matters of a time-sensitive nature. There were two such meetings in 2019 to allow the Board to consider matters relating to business performance and acquisition and disposal opportunities.

October, North America At a two-day meeting in October, the Board and Pearson Executive reviewed Pearson's digital transformation journey towards a single set of global platforms and the alignment of these initiatives with the long-term company strategy. The Board reviewed the Pearson Learning Platform (PLP) and discussed and agreed ways in which to accelerate the release of new products on the platform. They also considered the ways in which Pearson's technology and platform strategy would enable innovation through the ongoing development of the PLP while keeping learner experience and requirements at the centre of the plan.

Two stakeholder panel sessions allowed the Board to hear directly from authors, educators and learners about their experiences of digital teaching and learning in schools and higher education. You can read more about the Board's engagement with these stakeholders on p62–63. The Board also attended an event with new and emerging talent, particularly employees with digital and technology skills, engaged with new members of Pearson's senior leadership team who have enhanced our skills and expertise in digital platforms and AI, and gained valuable insights into employees' views on Pearson's current challenges and opportunities through a session facilitated by HR and Talent leadership.

December, North America At a three-day meeting in December, the Board and the Pearson Executive were joined by members of the Global Online Learning leadership team who provided an overview of the global business. The Board took a deeper dive into the OPM and Virtual Schools businesses, considering areas such as:

- Strategic plans and potential growth opportunities for OPM and Virtual Schools
- The customer-focused culture of the Virtual Schools business, and transformation programmes in respect of Virtual Schools technology and curriculum which would be delivered in the coming year
- Key points of differentiation between Connections Academy, our Virtual Schools business, and traditional 'bricks and mortar' schools
- Examples of OPM partnerships in action such as Arizona State University, Northeastern University and the University of Adelaide

The Board also participated in a tour of the facilities to see the OPM business in action and to meet with employees.

Corporate governance review

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. In these circumstances, the Directors receive relevant papers and, where possible, will communicate any comments and observations in advance of the meeting for raising as appropriate during the meeting. They are updated on any developments after the meeting by the Chair of the Board or Committee, as appropriate. Individuals' attendance at Board and Committee meetings is considered, as necessary, as part of the formal review of their performance.

In appointing Graeme Pitkethly as a Non-Executive Director during 2019, the Board noted that, due to Mr Pitkethly's external commitment as Chief Financial Officer of Unilever, there was expected to be a transitional period of approximately two years following Mr Pitkethly's appointment in which there may be a small number of meeting date conflicts due to the pre-existing corporate calendars of Pearson and Unilever. The Directors were of the view that Mr Pitkethly was a strong addition to the Board and approved this transitional arrangement. Mr Pitkethly has worked closely with the Chair and Company Secretary to minimise the impact of any overlapping dates.

There was a high level of attendance by the Directors at Board and Committee meetings in 2019 as shown in the table below and in the Committee reports that follow:

	Board meetings attended
Chair	
Sidney Taurel	9/9
Executive Directors	
John Fallon	9/9
Coram Williams	9/9

	Board meetings attended
Non-Executive Directors	
Elizabeth Corley[1]	8/9
Sherry Coutu[2]	6/6
Vivienne Cox	9/9
Josh Lewis	9/9
Linda Lorimer	9/9
Michael Lynton	9/9
Graeme Pitkethly[3]	5/6
Tim Score	9/9
Lincoln Wallen	9/9

1 Unable to attend one meeting due to an external commitment. Ahead of the meeting, Mrs Corley communicated her comments on the business of the Board to the Chair.
2 Ms Coutu joined the Board on 1 May 2019.
3 Mr Pitkethly joined the Board on 1 May 2019. Unable to attend one meeting due to a pre-existing commitment as noted above. Ahead of the meeting, Mr Pitkethly communicated his comments on the business of the Board to the Chair.

Board meeting focus during 2019

Strategy
- US Higher Education Courseware
- OPM and Global Online Learning
- Acquisitions of Lumerit Education and certain assets of Smart Sparrow
- Disposal of US K12 Courseware business
- Disposal of stake in Penguin Random House and use of proceeds
- Capital allocation
- Interactive product demonstrations
- Product, technology and operations strategies
- Operating and strategic plan discussions
- Digital advisory network

Performance
- 2018 preliminary results and annual report and accounts
- Interim results and trading updates
- Regular dashboard and milestone reports
- Oversight of 2019 operating plan and goals, and preparation for 2020
- Final and interim dividend proposals

Leadership & people
- Talent and succession planning
- Culture, values and organisational health
- Chief Executive's goals
- Employee Engagement Network feedback
- Events with senior management and facilitated talent breakfasts
- Receptions with employees in US and UK

Read more on employee engagement on p62

Governance & risk
- Legal and regulatory compliance including UK Corporate Governance Code, Companies Act and listing obligations
- Regular Brexit updates
- Shareholder activism and defence planning
- Organisational risk and resilience 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
- Approval of Committee terms of reference
- Tax update

Shareholder engagement
- Investor relations strategy and share price performance
- Major shareholders and share register analysis
- Shareholder issues and voting
- Feedback from Chair and Executive Director meetings with shareholders
- Focus on forthcoming AGM

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 p56

More Committee information:

Audit Committee	p74
Nomination & Governance Committee	p68
Remuneration Committee	p84
Reputation & Responsibility Committee	p72

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 stakeholder 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.

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 decision-making – Acquisition of Lumerit Education

This case study on Pearson's recent acquisition of Lumerit Education provides an illustrative example of how the Board has regard to relevant stakeholders and their interests in its decision-making processes.

In October 2019, Pearson announced the acquisition of Lumerit Education, an ed-tech company that leverages technology to provide students with a customised path to earn up to three-quarters of their degree online and outside of a traditional college. It aims to address the rising problem of the lack of affordability of a degree, while trying to increase flexibility and reduce the time commitment required to complete a degree. Its clients include private-pay consumer students as well as corporations providing tuition assistance programmes for their employees. Lumerit Education uses data and analytics to match learner profiles to academic programmes to enable more people to prosper in their lives through learning. Pearson viewed the acquisition of Lumerit Education as an opportunity to strengthen and develop its strategic focus on employability and lifelong learning. With this acquisition, we will use the Lumerit Education technology to accelerate the growth of our Accelerated Pathways business, making education more affordable and accessible in all phases of life. Lumerit Education works with employers to deliver education programs that improve employees' skills and knowledge, building a workforce that's more competitive, engaged, and prepared for the future of work. As Pearson's first acquisition for five years, Lumerit Education was an important milestone. The Board focussed on there being a strong strategic rationale, clear integration plans and achievable synergies.

As part of the consideration process for this acquisition, the Board received detailed updates from management, prepared by the internal advisory team (with key input from the business and external advisers) setting out the matters for evaluation, which included the anticipated synergies, due diligence findings, valuation and return impacts, stakeholder considerations and detailed post-acquisition integration plans. In its deliberations, the Board also considered developing the capability in-house, deciding against that option due to the expected time to complete.

Through the decision-making process, the Board considered the impact on its key stakeholders, including:

Employers: The Board noted the potential role for Pearson as a 'matchmaker', leveraging our experience to provide educational options to organisations looking to recruit, retain, upskill and re-skill their employee base. Lumerit Education's offering ensures better utilisation of costs already allocated to tuition reimbursement programmes, improves employee retention, course completion and helps to upskill employees.

Learners: Lumerit Education's offering provides learners with flexibility, helping them find the most efficient way to earn a degree. The acquisition will enable Pearson to apply its expertise in courseware to the delivery of general education and gateway courses and to make an impact on student learning outcomes.

Educational Institutions and Educators: The ability to offer on-demand courses through Lumerit Education's 'Global Digital Classroom' provides educational institutions and educators with the ability to offer any of the classes, at any time. The technology also allows partners access to a funnel of transfer students who want to complete their degree.

Employees: The Board considered the current employees of Lumerit Education in their deliberations, including how best to preserve the culture and sense of energy that the strong Lumerit Education leadership team had created and minimise the disruption to them while integrating the Lumerit Education team into the wider Pearson culture.

Shareholders: In evaluating the acquisition prospect, the Board considered the alignment of Lumerit Education with Pearson's strategy, ensuring that it was a good fit and would bring synergies to the business.

Corporate governance review

Engagement with stakeholders

A strong understanding of our stakeholders and their views is integral to Pearson's strategic planning process, and the Board's strategy sessions are informed by the views and needs of a wide range of stakeholders including customers (such as learners and educational institutions), technology companies, authors, shareholders, members of our Digital Advisory Network, Pearson management and the wider workforce. As required by the Code, the Board ensures that Pearson engages effectively with, and encourages participation from, its key stakeholders. The Board maintains its oversight through a variety of direct and indirect mechanisms as illustrated below and the Reputation & Responsibility Committee monitors the Group's stakeholder engagement framework. The key activities undertaken by the Board or by individual Directors in relation to stakeholder matters are set out below.

Learners

- Pearson helps millions of learners across the world to progress across all stages of learning.

- During the year, the Board met a panel of US higher education Campus Ambassadors who provided a learner's perspective on higher education, including on course materials, print versus digital, technology and employability.
- The Board receives new product demonstrations, including Aida during 2019, to understand first-hand the benefit of such products to learners.
- The Pearson Learning Platform (PLP), a key customer and learner-facing element of the digital transformation programme, was considered by the Board and Committees regularly throughout the year from strategic, operational and risk perspectives, including considering learner and educator impact and requirements.
- The Board considered the evolving brand strategy through a lens of robust reputational research which included the views of 2,000 learners and educators in the US and UK.
- The Reputation and Responsibility Committee considered Pearson's response to a security breach of a UK A level Mathematics examination and the lessons learned, including the engagement with learners, parents, schools, regulators and media.

Employees

- Our purpose-driven employees are key to the sustainable success of Pearson.

- Pearson has in place a well-established range of mechanisms to engage with employees, including town hall meetings, virtual global conversations, employee resource groups, and employee engagement and organisational health surveys. The Board has a variety of opportunities to engage both formally and informally with the workforce during events such as Board site visits and talent breakfasts. In the spirit of the Code's focus on stakeholder engagement, an Employee Engagement Network was established in early 2019 as an additional means for the Board to hear directly from employees. See more on p64
- During the year, Pearson held two gatherings of its Female & Diverse Executive Leadership Forum, hosted by Sidney Taurel in London and John Fallon in New York. The events were attended by external speakers as well as internal and external talent to raise awareness of Pearson's purpose and career opportunities, and to highlight the Group's commitment to talent development, D&I. Non-Executive Directors Elizabeth Corley and Linda Lorimer also attended.
- The Chair, Executive Directors and Non-Executive Director, Michael Lynton, attended the Pearson Leadership Summit held in Brooklyn, New York. 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 transformation, becoming a learning organisation, building our talent and culture and fostering diversity. The Chief Executive also attended the annual North America Higher Education Sales Conference where he engaged with sales and customer-facing representatives from across the North American business.
- You can read more about talent and succession planning on p65

Shareholders

- Pearson has a broad range of investors who entrust their capital with us and for whom we aim to deliver long-term sustainable value while recognising their diverse range of views.

- The Chair and Executive Directors, supported by the Company Secretary and Investor Relations team, meet regularly with institutional investors to discuss the business and to respond to any concerns they may have, and the Chair ensures that the Board is kept informed of investors' and advisers' views on strategy and corporate governance.
- In February 2020, Pearson hosted an event for our top five shareholders to meet Board members and discuss aspects of Pearson's strategy, product pipeline and governance framework. In attendance from the Board were: the Chair, Sidney Taurel; Chairs of the Audit, Remuneration and Nomination & Governance Committees; Non-Executive Director, Michael Lynton; and members of senior management.
- Committee Chairs are available to meet with major shareholders should they so wish, and undertake direct engagement in respect of significant matters within their remit, such as remuneration.
- Board members meet informally with shareholders after the AGM and respond to shareholder queries and requests as necessary throughout the year.
- Board Committees consider shareholder views on environmental, social and governance (ESG) and remuneration matters, as required.
- At each Board meeting, the Directors consider commentary from advisers on major shareholders' positions and Pearson's share price.

The insights which the Board gains into the views of its stakeholders through mechanisms such as those set out below form an important part of the context for all of the Board's discussions and decision-making processes. More information on Pearson's key stakeholders, including their areas of concern and our response, is set out in the Strategic report on p14. Further information on how the Directors discharge their duties under s172 of the Act is available on p28

Educational institutions and educators

- Pearson engages with teachers, instructors and educators across all stages of education.
- At its October meeting, the Board met a panel of authors and educators who provided insights into the challenges and opportunities they face with digital teaching and learning in schools and higher education. Participants discussed the importance of high-quality digital content, assessment and tools and the need for access to a high-quality career-focused education. This session enabled the Board to explore the issues posed by educators and to consider how Pearson's strategy would enable the Group to be part of the solution.
- The Board monitors brand tracker insights including satisfaction scores.
- The Chief Executive engages personally with high-level educator and teacher contacts whose views inform operating and strategic plans, products, technology and operations strategies.

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 thrive.
- The Chief Executive regularly meets with and listens to employers around the world including at the Pearson Leadership Forum in the US where leaders in higher education, business and government came together to network, share insights and explore how technology is creating opportunities for bold change. Sessions included: 'Preparing students for employment and partnering to support workforce needs'; and 'The demand for lifelong learning'.
- Employers are strategically material to our business, and the case study on p61 illustrates how the Directors discharged their duties under Section 172 of the Companies Act when considering the decision to acquire Lumerit Education.

Government and Regulators

- Pearson partners with governments (local, state, federal, national) to ensure learners have access to high-quality instruction, materials and assessments linked to beneficial outcomes, including building workforce skills.
- Engagement with statutory bodies such as listing authorities and financial regulators is key to doing business as a listed global company.
- The Chief Executive meets regularly with government representatives and regulators around the world. In 2019 he met with, among others, the Chinese Ministry of Human Resources and Social Security (MOHRSS), the UK Department for International Trade in China, the Deputy British High Commissioner in India, the Governor of São Paulo, the Canadian Minister of Immigration, Refugees, and Citizenship, and White House officials who lead workforce and education policy, including the Deputy Assistant Secretary, Employment and Training Administration, US Department of Labor.

Business Partners

- From vendors to suppliers, channel partners to our authors, Pearson has a broad range of partners across our global business.
- The Chief Executive and the Executive management team attended the annual supplier summit and meet regularly with key global suppliers and ensure smooth flow of information to Board level on material issues or concerns arising.
- Throughout the year, the Audit Committee had oversight of programmes such as: The Enabling Programme and PLP (each involving technology providers and suppliers); Internal Audit and Control's Centre of Excellence (including controls and audits at delivery partners' service centres); and Pearson's third-party anti-bribery and corruption due diligence programme.
- The Reputation & Responsibility Committee has oversight of Pearson's supply chain including strategic supplier partnerships and supply chain risk.
- The Board held a joint session with Pearson's Digital Advisory Network – a group of external thought leaders who are partnering with us as we navigate the digital transformation and look to maximise opportunities that this brings.

Corporate governance review

Employee Engagement Network

Pearson uses a wide range of effective mechanisms to enable the Board to keep a finger on the pulse of the organisation and employees' views on Pearson's strategy, communications, compensation and benefits, and the senior leadership team overall. In the spirit of the Code, Pearson has introduced an additional mechanism – an Employee Engagement Network – which is a hybrid of two methods suggested by the Code, consisting of a designated Non-Executive Director engaging with a panel of employee representatives. The Board considers this method of engagement to be effective as it provides a means for the Board to hear directly from employees as well as creating an opportunity to gain additional insight on how to enhance employee satisfaction and work effectiveness within Pearson and help engage and retain high performers.

Employee representatives were selected from across Pearson reflecting geographical, generational, operational and cultural diversity as well as length of service. The designated Board representative participating in the Network is Vivienne Cox, Non-Executive Director, who updates the Board on matters discussed with employees following each Network meeting. The Chief Executive and Chief Human Resources Officer also attend meetings.

The Network met twice in 2019. Prior to its first meeting, a survey was distributed to Network members to gauge views on topics for conversation. The first meeting set out the background and purpose of the Network, considered the results of the last organisational health survey as well as hearing a case study from the head of our Virtual Schools business – a high performer in the survey. Members also discussed broad topics of interest for further discussion.

Following consultation with Network members, a new format for subsequent meetings was proposed and approved by the Nomination & Governance Committee. This saw the adoption of a single focus area for discussion, a pre-meeting briefing and a request for employee representatives to seek feedback and perspectives on the issue from colleagues.

During the second meeting, the Network members participated in a facilitated exercise, the outputs of which were shared with Ms Cox and Mr Fallon. They recognised employees' desire for learning and development opportunities, building a culture of learning throughout Pearson, which has resulted in the Group-wide introduction of a learning 'time budget' for each employee to devote to their own learning and career development activities.

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. Our Directors can also make use of external courses.

During 2019, the Directors participated in a deep dive into information security and data privacy, enhancing their understanding of recent developments within Pearson from a technology and process perspective as well as considering cyber risk and other external factors affecting the company and the wider business landscape.

The 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 framework is reviewed by the Nomination & Governance Committee in advance of any Director onboarding.

The induction programmes for Sherry Coutu and Graeme Pitkethly, our most recently appointed Non-Executive Directors, took place in 2019. A tailored and bespoke induction programme was designed for each of them and included meetings with other Board members, business area familiarisation with members of the Pearson Executive, and a briefing on Directors' legal duties and governance obligations. Additionally, Sherry and Graeme each participated in sessions relating to their individual areas of interest as well as topics which were pertinent to the Committees which they have joined. The Company Secretary sought Sherry and Graeme's feedback following completion of their induction programmes, both of whom were positive about the benefits of the programme.

Succession planning and talent

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 on an annual basis; however, recognising Mr Fallon's seven-year tenure as Chief Executive, the Chair led discussions on Chief Executive succession at each of the Non-Executive sessions during 2019.

Succession planning for the Board as a whole and for the role of Chair is considered annually by the full Board and on an ongoing basis by the Nomination & Governance Committee, with the Chair and Senior Independent Director also discussing Committee Chair succession planning on a regular basis. There is regular discussion and oversight by the Board of succession planning for key positions at Executive management level. The Executive team has a key role to play in both our strategic planning process and in succession planning and fostering the culture of D&I required to continue to deliver on our strategy.

As well as Board and Executive management succession, the Board also oversees our leadership pipeline. In October, the Board's discussions on talent and culture, including a succession planning session focused on the executive pipeline from which the future leaders of Pearson were likely to emerge, both at PEM level and for other key roles. A diverse pipeline of 'ready now' and 'ready later' emerging talent has been identified, and plans are put in place to accelerate their development and path to succession where possible, including through measures such as participating in Board and Committee meetings, mentoring by Non-Executive Directors, and by encouraging and enabling individuals to take on external non-executive roles in order to increase their exposure to new areas of business. The company also has targeted development programmes for high-potential talent, mentorship programmes for senior women leaders, as well as a Manager Fundamentals programme for middle management.

Succession planning for Executive Directors

In late 2019, the Chief Executive, John Fallon, announced his intention to retire from Pearson during 2020. The Chair, Sidney Taurel, keeps the matter of Chief Executive succession under regular consideration and accelerated the search process following this announcement. The Board has a clear sense of the attributes which it is looking for in the new Chief Executive – these include, but are not limited to, having demonstrable experience in corporate transformation, digital experience, a global view, and an ability to nurture a strong and healthy organisational culture. The Board recognises the challenge in securing all of these attributes in one individual, but is confident with the progress made to date in the search process and will update shareholders at the appropriate time.

In early 2020, the Chief Financial Officer, Coram Williams, announced his intention to step down from the Board and leave Pearson. Accordingly, the Board activated its executive succession plans which had identified Sally Johnson, current Deputy CFO, as a 'ready now' candidate to succeed Coram as Chief Financial Officer. Mr Taurel and Ms Cox, Senior Independent Director and Chair of the Nomination & Governance Committee, led discussions on behalf of the Board which resulted in the recommendation of Ms Johnson as CFO-elect, a matter which the Board approved in principle in January 2020. Pearson has subsequently announced that Ms Johnson will join the Board and assume the position of Chief Financial Officer at the conclusion of the forthcoming AGM on 24 April 2020 (subject to being elected by shareholders at the AGM), with Mr Williams stepping down from the Board at that time. You can read Ms Johnson's biography on p54

Corporate governance review

Board evaluation

The Board operates a three-yearly evaluation cycle which employs a variety of methodologies to ensure the most effective evaluation outcomes.

Three-yearly evaluation cycle

Year	Methodology	Last undertaken
1	In-depth evaluation, externally facilitated	2017
2	Questionnaire, tailored to specific needs of the business	2018
3	Internally facilitated interview, to be led by the Chair, Senior Independent Director and/or Company Secretary as appropriate	2019

The Nomination & Governance Committee is responsible for overseeing the evaluation process on behalf of the Board and it spent time during the year scoping the process and themes for the 2019 evaluation, with Committee members being invited to suggest particular questions or items for discussion.

In line with the framework agreed by the Committee, the Senior Independent Director held one-to-one conversations with each member of the Board during October 2019. Discussion areas covered during the individual interviews included matters which are important to Pearson in particular, as well as those items laid down in the Code, including:

- the Board's understanding of markets, products and stakeholders, the quality of the information provided and discussion time to facilitate this
- Pearson's strategy, including its articulation and strategic process, and the quality of the Board's discussions on strategy
- the functioning of the Board, including composition, competencies, diversity and agendas
- relationships between the Board and senior leaders, and between members of the Board itself
- succession planning for Executive Directors and other senior leaders
- the Board's monitoring of organisational culture and behaviours
- understanding of risks facing the company, including probability and mitigation
- concerns and areas for improvement.

The Company Secretary invited all members of the Pearson Executive to provide their views on these topics by way of a questionnaire prior to the Directors' individual interviews. The findings from this exercise involving the Pearson Executive were analysed with the assistance of an external advisory firm, Lintstock,[1] and shared with the Senior Independent Director in advance of her conversations with Board members to allow for the Executive's opinions to be taken into account during the process.

The Nomination & Governance Committee reviewed the findings from the Board evaluation with the full Board at its meeting in December 2019. The Committee will develop an action plan to address areas for improvement and will monitor progress during the year.

Key findings included:

- a high overall level of satisfaction with the functioning of the Board, the competence and capabilities of the Directors, and the quality of relationships between Chair, Non-Executive Directors and the Executive
- the level of support and challenge provided by the Board to management was generally viewed to be of an appropriate and balanced level
- positive views in relation to the performance of the Committees including the volume and importance of work which they undertake on behalf of the Board
- the composition and size of the Board was considered to be appropriate, with a good balance of skills and capabilities. Board members noted that consideration should be given to agreeing the skills profile for any new Non-Executive Directors as part of ongoing succession planning for the Board.

The main areas identified by the Board for continued focus during 2020 were:

- refinement of the strategy, in particular continuing to develop the framework supporting lifelong learning and employability and ensuring clear and tight articulation of the strategy
- the Board's monitoring and challenge of the digital transformation, including scrutiny of progression metrics and oversight of the continued rollout of digital products
- an awareness of the risk of transformation fatigue within the organisation
- an ongoing focus on customers, including appropriate market and behavioural insights to facilitate the right level of scrutiny and challenge by the Board.

In addition, a number of actions were taken during the year in response to findings arising from the 2018 externally facilitated Board evaluation process. You can read more about progress on these in the table opposite. The Board has confirmed that these items were addressed to its satisfaction, with recommendations having been put into practice or a clear action plan identified for each.

Further, the Chair meets regularly with the Non-Executive Directors as a whole and these sessions include reciprocal feedback on the functioning of the Board to augment the formal Board evaluation process.

1 Lintstock's involvement with the Pearson Group is limited to matters led by the Company Secretary's office, namely to assist with tools and market insights in respect of listed company governance practices and obligations.

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 the key metrics for the company, including both financial and strategic objectives as well as goals linked to culture, talent and brand. Progress against each of these metrics is reviewed by the Board on a regular basis, as part of a dashboard of KPIs.

The Chair leads a formal individual evaluation of each Non-Executive Director every other year and encourages open channels of communication between Directors and the Chair on an ongoing basis. In the Board's opinion, these ongoing lines of communication, combined with a Group-wide culture which allows and encourages feedback at any time, provide the most effective means for evaluation. In assessing the contribution of each Non-Executive Director, the Chair has confirmed that each continues to make a significant contribution to the business and deliberations of the Board. 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 2019, the Committee evaluation process formed part of the wider Board evaluation led by the Senior Independent Director, and the findings from this were considered by the Board as a whole in December 2019. Read more on this in the Committee reports on the pages that follow.

Progress on findings of 2018 evaluation

Finding	Response/action taken
Ongoing development and articulation of the strategy	There is acknowledgement by longer-serving members of the Board of the significant progress that has been made on development of the strategy, particularly in respect of the articulation of the five-year strategic vision. Refinement and articulation of the strategy will be a continued area of focus throughout 2020, and the Board is mindful of the need to balance the thinking on the long term with execution of short-term goals in a challenging environment for certain parts of the business.
Board succession planning	Two new Non-Executive Directors, Sherry Coutu and Graeme Pitkethly, joined the Board in 2019. Succession planning for Non-Executives, including for the Committee Chair and Senior Independent Director roles, will be a continued focus in 2020. This will include a skills mapping process to enable the Board to design a candidate profile for future Non-Executive Directors in preparation for retirements in the coming years.
Leadership development and succession planning below Board level	Executive talent and succession planning are regular items on the Board's agenda, with two such sessions taking place during the year, augmented by networking and mentoring programmes involving the Board and senior leaders. Read more about succession planning on p65
Continue to enhance Board's oversight of culture	In early 2019, the Board considered results of the latest employee engagement survey, and it receives periodic updates on employee engagement from the designated Non-Executive Director, Vivienne Cox. The Nomination & Governance Committee discussed in detail the Code's requirement for the Board to monitor culture, and how best to achieve this, which led to a session on talent, culture and values at the Board's October meeting. The Board and its Committees also receive information which provides insights into organisational culture, such as compliance and talent metrics, and has a variety of opportunities to see the culture in action at events throughout the year. Culture will remain an area of focus during 2020 as the Board is mindful of the potential effects of business transformation on organisational culture.
Continue to consider the competitive landscape and customer views	During the year, the Board received updates on the competitive landscape and discussed customer trends during its regular sessions on the US Higher Education Courseware business, as well as meeting in person with learner and educator representatives. In December, as part of its site visit to the Online Program Management business in the US, the Board considered the competitive landscape for that sector. Additionally, the Board's milestones dashboard contains metrics regarding Pearson's performance in the markets in which the company operates, and the competitive landscape is a factor considered in any proposals relating to acquisitions or disposals.
Board's understanding of risk	Risk deep dives take place at each Audit Committee meeting on key risk areas, supplemented by Reputation & Responsibility Committee oversight of certain risks. The Board retains oversight of the organisational risk management process, with support from the Audit Committee, and during the year the full Board held a deep dive into data privacy and information security, considering the external landscape and Pearson's frameworks to address these risks.

Nomination & Governance Committee report

Committee Chair
Vivienne Cox

Members
Elizabeth Corley, Sherry Coutu, 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
Reviewing and overseeing 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 at www.pearson.com/governance.

Committee attendance

Attendance by Directors at Nomination & Governance Committee meetings throughout 2019:

	Meetings attended
Elizabeth Corley[1]	3/4
Sherry Coutu[2]	2/2
Vivienne Cox	4/4
Josh Lewis	4/4
Tim Score	4/4
Sidney Taurel	4/4

1 Unable to attend one meeting due to an external commitment. Ahead of the meeting, Mrs Corley communicated her comments on the business of the Committee to the Chair.
2 Ms Coutu joined the Committee on 1 July 2019.

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. Following the appointment of Sherry Coutu to the Committee on 1 July 2019, the Committee comprises five 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 2019

Throughout 2019, a major area of focus for the Committee was the consideration of the newly effective UK Corporate Governance Code, in particular to ensure that the agreed revisions to Pearson's governance framework were working effectively following implementation. As part of this, the Committee received a status tracker on a regular basis to enable it to consider the appropriateness and maturity of various elements of the framework. Notable items which the Committee discussed as part of its oversight role included:

› implementation of the new Employee Engagement Network (see p64)

› an internal guidance framework relating to Directors' external commitments (see p58)

› ways in which to facilitate further engagement by investors with the Board

› the Board's monitoring and understanding of organisational culture and values.

At its February meeting, the Committee considered the induction framework for potential new Board members, in addition to reviewing the company's standard form letter of appointment for Non-Executive Directors.

Other areas of focus for the Committee during the year included preparation for and oversight of the annual Board evaluation process, recommendation of revisions to the membership of Board Committees in response to the appointment of new Non-Executive Directors, and review of the Board Diversity Policy and adoption of revised accompanying objectives. The Committee also received periodic updates from the Chief Human Resources Officer and members of the D&I team in respect of D&I initiatives across the business – see p22 for further detail.

Board search

A key element of the Committee's remit is to lead the process for Board appointments in line with appropriate succession plans. The Committee has defined a set of specific criteria for potential new Non-Executive Directors, in particular giving consideration to the skills, experience and knowledge 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.

In its most recent search, the Committee agreed that it was particularly interested to identify candidates who would complement its current skill set, ideally bringing a combination of global executive experience, financial background and UK listed company expertise.

Taking into account the agreed person specification, the Committee engaged Russell Reynolds Associates in 2018 to commence a search process for new Non-Executive Directors. This process continued into early 2019 and, in line with the objectives of the Board's Diversity Policy, the Committee, led by Ms Cox, worked closely with Russell Reynolds Associates to ensure that the list of candidates reflected diversity of gender and ethnicity as well as diversity in its broadest sense.

Following consideration by the Committee of a shortlist of candidates, including their current commitments, skills and previous experience, and bearing in mind the Pearson culture, the search process culminated in the appointments of Sherry Coutu and Graeme Pitkethly as Non-Executive Directors with effect from 1 May 2019.

At the end of 2019, reflecting the announcement by John Fallon of his intention to retire from the Pearson Board, the Committee commenced a search process for a new Chief Executive, putting into practice the Chief Executive succession plans which are reviewed by the Board on an annual basis. This search process, in which both internal and external candidates are under consideration, is being led by the Chair of the Board, Sidney Taurel, with support from Ms Cox and other Board members as well as the Chief Human Resources Officer. Pearson is being assisted in the external element of this search process by Russell Reynolds Associates (search activity) and Jan Hall Consulting Limited (trading as 'No. 4') (advisory activity). You can read more about Succession planning for Executive Directors on p65

In addition to the Non-Executive Director and Chief Executive search processes, 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. Jan Hall Consulting Limited has no other current connection to Pearson.

Committee evaluation

The Committee undertook an annual evaluation to review its own performance and effectiveness. The process was undertaken as part of the wider Board evaluation process and sought views from the Board and Company Secretary 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.

The Committee was considered to have operated effectively throughout 2019 with a clear agenda and effective leadership, and there was recognition of the volume of work which the Committee had undertaken during the year. In response to the findings of the 2018 evaluation, the Committee gave consideration to the processes relating to Non-Executive Director search activity, as a result of which the Committee agreed an interview framework for candidates which would encourage openness and communication between potential candidates and existing Board members.

Nomination & Governance Committee meeting focus during 2019

Appointments

- Search for two new Non-Executive Directors, resulting in appointments of Sherry Coutu and Graeme Pitkethly
- Directors' commitments guidance framework

Balance

- Membership of Board Committees
- D&I initiatives at Pearson
- Review and approval of Board Diversity Policy and accompanying objectives

Succession

- Executive and Non-Executive Director succession planning
- Induction outline for new Directors

Governance

- Board evaluation preparation and findings
- 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

Committee aims for 2020

In 2020, the Committee will continue to pay attention to the principles and provisions of the Code, giving consideration to areas in which there may be scope to go above and beyond Pearson's current governance arrangements in ensuring a world-class corporate governance framework. Building on discussions during 2019, we will continue to monitor Pearson's organisational culture and, with the help of the Chief Human Resources Officer, we aim to introduce a dashboard drawing together key cultural indicators from across the Group, which will add quantitative metrics to augment the Board's existing oversight of culture and organisational health. We will also hold updates on D&I and talent and succession. As part of these sessions we will consider the Board D&I policy and wider initiatives in place across Pearson, such as Valuable 500 and mentoring programmes, and we will review the format of the Employee Engagement Network after its first complete year of operation. Additionally, the Committee will oversee the Board evaluation process which, for 2020, will be externally-facilitated.

Vivienne Cox
Chair of Nomination & Governance Committee

Nomination & Governance Committee report

Board diversity

The commercial benefits of having a diverse Board are well established. At Pearson, we believe that diversity of all types on the Board makes us a better business by enabling enhanced commercial results and also that inclusive leadership for the company leads to better decision-making. It also reflects an overt commitment to finding and retaining the best, most diverse talent.

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 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 recent Non-Executive Director search process, the Committee encouraged the retained search firm to place an emphasis on putting forward candidates who would enhance the overall diversity of the Board.

The gender diversity of the Board was 33% female representation as at 31 December 2019 (2018: 30%), achieving the recommendations suggested by the Hampton-Alexander Review aimed at having at least 33% female representation on the Board by 2020. We are committed to maintaining female representation on our Board at or in excess of this level. Pearson also satisfies the recommendation in the Parker Review that at least one Director should be from an ethnic minority background ahead of the 2021 target date.

Board D&I objectives

The Committee has agreed the following objectives on behalf of the Board, which were reviewed and updated during the year, to support the Board D&I Policy:

Objectives	Progress
We will strive to maintain a Board composition of: (Changed target) › at least 33% female Directors › at least one Director of colour.	(Target achieved) 33% female Directors achieved. (Target 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.	(Target achieved) Rigorous process used during recent search for Sherry Coutu and Graeme Pitkethly who each have relevant experience and skills.
(Changed target) The Board will continue to incorporate a focus on a diverse pipeline in its succession and appointment planning including to prioritise the use of search firms which adhere to the Voluntary Code of Conduct for Executive Search Firms (the Voluntary Code) when seeking to make Board-level appointments	(Target achieved) Russell Reynolds Associates assisted Pearson with the recent Non-Executive Director search process and are engaged on the external element of the Chief Executive search. Russell Reynolds Associates are a signatory to the Voluntary Code.
The Board will continue to adopt best practice, as appropriate, in response to the Davies Review, the Hampton-Alexander Review and the Parker Review.	(Target achieved) 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.
(New target) The Board will consider its composition and diversity as part of its consideration of effectiveness in the Board evaluation review process	(Target achieved) These matters were considered in the 2019 evaluation process.
Where appropriate, we will assist with the development and support of initiatives that promote all forms of D&I in the Board, Pearson Executive and our senior management.	(Target achieved) Board mentoring scheme of senior leadership talent ongoing throughout 2019. (Target achieved) Board members participated in Pearson's Female & Diverse Executive Leadership Forum events held in London and New York, developed in direct response to a suggestion by the Nomination & Governance Committee.
We will review and report on our progress in line with the policy and our objectives in the annual report, including providing details of initiatives to promote D&I in the Board, Pearson Executive and our senior management.	(Target achieved) The Nomination & Governance Committee reviewed the Board's Diversity Policy and accompanying objectives during the year, as well as developments on diversity in the external landscape.
We will continue to make key D&I information, about the Board, senior management and our wider employee population, available in the annual report, and aim for ongoing transparency in this area in line with best practice.	(Target achieved) This information is included in the annual report.

Target achieved New target Changed target

During the year, the Committee received a detailed progress update on the company's D&I strategic approach, framework, governance and measurement models and priority areas.

The Board also received an update on a new internal mentoring scheme and participated in the programme whereby each Director was paired with a high-potential Senior Vice President female leader at Pearson. This launched at the end of 2018 and ran throughout 2019.

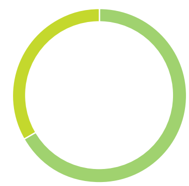
Diversity and talent in Executive pipeline

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 D&I Council launched in early 2019 chaired by Chief Executive, John Fallon. This comprises around 30 members representing employee resource groups, business leaders as well as allies and advocates. For more information on the company's approach to D&I, please see p22 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 nine members (22%) – this excludes the Chief Executive and Chief Financial Officer who are counted in the Board's metric (2018: 20%). As of 31 December 2019, the number of women forming part of the senior management team, i.e. the Pearson Executive and their direct reports, including the Company Secretary, as required by the Code, is 34 women representing 34% of that group (2018: 31%).

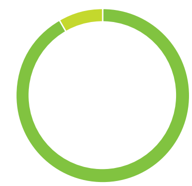
We believe that we have a multi-pronged plan in place to build our pipeline of women in leadership and senior management positions, and the Board and Committee will carefully monitor their development, and the development of all key talent.

Gender balance of Board



Male	8
Female	4

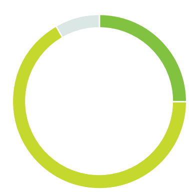
Ethnicity



White	11
Mixed	1

Mixed – White & Black Caribbean (1)
White – English/Welsh/Scottish/Northern Irish/British (7)
White – Any other White background (4)

Nationality of Directors



US	3
UK	8
Canada	1

Tenure on the Board for Chair and Non-Executive Directors

Under 3 years	3
3–6 years	4
Over 6 years	3

All information correct as at 31 December 2018.

Reputation & Responsibility Committee report

Committee Chair
Linda Lorimer

Members
Vivienne Cox, Linda Lorimer, Michael Lynton, Graeme Pitkethly 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, and ensuring that clear roles have been assigned for the management of the reputation dimension of risks identified.

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 that clearly set out its authority and duties. These are reviewed annually and can be found on the company at website www.pearson.com/governance.

Committee attendance

Attendance by Directors at Reputation & Responsibility Committee meetings throughout 2019:

	Meetings attended
Vivienne Cox	4/4
Linda Lorimer	4/4
Michael Lynton	4/4
Graeme Pitkethly[1]	3/3
Lincoln Wallen	4/4

1 Appointed to the Committee on 1 July 2019.

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 remit covers 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 a regular review of those incidents that could adversely affect the company's reputation. We promote Pearson's 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 Sustainability on p16

Changes to the Committee

Graeme Pitkethly, who joined the Board in May 2019, was appointed to the Reputation & Responsibility Committee on 1 July 2019. Graeme brings valuable experience in sustainability practice and consumer behaviour from his time at Unilever, as well as a strong understanding of best practice in external reporting on sustainability and climate change due to his role as Vice Chair of the Task Force on Climate-related Financial Disclosures. I look forward to working closely with him on the Committee; he is already adding important insights.

Areas of focus during 2019

The Committee conducts in-depth reviews of issues that are important to the sustainability of our business and our reputation. Key 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 & 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.

In the first year of the Code's stakeholder engagement requirements, we helped to scope and monitor the company's framework for gathering and responding to stakeholder views (see p14). Learners are a key stakeholder for Pearson, and we held in-depth discussions into privacy and ethical issues related to learners' data. The Committee also reviewed Pearson's planned standard for learner data management, which will shape the company's use of AI technology and personal data collection.

In October, the Committee considered plans for Pearson's 2030 Sustainability Strategy and carbon reduction targets. In particular, we discussed the three main pillars for the 2030 plan that had been identified through extensive stakeholder engagement and materiality mapping, namely: advance equity in learning; build skills for sustainable futures; and lead by example through initiatives for advancing such areas as human rights and the environment. Committee members offered guidance regarding potential goals for each of the three pillars and the timeline for the strategy, and considered the integration of sustainability within Pearson's business model with reference to the UN Sustainable Development Goals.

During 2019, the Committee also reviewed proposed public statements on modern slavery and considered Pearson's broader human rights strategy, both of which are important to Pearson's values and the delivery of its sustainability plan. We also considered incidents of reputational note, including those which had received coverage through traditional or social media such as Pearson's response to the security breach of a UK A level Maths exam paper and the company's subsequent engagement with learners, schools and the exam regulator.

Pearson's brand strategy was another important area of focus during the year for the Committee. The brand strategy was informed by reputational research insights from a study of learners, educators and members of the public across the US and UK. The Committee also spent time with the Chief Corporate Affairs Officer, who had joined Pearson at the start of 2019, in order to understand her priorities.

We also examined progress on supply chain risk and, as every year, delved into the areas of health, safety and safeguarding, which are principal risks for Pearson. The Committee also reviewed Pearson's efficacy programme and discussed future plans for continued integration of efficacy findings into our product development cycle. Read more about Efficacy on p27

Committee evaluation

In 2019, the Committee evaluation formed part of the wider Board evaluation process led by Senior Independent Director, Vivienne Cox. She sought views from all members of the Board and the Company Secretary through a series of one-to-one interviews. The evaluation found that Directors were pleased with the functioning of the Committee, recognising the Chair for the manner in which the Committee's work is cogently reported to the Board. The Directors commented that the work of the Committee is becoming ever more important and closely linked to strategy, and that it was necessary to ensure sufficient time during the year to cover the growing roster of matters within its remit. Particular areas highlighted by the Directors for continued focus during the coming year were privacy and data management and the development of the brand in support of the strategy.

Progress on findings of 2018 evaluation

The responses to the 2018 evaluation, which was conducted by way of a questionnaire to Committee members and key internal stakeholders, highlighted that:

- the Committee has matured, with increasing focus on strategically material issues. The development of the 2030 Sustainability Strategy will only make the Committee's work more valuable.
- the introduction of private sessions as part of each meeting, similar to Audit and Remuneration Committees, was recommended. They have proven to be beneficial and enable Committee members to discuss and agree on key issues to take forward with management. These sessions will be continued as a regular part of each Committee meeting over the coming year.

Committee aims for 2020

Over the next year, we will continue to focus on data privacy from the perspective of the learner and continue to monitor the advancement of our brand strategy as well as Pearson's approach to reputational risk.

We will continue to explore Pearson's material sustainability issues (e.g. 21st-century skills and climate change), monitor progress on supply chain risk, engage in the next phase of development of our 2030 Sustainability Strategy (focusing on the goals and KPIs to underpin successful delivery of the strategy). The Committee will also examine the results of our global learner survey and investor priorities and opportunities in the environmental, social and governance (ESG) space.

Linda Koch Lorimer

Linda Lorimer
Chair of Reputation & Responsibility Committee

Reputation & Responsibility Committee meeting focus during 2019

Reputation
- Supply chain and third-party risk management
- Issues and incidents reports
- Reputation research
- Editorial Policy – progress report

Risk
- Safeguarding
- Health & Safety

Sustainability
- 2030 Sustainability Strategy
- Greenhouse gas emissions and carbon reduction targets

Brand & culture
- Brand strategy
- Efficacy update and future plans

Ethics
- Human Rights Policy
- Modern Slavery Act statement

Strategy
- Learner data
- Artificial intelligence

Governance
- Committee terms of reference
- Stakeholder engagement framework

Audit Committee report

Committee Chair
Tim Score

Members
Elizabeth Corley, Vivienne Cox, Linda Lorimer, Michael Lynton, Graeme Pitkethly, 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.

Internal audit, risk & internal control

Risk management systems and the internal control environment including oversight of the work of the internal audit function.

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 at www.pearson.com/governance.

Committee attendance

Attendance by Directors at Audit Committee meetings throughout 2019:

	Meetings attended
Elizabeth Corley[1]	3/4
Vivienne Cox	4/4
Linda Lorimer	4/4
Michael Lynton	4/4
Graeme Pitkethly[2]	2/2
Tim Score	4/4
Lincoln Wallen	4/4

1 Part-attendance at one meeting due to an external commitment – this is formally recorded as an absence.
2 Appointed to the Audit Committee on 1 July 2019.

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 CFO 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 May 2019, Graeme Pitkethly was appointed to the Audit Committee on 1 July 2019. Graeme's leadership experience in complex global businesses, as well as his background as a Chartered Accountant and in-depth knowledge of financial and operational matters, will complement the Committee's existing skill set, and I look forward to working closely with him. Following Graeme's appointment, the Committee comprises seven 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 principle N 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 p110

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 2019, 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 p40

Business transformation

Ongoing business transformation and change 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 has received an update at each meeting during the planning and implementation phases of TEP, engaging with the senior management team leading the programme. The primary areas of focus for the Committee in 2019 were:

- in the first half of the year, oversight of the implementation of finance, procurement, e-commerce and supply chain systems to: (i) the remainder of our North American business which had been operating on legacy systems; and (ii) the Assessments business, including Clinical and VUE. In particular, the Committee considered the preparatory steps from technology, employee and customer perspectives, progress on system integration and testing, and status of key readiness milestones in advance of the implementation
- preparations for the Rest of World phase of TEP which will see most remaining markets outside of Pearson's UK and US business move to the new systems and processes
- in the second half of the year, monitoring the progress of the business value realisation (BVR) programme. Following TEP deployment in the UK and US, management took the decision to review the live environment in order to: (i) identify continuous improvement opportunities; and (ii) explore areas of the deployment where further integration was required, with the overall aim of BVR being to assess how best to leverage business value from TEP and integrated release investments. As part of the Committee's regular deep dives, Committee members were updated on the ways in which processes had been considered from an employee, customer and data quality perspective, resulting in opportunities being identified for improvements in areas such as data quality and end-to-end delivery. The Committee then considered the progress made in those areas, noting that attention was now turning to prevention and maintenance of those data assets.

Audit Committee meeting focus during 2019

Reporting

- Accounting and technical updates
- Impact of legal claims and regulatory issues on financial reporting
- Fair, balanced and understandable, going concern and viability statements
- 2018 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
- Analysis supporting viability statement

Policy

- Accounting matters and Group accounting policies
- Annual review and approval of external auditors' policy
- Treasury policy and reporting
- Tax strategy, including an update on EU state aid and impact of US tax reforms

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
- 2019 external audit plan
- Remuneration and engagement letter of external auditors
- Review opinion on interim results
- Review of the effectiveness of external auditors

Internal audit, risk & internal control

- Internal audit activity reports and review of key findings
- Organisational risk management
- 2020 internal audit plan
- 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 and insurance; anti-bribery and corruption (ABC); tax; business resilience
- Oversight of the programme to develop the Pearson Learning Platform
- Controls Centre of Excellence updates

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

Alongside TEP, Pearson has moved to a shared services model for delivery of certain Finance and HR processes, and the Committee considered regularly the work undertaken by the Controls Centre of Excellence team. The external auditors, PwC, updated the Committee at each meeting on the work that they had conducted in respect of testing controls, and they shared perspectives on strategic opportunities to further enhance the controls framework.

Data privacy and Information security

Pearson considers data privacy and information security as principal risks reflecting a business model which is increasingly based around digital products. In 2019, the Chief Privacy Officer and Chief Information Security Officer reported on both topics to the Committee, and the Board as a whole, recognising the increasing importance of cyber-risk to modern businesses.

As part of the report, the Committee reviewed Pearson's readiness for the California Consumer Privacy Act (which came into effect at the start of 2020), and an overview of privacy laws which would soon be introduced in other jurisdictions in which Pearson operates. Key aspects of Pearson's data privacy programme were also considered, including:

- the principles and priorities underpinning Pearson's multi-year data privacy strategy
- the emphasis on 'privacy by design' in the development of new Pearson products and platforms
- the advancement of processes to respond to user/data subject requests, including the rights to access, correct and delete data
- the review and enhancement of the data privacy governance structure

In addition, an update on the AimsWeb 1.0 security incident was provided.

The information security report allowed the Committee to consider the progress made in recent years. In considering the current status of the information security programme, the Committee noted the frameworks which had been put in place in respect of:

- fundamental and proactive user, network and cloud security building blocks which limit outsider access to critical information
- platforms and processes which control least-privilege access to various IT systems
- Pearson's ability to react as quickly as possible to a detected event, thereby aiming to reduce the window of vulnerability
- Tools and processes to help the business assess and manage risk, set standards and measure compliance with internal and external requirements
- The establishment of standards and methods to ensure Pearson products are designed to protect learners' data and to ensure products continue to function if attacked

The Committee considered in particular the ways in which the architecture of the PLP and ways of working in its design and development aim to greatly increase the inherent platform security as well as the many 'digital native' security features which have been built into PLP. Separately, the Chief Information Security Officer noted that the decommissioning of certain legacy systems was a particular area of focus in reducing the level of risk attached to Pearson's information security programme.

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 is evolving in support of Pearson's Global Business Services model.

In addition to the risk deep dives described above, the Committee also conducted deep dives into business resilience and crisis management, treasury, tax, and anti-bribery and corruption. In February 2020, the Committee considered the 2019 annual report and accounts, including the preliminary results announcement, financial statements, strategic report and Directors' report.

View the key activities of the Audit Committee on p75

Internal audit evaluation

The International Standards for the Professional Practice of Internal Auditing (the Standards) require an independent external assessment of internal audit to be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation. At its December meeting, the Audit Committee considered the findings of an external quality assessment of internal audit, facilitated by Protiviti. The objectives of the review were to assess conformance with the Standards; to assess the effectiveness of internal audit within the context of its mandate and stakeholder expectations; and to provide recommendations to internal audit on improvement opportunities and emerging practices. The assessment

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. Until July 2019, he also served as Audit Committee Chair for The British Land Company plc. The qualifications and relevant experience of the other Committee members are detailed on p54–56 was conducted by: interviewing key stakeholders of the internal audit function including the Committee Chair, members of the Pearson Executive, and senior financial, legal and operational management; reviewing a sample of internal audit files and other functional documentation including the audit universe and plan; and interviewing members of the internal audit function.

The findings indicated an effective internal audit function that conforms to the IIA's International Standards. One conformance gap was identified – the requirement to have an external quality assessment every five years – which was addressed by the review itself taking place. Opportunities for improvement were also noted, largely related to the quality of supporting documentation. Based on the findings of the external review, and on its own ongoing assessment of the effectiveness of the internal audit function, the Committee is of the opinion that the quality, experience and expertise of the function is appropriate for the business.

Additional meeting attendees

In addition to the Committee members, advisers and executives from across the business also attended meetings during the year. 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 and customer focus such as the ongoing transformation and digital initiatives. The Committee also meets regularly in private with the external auditors; SVP-Internal Audit, Risk and Compliance; and VP-Internal Audit.

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. In 2019, the Committee and other members of the Board and management participated in a training session covering:

- the reviews of the audit market and regulatory landscape
- corporate reporting and governance matters
- a technical update on IFRS 16 (Leases).

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 2019, the Committee evaluation formed part of the wider Board evaluation process led by Senior Independent Director, Vivienne Cox, which sought views from all members of the Board and the Company Secretary through a series of one-to-one interviews. The evaluation found that Directors were pleased with the functioning of the Committee, and they recognised the Chair for the quality of the work conducted by the Committee and the manner in which this is reported to the Board.

Progress on findings of 2018 evaluation

The responses to the 2018 evaluation found an effective and well-functioning Audit Committee, which uses its time well and has an appropriate focus on the key issues.

Suggestions arising from the 2018 process, and the progress which has been made on these, include:

- invite a wider range of business leaders to Committee meetings, enabling leaders to engage in Board-level discussions, as well as facilitating a greater understanding of the Committee's role in the wider business – the Committee has embraced this suggestion, with a number of leaders and senior managers (typically one or two levels below the Pearson Executive) leading sessions such as risk deep dives, internal control and process updates and financial review matters. The Committee also invited Pearson's Local Compliance Counsel of the year to lead a session on compliance and ABC achievements in Pearson's Brazilian 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 – progress on TEP and the associated BVR programme was a regular item for discussion for the Committee throughout the year and will continue to be considered as transformation initiatives continue during 2020. Read more detail on the risk deep dive overview on p74

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 CFO, 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. Progress 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 progress in implementing action plans, agreed as part of audits, to resolve any control deficiencies identified. Internal audit will request and assess evidence of action plan implementation and may re-test controls if necessary. 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 and, on behalf of the Board , considers 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.

Audit Committee report

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 2019, 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; CFO; 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 and independent external audit process. The main area identified as presenting an opportunity for possible improvement related to coordination between PwC and the Pearson team, namely ensuring clear and timely communication in respect of requirements and deliverables.

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 the current lead audit partner, Giles Hannam, rotated onto the Pearson audit at the beginning of 2018.

AQR Review of the external audit

During the year, the FRC's Audit Quality Review (AQR) team selected for review PwC's audit of the Group's 2018 financial statements as part of its 2019 annual inspection of audit firms. On completion of its review, the AQR team wrote to the Committee Chair and provided a copy of its final report. The Committee discussed the findings of the review with PwC at its February 2020 meeting, in particular focusing on those areas of the external audit procedures that had been identified as requiring improvement. The Committee was satisfied that PwC had taken all necessary actions to address the AQR findings in the audit of the Group's 2019 financial statements.

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. EU regulations and the 2014 Order by the UK Competition and Markets Authority (CMA) impose mandatory tendering and rotation requirements, with Pearson required to appoint a new auditor no later than for the 2024 financial year end.

In last year's annual report, the Committee reiterated its expectation that an audit tender process would commence in 2022, taking into account the significant level of business change being experienced by the Group – including through The Enabling Programme (TEP) – and the focus that would be required by finance and management teams to conduct the tender process, and any resulting auditor transition, thoroughly and effectively. As indicated however, the Committee, with the support of management, has kept under review whether this timing remains appropriate in the light of business developments. With TEP implementation and finance transformation in the UK and North America now complete, and more than 80% of Pearson's business in revenue terms having now transitioned to new systems and processes, the Committee has revisited the matter. As a result, at its meeting in February 2020, the Committee decided to proceed with an audit tender during 2020, which will commence with issuing a Request for Proposal (RFP) in April 2020, with a view to changing audit firm for the financial year ending 31 December 2021.

In making this decision, the Committee noted that finance and management teams believe they have the capacity to support a tender and change in auditor, leveraging changes from the finance transformation programme. Although TEP and the finance transformation are yet to be implemented in Pearson's remaining International markets, the majority of Group audit scope sits within North America and the UK and it is felt manageable by the Committee, management and the finance function to onboard a new auditor at a time of change in those smaller International markets.

In discussing its preferred approach to the tender process, the Committee has had regard to the detailed timeline, governance framework (including confirmation of the working group that will lead the process), selection criteria and the degree of involvement by all Committee members in the various stages of the process. The Committee has also given consideration to the Chief Financial Officer transition process which will take place during 2020 and has determined, with the agreement of the incoming CFO, Sally Johnson, that the proposed timeline achieves the optimal balance between business priorities and internal capacity while also allowing for the new senior finance team to ensure a rigorous and comprehensive audit tender process.

Following the upcoming audit tender, 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 Sir Donald Brydon's independent review into the quality and effectiveness of audit; and the outcome of the BEIS consultations on the recommendations made (i) by Sir John Kingman in his independent review of the FRC, and (ii) by the CMA in its market study into the statutory audit market, and will take these into account as and when appropriate.

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 2019.

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 2019 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 2019 Committee meeting, having concluded that their analysis of significant and elevated risks remained the same.

The table on p80–81 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 2019 and again at the conclusion of their audit of the financial statements for the full year in February 2020.

All the significant issues were also areas of focus for the auditors. Learn more in the Independent auditor's report on p114

In December 2019, 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 long-term revenue contracts and judgements in relation to provisions for returns

› Their work in evaluating management's goodwill impairment exercise, on a value-in-use basis, including assessing assumptions around CGU identification, goodwill reallocation, operating cash flow forecasts, the appropriateness of the inclusion of restructuring cost savings, perpetuity growth rates and discount rates

› The work performed over the nature and presentation of non-trading items, 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 and related disclosures

› Their evaluation of the recoverability of investments in digital platforms and pre-publication assets

› Their work over the completed disposal of the US K12 Courseware business

› 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 continued roll-out of TEP and the organisational change resulting from implementing the target operating model

› Their work in relation to the adoption of 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 unadjusted misstatements that they had found in the course of their work, which were immaterial, 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 that 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 policy takes into account certain voluntary commitments by PwC regarding independence and applies to all Pearson businesses globally, including associate companies.

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 2019, Pearson spent £0.7m less on non-audit fees with PwC compared with 2018, due to the absence of a requirement for the audit of disposals and a reduction in fees associated with the audit of efficacy reporting. For 2019, non-audit fees represented 6% of external audit fees (17% in 2018).

For all non-audit work in 2019, 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 2019 included:

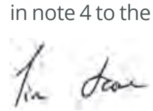
› audit of Pearson's efficacy programme

› provision of comfort letters for potential bond issues

› controls assurance related to non-financial controls

› 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 p145



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. Pearson has made significant impairments to goodwill across a variety of its businesses in recent years.	The Committee monitored the Group's plans and forecasts during the year to determine if there were impairment triggers and considered the results of the Group's annual goodwill impairment review including the revision to CGUs and the related reallocation of goodwill driven by organisation changes and systems consolidation. Key assumptions – including cash flows derived from strategic and operating plans that include longer-term plans for the OPM business, long-term growth rates and the weighted average cost of capital – were reviewed and challenged. The Committee considered the sensitivities to changes in assumptions and the adequacy of disclosures required by IAS 36 'Impairment of Assets' in relation to the Group's CGUs, noting that certain CGUs still remain sensitive to assumption changes after a number of impairments in recent years.	Revised CGUs confirmed and goodwill allocations agreed. Annual impairment review finalised with confirmation of sufficient headroom in each of the CGUs with the exception of Brazil, where a £65m impairment to acquired intangible assets was made to align the carrying values with the value in use.
Leases and IFRS 16		
Pearson adopted IFRS 16 in respect of its lease portfolio in 2019. The Group has a significant number of property leases and several other low-value vehicle and equipment leases. The implementation of the standard has resulted in the recognition of right-of-use assets and sublease investments and corresponding lease liabilities on the balance sheet for the first time.	The Committee continued to monitor progress on the IFRS 16 lease conversion process. This included review of the implementation of 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, strategic plans and the reporting of cash flow and net debt. In addition, the Committee reviewed the new policies and lease disclosures presented in the interim report and in this report.	The Committee reviewed the impact of adopting the new standard on the financial statements, key performance indicators, banking covenants and future strategy and approved the transition options taken, discount rates applied, and disclosures made.
Disposal transactions		
The Group finalised the sale of its US K12 Courseware business and announced the sale of its remaining stake in Penguin Random House.	The Committee reviewed the accounting for the disposal of the US K12 Courseware business with specific focus on the fair value of non-cash proceeds in the form of loans and an earn-out. The Committee also reviewed tax assumptions relating to the disposal transaction. The implications for the treatment of Penguin Random House as held for sale were noted.	The Committee determined that disposal accounting had been appropriately recorded and that the fair value of proceeds reflected its understanding of the disposal transaction and future expectations for cash flow. The Committee also agreed that the criteria for held for sale treatment in respect of the Penguin Random House interest had been met.

Issue	Action taken by Audit Committee	Outcome
Restructuring		
The restructuring programme announced in 2017 was in its final year of implementation in 2019. Costs incurred in 2019 were mainly related to redundancies and asset impairments. There are several accounting judgements to be made regarding categorisation and timing of cost recognition.	The Committee continued to review progress on the restructuring programme and considered the judgements required in accounting for the costs of redundancy and asset impairment, mainly in respect of the Group's North America operations and enabling functions. In particular, in 2019, the Committee reviewed the impact of restructuring on technology and content assets and the implications of initiatives to drive cost-efficiencies on strategic partnerships.	The Committee confirmed that the assumptions underlying the timing of cost recognition were reasonable and that the accounting and disclosure for the restructuring programme were appropriate.
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. The Committee were particularly interested to understand the impact of the new digital first strategy in North America on estimates associated with returns and stock obsolescence.	Assumptions underlying the returns reserve methodology were reviewed and challenged.
Tax		
The impact of tax legislation changes including US tax reform, EU state aid, proposed digital services tax, the trend for increased tax transparency, and provision levels.	The Committee considered various developments during the year, including the internal refinancing of the Group's US operations which completed in June, US tax reform, tax authority audit activity in Brazil and the EU state aid case. The outcome of the refinancing combined with provision releases reduced the 2019 adjusted tax rate. The 2019 adjusted tax rate is higher than the prior year due to several one-off benefits occurring in 2018. This was reported to the Committee at the December meeting. The Committee considered an update on Pearson's involvement endorsing the B-Team Responsible Tax Principles initiative. The Chair of the Committee approved the third report on tax strategy prior to its publication in November 2019.	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.

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 29 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 p74), and receives reports on the efficiency and effectiveness of internal controls. You can read more about Pearson's internal audit function on p77. 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.

The Board is ultimately accountable for effective risk management in Pearson and determines our strategic approach to risk. It confirms our organisational risk management framework as well as our risk appetite targets. Twice yearly it receives and reviews reports on the status of the top Group-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 Organisational Risk and Resilience 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 Pearson-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 organisational risk management section on p40

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.

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 Deputy Chief Financial Officer and Chief Financial Officer. Regular reports are prepared for the Audit Committee and the Board and an annual risk review meeting takes place between the Treasurer and Audit Committee. The Treasury Policy is described in more detail in note 19 to the financial statements on p165

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.

Tax

The Board has delegated responsibility for the integrity of financial reporting and risk management to the Audit Committee. This includes setting tax strategy and monitoring tax risk. The Tax Department reports at least annually to the Audit Committee. Regular updates are provided to the Deputy CFO and the CFO throughout the year.

Directors' remuneration report

Committee Chair
Elizabeth Corley

Members
Elizabeth Corley, Sherry Coutu, Josh Lewis, Tim Score and Sidney Taurel

Key messages from the Remuneration Committee

- 2019 incentive outcomes reflect the headwinds the company faced during the year, whilst recognising that Pearson is on track to deliver ahead of target for cost savings and is growing revenue in 76% of the company, whilst also becoming a leaner, more efficient and digitally-focused business. As a result, there will be no payout under the AIP for 2019 and a 33% payout under the 2017 LTIP vesting in 2020.
- We have reassessed our Remuneration Policy, following a fundamental review of remuneration principles to ensure it supports our purpose and strategy throughout the company.
- Changes have been made to align further the Remuneration Policy with the principles of remuneration, the 2018 UK Corporate Governance Code and shareholders' guidance.
- The Committee reviewed the remuneration implications of leadership changes to the Board and senior management, and the appointment terms of the new CFO.
- There will be no salary increases for incumbent Executive Directors in 2020.
- We have decided to maintain a significant discount to LTIP award levels in light of share price performance.
- The Committee remains focused on ensuring the remuneration arrangements in place for the broader employee population remain consistent with the need to attract the right talent for a digital future.

Terms of reference

The Committee's terms of reference are in line with the 2018 UK Corporate Governance Code and are available on the Governance page of the company's website at www.pearson.com/investors/governance. A summary of the Committee's responsibilities is shown on p96

Board Committee attendance

The following table shows attendance by Directors at Committee meetings throughout 2019:

	Remuneration
Elizabeth Corley	7/7
Sherry Coutu[1]	3/3
Josh Lewis	7/7
Tim Score	7/7
Sidney Taurel	7/7

1 Sherry Coutu joined the committee on 1 July 2019 and has attended all Committee meetings since her appointment.

In this section

Dear shareholders,

Over the last year, the Committee has been undertaking a thorough review of its remuneration principles and Directors' Remuneration Policy to ensure that they enable us to achieve the company's purpose of helping people make progress in their lives through learning and support the execution of the goal of generating long-term sustainable value for our shareholders.

To deliver on Pearson's purpose and strategy we need a strong global management team. Pearson competes for talent and key skills in an increasingly 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. The Committee considers that our revised principles of remuneration and Policy achieve this aim.

Our remuneration principles are described on p97

Changes have been made to our Policy to reflect best practice

The Committee rigorously re-evaluated the current remuneration framework from first principles as part of our review of Policy. Having done so, we believe that the current remuneration framework of annual incentive plan (AIP) plus Long-term Incentive Plan (LTIP) continues to support the execution of Pearson's strategy. The Committee will, however, continue to keep its approach to remuneration arrangements under review to ensure that it remains effective as we transition the leadership team and as Pearson's strategy continues to evolve.

Notwithstanding that the broad framework remains the same, the Committee has made changes to some elements of its Remuneration Policy and its implementation to simplify the approach, to reflect the 2018 UK Corporate Governance Code and evolving best practice, and to align better with business objectives over the long-term.

Changes to Policy include:

- In order to align with shareholder expectations, the AIP paid for 'on target' performance will be no more than 50% of the maximum potential. This results in a reduction in target AIP opportunity for the Chief Executive from 100% of salary to 90% of salary with no change to the maximum opportunity.
- Under our Policy, the maximum LTIP opportunity has been reduced to 350% of salary (previously 400% of salary in normal circumstances, up to 500% of salary in exceptional circumstances), in order to simplify the approach and to bring it more closely in line with how we have been applying the policy over the last three years. The intention is that annual LTIP opportunity will remain below this level.
- Currently, the LTIP holding period is structured so that, following the three-year performance period, 75% of any vested shares are released with the net award subject to a mandatory sales restriction for a further two years. The vesting of the remaining 25% of the shares is subject to continued employment over the same period. In order to simplify the approach and to align with market practice, 100% of the LTIP award (for awards made from 2020 onwards) will be subject to a two-year holding period following the end of the three-year performance period (i.e. five years from award).

- From 2018, 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. This is in line with the maximum company contribution as a percentage of salary that UK employees are eligible to receive. This provision will be incorporated into our new Policy.
- In light of evolving shareholder expectations and market practice, we have strengthened our existing post-employment shareholding guideline (implemented in 2017) such that Executive Directors are expected to retain their current guideline (300% of salary for the Chief Executive and 200% of salary for the CFO) for two years following stepping down as an Executive Director.

Performance measures for 2020

The Committee is proposing some minor changes to performance measures for the AIP and LTIP.

The AIP will continue to be based on a mix of adjusted operating profit, sales, operating cash flow and strategic objectives. The weightings of operating profit and sales have been changed to 30% on each (previously 40% on operating profit and 20% on sales). This change is to reflect that Pearson is focusing on delivering value for shareholders through top-line growth as well as through operational efficiencies and to strengthen further alignment with this objective. The remaining 40% of AIP opportunity will be equally weighted on operating cash flow and strategic objectives which will be aligned with our corporate goals.

The LTIP will continue to be based on adjusted EPS, ROIC and relative TSR vs. FTSE 100 (measures equally weighted). We have previously communicated that the Committee believes net ROIC is a fairer assessment of management's performance in generating shareholder returns on the capital currently invested in the business, but that this metric would only be introduced after the company had tracked it for a number of years. Net ROIC has now been used as a key metric in Board reporting and reported as a KPI since Pearson's 2017 strategic report; therefore, going forward, we will measure net ROIC rather than gross ROIC for the purposes of the LTIP. The Committee's intention is to operate net ROIC such that any payouts reflect the underlying performance of the new management team by measuring return on capital excluding existing impairments on legacy acquisitions only. If the management team impairs an asset within the performance period, the final calculation of the outcome under the LTIP will be adjusted to ensure it does not benefit the outcome.

Leadership changes

On 18 December 2019, we announced that our Chief Executive, John Fallon, will retire in 2020 once a successor has been appointed. John Fallon will remain eligible to participate in the AIP for 2020 on a pro-rata basis. He will not receive an LTIP award in respect of 2020 and his salary will remain at £817,400 per annum. His benefits also remain unchanged.

The Committee reviewed the approach to the Chief Executive's pension in light of shareholder views and best practice, and agreed with him that his pension allowance would be reduced on a phased basis over the next three years to bring it into line with the UK workforce at 16% of salary. Notwithstanding his planned retirement, John Fallon's cash pension allowance has been reduced by 3 percentage points to 23% of salary as the first step on this planned phased reduction.

On 16 January 2020, we announced that Coram Williams will be leaving the company and Sally Johnson, currently Deputy CFO, will succeed him as CFO. It has since been confirmed that Coram Williams will step down at the AGM on 24 April 2020 and Sally Johnson will be appointed as CFO and as an Executive Director on this date.

Coram Williams will not be eligible for AIP and LTIP in respect of 2020 and he will forfeit any unvested LTIP awards on departure. His salary will continue at £539,500 per annum until he steps down. His pension and other benefits remain unchanged. He will receive no payment in relation to loss of office.

Sally Johnson's salary will be £515,000 per annum. Her maximum AIP opportunity will be 170% of salary and her LTIP award will have a face value of 245% of salary (which is the same award opportunity as for Coram Williams in 2017, 2018 and 2019), reflecting the previous discounts to LTIP awards in light of share price performance.

The Committee believes that a further reduction in the CFO-elect's award level is not appropriate, beyond the discount already applied. This discount was set at a time when the share price was comparable to the current share price and the Committee considers that alignment between management and shareholders would be better supported by maintaining her level of grant at 245% of salary in 2020.

Sally Johnson is a member of the Pearson Pension Plan and will continue to accrue pension at a rate of 1/60th of pensionable salary per annum, restricted to the plan earnings cap, in line with other participants in the Plan.

Incentive outcomes for 2019 reflect a challenging year

Pearson as a whole was able to match prior year underlying sales for the first time since 2014 because the broader 76% of Pearson grew by 4% in aggregate, demonstrating that Pearson is starting to see the returns from the strategy of investment in growth businesses and the evolution towards a simpler, more sustainable business. This progress was, however, offset by an underlying decline in the US Higher Education Courseware business where sales from print textbooks reduced more rapidly than anticipated. Pearson delivered Group adjusted operating profit of £581m, an increase of 6% on 2018.

Despite strong progress against strategic objectives, financial performance did not meet the threshold required to result in a payment under the AIP and therefore there will be no bonus payment for the Executive Directors in respect of 2019. The Committee carefully considered the impact of no payout on talent and retention across the company, and agreed with management that to have no payout at all would not be a fair reflection of the progress that was made across the company. As such, the Committee approved discretionary funding for employees, excluding the Executive Directors.

LTIP awards granted in 2017 were based on adjusted EPS, gross ROIC and relative TSR performance. Adjusted EPS for 2019 was 57.8p which was between threshold and target, resulting in 39% of this portion of the award vesting. ROIC for 2019 was 5.2% which is again between threshold and target, resulting in 57% of this portion of the award vesting. TSR performance is below median and therefore no portion of this award vested. Overall, therefore, performance resulted in 32.7% of the 2017 LTIP award vesting.

Directors' remuneration report

The Committee very carefully considered the vesting outcome in the context of the shareholder experience, the progress made against the delivery of our strategic initiatives and sustainable efficiency measures, as well as achievements in innovation, people, culture and sustainability agendas. Despite the challenges the company has faced over the last year in US Higher Education Courseware, the Committee concluded that the vesting outcome was a fair reflection of the performance the company has achieved over the last three years and the progress against the strategic objectives and therefore it was not necessary to exercise discretion to adjust the vesting outcome. In doing so, we also considered that the LTIP targets were set with considerable stretch after extensive shareholder consultation.

The Committee consulted with shareholders regarding the changes to Policy and its implementation for 2020; the final proposals reflect feedback from shareholders. Continuing conversations with shareholders have been invaluable and we thank shareholders for the time they have spent with us in shaping our approach. I look forward to receiving your support at the AGM in relation to our Directors' Remuneration Policy and our remuneration report.

Elizabeth Corley
Chair of Remuneration Committee

6 March 2020

Remuneration framework

Remuneration Policy development and alignment to remuneration principles and company strategy

Our remuneration principles and Directors' Remuneration Policy have been developed to support our purpose and strategy throughout the company.

The Committee's review of our remuneration philosophy and Directors' Remuneration Policy focused on ensuring that the company was equipped to achieve its purpose of helping people make progress in their lives through learning, and supports the execution of the goal of generating long-term sustainable value for shareholders. Throughout the process, we had due regard for the 2018 Corporate Governance Code, wider workforce remuneration and emerging best practice in relation to Executive Director remuneration.

› Pearson developed a company-wide set of remuneration principles to govern how people are rewarded. The principles have been developed to ensure alignment to company culture, and the ability to attract and reward the right talent to enable the company's digital future, whilst recognising that remuneration is one part of the broader employee value proposition at Pearson. These principles were used to shape the development of our 2020 Executive Directors' Remuneration Policy.

› The Committee has taken steps to simplify our Policy and its implementation to ensure that it is clearly aligned to company strategy, including re-weighting measures in the AIP, aligning on target opportunities and consolidating maximum LTIP opportunity.

› In addition, the committee has reviewed quantum under incentive plans and reduced the Chief Executive target AIP opportunity to 90% of salary and the maximum LTIP award limit to 350% of salary – removing the exceptional maximum limit.

› Our remuneration framework and outcomes are designed to be aligned with performance achieved:

  – Performance measures selected for the AIP and LTIP are key to achieving strategic objectives. This year, we have made some changes to performance measures to ensure they continue to incentivise the right management behaviours and goals.

  – We carry out a robust target-setting process each year, taking into account Pearson's strategic plan, as well as analyst expectations to reflect market expectations, resulting in stretching yet achievable targets for the AIP and LTIP.

  – Maximum awards under the AIP and LTIP are capped and the maximums are disclosed in our Policy.

  – When determining payouts under each plan, the Committee discusses if the outcome is reflective of overall company performance and shareholder experience over the period and, if not, has discretion to alter plan outcomes up or down.

› The Committee is mindful of reputational and other risks when determining Remuneration Policy and outcomes for Executive Directors and senior management. The company also has safeguards in place, such as clawback and malus and a two-year holding period on the LTIP, as well as robust shareholding guidelines including post-employment which have been further strengthened this year.

› Before signing off the remuneration report and Remuneration Policy, the Committee reviewed drafts of the report and provided input to clarify our disclosure. We also undertook consultation with our top 20 shareholders, who represent 74% of our share capital, giving early sight to our Policy changes and to inform our final conclusions.

In 2019, Pearson developed remuneration principles that govern the whole organisation. We have evolved our Remuneration Policy to match the following updated remuneration principles, which are described on p97

› Aligned to longer-term strategy

› Pay for performance

› Market competitive

› Targeted differentiation

› Tailored

› Remuneration is one part of the employee value proposition at Pearson

Summary of key Policy changes for 2020

A summary of the material changes to be introduced in the 2020 Policy is provided below, more detail can be found in the notes to the Policy table on p102. The full future policy table is on p98–101

Element	Overview of changes	Description
Annual incentive plan AIP	› Target AIP will be no more than 50% of maximum	In order to align with shareholder expectations, the AIP paid for 'on target' performance will be no more than 50% of the maximum potential. This results in a reduction in target AIP opportunity for the Chief Executive from 100% of salary to 90% of salary, with no change to the maximum opportunity.
Long-term incentive plan LTIP	› Reduction in exceptional maximum for LTIP awards	Under current policy, LTIP awards of up to 400% of salary may be made in normal circumstances, with awards of up to 500% of salary in exceptional circumstances. In order to simplify the approach and to bring it more closely in line with how we have been applying the policy over the last three years, the award level limit under the LTIP will be reduced to be up to a maximum of 350% of base salary.
	› Simplification of the structure of the LTIP holding period	Currently, the LTIP holding period is structured so that, following the three-year performance period, 75% of any vested shares are released but subject to a mandatory sales restriction (other than shares used to settle tax) for a further two years. The vesting of the remaining 25% of the shares is subject to continued employment over the same period. In order to simplify the approach and to align with market practice, 100% of the LTIP award (for 2020 onwards) will be subject to a two-year holding period following the end of the three-year performance period (i.e. five years from award). During this period the awards will not be forfeitable for cessation of employment other than via clawback, e.g. in the case of gross misconduct.
Retirement benefits R	› Pension alignment with wider employee population over the life of the policy	From 2018, 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, in line with the maximum company contribution as a percentage of salary that UK employees who are over 45 are eligible to receive. Where an individual appointed to the Board is already a member of the Pearson Pension Plan (our defined benefit plan) then they will continue to be eligible to participate in the Plan on a consistent basis with other employees in the Plan. In October 2017, the Chief Executive 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 continued to receive a taxable cash supplement of 26% of base salary, in lieu of the previous FURBS arrangement. The Committee reviewed the approach to the Chief Executive's pension in light of shareholder views and best practice and agreed with the Chief Executive that his pension allowance would be reduced on a phased basis over the next three years to bring it in line with the UK workforce of 16% of salary. Notwithstanding his planned retirement, John Fallon's cash pension allowance has been reduced by 3% to 23% of salary as the first step on this planned phased reduction.
Shareholding guidelines SG	› Strengthening post-employment shareholding guidelines	Pearson was one of the first companies to introduce a post-retirement shareholding guideline as part of the review undertaken in 2017, such that Executive Directors are required to retain half of their shareholding guideline for a period of two years post-retirement. In light of evolving shareholder expectations and market practice in this area, we have strengthened the post-employment shareholding guideline in place so that Executive Directors are required to retain their current guideline (300% of salary for the Chief Executive and 200% of salary for the CFO) for a period of two years following stepping down as an Executive Director.

2019 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 £3.825m in 2019. These emoluments are included within the total employee benefit expense in note 5 to the financial statements (p146)

Executive Directors

The remuneration received by Executive Directors in respect of the financial years ended 31 December 2019 and 31 December 2018 is set out below.

Executive Director 'single figure' remuneration

Element of remuneration £000s	John Fallon		Coram Williams	
	2019	2018	2019	2018
B Base salary	813	795	537	525
A&B Allowances and benefits	30	43	8	14
R Retirement benefits	211	206	62	54
Total fixed pay	1,054	1,044	607	593
AIP Annual incentives	–	644	–	401
LTIP Long-term incentives	803	1,406	–	815
Total variable pay	803	2,050	–	1,216
Total remuneration	1,857	3,094	607	1,809

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 2019:

£000s	John Fallon	Coram Williams
Travel	28	5
Health	2	3

Travel benefits comprise car allowance, shared use of a company car and driver for business purposes, 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 and/or are available to all other employees in the same location.

R Retirement benefits

Further detail on retirement benefits is set out later in this report.

AIP Annual incentives

The 2019 AIP for the Executive Directors was based on a mix of financial (80% weighting) and strategic measures (20% weighting). The 2019 award resulted in a nil payout for both the Chief Executive and CFO. For more detail on performance metrics and performance against targets in 2019, see overleaf.

LTIP Long-term incentives

The single figure of remuneration for 2019 includes the vesting of the 2017 LTIP award, which was subject to performance conditions assessed to 31 December 2019. For more detail on performance metrics and performance against targets, see p90. The values of vested 2017 LTIP awards included in the figures for total remuneration have been calculated using a three-month average share price to year end of 671.0p and do not reflect any dividends accrued on those shares.

The share price on the date of grant of 11 September 2017 was 586.0p. The share price used to value the LTIP for single figure purpose of 671.0p represents an increase of 85p per share. The proportion of the 2017 LTIP value disclosed in the single figure attributable to share price growth for the Chief Executive was therefore £101,730. The Remuneration Committee did not exercise discretion in respect of the share price appreciation. Coram Williams will leave the company at the AGM, before the 2017 LTIP vests, and therefore his award will lapse in full.

The single figure of remuneration for 2018 includes the vesting of the 2016 LTIP award. The value of the award has been updated to reflect the dividends accrued and the share price on the date of vest (3 May 2019) of 813.7p.

The value of the 2016 award previously disclosed in the 2018 remuneration report was estimated to be £1,454,000 for the Chief Executive and £843,000 for the CFO, based on a three-month average share price of 904.0p and did not reflect any dividends accrued on those shares.

The 2016 LTIP awards which vested on 3 May 2019 were granted on 3 May 2016 when the share price was 805.0p. Between the date of grant and the vesting date, the share price had increased to 813.7p which equated to an increase in value of each vesting share of 8.7p. The proportion of the 2016 LTIP value disclosed in the single figure attributable to share price growth was therefore £13,995 for the Chief Executive and £8,112 for the CFO. The Remuneration Committee did not exercise discretion in respect of the share price appreciation.

AIP Executive Directors' annual incentive payments for 2019*

The following table summarises the performance targets and performance against these targets for the 2019 award which resulted in a nil payout for both the Chief Executive and CFO.

Overall outcome

Performance measure	% of total	Performance range: Threshold	Performance range: Target	Performance range: Max	Actual results	Payout: % of max bonus opportunity
Adjusted operating profit	40%	£588m	£612m	£671m	**£581m**	0%
Sales	20%	£3,902m	£3,976m	£4,050m	**£3,869m**	0%
Operating cash flow	20%	£401m	£434m	£492m	**£307m**	0%
Strategic measures	20%		See below			0%
	100%					**0%**

Note 1: Operating cash flow is measured post-restructuring. Operating cash flow pre-restructuring is £418m.

Note 2: See below for performance against strategic measures.

Note 3: The outcomes under all measures have been reviewed by internal audit.

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	5%	62.5% (+0.5% on 2018 result)	63% (+1% on 2018 result)	64.0% (+2% on 2018 result)	Digital and digitally-enabled sales increased to 66.3% of total revenues in 2019 vs 62% in 2018.
	Digital platforms – delivery of key 2019 milestones related to AI app and Revel pilots	5%	Critical milestones on track	Critical milestones and key deliverables on track	All milestones and deliverables on track	Aida app and Revel both launched and available for commercial use. Progress made against other milestones has resulted in an accelerated innovative product roadmap, which will drive cumulative incremental value at a lower cost than the original plan over future years.
Growing market opportunities	Invest in growing market opportunities – total revenue growth	5%	+5% revenue growth	+7.5% revenue growth	+10% revenue growth	Our growth businesses – Pearson VUE, Virtual Schools, OPM and PTE Academic – grew by 8% in revenue. These growth businesses will continue to grow in 2020, as we invest in new forms of online education, in better, smarter, online assessments, in new AI-inspired direct-to learner apps, and in shifting Pearson's focus to link education and employability with the workplace.
Becoming simpler, more efficient and sustainable	The Enabling Programme (TEP) – linked to key deliverables/milestones including (successful) deployment of Wave 3 Release, progress on RoW and Red Amber Green (RAG) status of value realisation plan	5%	Critical milestones on track	Critical milestones and key deliverables on track	All milestones and deliverables on track	Good progress was made against the business value realisation plan but further work is still needed to sustain fixes and overcome more complicated issues. Wave 3 was deployed successfully.

Due to significant progress against strategic goals in 2019, an above target result was achieved under these measures. However, as the financial underpin was not met therefore there will not be a payout under the strategic measures for 2019.

2019 remuneration report

Executive Directors' Long-Term Incentive Plan award vesting for 2019*

In September 2017, the Executive Directors were made awards under the LTIP which vest in May 2020 based on performance the business delivered over the three-year period from 2017 to 2019.

The target ranges were set following extensive consultation with our major shareholders in 2017, and took into account internal and external expectations of performance when the awards were made.

The level of awards granted to Executive Directors in 2017 was reduced by approximately 30% to 275% of salary for the Chief Executive and 245% of salary for the CFO to reflect the decline in share price at the time. The level of payout at threshold performance was also reduced under the adjusted EPS and ROIC measures.

The overall outcome based on performance achieved against targets is 32.7% of the maximum awards. However, Coram Williams will leave the company at the AGM, before the 2017 LTIP vests, and therefore his award will lapse in full.

The targets and performance against these targets are as follows:

		Performance range							Vesting	
Performance measure	% of total	Threshold	Target	Maximum	Payout at threshold	Payout at target	Payout at maximum	Actual	% achievement	% of total award
Adjusted EPS	40%	55p	62p	75p	15%	75%	100%	57.8p	39%	15.6%
ROIC	30%	4.5%	5.5%	7.5%	15%	75%	100%	5.2%	57%	17.1%
Relative TSR	30%	Median	N/A	Upper quartile	25%	N/A	100%	72 out of 95	0%	0%
	100%								**Total**	**32.7%**

Relative TSR was measured against the constituents of the FTSE 100 at the start of the performance period.

The Committee very carefully considered the vesting outcome in the context of financial performance, the shareholder experience, progress against the delivery of strategic initiatives including the business transformation and sustainable cost reduction delivered by the simplification programme, as well as reviews of talent, diversity, culture, customer experience and sustainability agendas. The Committee considered whether there had been a significant negative event (such as an ESG event) which would warrant an adjustment. Notwithstanding the challenges the company has faced over the last year in the US Higher Education Courseware business, the Committee concluded that the vesting outcome was a fair reflection of the progress the company has made over the last three financial years. No discretion was therefore exercised to adjust the vesting outcome.

Overall, the Committee considers that the Remuneration Policy has operated as it intended during 2019 and that the pay outcomes are aligned with the experience of shareholders and other stakeholders over the relevant performance period.

LTIP Long-term incentives awarded in 2019*

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)[1]	Performance Period
John Fallon	**1 May 2019**	**1 May 2022**	**271,000**	**£2,249,842**	**275%**	**18.3%**	**1 Jan 19–31 Dec 21**
Coram Williams[2]	**1 May 2019**	**1 May 2022**	**159,000**	**£1,320,018**	**245%**	**18.3%**	**1 Jan 19–31 Dec 21**

1 Under the adjusted EPS and ROIC elements, 15% vests for threshold performance; under the TSR element, 25% vests for threshold performance. This is the weighted average of vesting for threshold.

2 Coram Williams will leave the company at the AGM therefore his award will lapse in full.

Face value was determined using a share price of 830.2p (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 2024.

Details of the performance targets for the 2019 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 FY21	Vesting schedule (% max)	Adjusted ROIC for FY21	Vesting schedule (% max)	Ranked position vs FTSE 100
15%	65p	15%	5%	25%	Median
65%	70p	65%	6%	–	–
100%	80p or above	100%	9% or above	100%	Upper quartile

Note 1: Straight-line vesting will occur in between the points shown, with no vesting for performance below threshold.

Note 2: Pearson's TSR performance is measured relative to the constituents of the FTSE 100 Index over the performance period.

Performance targets for outstanding awards under the Long-Term Incentive Plan (LTIP)

The details of 2017 and 2018 LTIP awards and their performance conditions under the Long-Term Incentive Plan (LTIP) are 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 target	Payout at maximum
8 May 2018	893.6p	1 May 2021	Adjusted EPS	One-third	FY 2020	15% for EPS 65p	65% for EPS of 68p	100% for EPS 80p
			ROIC	One-third	FY 2020	15% for ROIC of 5%	65% for ROIC of 6%	100% for ROIC of 8%
			Relative TSR	One-third	1 Jan 2018 to 31 Dec 2020	25% at median	–	100% at upper quartile
11 September 2017	586.0p	1 May 2020	Adjusted EPS	40%	FY 2019	15% for EPS 55p	75% for EPS of 62p	100% for EPS 75p
			ROIC	30%	FY 2019	15% for ROIC of 4.5%	75% for ROIC of 5.5%	100% for ROIC of 7.5%
			Relative TSR	30%	1 Jan 2017 to 31 Dec 2019	25% at median	–	100% at upper quartile

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 2019 £000s	Accrued pension at 31 Dec 19 £000s
John Fallon	–	211	211	106
Coram Williams	62	–	62	40

Note 1: The accrued pension at 31 December 2019 is the deferred annual pension to which the member would be entitled on ceasing pensionable service on 31 December 2019. 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.

Plans

John Fallon – The Pearson Pension Plan

John Fallon 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 2019/20 earnings cap of £166,200, 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 2019, John Fallon received the pension supplement of 26% of salary. There are no enhanced early retirement benefits.

The Committee reviewed the approach to the Chief Executive's pension in light of shareholder views and best practice, and agreed with John Fallon that his pension allowance would be reduced on a phased basis over the next three years to bring it in line with the UK workforce at 16% of salary. Notwithstanding his planned retirement, John Fallon's cash pension allowance has been reduced by 3 percentage points to 23% of salary as the first step on this planned phased reduction.

Coram Williams – The Pearson Pension Plan

Accrual rate of 1/60th of pensionable salary per annum, restricted to the Plan earnings cap (£166,200 per annum in 2019/20), with continuous service with a service gap. There are no enhanced early retirement benefits.

2019 remuneration report

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 Chief Financial Officer. 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 re-tested, other than when shares are sold.

In light of evolving shareholder expectations and market practice, we have strengthened our existing post-employment shareholding guideline (implemented in 2017) such that Executive Directors are expected to retain their current guideline (300% of salary for the CEO and 200% of salary for the CFO) for two years following stepping down as an Executive Director. This guideline does not apply to shares purchased by the Director.

The shareholding guidelines do not apply to the Chair and Non-Executive Directors. However, a minimum of 25% of the Non-Executive Directors' basic 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 19	Conditional shares subject to performance at 31 Dec 19	Conditional shares subject to employment only at 31 Dec 19	Total number of ordinary and conditional shares at 31 Dec 19	Guideline (% salary)	Guideline met?
Chair						
Sidney Taurel	103,224	–	–	–	–	–
Executive Directors						
John Fallon	397,313	883,000	40,215	1,320,528	300%	Yes (see note 8)
Coram Williams	56,108	519,000	23,310	598,418	200%	n/a (see note 6)
Non-Executive Directors						
Elizabeth Corley	22,028	–	–	–	–	–
Sherry Coutu	3,175	–	–	–	–	–
Vivienne Cox	7,430	–	–	–	–	–
Josh Lewis	14,200	–	–	–	–	–
Linda Lorimer	11,040	–	–	–	–	–
Michael Lynton	8,535	–	–	–	–	–
Graeme Pitkethly	785	–	–	–	–	–
Tim Score	37,893	–	–	–	–	–
Lincoln Wallen	8,607	–	–	–	–	–

Note 1: The current value of the Executive Directors' shareholdings is based on the closing market value of Pearson shares of 582.0p on 25 February 2020 against base salaries at 31 December 2019.

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 subject to performance means unvested shares which remain subject to performance conditions and continuing employment for a pre-defined period. This includes the LTIP awards granted in 2017, 2018 and 2019; details of the performance period, measures and targets can be found on p90 and p91

Note 4: The performance targets for the 2017 award were partially met and therefore 32.7% of this award will vest on 1 May 2020 and the remaining portion will lapse for John Fallon. Vested shares will be subject to an additional two-year holding period to 2 May 2022. Coram Williams will leave the company at the AGM, before the 2017 LTIP vests, and therefore his award will lapse in full.

Note 5: Conditional shares subject to employment only means unvested shares which are subject to a holding period and continued employment. The shares shown are in relation to the 2016 LTIP and will be released in May 2021.

Note 6: Coram Williams has five years from the date of his appointment as an Executive Director on 1 August 2015 to reach the shareholding guideline. Coram Williams is due to step down from the Board at the AGM on 24 April 2020.

Note 7: There have been no changes in the interests of any Director between 31 December 2019 and 26 February 2020, being the latest practicable date prior to the publication of this report.

Note 8: John Fallon has met the shareholding guideline. However, as a result of the decrease in share price, the current value of his shareholding is less than 300% of salary. He has not sold any shares during 2019 and the number of ordinary shares held has increased from 326,784 at 31 December 2018.

Chair and Non-Executive Director remuneration*

The remuneration paid to the Chair and Non-Executive Directors in respect of the financial years ended 31 December 2019 and 31 December 2018 are as follows:

Director £000s	2019 Total fees	2019 Taxable benefits	2019 Total	2018 Total fees	2018 Taxable benefits	2018 Total
Sidney Taurel	500	8	508	500	11	511
Elizabeth Corley	115	–	115	115	–	115
Sherry Coutu	56	–	56	–	–	–
Vivienne Cox	128	1	129	128	3	131
Josh Lewis	88	2	90	88	4	92
Linda Lorimer	98	4	102	98	4	102
Michael Lynton	91	–	91	69	–	69
Harish Manwani	–	1	1	29	1	30
Graeme Pitkethly	57	–	57	–	–	–
Tim Score	116	1	117	116	–	116
Lincoln Wallen	91	4	95	91	5	96
Total	1,340	21	1,361	1,234	28	1,262

Note 1: A minimum of 25% of the Chair'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.

Note 3: Sherry Coutu and Graeme Pitkethly joined the Pearson Board as Non-Executive Directors with effect from 1 May 2019. 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 and his taxable benefits disclosed above relate to the UK tax year 2018/19.

Payments to former Directors*

There were no payments to former Directors in 2019.

Payments for loss of office*

There were no payments for loss of office made to or agreed for Directors in 2019.

The CFO will not receive any payments for loss of office in 2020. Departure arrangements for the Chief Executive have not yet been agreed.

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 AGM. 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. The Chair's appointment may be terminated on 12 months' notice.

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 2019 in respect of this role. In accordance with our policy, he is permitted to retain these fees.

2019 remuneration report

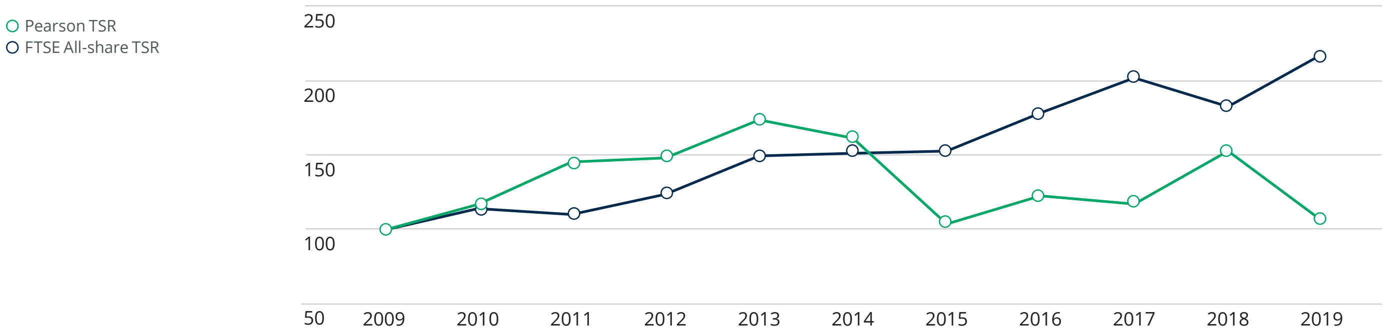
Historical performance and remuneration

Total shareholder return performance

Below, we set out 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 2010 to 31 December 2019. 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 Chief Executive over the last ten years and a summary of the variable pay outcomes relative to the prevailing maximum at the time.

Total shareholder return £



Source: Thomson Reuters Datastream

Chief Executive remuneration	Marjorie Scardino			John Fallon						
Total remuneration (single figure, £000s)	8,466	8,340	5,330	1,727	1,895	1,263	1,518	1,758	3,094	**1,857**
Annual incentive (% of maximum)	92%	76%	24%	34%	51%	Nil	24%	44%	45%	**Nil**
Long-term incentive (% of maximum)	98%	68%	37%	Nil	Nil	Nil	Nil	Nil	42%	**33%**

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 share awards 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 Chief Executive

The following table sets out the change between 2018 and 2019 in three elements of remuneration for the Chief Executive, in comparison with the average for all employees. While the Committee reviews base pay for the Chief Executive 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, annual allowances and benefits have decreased due to a reduction in the number of employees in higher cost locations. The change in Chief Executive base salary is in line with the country budget increase for the UK in 2019 which other UK-based employees were also eligible to receive. Annual incentives for employees have not reduced as much as for the Chief Executive as the all employee AIP was partially funded. The Chief Executive did not receive a payout under the AIP in relation to 2019.

Change in Chief Executive remuneration 2018/19

Base salary	Allowances and benefits	Annual incentives
↑ 2%	↓ 30%	↓ 100%

Change in employee remuneration 2018/19

Base salary	Allowances and benefits	Annual incentives
↓ 1%	↓ 14%	↓ 46%

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. 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.

			Headline change	
All figures in £ millions	2019	2018	£m	%
Adjusted operating profit	**581**	546	35	**6%**
Dividends	**147**	136	11	**8%**
Total wages and salaries	**1,258**	1,421	-163	**-11%**

Note 1: Adjusted operating profit is as set out in the financial statements.

Note 2: Wages and salaries include continuing operations only and include Directors. Average employee numbers for continuing operations for 2019 were 22,734 (2018: 24,322). Further details are set out in note 5 to the financial statements on p146

Note 3: Total wages and salaries would be -14% at constant exchange rates.

Chief Executive to employee pay ratio

The table below shows the ratio of Chief Executive to employee pay for 2019, using the single total figure remuneration as disclosed on p88 compared to the full-time equivalent total reward of employees whose pay is ranked at the 25th, 50th and 75th percentiles (as identified by the gender pay gap methodology) in the GB workforce.

	Chief Executive pay ratio		
Method	25th percentile	50th percentile	75th percentile
B: Gender pay gap methodology	65.9	47.2	36.0

- The gender pay gap data from April 2019 was used to identify employees at the 25th, 50th and 75th percentiles. Data was analysed for a number of employees around each quartile figure to ensure that there were no anomalies.
- The gender pay gap methodology to select the quartile employees is a good representation of the employee population at year end, and is the most practicable given the timing of the disclosure and final AIP outcome decisions for the wider workforce.
- Base salary and pension are based on full year figures taken from payroll. Benefits have been taken from P11D in line with the methodology used for the Executive Directors. Annual bonus figures are based on the manager recommendations as at 25 February 2020 relating to 2019. None of the employees at the 25th, 50th or 75th percentiles had share awards vesting in 2019.
- Total remuneration for each employee has been compared to the Chief Executive's single figure as shown on p88. Total remuneration figures for the 25th, 50th and 75th percentile employees are as follows: £28,164, £39,375, £51,575. Base salaries are as follows: £26,000, £34,320, £43,763.
- The company considers the median pay ratio consistent with the company's wider policies on employee pay, reward and progression.

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	2019
All Pearson plans	**6.8%**
Executive or discretionary plans	**5.0%**
Shares held in trust	**4.6%**

The Remuneration Committee in 2019

Role	Name	Title
Chair	Elizabeth Corley	Independent Non-Executive Directors
	Sherry Coutu	
	Josh Lewis	
	Tim Score	
	Sidney Taurel	Chair 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 (to April 2019)
	Paul Christian	VP-Executive Reward
	Stephen Jones	Company Secretary
External advisers	Deloitte LLP	

Sidney Taurel was a member of the Committee throughout 2019 as permitted under the UK Corporate Governance Code.

Advisers to the Remuneration Committee

During 2019, 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 £95,900. 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 or its Directors that may impair their independence. The Committee reviewed the potential for conflicts of interest and judged that there were appropriate safeguards against such conflicts.

2019 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 Pearson's Executive management (who report directly to the Chief Executive). 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.

→ Set termination arrangements

- Advise and decide on general and specific remuneration arrangements in connection with the termination of employment of Executive management.

→ Determine Chair's remuneration

- Delegated responsibility for determining the remuneration and benefits package of the Chair 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

- Appoint and set the terms of engagement for any remuneration review updates from management on talent, retention and gender pay gap.

Remuneration Committee meeting focus during 2019

During the year the Committee undertook the following activities:

- Reviewed remuneration philosophy for the company and how this will apply to Executive Directors and senior management.
- Developed the Remuneration Policy for 2020, taking into account Pearson's strategy, Remuneration Principles, wider workforce remuneration, emerging best practice and corporate governance developments.
- Reviewed shareholder and shareholder representative body feedback on remuneration, shareholder voting at Pearson's 2019 AGM and considered shareholder engagement strategy. Received input from investor relations on market expectations.
- Received updates on financial performance of the business and progress against strategic measures. Noted and reviewed the status of in-flight incentives.
- Reviewed and approved 2018 annual and long-term performance and payouts for Executive Directors and senior management.
- Reviewed and approved implementation of Remuneration Policy for 2020 for Executive Directors and senior management, including annual salary increases, incentive opportunities, performance targets and strategic measures.
- Noted updates on corporate governance, including a review of the 2019 AGM remuneration reporting season.
- Noted the activity of the Standing Committee of the Board in relation to the operation of the company's equity-based reward programmes and noted the company's use of equity for employee share plans.

Committee evaluation

Annually, the Committee reviews 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 review of its performance and effectiveness in October 2019, looking at areas such as the use of time, the opportunity for discussion and debate, dialogue with management and shareholders, and access to independent advice. The Committee concluded that remuneration continues to be a sensitive and high-profile area but that the support provided and the calibre of the papers were good. That said, given the pace and the scale of strategic developments at Pearson, the Committee remains vigilant in assessing the extent to which its activities support and enable progress in the company.

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 (2019 AGM)	97.9% (617,786,062)	2.1% (13,041,115)	104,839
2017 Remuneration Policy vote (2017 AGM)	68.8% (404,615,934)	31.2% (183,100,737)	43,738,267

2020 remuneration policy

The Remuneration Committee presents the 2020 Directors' Remuneration Policy (2020 Policy), which will be put to shareholders for binding vote at the AGM to be held on 24 April 2020. Subject to shareholder approval, the effective date of this Policy will be 24 April 2020. However, it is proposed, subject to approval at the AGM, that changes to Executive Director incentives be made effective from the start of the 2020 performance periods. The intention of the Committee is that the Policy will remain in place for three years from the date of its approval.

In 2019, Pearson reviewed its remuneration philosophy and developed a set of remuneration principles that govern the whole organisation. We have evolved our Remuneration Policy to align with these updated remuneration principles:

1
Aligned to longer-term strategy

Reward will be linked to achieving Pearson's longer-term strategy, growth and sustainability

2
Pay for performance

Remuneration framework and outcomes are aligned with performance

3
Market competitive

Pay levels will be market competitive, based on role, grade and contribution to ensure individuals are fairly rewarded in line with the market

4
Targeted differentiation

There will be targeted differentiation of reward across our employees linked to talent and performance management

5
Tailored

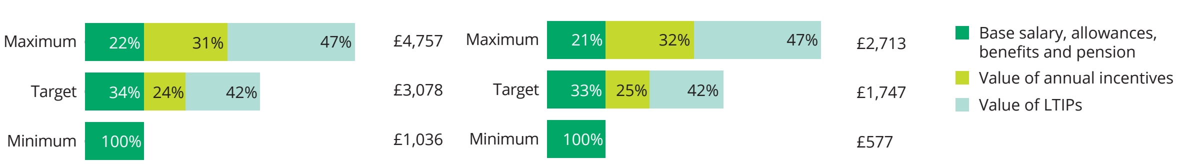
The approach to reward may be tailored in certain circumstances to address a specific market/business need but will be designed in a way which is consistent with our underlying reward philosophy

6
One part of the employee value proposition

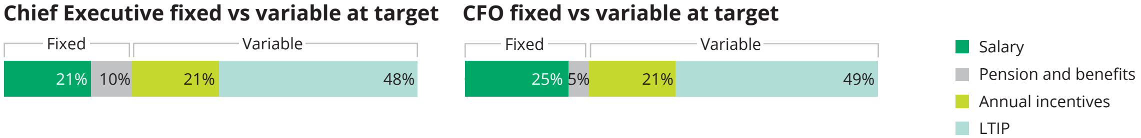
Remuneration is one part of our broader employee value proposition and not the only reason to work for Pearson

Pay and performance scenario analysis

Chief Executive (John Fallon) £000 **CFO (Sally Johnson)** £000



Chief Executive fixed vs variable at target **CFO fixed vs variable at target**



Performance scenario	Elements of remuneration and assumptions
Maximum	› Fixed pay › Maximum individual annual incentive (180% of salary for Chief Executive and 170% of salary for CFO) › Maximum value of 2020 long-term incentive award (275% for Chief Executive and 245% for CFO) with no share price growth assumed
Target	› Fixed pay › 50% of the maximum individual annual incentive › 50% of the maximum value of 2020 long-term incentive award (no share price growth assumed)
Minimum	› Fixed pay only

Consistent with its Policy, the Committee places considerable emphasis on the performance-linked elements, i.e. annual and long-term incentives. The charts above show what each Director could expect to receive in 2020 under different performance scenarios, based on the definitions of performance opposite. On this basis, the relative weighting of fixed and performance-related remuneration and the absolute size of the remuneration packages for the Chief Executive and the Chief Financial Officer are shown above. We will continue to review the mix of fixed and performance-linked remuneration on an annual basis, consistent with our overall Policy.

Note 1: Fixed pay includes 2020 base salary (Chief Executive £817,400, CFO £515,000); allowances and benefits and retirement benefits for Sally Johnson have been included based on the same percentage of base salary as Coram Williams in 2019. Retirement benefits for John Fallon are included at 23% of his base salary.

Note 2: The value of long-term incentives does not take into account dividend awards that are payable on the release of LTIP shares or share price growth.

Note 3: The maximum opportunity scenario plus 50% share price growth would result in overall opportunity of £5,882,000 for the Chief Executive and £3,348,000 for the CFO.

Note 4: Coram Williams will step down as CFO at the AGM in 2020. Until this time, he will be paid his base salary and benefits.

2020 remuneration policy

Policy table for Executive Directors

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different strategic objectives. Remuneration is normally reviewed annually in the context of business performance and conditions prevailing, taking into account pay levels for similar positions in comparable companies as well as internal ratios.

B Base salary

Purpose and link to strategy

- Helps to recruit, reward and retain.
- Reflects level, role, skills, experience, the competitive market and individual contribution.

Operation

Base salaries are set to provide the appropriate rate of remuneration for the job, taking into account relevant recruitment markets, business sectors and geographic regions.

Base salaries are normally reviewed annually taking into account: general economic and market conditions; 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 in both the UK, US and internationally; and individual performance.

Opportunity

While there is no maximum salary level or maximum increase that may be offered, salary increases will normally be in line with typical increases awarded to other employees in the Group.

However, increases may be above this level in certain circumstances such as:

- Where a new Executive Director has been appointed to the Board at a lower than typical market salary to allow for growth in the role then larger increases may be awarded to move salary positioning closer to typical market level as the Executive Director gains experience.
- Where an Executive Director has been promoted or has had a change in responsibilities.
- Where there has been a significant change in market practice or where there has been a significant change in the size and/or scope of the business.

Performance conditions and period

None, although performance of both the company and the individual are taken into account when determining an appropriate level of base salary increase each year.

A&B Allowances and benefits

Purpose and link to strategy

- Help to recruit, reward and retain.
- Reflect local competitive market.

Operation

Allowances and benefits comprise cash allowances and non-cash benefits which may include:

- travel-related benefits (such as car allowance, company car and private use of a driver)
- health-related benefits (such as healthcare, health assessment and gym subsidy) and
- risk benefits (such as additional life cover and long-term disability insurance that are not covered by the company's retirement plans).

Executive Directors are also eligible to participate in savings-related share acquisition programmes, which are not subject to any performance conditions, on the same terms and to the same value as other employees.

Where an Executive Director is required to relocate to perform their role, appropriate one-off or ongoing expatriate/relocation benefits may be provided (e.g. housing, schooling, etc.)

The Committee may introduce other benefits if it is considered appropriate to do so, taking into account the individual circumstances, the country of residence of a Director, the benefits available to all employees and the wider external market.

Opportunity

The cost of the provision of allowances and benefits varies from year to year depending on the cost to Pearson and there is no prescribed maximum limit. However, the Committee monitors annually the overall cost of the benefits provided, to ensure that it remains appropriate.

R Retirement benefits

Purpose and link to strategy

- Help to recruit, reward and retain.
- Recognise long-term commitment to the company.

Operation

Employees in the UK are eligible to join the Money Purchase 2003 section of the Pearson Pension Plan. Executive Directors are eligible to join this plan or receive a cash allowance of equivalent value.

If any Executive Director is from, or works, outside the UK, the Committee retains a discretion to put in place retirement benefit arrangements for that Director in line with local market practice including defined benefit pension arrangements operated by Pearson locally. The maximum value of such arrangement will reflect local market practice at the relevant time.

The Committee may also honour all pre-existing retirement benefit obligations, commitments or other entitlements that were entered into by a member of the Pearson Group before that person became a Director, such as participation in the Final Pay section of the Pearson Pension Plan which is now closed to new members.

Opportunity

New appointments: new appointments to the Board are eligible to receive pension contributions of up to 16% of pensionable salary or a cash allowance of up to 16% of salary in line with the maximum company contribution as a percentage of salary that UK employees who are over 45 are eligible to receive.

Current Chief Executive: John Fallon is a member of the Final Pay section of the Pearson Pension Plan. His pension accrual rate is 1/30th of pensionable salary per annum, restricted to the Plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS of 26% of salary.

John Fallon attained the maximum service accrual under the Final Pay section of his pension benefit when he reached 20 years' service in October 2017. Since this time, John Fallon receives the pension supplement of 26% of salary only.

The Committee reviewed the approach to John Fallon's pension in light of shareholder views and best practice and agreed with the Chief Executive that his pension allowance would be reduced on a phased basis over the next three years to bring it in line with the UK workforce of 16% of salary.

Notwithstanding his planned retirement, John Fallon's cash pension allowance has been reduced by 3 percentage points to 23% of salary as the first step on this planned phased reduction.

CFO-elect: Sally Johnson is also a member of the Final Pay section of the Pearson Pension Plan. Her pension accrual rate is 1/60th of pensionable salary per annum, restricted to the Plan earnings cap.

UK Executive Directors who are, or become, affected by the lifetime allowance may be provided with appropriate benefits, as an alternative to further accrual of pension benefits such as a cash supplement, in line with the treatment for the employee population.

SG Shareholding guidelines

Purpose and link to strategy

- Align the interests of Executives and shareholders and encourage long-term shareholding and commitment to the company.

Operation

Executive Directors are expected to build up a shareholding in the company.

Executive Directors are expected to reach the guideline within five years from the date of appointment.

Post-employment shareholding:

Executive Directors are expected to retain their shareholding guideline (or actual holding if lower) for two years following stepping down as an Executive Director. This provision does not apply to any shares purchased by the Executive Director.

Opportunity

The target holding is 300% of salary for the Chief Executive and 200% of salary for other Executive Directors.

Performance conditions and period

Not applicable.

2020 remuneration policy

AIP Annual incentive plan

Purpose and link to strategy

- Help to recruit, reward and retain.
- Motivate the achievement of annual business goals and strategic objectives.
- Provide a focus on key financial and non-financial metrics.
- Reward individual contribution to the success of the company.
- Align to strategy execution priorities.

Operation

Measures and performance targets are set by the Committee at the start of the year with payment made after year end following the Committee's assessment of performance relative to targets.

Annual incentive plans are discretionary. The Committee reserves the right to adjust payments up or down if it believes that the outcome does not reflect underlying financial or non-financial performance or if such other exceptional factors warrant doing so.

The Committee may apply malus and/or clawback for a period of five years in certain circumstances, such as financial misstatement, individual misconduct or reputational damage to the company.

Opportunity

Annual incentives will not exceed 200% of base salary.

For the Chief Executive, the individual maximum incentive opportunity that will apply for 2020 is 180% of base salary and 170% for the Chief Financial Officer (which are the same opportunities as applied for 2019).

There is normally no payout for performance at threshold.

50% of the maximum opportunity is payable for on-target levels of performance.

Performance conditions and period

The Committee has the discretion to select the performance measures and relative weightings from year to year to ensure continuing alignment with strategy and to ensure targets are sufficiently stretching. The Committee sets performance targets for each measure annually.

Annual incentives will normally be based on financial and strategic performance targets. Financial metrics will account for at least 75% of the total annual opportunity with the remaining portion normally being based on strategic and/or performance against personal objectives. Financial measures currently account for 80% of the total funding, The Committee would intend to consult with shareholders in advance if there was to be a significant change in the weighting of financial and strategic measures.

The plan is designed to incentivise and reward underlying performance. Actual results may be adjusted to remove the effect of foreign exchange and portfolio changes (acquisitions and disposals) and other relevant factors that the Committee considers do not reflect the underlying performance of the business in the performance year.

Details of performance measures, weightings and targets will be disclosed in the annual remuneration report for the relevant financial year if and to the extent that the Committee deems them to be no longer commercially sensitive.

The performance period is one year.

LTIP Long-term incentive plan

Purpose and link to strategy

- Help to recruit, reward and retain.
- Drive long-term earnings, share price growth and value creation.
- Align the interests of executives and shareholders.
- Encourage long-term shareholding and commitment to the company.

Operation

Awards of shares are made on an annual basis, which vest on a sliding scale based on performance against stretching corporate performance targets measured at the end of the three-year performance period.

Awards are normally subject to a post vesting holding period for two years following the end of the performance period. For awards granted prior to 2020, the holding period applied will be in line with the approach set out in the Directors' Remuneration Policy in place at the time of award.

Participants may receive additional shares representing the gross value of dividends that would have been paid on shares that vest during the performance period.

The Committee reserves the right to adjust payouts up or down before they are released if it believes that the vesting outcome does not reflect underlying financial or non-financial performance or if such other exceptional factors warrant doing so. In making such adjustments, the Committee is guided by the principle of aligning shareholder and management interests.

The Committee may apply malus and/or clawback for a period of five years in certain circumstances, such as financial misstatement, individual misconduct or reputational damage to the company.

Opportunity

The maximum award is 350% of base salary in respect of a financial year.

For 2020, the incoming CFO will be granted an award of 245% of salary.

Performance conditions and period

The Committee will determine the performance measures, weightings and targets governing an award of shares prior to grant to ensure continuing alignment with strategy and to ensure that targets are sufficiently stretching.

The Committee establishes a threshold below which no payout is achieved and a maximum at or above which the award pays out in full. The proportion of the award that vests at threshold may be up to 25%.

Awards will normally be subject to the achievement of targets for earnings per share, a return on measure and relative total shareholder return (weighted equally). The Committee may determine that different measures or weightings may apply for future awards; however, the Committee would intend to consult with shareholders in advance if there was to be a significant change in the weighting of measures or the performance measures used.

The performance period is three years.

2020 remuneration policy

Notes to the Policy table

Changes to Policy

The key changes to this Policy compared to the 2017 Policy are summarised below:

- Policy limits and measures – The exceptional maximum limits under base salary, benefits and LTIP have been removed to improve transparency for shareholders around how we intend to implement the Policy. Additional flexibility has been provided to allow for changes to performance measures for future years.
- LTIP limit reduced – The normal maximum potential LTIP award has also been reduced from 400% of salary to 350% of salary to bring it more in-line with how we have implemented the Policy in recent years.
- Target AIP – In order to align with shareholder expectations, the AIP paid for 'on target' performance will be no more than 50% of the maximum potential. This results in a reduction in target AIP opportunity for the Chief Executive from 100% of salary to 90% of salary with no change to maximum opportunity.
- Simplified the holding period – We have simplified the structure of the LTIP holding period to reflect typical market practice. 100% of the LTIP award (for 2020 onwards) will be subject to a two-year holding period following the end of the three-year performance period (i.e. five years from award).
- Best practice – Changes have been made to the Policy to reflect the adoption of the 2018 UK Corporate Governance Code (including to incorporate changes outlined in previous Directors' remuneration reports) as well as other areas of best practice. These include:
  - Pensions for new appointments – Pension arrangements for new appointments have been aligned with the pension arrangements available to the majority of UK employees of a similar age.
  - Pension for the Chief Executive – Chief Executive pension opportunity is being reduced in stages over three years to 16% of base salary to align with the rate available to UK employees.
  - Post-employment guideline – These guidelines have been formalised in the Policy and enhanced such that 100% of in-employment guideline is expected to be retained for two years following ceasing to be an Executive Director.
- Other minor changes have been made to the wording of the Policy to simplify and aid its operation and to increase clarity.

In determining the new Remuneration Policy, the Committee followed a robust process which included discussions on the content of the Policy at four Remuneration Committee meetings in 2019. The Committee considered the input from our independent advisors and management, and sought the views of Pearson's major shareholders. Further information on the Committee's decision-making process is set out in the remuneration report.

Selection of performance measures and target setting

In the selection and weighting of performance measures for the annual and long-term incentive awards, the Committee takes into account Pearson's strategic objectives and short and long-term business priorities.

Annual incentive plan AIP	For 2020, the Committee identified sales, adjusted operating profit, operating cash flow and key strategic business imperatives as being relevant measures of Pearson's performance against its shorter-term strategic objectives and business priorities.
Long-term incentive plan LTIP	For 2020 awards, the Committee has judged the following to be most closely matched to sustained delivery of strategy and alignment with shareholders' interests: › Adjusted earnings per share rewards the delivery of the desired outcomes from our strategic growth objectives and is imperative if the company is to improve our total shareholder return and our return on invested capital. › Return on invested capital is used to track investment returns and to help assess capital allocation decisions within the business. › Total shareholder return relative to the constituents of the FTSE 100 is used as the Committee believes, in line with many of our shareholders, that part of Executive Directors' rewards should be linked to long-term performance relative to companies of comparable size, scale and maturity that are similarly impacted by global macro-economic influences.

The performance ranges chosen set a careful balance between upside opportunity and downside risk and are normally based on targets in accordance with the company's operating and strategic plans.

The charts on p97 illustrate how remuneration will be implemented in 2020 based on threshold, target and maximum performance scenarios.

Pre-existing commitments

The Committee reserves the right to make remuneration payments and payments for loss of office (which includes exercising related discretions) that are not in line with this Policy if the terms of the payment were agreed:

1. before the Policy came into effect, if the payment was agreed or made in line with the policy in force at the time or was otherwise approved by shareholders; and
2. at a time when the recipient was not subject to the Policy, provided the Committee does not consider the payment to have been made in consideration of the recipient becoming subject to the Policy.

For these purposes 'payment' means any payment that would otherwise be subject to the Policy and, in relation to a share award, will not be considered to have been 'agreed' any later than the date of grant.

Remuneration policy for other employees

During the year, the Committee reviewed and developed a revised set of remuneration principles, which shape how we develop our remuneration policies. The principles are consistent across the employee population but how they are applied varies by business need, level and geography as required.

Our remuneration policy is as follows:

- The approach to setting base salary increases elsewhere in the company takes into account economic factors, competitive market rates, roles, skills, experience and individual performance.
- Allowances and benefits for employees reflect the local labour market in which they are based.

- Around 1,200 employees participate in an Annual Incentive Plan. The funding for the plan is based on the same performance conditions as those used for the Executive Directors. A number of other employees participate in other forms of cash-based annual incentive such as profit-share or sales commission plan based on performance targets.
- Share incentive plans for the Pearson Executive management team form the basis of the incentive plans throughout the organisation, establishing performance measures and standards and setting the ceiling for individual incentive opportunities. Approximately 5% of the company's employees below the Pearson Executive management team – selected on the basis of their role, performance and potential – participate in share incentive plans.
- All eligible employees (including Executive Directors) are also eligible to participate in savings-related share acquisition programmes in the UK, US and the rest of the world, which are not subject to any performance conditions.
- Pearson employees in the UK may participate in the same underlying pension arrangements as the Executive Directors, subject to certain age bands and legacy arrangements.

Recruitment

The Committee expects any new Executive Directors to be engaged on the same terms and to be awarded variable remuneration within the same normal limits and subject to the same conditions as for the current Executive Directors outlined in the policy.

The maximum level of variable remuneration which may be awarded (excluding any 'buyout' awards referred to above) in respect of recruitment is 550% of salary, which is in line with the current maximum limit under the annual bonus and LTIP.

In setting the basic salary for any new Executive Director, the Committee will apply a level appropriate to recruit a suitable candidate, having regard to the factors set out in the future policy table.

The Committee recognises that it cannot always predict accurately the circumstances in which any new Directors may be recruited. The Committee may determine that it is in the interests of the company and shareholders to secure the services of a particular individual which may require the Committee to take account of the terms of that individual's existing employment and/or their personal circumstances. The Committee may do this in the following circumstances:

- Where an individual is relocating in order to take up the role, in which case the company may provide certain benefits such as reasonable relocation expenses, accommodation for a short period following appointment and assistance with visa applications or other immigration issues and ongoing arrangements such as tax equalisation, annual flights home, schooling and housing allowance.
- Where an individual forfeits outstanding variable pay opportunities or contractual rights at a previous employer as a result of appointment, the Committee may offer compensatory payments or awards, in such form as the Committee considers appropriate taking into account all relevant factors including the form of awards, expected value and vesting timeframe of forfeited opportunities. The Committee would require reasonable evidence of the nature and value of any forfeited award and would, to the extent practicable, ensure any compensation was provided on a like-for-like basis and was no more valuable than the forfeited award.

In making any decision on any aspect of the remuneration package for a new recruit, the Committee would balance shareholder expectations, current best practice and the requirements of any new recruit and would strive not to pay more than is necessary to achieve the recruitment. The Committee would give full details of the terms of the package of any new recruit in the next annual remuneration report.

Where an existing employee of the company is promoted to the Board, the company may honour all existing contractual commitments including any outstanding share awards and benefits, including pensions.

Pearson expects any new Chair or Non-Executive Director to be engaged on terms that are consistent with the general remuneration principles outlined in the relevant sections of this Policy.

Service contracts and termination provisions

In accordance with long established policy, all Executive Directors have service agreements under which, other than by termination in accordance with the terms of these agreements, employment continues indefinitely.

There are no special provisions for notice or non-share-based compensation in the event of a change of control of Pearson.

It is the company's policy that the company may terminate the Chair's and Executive Directors' service agreements by giving no more than 12 months' notice.

Payment in lieu of notice

As an alternative, for Executive Directors the company may at its discretion pay in lieu of that notice. Payment in lieu of notice may be made in equal monthly instalments from the date of termination to the end of any unexpired notice period. Payment in lieu of notice in instalments may also be subject to mitigation and reduced taking into account earnings from alternative employment.

For Executive Directors, payment in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. For the Chair, payment in lieu of notice comprises 100% of the annual fees at the date of termination.

The company may, depending on the circumstances of the termination, determine that it will not pay the Director in lieu of notice and may instead terminate a Director's contract in breach and make a damages payment, taking into account as appropriate the Director's ability to mitigate his or her loss.

The company may also pay an amount considered to be reasonable by the Remuneration Committee in respect of fees for legal and tax advice and outplacement support for the departing Director. The Committee reserves the right to make any other payments in connection with a Director's cessation of office or employment where the payments are made in good faith, in discharge of an existing legal obligation (or by way of damages for breach of such an obligation) or by way of settlement of any claim arising in connection with the cessation of a Director's office or employment.

Share awards

On cessation of employment, unless otherwise provided for under the rules of Pearson's discretionary share plans, Executive Directors' entitlements to any unvested awards lapse automatically. In the case of injury, disability, ill-health or redundancy (as determined by the Committee), where a participant's employing company ceases to be part of Pearson, or any other reason if the Committee so decides in its absolute discretion:

2020 remuneration policy

- awards will stay in force as if the participant had not ceased employment and shall ordinarily vest on the original vesting date/be released in line with normal time horizons subject to performance conditions.
- the number of shares that are released shall be pro-rated for the period of the participant's service in the restricted period (although the Committee may in its absolute discretion waive or vary the pro-rating).

In determining whether and how to exercise its discretion under Pearson's discretionary share plans, the Committee will have regard to all relevant circumstances distinguishing between different types of leaver, the circumstances at the time the award was originally made, the Director's performance and the circumstances in which the Director left employment.

The rules of Pearson's discretionary share plans also make provision for the treatment of awards in respect of corporate activity, including a change of control of Pearson. The Committee would act in accordance with the terms of the awards in these circumstances, which includes terms as to the assessment of performance conditions and time apportionment.

Annual bonus
On cessation of employment, Executive Directors may, at the Committee's discretion, retain entitlement to a pro rata annual incentive for their period of service in the financial year prior to their leaving date. Such payout will normally be calculated in good faith on the same terms and paid at the same time as for continuing Executive Directors.

Other elements of remuneration
Eligibility for allowances and benefits including retirement benefits (other than pension payments in connection with subsequent retirement) normally ceases on retirement or on the termination of employment for any other reason.

Individual service agreements

Details of each individual's service agreement are outlined in the table below. Employment agreements for other employees are determined according to local labour law and market practice.

Position	Date of agreement	Notice periods	Compensation on termination of employment by the company without notice or cause
Chair	25 October 2015	12 months from the Director; 12 months from the company	Payment in lieu of notice of 100% of annual fees at the date of termination
Executive Directors	31 December 2012 (John Fallon) 26 February 2015 (Coram Williams) 15 January 2020 (Sally Johnson)	6 months from the Director; 12 months from the company	Payment in lieu of notice of 100% of annual salary at the date of termination and the annual cost of pension and all other benefits

Note Under payment in lieu of notice, the annual cost of pension for Executive Directors is normally calculated as the sum, where applicable, of: an amount equal to the company's cost of providing the Executive's pension under the pension plan based on the Future Service Company Contribution Rate for the relevant section of the pension plan as stated in the most recent actuarial valuation (as at the date of termination of employment) as limited by the earnings cap; and any cash allowance in lieu of pension or to take account of the fact that pension benefits and life assurance cover are restricted by the earnings cap.

Non-Executive Directors serve Pearson under letters of appointment which are renewed annually and do not have service contracts. For Non-Executive Directors, there is no notice period or entitlement to compensation on the termination of their directorships.

Executive Directors' non-Executive Directorships

The Committee's policy is that Executive Directors may, by agreement with the Board, serve as non-executives of other companies and retain any fees payable for their services.

Employment conditions

Under the Committee's charter and terms of reference, the Committee's remit includes determining remuneration for the Chief Executive, other Executive Directors and other members of the Pearson Executive management team. In addition, the Committee's remit includes oversight of certain remuneration matters below this level. Before the remuneration packages for the Pearson Executive management team are set for the year ahead, the Committee considers reports from the Chief Executive on general morale and Chief Human Resources Officer on retention, general pay trends in the market and the level of pay increases and incentives across the company as a whole. This helps to ensure that Executive remuneration packages are reviewed in the context of the wider organisation.

The company consults with various employee representative bodies – including trade unions and works councils in some jurisdictions – about the company's strategy, competitiveness and performance of the business and other matters affecting employees. The company also conducts an employee engagement survey to find out how people feel about working for Pearson, what they think about the work they do, the opportunities they have and the rewards they get (including a section on pay and benefits). The company uses all of this feedback to inform decisions on people-related activities, resources and investment, local management action plans and wider business unit and organisational strategies.

It is the company's intention to continue to engage with employees and employee representatives in this way in the future.

The Committee has not consulted directly with employees on the setting of the Directors' Remuneration Policy.

Shareholder views

The company consults regularly with shareholders on all matters affecting its strategy and business operations. As part of that process, we also engage with shareholders on matters relating to Executive remuneration. The Committee continues to monitor and respond to best practice guidelines of shareholders and their representative bodies.

Over the past three years, we have undertaken a thorough review of our Executive Director Remuneration Policy and its implementation. As part of this review, we engaged extensively with our shareholders to ensure Executive remuneration is set appropriately, rewards for performance and aligns management with the shareholder experience. We would like to thank our shareholders for the time they have spent with us in this regard.

In January 2020, we wrote to our key shareholders and the voting advisory agencies, seeking their views on the proposed changes to Pearson's Directors' Remuneration Policy. We received valuable feedback on a number of points, which reflected a significant range of opinions. This feedback has been helpful to the Committee in formulating policy and is much appreciated.

We are committed to continued engagement going forward.

Future policy table for Chair's and Non-Executive Directors' remuneration

The table below summarises policy with respect to the remuneration of the Chair and Non-Executive Directors:

Chair and Non-Executive Director remuneration

Purpose and link to strategy

› To attract and retain high-calibre individuals, with appropriate experience or industry-relevant skills, by offering market competitive fee levels.

Operation	Opportunity	Performance conditions and period
The Chair is paid a single fee for all of their responsibilities. The Chair's fee is set at a level that is competitive with those of chairmen in similar positions in comparable companies. The Non-Executive Directors are paid a basic fee. The Committee Chairs, members of the main Board Committees and the Senior Independent Director are paid an additional fee to reflect their extra responsibilities. Fees for Non-Executive Directors are determined by the full Board having regard to market practice. Additional fees or other payments may be paid to reflect additional responsibilities, roles or contribution, as appropriate. The Chair and Non-Executive Directors are not entitled to any annual or long-term incentive, retirement or other employee benefits. Selected benefits may be introduced, if considered appropriate. The company reimburses the Chair's and Non-Executive Directors' travel and other business expenses and any tax incurred thereon, if applicable. Normally a minimum of 25% of the Chair's and Non-Executive Directors' basic fee is paid in Pearson shares that the Non-Executive Directors have committed to retain for the period of their directorships. Shares are normally acquired quarterly at the prevailing market price with the individual's after-tax fee payments.	Fee levels are reviewed on a periodic basis. The total fees payable to the Non-Executive Directors (excluding the Chair) are subject to the limit set out in the Articles of Association of the company (currently £750,000) and as increased by ordinary resolution from time to time.	None.

Implementation of remuneration in 2020

B Base salaries

Given their planned departures from the Board, no salary increases were awarded for John Fallon and Coram Williams. Salaries effective 1 April 2020:

John Fallon	£817,400 (0%)
Coram Williams	£539,500 (0%)

Sally Johnson will receive a salary of £515,000 per annum from her appointment on 24 April 2020. This is in line with Coram Williams' starting salary in 2015.

A&B Allowances and benefits

There will be no changes to allowances and benefits allowances for John Fallon and Coram Williams in 2020. Sally Johnson's allowances and benefits are in line with policy.

R Retirement benefits

The Committee reviewed the approach to the Chief Executive's pension in light of shareholder views and best practice and agreed with John Fallon that his pension allowance would be reduced on a phased basis over the next three years to bring it in line with the UK workforce of 16% of salary. Notwithstanding his planned retirement, John Fallon's cash pension allowance has been reduced by 3 percentage points to 23% of salary as the first step on this planned phased reduction.

Coram Williams will continue to be a part of the Final Pay Section of the Pearson Pension Plan until his leave date, accruing at 1/60th of pensionable salary per annum.

Sally Johnson is a member of the Final Pay Section of the Pearson Pension Plan and will continue to accrue pension at a rate of 1/60th of pensionable salary per annum, restricted to the Plan earnings cap, in line with other participants in the Plan.

AIP Annual incentive plan

John Fallon will continue to participate in the AIP until his retirement date. Coram Williams will not be eligible for an AIP payment in respect of 2020.

AIP opportunity will be pro-rated to reflect the period of the year served for John Fallon and Sally Johnson.

Maximum annual opportunity will remain unchanged for 2020:

Chief Executive	180% of base salary
CFO	170% of base salary

The Chief Executive's target AIP opportunity will be reduced to 50% of the maximum opportunity, from 100% of salary to 90% of salary. The CFO-elect's target AIP opportunity will be unchanged at 50% of maximum opportunity (85% of salary).

For 2020, the mix of performance measures has been changed to reflect Pearson's focus on delivering top-line growth as well as operational efficiencies. The following financial and strategic measures will be used:

Adjusted operating profit	Sales	Operating cash flow	Strategic measures
30%	30%	20%	20%

2020 strategic measures will align with our continued efforts to accelerate the digital transformation of the company (10%), make the most of Pearson's world of talent (5%) and create a simpler and more sustainable organisation (5%).

Targets are considered by the Board to be commercially sensitive and will be disclosed in the 2020 Directors' remuneration report.

LTIP Long-term incentive plan

Coram Williams and John Fallon will not be eligible for an LTIP award in 2020.

The LTIP award level for the incoming CFO is 245% of base salary (which is the same award opportunity as for Coram Williams in 2017, 2018 and 2019), reflecting the 2017 discounts to LTIP awards in light of share price performance.

The Committee believes that a further reduction in the incoming CFO's award level is not appropriate, beyond the discount already applied. This discount was set at a time when the share price was comparable to the current share price and the Committee considered that alignment between management and shareholders would be better supported by maintaining her level of grant at 245% of salary in 2020.

Performance metrics, weightings and targets

Performance will continue to be tested over three years.

At the time of writing, the strategic goals for the company over the next three years were still under development by the Board. The targets for the 2020 LTIP grant will therefore be made available on the website before the AGM and disclosed in the RNS announcement accompanying the grant, which is expected to be in May as normal. The Committee remains committed to timely/prompt disclosure of targets once they have been confirmed.

Full details of the award will also be included in the annual remuneration report for 2020.

Chair and Non-Executive Director fees

The fees for the Reputation & Responsibility Committee have been increased to £15,000 and £8,000 to recognise the increasing responsibilities of that Committee. There will be no other changes to fees for 2020:

Role	Fees for 2020
Chair 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	£15,000	£8,000

The Directors' remuneration report has been approved by the Board on 6 March 2020 and signed on its behalf by:

Elizabeth Corley
Chair of the Remuneration Committee.

Additional disclosures

Pages 52–112 of this document comprise the Directors' report for the year ended 31 December 2019.

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 p50, the Board has also reviewed the prospects of Pearson over the three-year period to December 2022 taking account of the company's three-year plan, a 'severe but plausible' downside case and further stress-testing based on the principal risks set out from p40

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 2022. Further details of the Group's liquidity are shown in the Financial review on p33

Share capital

Details of share issues and cancellations are given in note 27 to the financial statements on p178. 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 2019, 782,098,929 ordinary shares were in issue. At the AGM held on 26 April 2019, the company was authorised, subject to certain conditions, to acquire up to 78,141,414 ordinary shares by market purchase and to issue up to 520,942,760 ordinary shares. Shareholders will be asked to renew this authority at the AGM on 24 April 2020.

Share buyback

In December, we announced the sale of our 25% stake in Penguin Random House to Bertelsmann, generating total net proceeds of approximately $675m. The partial divestment of our stake in Penguin Random House was in line with our strategy for simplification and allowed us to create significant shareholder value through the synergies from the integration of the two businesses. Our stake in Penguin Random House will have generated c.£1.9bn in net disposal proceeds and dividends.

We have set out clear capital allocation priorities as follows:

- Maintaining a strong balance sheet and solid investment-grade credit ratings through an appropriate capital structure. Accordingly, we intend to maintain a year-end net debt/EBITDA of less than 2.2x on a post IFRS 16 basis and 1.5x on a pre IFRS 16 basis.
- Simplifying our portfolio and investing in the business to drive sustainable organic growth.
- Delivering shareholder returns through a sustainable and progressive dividend policy, returning surplus cash to shareholders where appropriate through buybacks or special dividends.

In line with those priorities, the Board decided that we would use the proceeds from the transaction to maintain a strong balance sheet and invest in our business in addition to returning £350m of surplus capital to shareholders following the closing of the transaction.

The Board considered investor views on preferred methods of cash return, the amount being returned and other factors and concluded a share buyback was the most appropriate methodology to return that capital to our shareholders at that time.

We commenced a £350m share buyback programme on 16 January 2020. As of 3 March 2020, being the latest practicable date before the publication of this report, we had repurchased for cancellation 18,356,161 shares at an average price of 574 pence per share.

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 2019, 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	97,302,791	12.44%
Lindsell Train Limited	78,465,444	10.04%
Silchester International Investors LLP	77,889,093	9.98%
BlackRock, Inc.	50,946,154	6.51%
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.

Additional disclosures

Between 31 December 2019 and 3 March 2020, 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:

	Number of voting rights	Percentage as at date of notification
Schroders plc	101,370,711	13.00%
Silchester International Investors LLP	85,106,480	11.00%

Annual General Meeting

The notice convening the AGM, to be held at 12 noon on Friday, 24 April 2020 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 23 March 2020.

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 2,095,272 shares held as at 31 December 2019. 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 2,515,611 shares held in the Sharestore account and 902,514 shares held in the Global Nominee account as at 31 December 2019. 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 email 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.

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 a general meeting).

Additional disclosures

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 2019 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.

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 2019, the Group had a $1,190m revolving credit facility agreement dated August 2014 (amended February 2019) which matures in February 2024 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. 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) and by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended) 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	**p30**
Financial instruments and financial risk management	**p165**
Important events since year end	**p34**
Future development of the business	**p6**
Research and development activities	**p27**
Employment of disabled persons	**p22**
Employee involvement	**p21**
Greenhouse gas emissions	**p22**
Statement describing employee engagement	**p28**
Statement describing regard to suppliers, customers and other stakeholders' interests	**p28**

With the exception of the dividend waiver described on p108 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 2019. 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, 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	**M M Lynton**
S L Coutu (appointed on 1 May 2019)	**G D Pitkethly** (appointed on 1 May 2019)
V Cox	**T Score**
J J Fallon	**S Taurel**
S J Lewis	**L A Wallen**
L K Lorimer	**C Williams**

The Directors' report has been approved by the Board on 6 March 2020 and signed on its behalf by:

Stephen Jones
Company Secretary

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 p54–56, 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 6 March 2020 and signed on its behalf by:

Coram Williams
Chief Financial Officer

Financial statements

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Consolidated financial statements

Notes to the consolidated financial statements

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Independent auditors' report to the members of Pearson plc

Report on the audit of the financial statements

Opinion

In our opinion, Pearson plc's consolidated financial statements and company financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the company's affairs at 31 December 2019 and of the Group's profit and the Group's and the 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 company 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 consolidated 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 2019; 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 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 company.

Other than those disclosed in note 4 to the consolidated financial statements, we have provided no non-audit services to the Group or to the company in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview

Materiality

- Overall Group materiality: £27 million (2018: £25 million) based on approximately 5% of adjusted profit before tax.
- Overall company materiality: £49 million (2018: £45 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 four reporting components and specific audit procedures at a further eight components. In addition, we obtained an audit opinion on the financial information reported by the US component of 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: 73% of the Group's revenue; 73% of the Group's statutory profit before tax; and 73% of the Group's adjusted profit before tax.

Areas of focus for the 2019 audit were as follows:

- Carrying values of goodwill and acquired intangible assets (Group)
- Returns provisioning (Group)
- Recoverability of pre-publication assets (Group)
- Provisions for uncertain tax positions (Group)
- Finance transformation (Group)
- Disposals (Group)
- Risk of fraud in revenue recognition (Group)
- Carrying values of investments in subsidiaries (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.

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 failure to comply with UK and 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 preparation of 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 including estimates relating to revenue recognition 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;
- Identification and testing of significant manual journal entries; and
- Testing of 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.

Independent auditors' 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.

Significant issues considered by the Audit Committee

Key audit matter	How our audit addressed the key audit matter
→ Carrying values of goodwill and acquired intangible assets	
Refer to note 11 in the consolidated financial statements. The Group recorded goodwill of £2,139m (2018: £2,111m) and acquired intangible assets of £310m (2018: £451m) at 31 December 2019, including acquired customer lists, contracts and relationships, acquired trademarks and brands and acquired publishing rights. The carrying values of goodwill and intangible assets are dependent on estimates of future cash flows of the underlying cash generating units (CGUs) and there is a risk that if management does not achieve these cash flow estimates 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. In addition, management has changed the level at which certain reporting units are monitored and reported in 2019 as a result of the continued roll-out of the Group's new ERP system and following the disposal of the US K12 Courseware business, thereby requiring a change in CGU determination and a reallocation of goodwill to the new CGU groupings. An impairment charge of £65m has been recorded in 2019 relating to Brazil which has been applied against Brazil's acquired intangible assets.	We tested management's CGU reassessment and reallocation of goodwill within these newly defined CGUs and we evaluated the methodology applied by management to reallocate goodwill. We assessed whether return on asset measures encompassing goodwill are monitored or measured at a level lower than management's revised CGU groupings. We obtained management's value in use impairment model at 31 December 2019 and we tested its mathematical integrity, including validating forecasts and carrying values included in management's model. Our procedures have been focused on the North American Courseware, OPM, Core and Brazil CGUs where headroom is lower or more sensitive to changes in key assumptions. We agreed the forecast cash flows to Board approved budgets and strategic plans and we assessed how these budgets and strategic plans are compiled. We evaluated management's related judgements and estimates, including short-term revenue and operating profit growth rates, cash conversion, corporate cost allocations and restructuring savings. We compared management's forecasts and key assumptions to industry projections and comparable companies where this information was available. Management has applied a longer forecast period extending until 2030 for specific cash flow projections for the OPM CGU compared to the three year period covered by the Group's strategic planning process, which is applied to all other CGUs. We evaluated the rationale why a longer period was appropriate for OPM and why management was able to prepare reliable forecasts over the longer-term. 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 compared management's valuations with third party valuations implied by trading and transaction multiples of the Group's competitors where this information was available for specific CGUs. Where an impairment was identified by management relating to the Brazil CGU based on value in use, we tested the calculation of the impairment charge and we ensured that the fair value less costs of disposal would not give rise to a higher recoverable amount for this CGU. We performed our own independent sensitivity analyses to understand the impact of reasonably possible changes to key assumptions. We assessed the appropriateness of management's decision to provide additional disclosures about sensitivities in note 11 of the financial statements in relation to the North American Courseware, OPM, Core and Brazil CGUs. More broadly, we considered whether the disclosures in note 11 complied with IAS 36. Based on the procedures performed, we noted no material issues arising from our work.

Key audit matter	How our audit addressed the key audit matter
Returns provisioning	
Refer to notes 3 and 24 in the consolidated financial statements. The Group has provided £122m (2018: £173m) for sales returns at 31 December 2019. 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. In 2019, management changed its methodology to apply a two year historical returns average compared to three years previously in response to market changes and related changes to customer buying patterns.	We assessed management's evaluation of market trends and the Group's responses and we considered whether management's revised provisioning methodology is appropriate in this context. We tested the returns provision calculations at 31 December 2019 and we agreed inputs including historical sales and actual returns experience to underlying records. We performed detailed testing over shipment and returns levels around the year-end and we evaluated whether these gave rise to an increased risk of future returns. We considered the reduction in the provision for sales returns in 2019 by reference to the related reduction in US Higher Education Courseware sales. We evaluated whether management had adopted methods and reached estimates for future returns that were supportable and appropriate. Based on the procedures performed, we noted no material issues arising from our work.
Recoverability of pre-publication assets	
Refer to note 20 in the consolidated financial statements. The Group holds £870m (2018: £817m) of pre-publication assets at 31 December 2019. 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 we considered whether these policies had been consistently applied. We selected a sample of costs to test their magnitude and appropriateness for capitalisation. We evaluated the reasonableness of amortisation periods and profiles compared to sales forecasts and historical sales experience, 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 we obtained supporting evidence for management's explanations. Based on the procedures performed, we noted no material issues arising from our work.
Provisions for uncertain tax positions	
Refer to notes 7 and 34 in the consolidated financial statements. The Group is subject to several tax regimes due to the geographical diversity of its businesses. At 31 December 2019, the Group held provisions for uncertain tax positions of £152m (2018: £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 provisions relate to US tax, transfer pricing and tax on prior year disposals. In addition, there are material unprovided tax exposures related to EU state aid and a Brazilian tax authority assessment related to goodwill amortisation deductions. Changes in assumptions about the views that might be taken by tax authorities can materially impact the level of provisions recorded in the consolidated financial statements.	We engaged our tax specialists in the US and UK and we obtained an understanding of the Group's tax strategy and risks. We assessed the tax impact of business developments in 2019, including the disposal of the US K12 Courseware business and internal refinancing transactions. 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 of similar situations at comparable companies. We evaluated whether any risk of material misstatement existed for uncertain tax position provisioning outside of the US and UK. We evaluated the consistency of management's approach to establishing or changing prior provision estimates and we validated that changes in prior provisions reflected a change in facts and circumstances during 2019. Where provisions have not been established, including for material potential exposures like EU state aid and the assessment from the Brazilian tax authority, we evaluated the basis for management's judgements, including an assessment of the treatment of similar exposures at comparable companies. We evaluated third party advice obtained by the Group as we independently formed our own view about the likelihood of these possible tax risks crystallising in future cash outflows. We noted that the assumptions and judgements required to formulate these provisions mean that the range of possible outcomes is broad. We evaluated the disclosures in notes 7 and 34 in relation to uncertain tax provisions and we considered whether the disclosures were consistent with the underlying positions and with the requirements of IAS 1 and IAS 12. In addition, we considered the Group's application of IFRIC 23 with effect from 1 January 2019. Based on the procedures performed, we noted no material issues arising from our work.

Independent auditors' report to the members of Pearson plc

Key audit matter	How our audit addressed the key audit matter
Finance transformation	
The Group has continued to implement significant change across its finance function in 2019 with the continued roll-out of The Enabling Programme (TEP) and the organisational change resulting from implementing the target operating model. The ERP system roll-out continued in 2019 with certain US businesses going live and finance transaction processing activities were migrated to offshore shared service centres. 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 system environment and into new shared service centres. 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 transaction 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 after the migration including IT general controls and controls in respect of data migration into the new ERP system 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 substantive transaction testing to address any residual risk.
Disposals	
Refer to note 31 in the consolidated financial statements. In March 2019, the Group completed the disposal of its US K12 Courseware business, resulting in a pre-tax profit of £13m. Total proceeds amounted to £200m of which £180m is deferred. Accounting for the transaction required management judgement and estimation to establish the fair value of the deferred proceeds related to an unconditional vendor note for $225m and an entitlement to 20% of future cash flows to equity holders and to 20% of net proceeds in the event of a subsequent sale of K12. Changes to the assumptions applied by management in establishing the fair value of the deferred proceeds could have a material effect on the profit on disposal.	We reviewed the sale agreement and we vouched the cash received. We assessed the net assets disposed by reference to the audited balance sheet of K12 at 31 December 2018, understanding and evaluating any subsequent movements in key balances. We validated the cash held on the completion balance sheet and we recalculated management's goodwill allocation. We tested a sample of the transaction costs. We focused our assessment on the valuation of the deferred proceeds at the date of disposal. The vendor note and earn-out receivables are measured at fair value which is calculated as the present value of the expected future cash flows, meaning that the fair value is impacted by both the quantum and timing of any future payments from the vendor. We assessed management's assumptions related to the expected payment profile of the vendor note, the expected timing of the vendor's potential exit and the estimated equity value of K12 at that time. We compared management's assumptions against external evidence where available. We performed our own independent sensitivity analyses to understand the impact of reasonably possible changes in the key assumptions. We deployed our treasury specialists to test the appropriateness of the discount rate used to present value the future cash flows and to assess management's classification of these receivables as fair value through profit and loss as defined by IFRS 9. We have subsequently tested management's remeasurement and disclosure of these receivables at 31 December 2019. We separately considered management's decision to classify Penguin Random House (PRH) as held for sale at year-end and whether the announcement of the sale of the Group's stake in December 2019 crystallised any impairment, comparing the carrying value of PRH's net assets with the contracted disposal proceeds. Based on the procedures performed, we noted no material issues arising from our work.
Risk of fraud in revenue recognition	
Refer to note 3 in the consolidated financial statements. Certain of the Group's businesses in the US and UK enter into 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 services. These contracts generate material deferred revenue balances and changes to the underlying assumptions or estimation calculations could have a material effect on the consolidated financial statements.	For a selection of the larger, more judgemental and more recent long-term contracts, covering both assessment activities and online delivery of teaching, we read the contracts and we assessed the accounting methodologies being applied to calculate the proportion of revenue being recognised in 2019. We considered whether management's revenue recognition practices are in accordance with Group policies and related accounting standards and have been consistently applied. We tested costs incurred to date and management's estimates of forecast costs and revenues by reference to historical experience and current contract status. We recalculated management's percentage of completion estimates and we performed look-back tests to assess management's historical accuracy of forecasting for these types of arrangement. In addition, we performed manual journals testing focusing on unusual or unexpected entries to revenue. Based on the procedures performed, we noted no material issues arising from our work.

Key audit matter	How our audit addressed the key audit matter
Carrying values of investments in subsidiaries	
Refer to note 2 in the company financial statements. The company holds investments in subsidiaries amounting to £6,664m (2018: £6,710m) at 31 December 2019. Investments in subsidiaries are accounted for at cost less provision for 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. The impairment assessment was identified as a key audit matter given the size of the underlying investment carrying values and the differential to the Group's market capitalisation. Further impairment indicators were identified in connection with certain of the investments in subsidiaries due to the carrying value of investments exceeding their net assets. 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. Changes to these judgements and estimates could have a material impact on the company financial statements.	We evaluated management's assessment whether any indicators of impairment existed by comparing the carrying values of investments in subsidiaries with their net assets at 31 December 2019. For investments where the net assets were lower than the carrying values, we assessed their recoverable value by reference to the value in use of the investments compared to their carrying values at 31 December 2019. Where applicable, we verified that the recoverable values of investments were consistent with the recoverable values of the related CGUs tested for goodwill impairment purposes, leveraging the audit work undertaken as part of the Group audit. We separately evaluated the difference between the investment carrying values and the Group's market capitalisation. Based on the procedures performed, we noted no material issues arising from our work.

How we tailored the 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 company, the accounting processes and controls and the industry in which they operate.

The consolidated financial statements are a consolidation of 565 reporting units, each of which is considered to be a component. We identified four 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 eight components in the UK, US and Brazil to achieve 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 NCS Pearson, Pearson Education US, Pearson Education UK, Pearson Italy and Penguin Random House US.

We performed specified procedures at a further eight components over financial statement line items including revenue, trade and other receivables and deferred income, cash, intangible assets, 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 engagement team. This included our work over taxation, goodwill and acquired intangible assets, post-retirement benefits and major transactions.

Taken together, the components and corporate functions where we conducted audit procedures accounted for approximately 73% of the Group's revenue, 73% of the Group's statutory profit before tax and 73% 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 covered 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.

Independent auditors' report to the members of Pearson plc

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

	Group financial statements	Company financial statements
Overall materiality	£27 million (2018: £25 million)	£49 million (2018: £45 million)
How we determined it	Approximately 5% of adjusted profit before tax	Approximately 1% of net assets
Rationale for benchmark applied	The Group's principal measure of performance is adjusted operating profit (£581m), which excludes one-off gains and losses, costs of major restructuring and acquired intangible asset amortisation and impairment charges, in order to present results from operating activities on a consistent basis. We have taken this measure into account in determining our materiality. 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 overall materiality established for our audit of the consolidated financial statements.

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 £4 million to £20 million. We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2 million (2018: £2 million) for the Group and company audits as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

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 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 company's ability to continue as a going concern. For example, the terms of the United Kingdom's withdrawal from the European Union 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 2019 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 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 p40 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 p50 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 on p107 of the Annual Report 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 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 p111, 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 company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and company obtained in the course of performing our audit;

› The section of the Annual Report on p80 and 81 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 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 p112, 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 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 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 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 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 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 24 years, covering the years ended 31 December 1996 to 31 December 2019.

Giles Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

6 March 2020

Consolidated income statement

Year ended 31 December 2019

All figures in £ millions	Notes	2019	2018
Continuing operations			
Sales	2	**3,869**	4,129
Cost of goods sold	4	**(1,858)**	(1,943)
Gross profit		**2,011**	2,186
Operating expenses	4	**(1,806)**	(1,907)
Other net gains and losses	4	**16**	230
Share of results of joint ventures and associates	12	**54**	44
Operating profit	2	**275**	553
Finance costs	6	**(84)**	(91)
Finance income	6	**41**	36
Profit before tax		**232**	498
Income tax	7	**34**	92
Profit for the year		**266**	590
Attributable to:			
Equity holders of the company		**264**	588
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	**34.0p**	75.6p
– diluted	8	**34.0p**	75.5p

Consolidated statement of comprehensive income

Year ended 31 December 2019

All figures in £ millions	Notes	2019	2018
Profit for the year		**266**	590
Items that may be reclassified to the income statement			
Net exchange differences on translation of foreign operations – Group		**(113)**	91
Net exchange differences on translation of foreign operations – associates		**(2)**	(1)
Currency translation adjustment disposed		**4**	(4)
Attributable tax	7	**5**	(4)
Items that are not reclassified to the income statement			
Fair value gain on other financial assets		**20**	8
Attributable tax	7	**(4)**	–
Remeasurement of retirement benefit obligations – Group	25	**(145)**	22
Remeasurement of retirement benefit obligations – associates		**(4)**	3
Attributable tax	7	**22**	9
Other comprehensive (expense)/income for the year	29	**(217)**	124
Total comprehensive income for the year		**49**	714
Attributable to:			
Equity holders of the company		**47**	712
Non-controlling interest		**2**	2

Consolidated balance sheet

As at 31 December 2019

All figures in £ millions	Notes	2019	2018
Assets			
Non-current assets			
Property, plant and equipment	10	**618**	237
Intangible assets	11	**2,900**	3,009
Investments in joint ventures and associates	12	**7**	392
Deferred income tax assets	13	**59**	60
Financial assets – derivative financial instruments	16	**29**	67
Retirement benefit assets	25	**429**	571
Other financial assets	15	**122**	93
Trade and other receivables	22	**313**	100
		4,477	4,529
Current assets			
Intangible assets – pre-publication	20	**870**	817
Inventories	21	**169**	164
Trade and other receivables	22	**1,275**	1,178
Financial assets – derivative financial instruments	16	**25**	1
Cash and cash equivalents (excluding overdrafts)	17	**437**	568
		2,776	2,728
Assets classified as held for sale	32	**397**	648
Total assets		**7,650**	7,905
Liabilities			
Non-current liabilities			
Financial liabilities – borrowings	18	**(1,572)**	(674)
Financial liabilities – derivative financial instruments	16	**(24)**	(36)
Deferred income tax liabilities	13	**(48)**	(136)
Retirement benefit obligations	25	**(92)**	(100)
Provisions for other liabilities and charges	23	**(13)**	(145)
Other liabilities	24	**(86)**	(155)
		(1,835)	(1,246)

Consolidated balance sheet continued

As at 31 December 2019

All figures in £ millions	Notes	2019	2018
Current liabilities			
Trade and other liabilities	24	**(1,278)**	(1,400)
Financial liabilities – borrowings	18	**(92)**	(46)
Financial liabilities – derivative financial instruments	16	**(15)**	(23)
Current income tax liabilities		**(55)**	(72)
Provisions for other liabilities and charges	23	**(52)**	(20)
		(1,492)	(1,561)
Liabilities classified as held for sale	32	**–**	(573)
Total liabilities		**(3,327)**	(3,380)
Net assets		**4,323**	4,525
Equity			
Share capital	27	**195**	195
Share premium	27	**2,614**	2,607
Treasury shares	28	**(24)**	(33)
Capital redemption reserve		**11**	11
Fair value reserve		**39**	19
Translation reserve		**567**	678
Retained earnings		**911**	1,039
Total equity attributable to equity holders of the company		**4,313**	4,516
Non-controlling interest		**10**	9
Total equity		**4,323**	4,525

These financial statements have been approved for issue by the Board of Directors on 6 March 2020 and signed on its behalf by

Coram Williams
Chief Financial Officer

Consolidated statement of changes in equity

Year ended 31 December 2019

	Equity attributable to equity holders of the company									
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**
At 1 January 2019	**195**	**2,607**	**(33)**	**11**	**19**	**678**	**1,039**	**4,516**	**9**	**4,525**
Adjustment on initial application of IFRS 16 net of tax (see note 1b)	**–**	**–**	**–**	**–**	**–**	**–**	**(83)**	**(83)**	**–**	**(83)**
Adjustment on initial application of IFRIC 23 net of tax (see note 1c)	**–**	**–**	**–**	**–**	**–**	**–**	**5**	**5**	**–**	**5**
At 1 January 2019 (restated)	**195**	**2,607**	**(33)**	**11**	**19**	**678**	**961**	**4,438**	**9**	**4,447**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**264**	**264**	**2**	**266**
Other comprehensive income/(expense)	**–**	**–**	**–**	**–**	**20**	**(111)**	**(126)**	**(217)**	**–**	**(217)**
Total comprehensive income/(expense)	**–**	**–**	**–**	**–**	**20**	**(111)**	**138**	**47**	**2**	**49**
Equity-settled transactions	**–**	**–**	**–**	**–**	**–**	**–**	**25**	**25**	**–**	**25**
Tax on equity-settled transactions	**–**	**–**	**–**	**–**	**–**	**–**	**(5)**	**(5)**	**–**	**(5)**
Issue of ordinary shares under share option schemes	**–**	**7**	**–**	**–**	**–**	**–**	**–**	**7**	**–**	**7**
Buyback of equity	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Purchase of treasury shares	**–**	**–**	**(52)**	**–**	**–**	**–**	**–**	**(52)**	**–**	**(52)**
Release of treasury shares	**–**	**–**	**61**	**–**	**–**	**–**	**(61)**	**–**	**–**	**–**
Transfer of gain on disposal of FVOCI investment	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Dividends	**–**	**–**	**–**	**–**	**–**	**–**	**(147)**	**(147)**	**(1)**	**(148)**
At 31 December 2019	**195**	**2,614**	**(24)**	**11**	**39**	**567**	**911**	**4,313**	**10**	**4,323**

	Equity attributable to equity holders of the company									
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**
At 1 January 2018	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)
Purchase of treasury shares										
Release of treasury shares	–	–	28	–	–	–	(28)	–	–	–
Transfer of gain on disposal of FVOCI investment	–	–	–	–	(2)	–	2	–	–	–
Dividends	–	–	–	–	–	–	(136)	(136)	(1)	(137)
At 31 December 2018	195	2,607	(33)	11	19	678	1,039	4,516	9	4,525

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 2019

All figures in £ millions	Notes	2019	2018
Cash flows from operating activities			
Net cash generated from operations	33	**480**	547
Interest paid		**(81)**	(42)
Tax paid		**(30)**	(43)
Net cash generated from operating activities		**369**	462
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	30	**(45)**	(5)
Additional capital invested in associates		**(40)**	–
Purchase of investments		**(12)**	(10)
Purchase of property, plant and equipment		**(55)**	(70)
Purchase of intangible assets		**(138)**	(130)
Disposal of subsidiaries, net of cash disposed	31	**(101)**	83
Proceeds from sale of associates	31	**–**	18
Proceeds from sale of investments		**5**	6
Proceeds from sale of property, plant and equipment	33	**1**	128
Proceeds from sale of liquid resources		**–**	10
Lease receivables repaid		**26**	–
Loans (advance to)/repaid by related parties		**(49)**	46
Investment in liquid resources		**–**	(2)
Interest received		**17**	20
Investment income		**2**	–
Dividends received from joint ventures and associates		**64**	117
Net cash (used in)/generated from investing activities		**(325)**	211
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	**7**	6
Buyback of equity	27	**–**	(153)
Purchase of treasury shares		**(52)**	–
Proceeds from borrowings		**230**	–
Repayment of borrowings		**(48)**	(441)
Repayment of lease liabilities		**(91)**	(4)
Dividends paid to company's shareholders	9	**(147)**	(136)
Dividends paid to non-controlling interest		**(1)**	(1)
Net cash used in financing activities		**(102)**	(729)
Effects of exchange rate changes on cash and cash equivalents		**(33)**	(49)
Net decrease in cash and cash equivalents		**(91)**	(105)
Cash and cash equivalents at beginning of year		**525**	630
Cash and cash equivalents at end of year	17	**434**	525

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 6 March 2020.

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, and the company 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, and the company 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 2019 – The following standards were adopted in 2019:

› IFRS 16 Leases

› IFRIC 23 Uncertainty over Income Tax Treatments

› IFRS 9 and IFRS 7 Amendments

The impact of the adoption of these new standards is set out in notes 1b, 1c and 1d.

A number of other new pronouncements are also effective from 1 January 2019 but they do not have a material impact on the consolidated financial statements, or the company financial statements. Additional disclosure has been given where relevant.

2. Standards, interpretations and amendments to published standards that are not yet effective – A number of other new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2020, 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, or the company 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: Provisions for returns
Employee benefits: Pensions

In addition, certain assumptions have been used and judgements exercised in the valuation of the other receivable which arose on the disposal of the US K12 Courseware business (see note 14).

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.

1a. Accounting policies continued

Consolidation continued

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.

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 \$1.28 (2018: \$1.34) and the year-end rate was \$1.32 (2018: \$1.27).

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.

Notes to the consolidated financial statements

1a. Accounting policies continued

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; impairment is a key source of estimation uncertainty and has a significant risk of resulting in a material adjustment to the carrying amount of relevant assets within the next financial year. A summary of these assets by CGU and 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.

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 ten 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 relating to content 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. Pre-publication assets relating to product platforms are amortised over ten years or less being an estimate of the expected useful life.

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 income statement unless they represent a return of capital.

1a. Accounting policies continued

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.

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.

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.

Notes to the consolidated financial statements

1a. Accounting policies continued

Derivative financial instruments continued

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 and foreign exchange 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.

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 represent 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.

1a. Accounting policies continued

Employee benefits continued

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.

Prior to 1 January 2019 the Group recognised a provision for onerous lease contracts when the expected benefits to be derived from a contract were less than the unavoidable costs of meeting the obligations under the contract. The calculation of onerous lease provisions involved estimates of potential sublet income, lease terms including rent free periods, void periods, lease incentives and running costs. On the initial application of IFRS 16 on 1 January 2019, onerous lease provisions have been offset against the relevant right-of-use asset (see note 23).

The provision was 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 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 transfers 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.

Additional details on the Group's revenue streams are also included in note 3.

Notes to the consolidated financial statements

1a. Accounting policies continued

Leases

Policy applicable from 1 January 2019

The Group as a lessee
The Group assesses whether a contract is or contains a lease at the inception of the contract. A contract is, or contains a lease, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Group recognises a right-of-use asset and a lease liability at the lease commencement date with respect to all lease arrangements except for short-term leases (leases with a lease term of 12 months or less) and leases of low value assets. For these leases, the lease payments are recognised as an operating expense on a straight-line basis over the term of the lease.

The right-of-use asset is initially measured at cost, comprising the initial amount of the lease liability plus any initial direct costs incurred and an estimate of costs to restore the underlying asset, less any lease incentives received. The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the asset or the end of the lease term. The Group applies IAS 36 to determine whether a right-of-use asset is impaired. The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the incremental borrowing rate. The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or a rate or a change in the Group's assessment of whether it will exercise an extension or termination option. When the lease liability is remeasured, a corresponding adjustment is made to the right-of-use asset.

Management uses judgement to determine the lease term where extension and termination options are available within the lease.

The Group as a lessor:
When the Group is an intermediate lessor, the head lease and sub-lease are accounted for as two separate contracts. The head lease is accounted for as per the lessee policy above. The sub-lease is classified as a finance lease or operating lease by reference to the right-of-use asset arising from the head lease. Where the lease transfers substantially all the risks and rewards of ownership to the lessee the contract is classified as a finance lease; all other leases are classified as operating leases. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Amounts due from lessees under finance sub-leases are recognised as receivables at the amount of the Group's net investment in the leases discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the discount rate used in the head lease.

Policy applicable before 1 January 2019

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.

Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts. 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. Trade receivables are also stated after provision for anticipated future sales returns (also see Revenue recognition policy).

1b. Change of accounting policy: IFRS 16

The Group has adopted IFRS 16 'Leases' at 1 January 2019 and applied the modified retrospective approach. Comparatives for 2018 have not been restated and the cumulative impact of adoption has been recognised as a decrease to net assets with a corresponding decrease in retained earnings at 1 January 2019 as follows:

All figures in £ millions	1 January 2019
Non-current assets	
Property, plant and equipment (right-of-use assets)	424
Investment in joint ventures and associates	(2)
Deferred income tax assets	1
Trade and other receivables	185
Current assets	
Trade and other receivables	7
Non-current liabilities	
Financial liabilities – borrowings	(792)
Deferred income tax liabilities	14
Provisions for other liabilities and charges	101
Other liabilities	58
Current liabilities	
Financial liabilities – borrowings	(89)
Trade and other liabilities	10
Total decrease in retained earnings at 1 January 2019	(83)

The Group's lease portfolio consists of approximately 750 property leases together with a number of 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 has been measured at the 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 was not available to enable this measurement to be made, the right-of-use asset has been measured at an amount equal to the lease liability.

On transition the Group elected not to reassess whether a contract is, or contains, a lease, instead relying on the assessment already made applying IAS 17 'Leases' and IFRIC 4 'Determining whether and Arrangement contains a Lease'. In addition, the Group applied the available practical expedients as follows:

› Relied on its assessment of whether leases are onerous immediately prior to the date of initial application.

› Applied the short-term leases exemptions to leases with lease term ending within 12 months at the date of the initial application.

› Excluded the initial direct costs from the measurement of the right-to-use asset at the date of the initial application.

› Used hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

Adoption of the new standard has a material impact on the Group. The lease liability brought onto the balance sheet at transition was £881m with the corresponding right-of-use asset valued at £424m. In addition, certain subleases have been reclassified as finance leases resulting in an additional lease receivable of £215m being brought on balance sheet. The net impact on the balance sheet is a reduction of net assets of £83m after taking into account existing liabilities relating to onerous lease provisions, lease incentives, prepayments, adjustments to tax and the net impact on associates. There were no leases relating to held for sale assets at 1 January 2019.

For leases previously classified as finance leases under IAS 17 'Leases', the carrying amount of the right-of-use asset and the lease liability at 1 January 2019 are determined at the carrying amount of the lease asset and lease liability under IAS 17 immediately before that date.

The impact on the income statement for 2019 was to reduce profit before tax by £9m (increasing both adjusted and statutory operating profit by £25m and increasing net finance costs by £34m). The operating lease expense recognised under the previous accounting standards is now replaced by depreciation and net finance costs. The impact on the Group's share of joint venture and associate profit is not material.

There is no overall impact on the Group's cash and cash equivalents although there is a change to the classification of cash flows in the cash flow statement with lease payments and finance lease receipts previously categorised as net cash used in operations now being split between the principal element (categorised in financing activities for payments and investing activities for receipts) and the interest element (categorised as interest paid in operating activities or interest received in investing activities). In 2019 there were £91m of lease payments classified as financing cash flows, £26m of lease receipts classified as investing cash flows, £45m of lease interest payments and £11m of lease interest receipts.

Notes to the consolidated financial statements

1b. Change of accounting policy: IFRS 16 continued

The Group has also included the lease liability and investment in finance lease as part of its net debt which impacts the calculation of the Group's non-GAAP measures for operating cash flow and free cash flow.

The lease liabilities at 1 January 2019 can be reconciled to the operating lease commitments at 31 December 2018 as follows:

All figures in £ millions	1 January 2019
Operating lease commitments disclosed at 31 December 2018 (note 35)	1,175
Discounted using the lessee's incremental borrowing rate at the date of initial application	(290)
(Less): commitments relating to short-term leases	(7)
Add: adjustments relating to the different treatment of extension and termination options	3
Additional lease liability recognised at 1 January 2019	881
Analysed at:	
Current lease liabilities	89
Non-current lease liabilities	792

In addition to the lease liabilities transitioned above, the Group had £5m of lease liabilities that were accounted for as finance leases at 31 December 2018. The weighted average incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 5.0%.

1c. Change of accounting policy: IFRIC 23

The Group adopted IFRIC 23 'Uncertainty over Income Tax Treatments' effective 1 January 2019. The interpretation clarifies the application of the recognition and measurement requirements in IAS 12 'Income taxes' where there is uncertainty over income tax treatments. The interpretation provides guidance to determine whether uncertain tax positions should be considered separately or together, and that measurement should be whether the single most likely outcome or the probability weighted sum of a range of outcomes, whichever better predicts the resolution. The reassessment of current tax liabilities resulted in a decrease in liabilities of £5m but does not have a material impact on the income statement.

1d. Change of accounting policy: Amendments to IFRS 9 and IFRS 7

The Group has considered the impact of IBOR reform on its hedge accounting. The Group has elected to early adopt amendments to IFRS 9 and IFRS 7 'Interest Rate Benchmark Reform' issued in September 2019. In accordance with the transition provisions, the amendments have been adopted retrospectively to hedging relationships that existed at the start of the reporting period or were designated thereafter. The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. The adoption of these amendments has not had a material impact on these financial statements (see note 19).

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.

							2019
All figures in £ millions	**Notes**	**North America**	**Core**	**Growth**	**Penguin Random House**	**Corporate**	**Group**
Sales		2,534	838	497	–	–	3,869
Adjusted operating profit		361	92	63	65	–	581
Cost of major restructuring		(110)	(28)	(19)	(2)	–	(159)
Intangible charges		(62)	(7)	(82)	(12)	–	(163)
Other net gains and losses		13	8	(5)	–	–	16
Operating profit (loss)		202	65	(43)	51	–	275
Finance costs	6						(84)
Finance income	6						41
Profit before tax							232
Income tax	7						34
Profit for the year							266
Segment assets		4,316	1,957	484	–	489	7,246
Associates	12	–	7	–	397	–	404
Total assets		4,316	1,964	484	397	489	7,650
Other segment items							
Share of results of joint ventures and associates	12	–	3	–	51	–	54
Capital expenditure	10, 11	176	35	51	–	–	262
Pre-publication investment	20	189	81	49	–	–	319
Depreciation	10	75	23	25	–	–	123
Amortisation	11, 20	305	85	147	–	–	537

Notes to the consolidated financial statements

2. Segment information continued

All figures in £ millions	Notes	North America	Core	Growth	Penguin Random House	Corporate	Group
							2018
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
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 in 2018 is £60m in pre-publication investment and £67m in amortisation relating to assets held for sale.

There were no material inter-segment sales in either 2019 or 2018.

For additional detailed information on the calculation of adjusted operating profit as shown in the above tables, see p201-204 (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 costs incurred to date relate to delivery of cost efficiencies in the US Higher Education Courseware business and enabling functions together with further rationalisation of the property and supplier portfolio. The restructuring costs in 2019 of £159m mainly relate to staff redundancies while the restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation including the net impact of the consolidation of the Group's property footprint in London. 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 relating to acquired intangibles, acquisition costs and movements in contingent acquisition and disposal consideration. 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 2019 were £163m, including an impairment charge of £65m relating to acquired intangibles in Brazil, compared with a charge of £113m in 2018.

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 £16m in 2019 mainly relate to the sale of the US K12 Courseware business. 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 (see note 31).

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.

2. Segment information continued

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 £23m (2018: £nil) (see note 30).

The Group operates in the following main geographic areas:

	Sales		Non-current assets	
All figures in £ millions	2019	2018	2019	2018
UK	385	377	694	900
Other European countries	244	246	125	143
US	2,417	2,627	2,604	2,162
Canada	105	126	163	250
Asia Pacific	441	455	149	146
Other countries	277	298	103	137
Total	**3,869**	4,129	**3,838**	3,738

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.

				2019
All figures in £ millions	North America	Core	Growth	Group
Sales:				
Courseware				
School Courseware	86	169	118	373
Higher Education Courseware	975	81	44	1,100
English Courseware	14	56	107	177
	1,075	306	269	1,650
Assessments				
School and Higher Education Assessments	309	264	26	599
Clinical Assessments	175	52	–	227
Professional and English Certification	390	168	80	638
	874	484	106	1,464
Services				
School Services	319	2	46	367
Higher Education Services	266	45	26	337
English Services	–	1	50	51
	585	48	122	755
Total	2,534	838	497	3,869

Notes to the consolidated financial statements

3. Revenue from contracts with customers continued

All figures in £ millions	North America	Core	Growth	Group
				2018
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[1]	298	237	23	558
Clinical Assessments[1]	174	55	–	229
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

1 The analysis of Assessments revenues in 2018 has been re-presented to reflect the transfer of a product from School to Clinical.

The Group derived revenue 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
				2019
Courseware				
Products transferred at a point in time (sale or return)	448	291	178	917
Products transferred at a point in time (other)	–	–	37	37
Products and services transferred over time	627	15	54	696
	1,075	306	269	1,650
Assessments				
Products transferred at a point in time	113	55	6	174
Products and services transferred over time	761	429	100	1,290
	874	484	106	1,464
Services				
Products transferred at a point in time	–	26	–	26
Products and services transferred over time	585	22	122	729
	585	48	122	755
Total	2,534	838	497	3,869

3. Revenue from contracts with customers continued

All figures in £ millions	North America	Core	Growth	Total
				2018
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[1]				
Products transferred at a point in time	106	52	–	158
Products and services transferred over time	710	390	87	1,187
	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	2,784	806	539	4,129

1 The analysis of Assessments revenues in 2018 has been re-presented to better reflect the nature of sales.

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 24). 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. The sales return liability at the end of 2019 was £122m (see note 24). This represents 3% of annual sales subject to sale or return.

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.

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 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.

Notes to the consolidated financial statements

3. Revenue from contracts with customers continued

a. Nature of goods and services continued

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. These services 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 that 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 Revenue from Contracts with Customers 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 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, a variety of services are provided such as programme development, student acquisition, education technology and student support services. These services 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.

Where Services are provided to university customers, volume and transaction price are 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 that 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 for work performed to date, and take possession of work in process.

3. Revenue from contracts with customers continued

a. Nature of goods and services continued

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 both 2019 and 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.

e. Remaining transaction price

The below table depicts the remaining transaction price on unsatisfied or partially unsatisfied performance obligations from contracts with customers.

All figures in £ millions	Sales	Deferred income	Committed sales	Total remaining transaction price	2020	2021	2022 and later
	2019						
Courseware							
Products transferred at a point in time (sale or return)	917	1	–	1	1	–	–
Products transferred at a point in time (other)	37	1	–	1	1	–	–
Products and services transferred over time	696	118	–	118	82	13	23
Assessments							
Products transferred at a point in time	174	–	–	–	–	–	–
Products and services transferred over time	1,290	206	375	581	433	146	2
Services							
Products transferred at a point in time	26	3	–	3	3	–	–
Products and services transferred over time – subscriptions	310	11	–	11	11	–	–
Products and services transferred over time – other ongoing performance obligations	419	20	106	126	125	1	–
Total	3,869	360	481	841	656	160	25

Notes to the consolidated financial statements

3. Revenue from contracts with customers continued

e. Remaining transaction price continued

							2018
All figures in £ millions	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[1]							
Products transferred at a point in time	158	–	–	–	–	–	–
Products and services transferred over time	1,187	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

1 The analysis of Assessments revenues in 2018 has been re-presented to better reflect the nature of sales.

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 stated above represent the expected timing of when the remaining transaction price will be recognised as revenue.

4. Operating expenses

All figures in £ millions	2019	2018
By function:		
Cost of goods sold	**1,858**	1,943
Operating expenses		
Distribution costs	**73**	88
Selling, marketing and product development costs	**631**	759
Administrative and other expenses	**999**	1,039
Restructuring costs	**157**	90
Other income	**(54)**	(69)
Total net operating expenses	**1,806**	1,907
Other net gains and losses	**(16)**	(230)
Total	**3,648**	3,620

Included in other income is service fee income from Penguin Random House of £4m (2018: £3m). Included in administrative and other expenses are research and efficacy costs of £13m (2018: £14m). In addition to the restructuring costs shown above, there were major restructuring costs in relation to associates of £2m (2018: £12m).

4. Operating expenses continued

An analysis of major restructuring costs is as follows:

All figures in £ millions	2019	2018
By nature:		
Product costs	**16**	12
Employee costs	**90**	56
Depreciation and amortisation	**14**	1
Property and facilities	**12**	(5)
Technology and communications	**2**	1
Professional and outsourced services	**17**	9
General and administrative costs	**6**	16
Total restructuring – operating expenses	**157**	90
Share of associate restructuring	**2**	12
Total	**159**	102

In May 2017, the Group announced a restructuring programme to run between 2017 and 2019 to drive further 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	2019	2018
By nature:			
Royalties expensed		**242**	236
Other product costs		**466**	516
Employee benefit expense	5	**1,452**	1,637
Contract labour		**139**	161
Employee-related expense		**94**	115
Promotional costs		**254**	233
Depreciation of property, plant and equipment	10	**123**	66
Amortisation of intangible assets – pre-publication	20	**271**	338
Amortisation of intangible assets – software	11	**115**	88
Amortisation and impairment of intangible assets – other	11	**151**	99
Property and facilities		**96**	147
Technology and communications		**196**	192
Professional and outsourced services		**480**	396
Other general and administrative costs		**104**	85
Costs capitalised to intangible assets		**(465)**	(390)
Other net gains and losses		**(16)**	(230)
Other income		**(54)**	(69)
Total		**3,648**	3,620

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

All figures in £ millions	2019	2018
The audit of parent company and consolidated financial statements	**5**	4
The audit of the company's subsidiaries	**2**	2
Total audit fees	**7**	6
Audit-related and other assurance services	**–**	1
Other non-audit services	**–**	–
Total other services	**–**	1
Total non-audit services	**–**	1
Total	**7**	7

Notes to the consolidated financial statements

4. Operating expenses continued

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

All figures in £ millions	2019	2018
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	7	6
Non-audit fees	–	1
Total	7	7

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 Group audit fees for 2019 are additional fees in relation to prior year audit work.

5. Employee information

All figures in £ millions	Notes	2019	2018
Employee benefit expense			
Wages and salaries (including termination costs)		1,258	1,421
Social security costs		100	112
Share-based payment costs	26	25	37
Retirement benefits – defined contribution plans	25	57	56
Retirement benefits – defined benefit plans	25	13	23
Other post-retirement medical benefits	25	(1)	(12)
Total		1,452	1,637

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

Average number employed	2019	2018
Employee numbers		
North America	13,564	14,113
Core	4,951	5,192
Growth	3,693	4,521
Other	526	496
Total	22,734	24,322

6. Net finance costs

All figures in £ millions	Notes	2019	2018
Interest payable on financial liabilities at amortised cost and associated derivatives		(22)	(42)
Interest on lease liabilities		(45)	–
Net foreign exchange losses		(5)	(36)
Finance costs associated with transactions		–	(1)
Derivatives not in a hedge relationship		(12)	(7)
Derivatives in a hedge relationship		–	(5)
Finance costs		(84)	(91)
Interest receivable on financial assets at amortised cost		15	18
Interest on lease receivables		11	–
Net finance income in respect of retirement benefits	25	13	11
Derivatives not in a hedge relationship		2	6
Derivatives in a hedge relationship		–	1
Finance income		41	36
Net finance costs		(43)	(55)
Analysed as:			
Net interest payable reflected in adjusted earnings		(41)	(24)
Other net finance costs		(2)	(31)
Total net finance costs		(43)	(55)

6. Net finance costs continued

Included in interest receivable is £1m (2018: £1m) of interest receivable from related parties. Net movement in fair value of hedges is explained in note 16.

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

7. Income tax

All figures in £ millions	Notes	2019	2018
Current tax			
(Charge)/credit in respect of current year		**(51)**	92
Adjustments in respect of prior years		**21**	34
Total current tax (charge)/credit		**(30)**	126
Deferred tax			
In respect of temporary differences		**59**	(6)
Other adjustments in respect of prior years		**5**	(28)
Total deferred tax credit/(charge)	13	**64**	(34)
Total tax credit		**34**	92

The adjustments in respect of prior years in both 2019 and 2018 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.

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	2019	2018
Profit before tax	**232**	498
Tax calculated at UK rate (2019: 19%, 2018: 19%)	**(44)**	(94)
Effect of overseas tax rates	**(2)**	(28)
Joint venture and associate income reported net of tax	**10**	8
Intra-group financing benefit	**11**	25
Movement in provisions for tax uncertainties	**3**	111
Net expense not subject to tax	**(10)**	(29)
Benefit from change in US tax accounting treatment	**–**	25
Gains and losses on sale of businesses not subject to tax	**57**	77
Unrecognised tax losses	**(17)**	(9)
Adjustments in respect of prior years	**26**	6
Total tax credit	**34**	92
UK	**(12)**	37
Overseas	**46**	55
Total tax credit	**34**	92
Tax rate reflected in earnings	**(14.7)%**	(18.5)%

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, utilisation of brought forward provisions and the establishment of provisions for new uncertain tax positions. The current tax liability of £55m (2018: £72m) includes £152m (2018: £181m) 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 £152m, £88m relates to 2015 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, £18m relates to 2016, £30m to 2017, £4m to 2018 and £12m to 2019. If relevant enquiry windows pass with no audit, management believes it is reasonably possible that provision levels will reduce by an estimated £3m 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, any incremental exposure is not expected to be material this year (2018: £25m). Contingent liabilities relating to tax are disclosed in note 34.

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	2019	2018
Profit before tax	232	498
Adjustments:		
Cost of major restructuring	159	102
Other net gains and losses	(16)	(230)
Intangible charges	163	113
Other net finance costs/(income)	2	31
UK pension GMP equalisation	–	8
Adjusted profit before tax	540	522
Total tax credit	34	92
Adjustments:		
Tax benefit on cost of major restructuring	(35)	(37)
Tax benefit on other net gains and losses	(68)	(31)
Tax benefit on intangible charges	(48)	(18)
Tax benefit on other net finance costs	–	(6)
Tax benefit on UK pension GMP equalisation	–	(2)
Tax amortisation benefit on goodwill and intangibles	28	29
Adjusted income tax (charge)/credit	(89)	27
Tax rate reflected in adjusted earnings	16.5%	(5.2)%

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	2019	2018
Net exchange differences on translation of foreign operations	5	(4)
Fair value gain on other financial assets	(4)	–
Remeasurement of retirement benefit obligations	22	9
	23	5

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	2019	2018
Earnings for the year	266	590
Non-controlling interest	(2)	(2)
Earnings attributable to equity holders of the company	264	588
Weighted average number of shares (millions)	777.0	778.1
Effect of dilutive share options (millions)	0.5	0.6
Weighted average number of shares (millions) for diluted earnings	777.5	778.7
Earnings per share		
Basic	34.0p	75.6p
Diluted	34.0p	75.5p

8. Earnings per share continued

Adjusted

For additional detailed information on the calculation of adjusted measures, see p201-204 (Financial key performance indicators). See note 2 for details of specific items excluded from or included in adjusted operating profit in 2019 and 2018.

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 costs incurred to date relate to delivery of cost efficiencies in the US Higher Education Courseware business and enabling functions together with further rationalisation of the property and supplier portfolio. The restructuring costs in 2019 of £159m mainly relate to staff redundancies while the restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation including the net cost of the consolidation of the Group's property footprint in London. 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. Other net gains of £16m in 2019 mainly relate to the sale of the US K12 Courseware business. 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 (see note 31).

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 2019 were £163m, including an impairment charge of £65m relating to acquired intangibles in Brazil, compared with a charge of £113m in 2018.

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 2019 and 2018 the foreign exchange gains and losses largely relate to foreign exchange differences on unhedged US dollar and euro loans, cash and cash equivalents.

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.

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.

Non-controlling interest – Non-controlling interest for the above items is excluded from adjusted earnings.

Notes to the consolidated financial statements

8. Earnings per share continued

Adjusted continued

The following tables reconcile the statutory income statement to the adjusted income statement.

								2019
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	275	159	(16)	163	–	–	–	581
Net finance costs	(43)	–	–	–	2	–	–	(41)
Profit before tax	232	159	(16)	163	2	–	–	540
Income tax	34	(35)	(68)	(48)	–	–	28	(89)
Profit for the year	266	124	(84)	115	2	–	28	451
Non-controlling interest	(2)	–	–	–	–	–	–	(2)
Earnings	264	124	(84)	115	2	–	28	449
Weighted average number of shares (millions)	777.0							777.0
Weighted average number of shares (millions) for diluted earnings	777.5							777.5
Earnings per share (basic)	34.0p							57.8p
Earnings per share (diluted)	34.0p							57.7p

								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

9. Dividends

All figures in £ millions	2019	2018
Final paid in respect of prior year 13p (2018: 12.0p)	101	93
Interim paid in respect of current year 6p (2018: 5.5p)	46	43
	147	136

The Directors are proposing a final dividend in respect of the financial year ended 31 December 2019 of 13.5p per equity share which will absorb an estimated £106m of shareholders' funds. It will be paid on 7 May 2020 to shareholders who are on the register of members on 27 March 2020. These financial statements do not reflect this dividend.

10. Property, plant and equipment

	Right-of-use assets		Owned assets			
All figures in £ millions	Land and buildings	Plant and equipment	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost						
At 1 January 2018	–	–	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
Adjustment on initial application of IFRS 16 (see note 1b)	418	6	–	–	–	424
Exchange differences	(9)	–	(8)	(15)	–	(32)
Additions	64	2	–	18	40	124
Disposals	(13)	(4)	(13)	(108)	(8)	(146)
Reclassifications	–	–	4	(4)	–	–
Transfer of finance leases	–	19	–	(19)	–	–
Transfer to intangible assets	–	–	–	(3)	(4)	(7)
Transfer to intangible assets – pre-publication	–	–	–	(2)	(10)	(12)
At 31 December 2019	460	23	300	325	36	1,144

	Right-of-use assets		Owned assets			
All figures in £ millions	Land and buildings	Plant and equipment	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation						
At 1 January 2018	–	–	(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)
Exchange differences	2	–	6	13	–	21
Charge for the year	(60)	(4)	(21)	(38)	–	(123)
Disposals	–	–	10	116	–	126
Transfer of finance leases	–	(12)	–	12	–	–
Transfer to intangible assets	–	–	–	3	–	3
Transfer to intangible assets – pre-publication	–	–	–	3	–	3
At 31 December 2019	(58)	(16)	(200)	(252)	–	(526)
Carrying amounts						
At 1 January 2018	–	–	133	119	29	281
At 31 December 2018	–	–	122	97	18	237
At 31 December 2019	402	7	100	73	36	618

Notes to the consolidated financial statements

10. Property, plant and equipment continued

Depreciation expense of £42m (2018: £18m) has been included in the income statement in cost of goods sold and £81m (2018: £48m) in operating expenses.

Prior to 1 January 2019 the Group leased certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment in 2018 was £7m. On the initial application of IFRS 16 these finance leases have been transferred from owned assets to right-of-use assets within property, plant and equipment.

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 2018	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 to assets classified as held for sale	7	–	–	–	–	–	7
At 31 December 2018	2,111	959	910	267	184	457	4,888
Exchange differences	**(57)**	**(22)**	**(29)**	**(10)**	**(5)**	**(20)**	**(143)**
Additions – internal development	**–**	**137**	**–**	**–**	**–**	**–**	**137**
Additions – purchased	**–**	**1**	**–**	**–**	**–**	**–**	**1**
Disposals	**–**	**(15)**	**(88)**	**(19)**	**–**	**(47)**	**(169)**
Acquisition through business combination	**18**	**–**	**–**	**–**	**–**	**23**	**41**
Transfer from property, plant and equipment	**–**	**7**	**–**	**–**	**–**	**–**	**7**
Transfer to intangible assets – pre-publication	**–**	**(28)**	**–**	**–**	**–**	**–**	**(28)**
Movement in held for sale	**67**	**–**	**–**	**–**	**–**	**–**	**67**
At 31 December 2019	**2,139**	**1,039**	**793**	**238**	**179**	**413**	**4,801**

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 2018	–	(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
At 31 December 2018	–	(512)	(647)	(181)	(178)	(361)	(1,879)
Exchange differences	**–**	**16**	**22**	**7**	**4**	**19**	**68**
Charge for the year	**–**	**(115)**	**(51)**	**(23)**	**(2)**	**(75)**	**(266)**
Disposals	**–**	**10**	**88**	**19**	**–**	**46**	**163**
Transfer from property, plant and equipment	**–**	**(3)**	**–**	**–**	**–**	**–**	**(3)**
Transfer to intangible assets – pre-publication	**–**	**16**	**–**	**–**	**–**	**–**	**16**
At 31 December 2019	**–**	**(588)**	**(588)**	**(178)**	**(176)**	**(371)**	**(1,901)**
Carrying amounts							
At 1 January 2018	2,030	389	309	101	6	129	2,964
At 31 December 2018	2,111	447	263	86	6	96	3,009
At 31 December 2019	**2,139**	**451**	**205**	**60**	**3**	**42**	**2,900**

11. Intangible assets continued

Goodwill

The goodwill carrying value of £2,139m 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 £19m (2018: £18m) is included in the income statement in cost of goods sold and £182m (2018: £169m) in operating expenses. Impairment of £65m (2018: £nil), of which £53m relates to other intangibles acquired and £12m to acquired trademarks and brands, is included in operating expenses.

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

	2019 Useful economic life
Class of intangible asset	
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	2019 One to five years	Six to ten years	More than ten years	Total
Class of intangible asset				
Acquired customer lists, contracts and relationships	154	49	2	205
Acquired trademarks and brands	42	14	4	60
Acquired publishing rights	3	–	–	3
Other intangibles acquired	31	11	–	42

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. CGUs have been revised in 2019. Impairment reviews were conducted on these revised CGUs as summarised below:

2019 CGUs

All figures in £ millions	2019 Goodwill
North American Courseware	–
OPM	18
Virtual Schools	386
Assessments	1,035
Core	700
Growth (includes the separate CGUs of Brazil, China, India and South Africa)	–
Total	**2,139**

Goodwill is tested at least annually for impairment. The recoverable amount of each aggregated CGU is based on the higher of value in use and fair value less costs of disposal. The value in use was higher than the fair value less costs of disposal in each of the CGUs. Other than goodwill there are no intangible assets with indefinite lives.

Notes to the consolidated financial statements

11. Intangible assets continued

2018 CGUs

All figures in £ millions	2018
North America	930
Core	701
Growth (includes the separate CGUs of Brazil, China, India and South Africa)	–
Pearson VUE	480
Total	2,111

Following a reassessment of the relative risk in the Brazil CGU compared to Pearson as a whole, it was determined in the course of the impairment review that neither the value in use nor the fair value less costs of disposal of the Brazil CGU supported the carrying value of the CGU. As the goodwill related to the Brazil CGU was fully impaired in prior years, the acquired intangibles of the Brazil CGU were impaired by £65m, bringing their carrying value to £27m. The Brazil CGU incorporates all the Group's trading operations in Brazil. A pre-tax discount rate of 16.3% was used to determine the value in use of the Brazil CGU. At 31 December 2018, the impairment review showed headroom of £20m in the Brazil CGU.

Determination of CGUs and reallocation of goodwill

Pearson identifies its CGUs based on its operating model and how data is collected and reviewed for management reporting and strategic planning purposes in accordance with IAS 36 "Impairment of assets". In 2019, the CGUs and aggregation of CGUs have been revised to take account of the following:

- The implementation of a new Enterprise Resource Planning (ERP) system in North America meant that ledgers are structured on a legal entity basis rather than the previous divisional basis. This has meant it is no longer possible to identify the carrying values of the Pearson VUE business separately from the wider Assessments business. As a result, the Pearson VUE business has been combined with the Assessments business as one CGU for impairment testing.
- The disposal of the US K12 Courseware business in 2019 has caused management to disaggregate the North America CGU.

At 1 January 2019, the goodwill of the previous North America and Pearson VUE CGUs was therefore reallocated between North American Courseware, OPM, Virtual Schools and Assessments, based on their relative fair value at 1 January 2019 amended to take into account previous impairments taken. No goodwill was allocated to the North American Courseware CGU reflecting the significant impairments taken in 2015 and 2016.

Key assumptions

For the purpose of estimating the value in use 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 three-year period, whilst a projection to 2030 was available and used for the OPM CGU, as the three-year projection reflected the investment phase and not the longer-term return of this business, and because the long-term nature of OPM's contracts allows for reliable forecasts to be prepared beyond three years. OPM relies on contracts with key customers and the forecast to 2030 assumes these are renewed or replaced. The key assumptions used by management in the value in use calculations were:

Discount rates – The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each CGU. The average pre-tax discount rates range from 9.5% to 17% (2018: post-tax 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% (2018: 2%) 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 3.2% to 6.5% (2018: 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 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 sales forecasts use average nominal growth rates between (5%) and 11% (2018: 2% and 3%) for mature markets and between 5% and 11% (2018: (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 the impact of the implementation of our 2017-2019 cost efficiency programme. Management applies judgement in allocating corporate costs in order to determine operating profit at a CGU level.

11. Intangible assets continued

Key assumptions continued

The table below shows the key assumptions for those CGUs for which the carrying value of goodwill is significant in comparison to the total carrying value of goodwill:

	Discount rate	Perpetuity growth rate
Virtual Schools	10%	2%
Core	10%	2%
Assessments	10%	2%

Comparative figures have not been shown as CGUs have been changed in 2019.

Sensitivities

Impairment testing for the year ended 31 December 2019 has identified the following CGUs, or groups of CGUs, as being sensitive to reasonably possible changes in key assumptions. The table below shows the headroom at 31 December 2019 and the changes in the key assumptions required in order for the recoverable amount to equal the carrying value.

	Headroom at 31 December 2019	Discount rate	Discount rate for zero headroom	Perpetuity growth rate	Perpetuity growth rate for zero headroom	Contribution* reduction p.a. for zero headroom
North American Courseware	£115m	10.0%	10.3%	2.0%	1.6%	£9m
OPM	£81m	10.0%	10.3%	2.0%	0.3%	£7m
Core	£191m	10.0%	10.7%	2.0%	1.2%	£15m
Brazil	–	16.3%	16.3%	4.1%	4.1%	–

* CGU contribution is operating profit excluding fixed costs and corporate overheads.

12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2019	2018
Associates	7	392
Joint ventures	–	–
Associates classified as held for sale	397	–
Total	404	392

The amounts recognised in the income statement are as follows:

All figures in £ millions	2019	2018
Associates	54	43
Joint ventures	–	1
Total	54	44

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. Pearson discloses Penguin Random House separately, presenting disclosures related to its interests in Penguin Random House on a combined basis.

Notes to the consolidated financial statements

12. Investments in joint ventures and associates continued

Investment in associates continued

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 did not change. Penguin Random House does not have a quoted market price.

In December 2019, the Group announced the sale of its remaining 25% interest in Penguin Random House. At the end of 2019 the Group's share of the assets of Penguin Random House has been classified as held for sale on the balance sheet (see note 32).

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

All figures in £ millions	2019 Penguin Random House	2018 Penguin Random House
Assets		
Non-current assets	**1,346**	1,043
Current assets	**2,273**	1,929
Liabilities		
Non-current liabilities	**(1,357)**	(1,104)
Current liabilities	**(1,874)**	(1,546)
Net assets	**388**	322
Sales	**2,916**	2,775
Profit for the year	**205**	185
Other comprehensive (expense)/income	**(27)**	13
Total comprehensive income	**178**	198
Dividends received from associate in relation to profits	**63**	67
Re-capitalisation dividends received from associate	**–**	50

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 full summarised financial information to the carrying value of the material associate is shown below:

All figures in £ millions	2019 Penguin Random House	2018 Penguin Random House
Opening net assets	**322**	368
Adjustment on initial application of IFRS 16 (see note 1b)	**(7)**	–
Exchange differences	**(9)**	18
Profit for the year	**205**	185
Other comprehensive (expense)/income	**(27)**	13
Dividends, net of tax paid	**(260)**	(262)
Capital contribution	**164**	–
Closing net assets	**388**	322
Share of net assets	**97**	80
Goodwill	**300**	307
Carrying value of associate (see note 32)	**397**	387

12. Investments in joint ventures and associates continued

Investment in associates continued

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2019	2018
Profit/(loss) for the year	3	(3)
Total comprehensive income/(expense)	**3**	(3)

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 2019 was £49m (2018: £nil) and interest received was £1m (2018: £1m). The loans are provided under a working capital facility and fluctuate during the year.

The Group also has a current asset receivable of £16m (2018: £17m) from Penguin Random House arising from the provision of services. Included in other income (note 4) is £4m (2018: £3m) of service fees. In 2018 the Group received a further re-capitalisation dividend of £50m 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	2019	2018
Profit for the year	–	1
Total comprehensive income	**–**	1

13. Deferred income tax

All figures in £ millions	2019	2018
Deferred income tax assets	59	60
Deferred income tax liabilities	(48)	(136)
Net deferred income tax	**11**	(76)

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 2019, the Group has unrecognised deferred income tax assets of £28m (2018: £31m) in respect of UK losses, £20m (2018: £28m) in respect of US losses and approximately £100m (2018: £90m) in respect of losses in other territories. The UK losses are capital losses. The US losses relate to federal and state taxes. Federal tax losses can be carried forward indefinitely; state tax losses have expiry periods of between five and 20 years. Other deferred tax assets of £25m (2018: £12m) have not been recognised.

Deferred tax assets of £41m (2018: £43m) 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. In some cases deferred income tax assets are forecast to be recovered through taxable profits over a period that exceeds five years. Management consider these forecasts are sufficiently reliable to support the recovery of the assets.

Notes to the consolidated financial statements

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 2018	9	34	(44)	42	(155)	64	(50)
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 benefit in other comprehensive income	–	–	9	–	–	–	9
Tax benefit in equity	–	–	–	–	–	4	4
At 31 December 2018	20	31	(55)	68	(205)	65	(76)
Adjustment on initial application of IFRS 16 (see note 1b)	–	–	–	–	–	15	15
Exchange differences	(1)	(1)	(1)	(3)	6	(5)	(5)
Income statement benefit/(charge)	70	(10)	(4)	(24)	–	32	64
Tax benefit/(charge) in other comprehensive income	–	–	22	–	–	(4)	18
Tax charge in equity	–	–	–	–	–	(5)	(5)
At 31 December 2019	89	20	(38)	41	(199)	98	11

Other deferred income tax items include temporary differences in respect of share-based payments, provisions, depreciation, interest limitation and royalty advances.

As at 31 December 2019, no deferred tax assets or liabilities were classified as held for sale (2018: £98m asset). In 2018 there was a charge of £8m 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:

		2019					2018				
		Fair value			Amortised cost		Fair value			Amortised cost	
All figures in £ millions	Notes	FVOCI	FVTPL	Fair value – hedging instrument	Financial assets	Total carrying value	FVOCI	FVTPL	Fair value – hedging instrument	Financial assets	Total carrying value
Investments in unlisted securities	15	122	–	–	–	122	93	–	–	–	93
Cash and cash equivalents	17	–	–	–	437	437	–	–	–	568	568
Derivative financial instruments	16	–	6	48	–	54	–	4	64	–	68
Trade receivables	22	–	–	–	918	918	–	–	–	904	904
Other receivable		–	182	–	–	182	–	–	–	–	–
Trade receivables – within assets classified as held for sale		–	–	–	–	–	–	–	–	49	49
Total financial assets		122	188	48	1,355	1,713	93	4	64	1,521	1,682

The carrying value of the Group's financial assets is equal to, or approximately equal to, the market value. The other receivable relates to the receivable which arose on the disposal of the US K12 Courseware business and is included in other receivables, non-current and current, in note 22.

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:

		2019					2018				
			Fair value	Amortised cost				Fair value	Amortised cost		
All figures in £ millions	Notes	FVTPL	Fair value – hedging instrument	Other financial liabilities	Total carrying value	Total market value	FVTPL	Fair value – hedging instrument	Other financial liabilities	Total carrying value	Total market value
Derivative financial instruments	16	(7)	(32)	–	(39)	(39)	–	(59)	–	(59)	(59)
Trade payables	24	–	–	(358)	(358)	(358)	–	–	(311)	(311)	(311)
Trade payables – within liabilities classified as held for sale		–	–	–	–	–	–	–	(22)	(22)	(22)
Bank loans and overdrafts	18	–	–	(3)	(3)	(3)	–	–	(43)	(43)	(43)
Other borrowings due within one year	18	–	–	(89)	(89)	(89)	–	–	(3)	(3)	(3)
Borrowings due after more than one year	18	–	–	(1,572)	(1,572)	(1,574)	–	–	(674)	(674)	(663)
Total financial liabilities		(7)	(32)	(2,022)	(2,061)	(2,063)	–	(59)	(1,053)	(1,112)	(1,101)

The market value of leases has been stated at book value.

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 bonds valued at £595m (2018: £661m) are classified as level 1. The Group's derivative assets valued at £54m (2018: £68m) and derivative liabilities valued at £39m (2018: £59m) are classified as level 2. The Group's investments in unlisted securities are valued at £122m (2018: £93m) and holding in other receivable is valued at £182m (2018: £nil); both are classified as level 3.

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

	2019			2018
All figures in £ millions	Other receivable	Investments in unlisted securities	Total	Investments in unlisted securities
At beginning of year	–	93	93	77
Exchange differences	1	(3)	(2)	4
Acquisition of investments and other receivable	181	12	193	13
Fair value movements	–	20	20	7
Disposal of investments	–	–	–	(8)
At end of year	182	122	304	93

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.

The fair value of the other receivable, which arose on the disposal of the US K12 Courseware business, is determined using present value techniques whereby the expected value of future cash flows is discounted using a rate which is representative of the creditworthiness of the US K12 Courseware business. The key inputs used in the present value calculations are forecast sales, discount rate and the expected date of a subsequent sale of the US K12 Courseware business. If the forecast sales used in the calculations were increased/ decreased by 5%, the value of the receivable would increase/decrease by approximately £20m. If the discount rate used in the calculations of 3.25% was increased/decreased by 1%, the value of the receivable would decrease/increase by approximately £5m. The calculations are not materially sensitive to reasonable changes in the expected date of a subsequent sale of the K12 business.

Notes to the consolidated financial statements

15. Other financial assets

All figures in £ millions	2019	2018
At beginning of year	93	77
Exchange differences	(3)	4
Acquisition of investments	12	13
Fair value movements	20	7
Disposal of investments	–	(8)
At end of year	122	93

Other financial assets include unlisted securities of £122m (2018: £93m) 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 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:

	2019			2018		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	336	13	–	404	13	–
Interest rate derivatives – not in a hedge relationship	557	2	(6)	362	3	–
Cross-currency rate derivatives – in a hedge relationship	502	29	(31)	577	51	(35)
FX derivatives – in a hedge relationship	555	6	(1)	434	–	(24)
FX derivatives – not in a hedge relationship	386	4	(1)	473	1	–
Total	2,336	54	(39)	2,250	68	(59)
Analysed as expiring:						
In less than one year	1,167	25	(15)	771	1	(23)
Later than one year and not later than five years	694	13	(6)	795	22	(1)
Later than five years	475	16	(18)	684	45	(35)
Total	2,336	54	(39)	2,250	68	(59)

The Group's treasury policies only allow derivatives to be traded where the objective is risk mitigation. These are then designated for hedge accounting using the following criteria:

› If the derivative and the underlying hedged exposure would normally be revalued through the income statement and valuation changes are expected to be perfectly or near perfectly equal and opposite, these will not be classified in a hedge relationship.

› Where interest rate and cross currency interest rate swaps are used to convert fixed rate debt to floating and we expect to receive inflows equal to the fixed rate debt interest, these are classified as fair value hedges.

› Where derivatives are used to create a future foreign currency liability to provide protection against currency movements affecting the valuation of an overseas investment, these are designated as a net investment hedge.

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%.

16. Derivative financial instruments and hedge accounting continued

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 3.6%. In addition to this the Group has executed additional interest rate swaps to offset the floating rate borrowings paying between 0.83% and 2.1%. At 31 December 2019, the Group had interest rate swap contracts to fix £557m of debt and a further £246m of outstanding fixed rate bonds bringing the total fixed rate debt to £803m. These 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 2019 were held at an average GBP/USD rate of 1.34. These derivatives are in designated net investment hedging relationships. The weighted average rate achieved for the bonds in a net investment hedge relationship was GBP/USD 1.59 for the USD bonds and EUR/GBP 0.86 for the euro bonds. Outstanding contracts on the cross currency swaps at 31 December 2019 were held at an average EUR/GBP rate of 0.79. These derivatives are in designated fair value hedging relationships.

At the end of 2019, 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 £(167)m, sterling £(166)m and euro £336m (2018: US dollar £(185)m, sterling £(215)m and euro £432m).

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.

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 in 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, there is an expectation that the value of the hedging instrument and the value of the hedged item will move in the opposite direction as a result of movements in the zero coupon Euribor curve. The hedge ratio is therefore expected to be 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.

The Group held the following instruments to hedge exposures to changes in interest rates and foreign currency risk associated with borrowings:

	2019		
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**
Derivative financial instruments for interest rate risk	**13**	**–**	**336**
Derivative financial instruments for currency risk	**25**	**(21)**	**336**

	2018		
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**
Derivative financial instruments for interest rate risk	13	(7)	404
Derivative financial instruments for currency risk	51	3	404

Notes to the consolidated financial statements

16. Derivative financial instruments and hedge accounting continued

The amounts at the reporting date relating to items designated as hedge items were as follows:

					2019
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	**(347)**	**(9)**	**–**	**–**	**n/a**
Currency risk					
Financial liabilities – borrowings	**(347)**	**n/a**	**21**	**–**	**n/a**

					2018
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.

The amounts related to items designated as hedging instruments were as follows:

					2019
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
Derivative financial instruments	**(21)**	**13**	**(722)**	**13**	**–**
Financial liabilities – borrowings	**(246)**	**10**	**(246)**	**10**	**–**

16. Derivative financial instruments and hedge accounting continued

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
					2018
Derivative financial instruments	(59)	(22)	(607)	(22)	–
Financial liabilities – borrowings	(256)	(10)	(256)	(10)	–

In addition to the above, £3m of hedging gains were recognised in OCI in relation to derivative financial instruments that matured during the year. Included in the translation reserve is a cost of hedging reserve of £2m relating to the time value of FX collars which is not separately disclosed due to materiality.

Offsetting arrangements with derivative counterparties

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

			2019			2018
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	52	(34)	18	67	(44)	23
Counterparties in a liability position	2	(5)	(3)	1	(15)	(14)
Total as presented in the balance sheet	54	(39)	15	68	(59)	9

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	2019	2018
Cash at bank and in hand	401	533
Short-term bank deposits	36	35
	437	568

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

At the end of 2019, the currency split of cash and cash equivalents was US dollar 30% (2018: 18%), sterling 12% (2018: 30%), and other 58% (2018: 52%).

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	2019	2018
Cash and cash equivalents	437	568
Bank overdrafts	(3)	(43)
	434	525

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	2019	2018
Non-current		
1.875% euro notes 2021 (nominal amount €195m; 2018 nominal amount €250m)	**170**	233
3.75% US dollar notes 2022 (nominal amount $117m)	**89**	92
3.25% US dollar notes 2023 (nominal amount $94m)	**72**	74
1.375% euro notes 2025 (nominal amount €300m)	**262**	273
Revolving credit facility	**230**	–
Lease liabilities (see note 35)	**749**	2
	1,572	674
Current		
Due within one year or on demand:		
Bank loans and overdrafts	**3**	43
Lease liabilities (see note 35)	**89**	3
	92	46
Total borrowings	**1,664**	720

Included in the non-current borrowings above is £5m of accrued interest (2018: £6m). Included in the current borrowings above is £nil of accrued interest (2018: £nil).

Prior to 1 January 2019 the Group leased certain equipment under a number of finance lease agreements which were included within Financial liabilities – borrowings. On the application of IFRS 16 at 1 January 2019 (see note 1b) all lease liabilities are now included within Financial liabilities – borrowings.

The maturities of the Group's non-current borrowings are as follows:

All figures in £ millions	2019	2018
Between one and two years	**251**	1
Between two and five years	**609**	400
Over five years	**712**	273
	1,572	674

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

	2019			2018		
All figures in £ millions	Effective interest rate	Carrying value	Market value	Effective interest rate	Carrying value	Market value
Bank loans and overdrafts	**n/a**	**3**	**3**	n/a	43	43
1.875% euro notes 2021	**2.04%**	**170**	**170**	2.04%	233	233
3.75% US dollar notes 2022	**3.94%**	**89**	**90**	3.94%	92	91
3.25% US dollar notes 2023	**3.36%**	**72**	**72**	3.36%	74	71
1.375% euro notes 2025	**1.44%**	**262**	**263**	1.44%	273	266
Revolving credit facility	**1.075%**	**230**	**230**	–	–	–
Lease liabilities	**n/a**	**838**	**838**	n/a	5	5
		1,664	**1,666**		720	709

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.

18. Financial liabilities – borrowings continued

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	2019	2018
US dollar	**539**	188
Sterling	**576**	23
Euro	**442**	506
Other	**107**	3
	1,664	720

The Group has $0.9bn (£0.7bn) of undrawn capacity on its committed borrowing facilities as at 31 December 2019 (2018: $1.75bn (£1.4bn) 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 lease obligations, the rights to the leased asset revert to the lessor in the event of default.

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 receives quarterly reports incorporating compliance with measurable targets and review, and approve, any changes to 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 organically and through acquisitions;
- To have a sustainable and progressive dividend policy, and;
- To return surplus cash to our shareholders where appropriate.

The Group aimed to maintain net debt at a level less than 1.5 times adjusted EBITDA before the adoption of IFRS 16 and less than 2.2 times adjusted 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.

At 31 December 2019 the Group was rated BBB (negative outlook) with Standard and Poor's and Baa2 (stable outlook) with Moody's.

Net debt

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

All figures in £ millions	2019	2018
Cash and cash equivalents	**437**	568
Derivative financial instruments	**15**	9
Bank loans and overdrafts	**(3)**	(43)
Bonds	**(593)**	(672)
Revolving credit facility	**(230)**	–
Investment in finance lease receivable	**196**	–
Lease liabilities	**(838)**	(5)
Net debt	**(1,016)**	(143)

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 2019, £1,641m of the Group's debt is held at fixed rates (2018: £674m), with £23m held at floating rates (2018: £103m), 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.

Notes to the consolidated financial statements

19. Financial risk management continued

Interest and foreign exchange rate management continued

As at 31 December 2019, the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

					2019
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	**122**	**–**	**–**	**(9)**	**11**
Other receivable	**182**	**–**	**–**	**(17)**	**20**
Cash and cash equivalents	**437**	**–**	**–**	**(32)**	**39**
Derivative financial instruments	**15**	**16**	**(18)**	**22**	**(23)**
Bonds	**(593)**	**11**	**(12)**	**53**	**(64)**
Other borrowings	**(1,071)**	**2**	**(2)**	**46**	**(56)**
Other net financial assets	**560**	**–**	**–**	**(43)**	**52**
Total financial instruments	**(348)**	**29**	**(32)**	**20**	**(21)**

					2018
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 £22m lower than the reported figure of £581m at £559m. Adjusted EBITDA translated at year-end closing rates would be £26m lower than the reported figure of £804m at £778m.

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 2019, the Group had cash of £0.4bn and an outstanding drawing of £230m on the US dollar denominated revolving credit facility due 2024 of $1.19bn (£0.9bn).

The $1.19bn facility contains interest cover and leverage covenants which the Group has complied with for the year ended 31 December 2019. 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 2019, the currency split of the Group's trade payables was US dollar £214m, sterling £57m and other currencies £87m (2018: US dollar £178m, sterling £57m and other currencies £98m) . Trade payables are all due within one year (2018: all due within one year).

The table opposite 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.

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.

19. Financial risk management continued

Financial counterparty and credit risk management continued

All figures in £ millions	Analysed by maturity: Greater than one month and less than one year	Later than one year but less than five years	Five years or more	Total	Analysed by currency: USD	GBP	Other	Total
At 31 December 2019								
Bonds	**12**	**354**	**259**	**625**	**177**	**–**	**448**	**625**
Rate derivatives – inflows	**(19)**	**(223)**	**(332)**	**(574)**	**(41)**	**(172)**	**(361)**	**(574)**
Rate derivatives – outflows	**23**	**237**	**331**	**591**	**242**	**344**	**5**	**591**
FX forwards – inflows	**(186)**	**(24)**	**–**	**(210)**	**–**	**(210)**	**–**	**(210)**
FX forwards – outflows	**186**	**23**	**–**	**209**	**209**	**–**	**–**	**209**
Total	**16**	**367**	**258**	**641**	**587**	**(38)**	**92**	**641**
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

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 2019, 84% of cash and cash equivalents was held with investment grade bank counterparties, 12% with AAA money market funds and 4% held with non-investment grade bank counterparties.

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.

Change of accounting policy: Amendments to IFRS 9 and IFRS 7

Pearson has considered the impact of IBOR reform on Pearson's hedge accounting. The Group has elected to early adopt the 'Amendments to IFRS 9, and IFRS 7 Interest Rate Benchmark Reform' issued in September 2019. In accordance with the transition provisions, the amendments have been adopted retrospectively to hedging relationships that existed at the start of the reporting period or were designated thereafter. The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform.

The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness continue should be recorded in the income statement. Furthermore, the amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present.

Pearson has a limited exposure to changes in the EUR IBOR benchmark. The Group has €395m (£336m) of Interest Rate Swaps which are in fair value hedge relationships of €395m (£336m). Pearson has considered a IBOR transition plan. Pearson currently anticipates that the areas of greatest change will be amendments to the contractual terms of EUR-IBOR-referenced floating-rate swaps, and updating hedge designations

In summary, the reliefs provided by the amendments that apply to the Group are:

› In assessing whether the hedge is expected to be highly effective on a forward-looking basis, the Group has assumed that the Euribor interest rate on which the cash flows of the interest rate swap that hedges fixed-rate Euro bonds is not altered by IBOR reform.

› The Group will not discontinue hedge accounting during the period of IBOR-related uncertainty solely because the retrospective effectiveness demonstrates ineffectiveness due to IBOR reform. The Group has assessed whether the hedged Euribor risk component is a separately identifiable risk only when it first designates the hedge and not on an ongoing basis

Notes to the consolidated financial statements

20. Intangible assets – pre-publication

All figures in £ millions	2019	2018
Cost		
At beginning of year	2,096	1,854
Exchange differences	(66)	70
Additions	306	328
Disposals	(82)	(158)
Transfer from property, plant and equipment	9	2
Transfer from intangible assets	12	–
At end of year	2,275	2,096
Amortisation		
At beginning of year	(1,279)	(1,113)
Exchange differences	53	(53)
Charge for the year	(261)	(271)
Disposals	82	158
At end of year	(1,405)	(1,279)
Carrying amounts at end of year	870	817

Included in the above are pre-publication assets amounting to £585m (2018: £577m) 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, in 2019 there was a £10m charge and additions of £13m relating to assets and liabilities held for sale. In 2018 £242m of pre-publication assets were included in assets classified as held for sale (see note 32) with a charge of £67m and additions of £60m in 2018 related to assets and liabilities held for sale.

21. Inventories

All figures in £ millions	2019	2018
Raw materials	5	5
Work in progress	2	–
Finished goods	155	149
Returns asset	7	10
	169	164

The cost of inventories recognised as an expense and included in the income statement in cost of goods sold amounted to £231m (2018: £375m). In 2019, £33m (2018: £39m) 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. 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 2019 (2018: £nil). The returns asset all relates to finished goods.

22. Trade and other receivables

All figures in £ millions	2019	2018
Current		
Trade receivables	**903**	874
Royalty advances	**4**	5
Prepayments	**138**	103
Investment in finance lease receivable	**25**	–
Deferred contract costs	**–**	1
Accrued income	**11**	2
Other receivables	**194**	193
	1,275	1,178
Non-current		
Trade receivables	**15**	30
Royalty advances	**–**	21
Prepayments	**7**	13
Investment in finance lease receivable	**171**	–
Deferred contract costs	**–**	1
Accrued income	**5**	10
Other receivables	**115**	25
	313	100

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 (2018: £nil). 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.

The movements in the provision for bad and doubtful debts are as follows:

All figures in £ millions	2019	2018
At beginning of year	**(96)**	(116)
Adjustment on initial application of IFRS 9	**–**	(12)
Exchange differences	**3**	2
Income statement movements	**(35)**	(1)
Utilised	**36**	31
At end of year	**(92)**	(96)

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	2019	2018
Within due date	**654**	606
Up to three months past due date	**155**	172
Three to six months past due date	**35**	72
Six to nine months past due date	**9**	16
Nine to 12 months past due date	**14**	24
More than 12 months past due date	**51**	14
Net trade receivables	**918**	904

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historical payment profiles, and assessment of forward looking risk factors. Management believes all the remaining receivable balances are fully recoverable.

Notes to the consolidated financial statements

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2019	42	102	5	16	165
Adjustment on initial application of IFRS 16 (see note 1b)	–	(101)	–	–	(101)
Exchange differences	(1)	–	–	(2)	(3)
Charged to income statement	–	10	–	67	77
Released to income statement	–	–	(5)	(15)	(20)
Utilised	(5)	(1)	–	(17)	(23)
Transfer from trade and other liabilities	–	6	–	–	6
Transfer to other liabilities	(36)	–	–	–	(36)
At 31 December 2019	–	16	–	49	65

Analysis of provisions:

					2019
All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
Current	–	9	–	43	52
Non-current	–	7	–	6	13
	–	16	–	49	65
					2018
Current	6	2	5	7	20
Non-current	36	100	–	9	145
	42	102	5	16	165

Deferred consideration primarily related to the formation of a venture in North America in 2011. This provision was reclassified to other liabilities during 2019.

Property provisions in 2018 predominantly related to restructuring and onerous leases. The main provisions related to the consolidation of London properties and were expected to be utilised from 2020. Uncertainties around property provisions related to prevailing market conditions including potential sublet income, lease terms including rent free periods, void periods, lease incentives and running costs. On the initial application of IFRS 16 (see note 1b) in 2019 onerous lease provisions have been offset against the relevant right-of-use asset. Property provisions in 2019 relate to restructuring and dilapidation provisions.

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	2019	2018
Trade payables	358	311
Sales return liability	122	173
Social security and other taxes	13	16
Accruals	295	397
Deferred income	360	387
Interest payable	28	46
Other liabilities	188	225
	1,364	1,555
Less: non-current portion		
Accruals	–	15
Deferred income	55	66
Other liabilities	31	74
	86	155
Current portion	1,278	1,400

24. Trade and other liabilities continued

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.

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

At 31 December 2019, the UK Group plan had approximately 26,000 members, analysed in the following table:

All figures in %	Active	Deferred	Pensioners	Total
Defined benefit	–	20	33	53
Defined contribution	12	35	–	47
Total	12	55	33	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.

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. A liability of £33m (2018: £23m) 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. 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 £512m at 31 December 2019 (2018: £453m).

Notes to the consolidated financial statements

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.

			2019			2018
All figures in %	**UK Group plan**	**Other plans**	**PRMB**	**UK Group plan**	**Other plans**	**PRMB**
Inflation	**3.0**	**1.7**	**1.5**	3.3	1.6	1.5
Rate used to discount plan liabilities	**2.0**	**3.0**	**3.1**	2.8	4.0	4.1
Expected rate of increase in salaries	**3.5**	**2.9**	**3.0**	3.8	2.9	3.0
Expected rate of increase for pensions in payment and deferred pensions	**1.85 to 5.05**	**–**	**–**	2.1 to 5.1	–	–
Initial rate of increase in healthcare rate	**–**	**–**	**6.8**	–	–	7.0
Ultimate rate of increase in healthcare rate	**–**	**–**	**5.0**	–	–	5.5

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% 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% has been used.

The expected rate of increase in salaries has been set at 3.5% for 2019.

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 (Pri – 2012) and 2019 improvement scale (MP – 2019) 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:

		UK		US
All figures in years	**2019**	**2018**	**2019**	**2018**
Male	**24.0**	23.8	**20.6**	20.7
Female	**24.3**	24.5	**22.6**	22.7

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:

		UK		US
All figures in years	**2019**	**2018**	**2019**	**2018**
Male	**25.5**	25.4	**22.2**	22.3
Female	**26.1**	26.3	**24.1**	24.2

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
						2019
Current service cost	6	3	9	57	–	66
Past service cost	–	–	–	–	–	–
Curtailments	(2)	–	(2)	–	(1)	(3)
Administration expenses	6	–	6	–	–	6
Total operating expense	10	3	13	57	(1)	69
Interest on plan assets	(89)	(5)	(94)	–	–	(94)
Interest on plan liabilities	73	6	79	–	2	81
Net finance (income)/expense	(16)	1	(15)	–	2	(13)
Net income statement charge	(6)	4	(2)	57	1	56

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

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
				2019				2018
Fair value of plan assets	3,341	120	–	3,461	3,240	141	–	3,381
Present value of defined benefit obligation	(2,912)	(138)	(19)	(3,069)	(2,671)	(158)	(19)	(2,848)
Net pension asset/(liability)	429	(18)	(19)	392	569	(17)	(19)	533
Other post-retirement medical benefit obligation				(43)				(49)
Other pension accruals				(12)				(13)
Net retirement benefit asset				337				471
Analysed as:								
Retirement benefit assets				429				571
Retirement benefit obligations				(92)				(100)

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

All figures in £ millions	2019	2018
Amounts recognised for defined benefit plans	(148)	16
Amounts recognised for post-retirement medical benefit plans	3	6
Total recognised in year	(145)	22

Notes to the consolidated financial statements

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

The fair value of plan assets comprises the following:

	2019			2018		
All figures in %	UK Group plan	Other funded plans	Total	UK Group plan	Other funded plans	Total
Insurance	43	–	43	28	1	29
Equities	1	1	2	1	1	2
Bonds	5	2	7	–	2	2
Property	5	–	5	7	–	7
Pooled asset investment funds	30	–	30	44	–	44
Other	13	–	13	16	–	16

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:

	2019		2018	
All figures in %	Quoted market price	No quoted market price	Quoted market price	No quoted market price
Insurance	43	–	29	–
Non-UK equities	–	2	–	2
Fixed-interest securities	7	–	2	–
Property	–	5	–	7
Pooled asset investment funds	30	–	44	–
Other	–	13	–	16
Total	80	20	75	25

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

All figures in %	2019	2018
Liquid – call <1 month	37	51
Less liquid – call 1–3 months	–	–
Illiquid – call >3 months	63	49

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	2019 UK Group plan	2019 Other plans	2019 Total	2018 UK Group plan	2018 Other plans	2018 Total
Fair value of plan assets						
Opening fair value of plan assets	3,240	141	3,381	3,337	155	3,492
Exchange differences	–	(5)	(5)	–	4	4
Interest on plan assets	89	5	94	82	5	87
Return on plan assets excluding interest	133	13	146	(45)	(13)	(58)
Contributions by employer	3	2	5	6	1	7
Benefits paid	(124)	(16)	(140)	(140)	(11)	(151)
Other	–	(20)	(20)	–	–	–
Closing fair value of plan assets	3,341	120	3,461	3,240	141	3,381
Present value of defined benefit obligation						
Opening defined benefit obligation	(2,671)	(177)	(2,848)	(2,792)	(181)	(2,973)
Exchange differences	–	5	5	–	(3)	(3)
Current service cost	(6)	(3)	(9)	(7)	(2)	(9)
Past service cost	–	–	–	(8)	–	(8)
Curtailments	2	–	2	–	–	–
Administration expenses	(6)	–	(6)	(6)	–	(6)
Interest on plan liabilities	(73)	(6)	(79)	(68)	(6)	(74)
Actuarial gains/(losses) – experience	(6)	(1)	(7)	(49)	(2)	(51)
Actuarial gains/(losses) – demographic	18	1	19	(12)	–	(12)
Actuarial gains/(losses) – financial	(294)	(12)	(306)	131	6	137
Contributions by employee	–	–	–	–	–	–
Other	–	20	20	–	–	–
Benefits paid	124	16	140	140	11	151
Closing defined benefit obligation	(2,912)	(157)	(3,069)	(2,671)	(177)	(2,848)

The weighted average duration of the defined benefit obligation is 16 years for the UK and 8 years for the US.

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

All figures in £ millions	2019	2018
Opening defined benefit obligation	(49)	(67)
Exchange differences	1	(2)
Current service cost	–	1
Curtailments	1	11
Interest on plan liabilities	(2)	(2)
Actuarial gains/(losses) – experience	4	4
Actuarial gains/(losses) – demographic	1	–
Actuarial gains/(losses) – financial	(2)	2
Benefits paid	3	4
Closing defined benefit obligation	(43)	(49)

Notes to the consolidated financial statements

25. Retirement benefit and other post-retirement obligations continued

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 91.5% to matching assets and 8.5% 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 employer contributions to the plan in respect of the defined benefit sections are estimated to be £3m for 2020.

Sensitivities

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

All figures in £ millions	2019 1% increase	2019 1% decrease
Effect:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(434)	591
(Decrease)/increase in defined benefit obligation – US plan	(11)	13

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

All figures in £ millions	2019 One year increase	2019 One year decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	132	(126)
Increase/(decrease) in defined benefit obligation – US plan	8	(8)

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

All figures in £ millions	2019 0.5% increase	2019 0.5% decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	153	(136)
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	2019	2018
Pearson plans	25	37

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 Depositary 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 2019 and May 2018 vest dependent on relative total shareholder return, return on invested capital and adjusted earnings per share growth. Other restricted shares awarded in 2019 and 2018 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 2018 Management Incentive Plan were granted in April 2019. Restricted shares awarded as part of the 2019 Management Incentive Plan will be granted in April 2020.

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

	2019		2018	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	2,728	5.76	2,981	6.84
Granted during the year	660	6.77	729	5.80
Exercised during the year	(419)	6.74	(70)	6.57
Forfeited during the year	(492)	6.21	(668)	7.58
Expired during the year	(83)	11.15	(244)	8.19
Outstanding at end of year	2,394	6.06	2,728	5.76
Options exercisable at end of year	161	7.14	169	11.31

Options were exercised regularly throughout the year. The weighted average share price during the year was £8.07 (2018: £8.45). 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:

	2019		2018	
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	2,376	1.94	2,553	2.29
>10	18	1.04	175	0.29
	2,394	1.93	2,728	2.16

Notes to the consolidated financial statements

26. Share-based payments

In 2019 and 2018, 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:

	2019 Weighted average	2018 Weighted average
Fair value	**£2.31**	£1.88
Weighted average share price	**£8.30**	£7.49
Weighted average exercise price	**£6.77**	£5.80
Expected volatility	**32.07%**	35.78%
Expected life	**3.7 years**	3.7 years
Risk-free rate	**0.66%**	0.87%
Expected dividend yield	**2.11%**	5.21%
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:

	2019		2018	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	**2,785**	**8.09**	2,907	7.55
Management Incentive Plan	**1,435**	**8.49**	2,035	7.45

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 plans 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 2018	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
Issue of ordinary shares – share option schemes	**1,021**	**–**	**7**
Purchase of own shares	**–**	**–**	**–**
At 31 December 2019	**782,099**	**195**	**2,614**

The ordinary shares have a par value of 25p per share (2018: 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. 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 2019 was £11m (2018: £11m).

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.

27. Share capital and share premium continued

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 2018	5,994	61
Purchase of treasury shares	–	–
Release of treasury shares	(2,769)	(28)
At 31 December 2018	3,225	33
Purchase of treasury shares	**6,100**	**52**
Release of treasury shares	**(6,067)**	**(61)**
At 31 December 2019	**3,258**	**24**

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% (2018: 0.4%) 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 (2018: £0.8m). Dividends on treasury shares are waived.

At 31 December 2019, the market value of Pearson plc treasury shares was £21m (2018: £30m).

29. Other comprehensive income

	2019					
	Attributable to equity holders of the company					
All figures in £ millions	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	**–**	**(113)**	**–**	**(113)**	**–**	**(113)**
Net exchange differences on translation of foreign operations – associates	**–**	**(2)**	**–**	**(2)**	**–**	**(2)**
Currency translation adjustment disposed	**–**	**4**	**–**	**4**	**–**	**4**
Attributable tax	**–**	**–**	**5**	**5**	**–**	**5**
Items that are not reclassified to the income statement						
Fair value gain on other financial assets	**20**	**–**	**–**	**20**	**–**	**20**
Attributable tax	**–**	**–**	**(4)**	**(4)**	**–**	**(4)**
Remeasurement of retirement benefit obligations – Group	**–**	**–**	**(145)**	**(145)**	**–**	**(145)**
Remeasurement of retirement benefit obligations – associates	**–**	**–**	**(4)**	**(4)**	**–**	**(4)**
Attributable tax	**–**	**–**	**22**	**22**	**–**	**22**
Other comprehensive (expense)/income for the year	**20**	**(111)**	**(126)**	**(217)**	**–**	**(217)**

Notes to the consolidated financial statements

29. Other comprehensive income continued

						2018
	Attributable to equity holders of the company					
All figures in £ millions	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

30. Business combinations

During the year the Group made some small acquisitions, including Lumerit Education and Smart Sparrow, for total consideration of £40m. Details of the assets acquired, and the associated consideration, are shown in the table below.

all figures in £ millions	2019
Intangible assets	**23**
Trade and other receivables	**1**
Trade and other liabilities	**(2)**
Net assets acquired	**22**
Goodwill	**18**
Total	**40**
Satisfied by:	
Cash	**40**
Total consideration	**40**

There were no significant acquisitions in 2018. There were no material adjustments to prior year acquisitions in 2019. The net cash outflow relating to acquisitions in the year is shown below.

All figures in £ millions	2019	2018
Cash flow on acquisitions		
Cash – current year acquisitions	**(40)**	–
Deferred payments for prior year acquisitions and other items	**(5)**	(5)
Net cash outflow	**(45)**	(5)

During 2019, the Group's associate, Penguin Random House raised additional capital from its owners in proportion to their equity interests with the Group's share being £40m.

31. Disposals

In March 2019, the Group completed the sale of its US K12 Courseware business resulting in a pre-tax profit on sale of £13m. Total gross proceeds were £200m including £180m of deferred proceeds which include the fair value of an unconditional vendor note for $225m and an entitlement to 20% of future cash flows to equity holders and 20% of net proceeds in the event of a subsequent sale (see note 14 for further details). Tax on the disposal is a benefit of £51m. Other disposal items relate to investment sales and adjustments to prior year transactions.

				2019	2018
All figures in £ millions	Notes	K12	Other	Total	Total
Disposal of subsidiaries and associates					
Property, plant and equipment		–	–	–	(17)
Intangible assets		(101)	–	(101)	(17)
Investments in joint ventures and associates		–	–	–	(3)
Net deferred income tax assets		(100)	–	(100)	–
Intangible assets – pre-publication		(238)	–	(238)	(8)
Inventories		(64)	–	(64)	(1)
Trade and other receivables		(70)	–	(70)	(30)
Cash and cash equivalents (excluding overdrafts)		(104)	–	(104)	(119)
Net deferred income tax liabilities		–	–	–	16
Trade and other liabilities		520	–	520	172
Provisions for other liabilities and charges		–	–	–	1
Cumulative currency translation adjustment	29	(4)	–	(4)	4
Net assets disposed		(161)	–	(161)	(2)
Cash received		20	–	20	243
Deferred proceeds		180	–	180	2
Fair value of financial asset acquired		–	–	–	3
Costs		(26)	3	(23)	(16)
Gain on disposal		13	3	16	230

All figures in £ millions	2019	2018
Cash flow from disposals		
Cash – current year disposals	20	243
Cash and cash equivalents disposed	(104)	(119)
Costs and other disposal liabilities paid	(17)	(23)
Net cash (outflow)/inflow	(101)	101
Analysed as:		
Cash (outflow)/inflow from sale of subsidiaries	(101)	83
Cash inflow from sale of joint ventures and associates	–	18

Notes to the consolidated financial statements

32. Held for sale

The held for sale asset in 2019 is the 25% holding in Penguin Random House following announcement of the sale in December 2019. Held for sale assets and liabilities in 2018 related to the US K12 Courseware business prior to disposal in 2019.

All figures in £ millions	2019 Total	2018 Total
Non-current assets		
Intangible assets	–	168
Investments in joint ventures and associates	397	–
Deferred income tax assets	–	98
Trade and other receivables	–	25
	397	291
Current assets		
Intangible assets – pre-publication	–	242
Inventories	–	55
Trade and other receivables	–	60
	–	357
Assets classified as held for sale	397	648
Non-current liabilities		
Other liabilities	–	(371)
	–	(371)
Current liabilities		
Trade and other liabilities	–	(202)
	–	(202)
Liabilities classified as held for sale	–	(573)
Net assets classified as held for sale	397	75

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 Group has historically presented the results of PRH separately within segment information (see note 2) to provide further information about the composition of the Group outside of the primary segments. The Group has not viewed Penguin Random House as comprising a separate major line of business since the sale of 22% of the Group's stake in Penguin Random House to Bertelsmann in 2017. On this basis, the Group has not classified Penguin Random House as a discontinued operation.

33. Cash generated from operations

All figures in £ millions	Notes	2019	2018
Profit		**266**	590
Adjustments for:			
Income tax		**(34)**	(92)
Depreciation	10	**123**	66
Amortisation and impairment of acquired intangibles and goodwill	11	**151**	99
Amortisation of software	11	**115**	88
Net finance costs	6	**43**	55
Charges relating to GMP equalisation		**–**	8
Share of results of joint ventures and associates	12	**(54)**	(44)
Profit on disposal of subsidiaries, associates, investments and fixed assets		**(9)**	(315)
Net profit on disposal of right-of-use assets held under leases		**(4)**	–
Net foreign exchange adjustment from transactions		**(21)**	28
Investment income		**(2)**	–
Share-based payment costs	26	**25**	37
Pre-publication		**(55)**	(37)
Inventories		**(20)**	(10)
Trade and other receivables		**59**	(15)
Trade and other liabilities		**(157)**	35
Retirement benefit obligations		**5**	(9)
Provisions for other liabilities and charges		**49**	63
Net cash generated from operations		**480**	547
Dividends from joint ventures and associates		**64**	117
Re-capitalisation dividends from Penguin Random House		**–**	(50)
Purchase of property, plant and equipment		**(55)**	(74)
Acquisition of new right-of-use lease assets		**(64)**	–
Purchase of intangible software assets		**(138)**	(130)
Proceeds from sale of property, plant and equipment and intangible software assets		**1**	128
Disposal of right-of-use lease assets		**17**	–
Investment income		**2**	–
Net cost paid for/(proceeds from) major restructuring		**111**	(25)
Operating cash flow		**418**	513
Operating tax paid		**(9)**	(43)
Net operating finance costs paid		**(64)**	(22)
Operating free cash flow		**345**	448
Non-operating tax paid		**(21)**	–
Net (cost paid for)/proceeds from major restructuring		**(111)**	25
Free cash flow		**213**	473
Dividends paid (including to non-controlling interests)		**(148)**	(137)
Net movement of funds from operations		**65**	336
Acquisitions and disposals		**(193)**	92
Re-capitalisation dividends from Penguin Random House		**–**	50
Loans (advanced)/repaid (including to related parties)		**(49)**	46
New equity		**7**	6
Buyback of equity		**–**	(153)
Purchase of treasury shares		**(52)**	–
Other movements on financial instruments		**(9)**	(6)
Net movement of funds		**(231)**	371
Exchange movements on net debt		**24**	(82)
Total movement in net debt		**(207)**	289
Opening net debt		**(143)**	(432)
Adjustment on initial application of IFRS 16		**(666)**	–
Closing net debt		**(1,016)**	(143)

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	2019	2018
Net book amount	**3**	41
Profit/(loss) on sale of property, plant and equipment	**(2)**	87
Proceeds from sale of property, plant and equipment	**1**	128

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

All figures in £ millions	2018	IFRS 16 Transition	New leases/ disposal of leases	Transfer from non-current to current	Financing cash flows	Foreign exchange movements	Fair value and other movements	2019
Financial liabilities								
Non-current borrowings	643	792	61	(88)	230	(80)	9	**1,567**
Current borrowings	25	89	–	88	(139)	16	–	**79**
Total	668	881	61	–	91	(64)	9	**1,646**

Non-current borrowings include bonds, derivative financial instruments and leases. Current borrowings include loans repayable within one year and leases, but exclude overdrafts classified within cash and cash equivalents.

34. Contingencies and commitments

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.

On 25 April 2019, the European Commission published the full decision that the United Kingdom controlled foreign company group financing partial exemption (FCPE) partially constitutes State Aid. The Group has lodged an appeal. 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.

During 2019 the Group received an assessment from the tax authorities in Brazil challenging the deduction for tax purposes of goodwill amortisation for the years 2013 to 2016. Similar assessments may be raised for other years. Potential total exposure could be up to £124m (BRL 656m) up to 31 December 2019, with additional potential exposure of £45m (BRL 239m) in relation to deductions expected to be taken in future periods. Such assessments are common in Brazil. The Group believes that the likelihood that the tax authorities will ultimately prevail is low, and that the Group's position is strong. At present the Group believes no provision is required.

At the balance sheet date there were no commitments for capital expenditure contracted for but not yet incurred. Commitments in respect of leases are shown in note 35.

35. Leases

The Group's lease portfolio consists of approximately 750 property leases, mainly offices and test centres, together with a number of vehicle and equipment leases. The Group has adopted IFRS 16 'Leases' at 1 January 2019 and applied the modified retrospective approach. Comparatives for 2018 have not been restated. The Group has elected not to recognise right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low value assets. The Group recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

Disclosure required by IFRS 16:

As a lessee:

The amounts recognised in the income statement are as follows:

All figures in £ millions	Note	2019
Interest on lease liabilities	6	**(45)**
Expenses relating to short-term leases		**(2)**
Depreciation of right-of-use assets	10	**(64)**

35. Leases continued

Right-of-use assets comprise the following and are included within property, plant and equipment in the balance sheet:

All figures in £ millions	Land and buildings 2019	Plant and equipment 2019	Total 2019
Balance at 1 January 2019	–	–	–
Adjustment on initial application of IFRS 16 (see note 1b)	418	6	424
Balance at 31 December 2019	402	7	409

For additional analysis of the right-of-use assets, including additions, depreciation and disposals, see note 10.

Lease liabilities are included within financial liabilities – borrowings in the balance sheet, see note 18. The maturities of the Group's lease liabilities are as follows:

All figures in £ millions	2019
Less than one year	123
One to five years	420
More than five years	622
Total undiscounted lease liabilities	1,165
Lease liabilities included in the balance sheet	838
Analysed as:	
Current	89
Non-current	749

The amounts recognised in the cash flow statement are as follows:

All figures in £ millions	2019
Total cash outflow for leases as a lessee	136

At the balance sheet date commitments for capital leases contracted for but not yet incurred were £25m. Extension and termination options and variable lease payments are not significant within the lease portfolio. Short-term leases to which the Group is committed at the balance sheet date are similar to the portfolio of short-term leases to which the short-term lease expense is disclosed above.

As a lessor:

In the event that the Group has excess capacity in its leased offices and warehouses, the Group sub-leases some of its properties under operating and finance leases.

The amounts recognised in the income statement are as follows:

All figures in £ millions	Note	2019
Interest on finance lease receivable	6	11
Income from sub-leasing right-of-use assets (within other income)		17

The amounts recognised in the cash flow statement are as follows:

All figures in £ millions	2019
Total cash inflow for leases as a lessor	37

During the year the investment in finance lease receivable decreased by £19m due to payments received.

Notes to the consolidated financial statements

35. Leases continued

The following table sets out the maturity analysis of lease payments receivable for sub-leases classified as operating leases, showing the undiscounted lease payments to be received after the reporting date, and sub-leases classified as finance leases showing the undiscounted lease payments to be received after the reporting date and the net investment in the finance lease receivable.

All figures in £ millions	Operating leases	Finance leases	2019 Total
Less than one year	12	34	**46**
One to two years	4	40	**44**
Two to three years	4	33	**37**
Three to four years	3	30	**33**
Four to five years	3	31	**34**
More than five years	20	67	**87**
Total undiscounted lease payments receivable	46	235	**281**
Unearned finance income		(39)	
Net investment in finance lease receivable		196	

IAS 17 disclosure for 2018:

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

All figures in £ millions	2018
Finance lease liabilities – minimum lease payments	
Not later than one year	3
Later than one year and not later than two years	1
Later than two years and not later than three years	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

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

All figures in £ millions	2018
Not later than one year	3
Later than one year and not later than five years	2
Later than five years	–
	5

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

In 2018 the Group leased various offices and warehouses under non-cancellable operating lease agreements. The leases had varying terms and renewal rights. The Group also leased various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement in 2018 was £128m. The future aggregate minimum lease payments in respect of operating leases were as follows:

All figures in £ millions	2018
Not later than one year	143
Later than one year and not later than two years	130
Later than two years and not later than three years	115
Later than three years and not later than four years	101
Later than four years and not later than five years	91
Later than five years	595
	1,175

35. Leases continued

In the event that the Group had excess capacity in its leased offices and warehouses, it entered 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 were as follows:

All figures in £ millions	2018
Not later than one year	51
Later than one year and not later than two years	44
Later than two years and not later than three years	41
Later than three years and not later than four years	39
Later than four years and not later than five years	35
Later than five years	124
	334

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 p57). It is this Committee which had responsibility for planning, directing and controlling the activities of the Group in 2019. Key management personnel compensation is disclosed below:

All figures in £millions	2019	2018
Short-term employee benefits	**5**	6
Retirement benefits	**1**	1
Share-based payment costs	**4**	7
Total	**10**	14

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

37. Events after the balance sheet date

In January 2020, the Group commenced a £350m share buyback programme in connection with the announcement in December 2019 of the sale of its remaining 25% interest in Penguin Random House.

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 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 Limited	07970304
Pearson International Finance Limited	02496206
Pearson Loan Finance No. 3 Limited	05052661

	Company number
Pearson Loan Finance No. 4 Limited	02635107
Pearson Loan Finance No. 5 Limited	12017252
Pearson Loan Finance No. 6 Limited	12030662
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
PVNT Limited	08038068
TQ Catalis Limited	07307943
TQ Clapham Limited	07307925
TQ Global Limited	07802458

Company balance sheet

As at 31 December 2019

All figures in £ millions	Notes	2019	2018
Assets			
Non-current assets			
Investments in subsidiaries	2	**6,664**	6,710
Amounts due from subsidiaries		**2,122**	2,269
Deferred income tax assets		**21**	–
Financial assets – derivative financial instruments	6	**29**	67
		8,836	9,046
Current assets			
Amounts due from subsidiaries		**827**	361
Amounts due from related parties	11	**48**	–
Current income tax assets		**2**	28
Cash and cash equivalents (excluding overdrafts)	4	**18**	50
Financial assets – derivative financial instruments	6	**25**	1
Other assets		**2**	–
		922	440
Total assets		**9,758**	9,486
Liabilities			
Non-current liabilities			
Amounts due to subsidiaries		**(2,740)**	(2,944)
Financial liabilities – borrowings	5	**(230)**	–
Financial liabilities – derivative financial instruments	6	**(24)**	(36)
		(2,994)	(2,980)
Current liabilities			
Amounts due to subsidiaries		**(1,800)**	(2,007)
Financial liabilities – borrowings	5	**–**	(11)
Other liabilities		**(5)**	(8)
Financial liabilities – derivative financial instruments	6	**(15)**	(23)
		(1,820)	(2,049)
Total liabilities		**(4,814)**	(5,029)
Net assets		**4,944**	4,457
Equity			
Share capital	7	**195**	195
Share premium	7	**2,614**	2,607
Treasury shares	8	**21**	12
Capital redemption reserve		**11**	11
Special reserve		**447**	447
Retained earnings – including profit for the year of £789m (2018: loss of £160m)		**1,656**	1,185
Total equity attributable to equity holders of the company		**4,944**	4,457

These financial statements have been approved for issue by the Board of Directors on 6 March 2020 and signed on its behalf by

Coram Williams
Chief Financial Officer

Company statement of changes in equity

Year ended 31 December 2019

All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Special reserve	Retained earnings	Total
	Equity attributable to equity holders of the company						
At 1 January 2019	195	2,607	12	11	447	1,185	4,457
Profit for the year	–	–	–	–	–	789	789
Issue of ordinary shares under share option schemes[1]	–	7	–	–	–	–	7
Buyback of equity	–	–	–	–	–	–	–
Purchase of treasury shares	–	–	(52)	–	–	–	(52)
Release of treasury shares	–	–	61	–	–	(61)	–
Capital reduction	–	–	–	–	–	(110)	(110)
Dividends	–	–	–	–	–	(147)	(147)
At 31 December 2019	**195**	**2,614**	**21**	**11**	**447**	**1,656**	**4,944**

All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Special reserve	Retained earnings	Total
	Equity attributable to equity holders of the company						
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]	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

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 (2018: £162m) relating to profit on intra-Group disposals that is not distributable.

1 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 2019

All figures in £ millions	Notes	2019	2018
Cash flows from operating activities			
Net profit/(loss)		789	(160)
Adjustments for:			
Income tax		–	(26)
Net finance costs		29	107
Disposals, liquidations and impairment charges		–	57
Amounts due (to)/from subsidiaries		(818)	302
Net cash generated from operations		–	280
Interest paid		(26)	(68)
Tax paid		7	(7)
Net cash generated from operating activities		(19)	205
Cash flows from investing activities			
Loans (advanced to) /repaid by related parties		(49)	46
Interest received		–	4
Net cash received (used in)/ from investing activities		(49)	50
Cash flows from financing activities			
Proceeds from issue of ordinary shares	7	7	6
Buyback of equity		(52)	(153)
Repayment of borrowings		–	(44)
Proceeds from borrowings		230	–
Dividends paid to company's shareholders		(147)	(136)
Net cash used in financing activities		38	(327)
Effects of exchange rate changes on cash and cash equivalents		9	(5)
Net decrease in cash and cash equivalents		(21)	(77)
Cash and cash equivalents at beginning of year		39	116
Cash and cash equivalents at end of year	4	18	39

Notes to the company financial statements

1. Accounting policies

The financial statements on p188-198 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 (2018: nil).

The basis of preparation and accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1a 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.

Amounts owed by subsidiaries

Amounts owed by subsidiaries generally mature within five years, but can be called upon on short notice, or are repayable on demand. The company has assessed and concluded that these loans will be fully recovered. Therefore credit losses are considered to be immaterial.

New accounting standards

The following standards were adopted in 2019:

› IFRS 16 Leases

› IFRIC 23 Uncertainty over Income Tax Treatment

› Amendments to IFRS 9 and IFRS 7

Adoption of these standards has not had a material impact on the company financial statements.

2. Investments in subsidiaries

All figures in £ millions	2019	2018
At beginning of year	**6,710**	6,691
Impairments	**–**	(57)
Currency revaluations	**(46)**	76
At end of year	**6,664**	6,710

Impairments in 2018 related to the carrying value of intermediate holding company investments. There were no impairments in 2019.

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 consolidated 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 and current borrowings. 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 a £16m increase in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in an £18m decrease in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £23m, while a 10% weakening in the value of sterling would increase the carrying value by £22m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

Notes to the company financial statements

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 2019								
Rate derivatives – inflows	**(19)**	**(223)**	**(332)**	**(574)**	**(41)**	**(172)**	**(361)**	**(574)**
Rate derivatives – outflows	**23**	**237**	**331**	**591**	**242**	**344**	**5**	**591**
FX forwards – inflows	**(186)**	**(24)**	**–**	**(210)**	**–**	**(210)**	**–**	**(210)**
FX forwards – outflows	**186**	**23**	**–**	**209**	**209**	**–**	**–**	**209**
Total	**4**	**13**	**(1)**	**16**	**410**	**(38)**	**(356)**	**16**
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

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 subsidiaries 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 £1.3bn (2018: £1.4bn) and the change in value during the year which was used to assess hedge ineffectiveness was £46m (2018: £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	2019	2018
Cash at bank and in hand	**18**	50
	18	50

At the end of 2019 the currency split of cash and cash equivalents was US dollar 2% (2018: 0%), sterling 59% (2018: 79%) and other 39% (2018: 21%).

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	2019	2018
Cash and cash equivalents	**18**	50
Bank overdrafts	**–**	(11)
	18	39

5. Financial liabilities – borrowings

All figures in £ millions	2019	2018
Non-current		
Revolving credit facility	230	–
	230	–
Current		
Due within one year or on demand:		
Bank loans and overdrafts	–	11
	–	11
Total borrowings	230	11

Current borrowings 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 in 2018 are denominated in US dollars.

6. Derivative financial instruments

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

	2019			2018		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives	893	15	(6)	766	16	–
Cross-currency rate derivatives	502	29	(31)	577	51	(35)
FX derivatives	941	10	(2)	907	1	(24)
Total	2,336	54	(39)	2,250	68	(59)
Analysed as expiring:						
In less than one year	1,167	25	(15)	771	1	(23)
Later than one year and not later than five years	694	13	(6)	795	22	(1)
Later than five years	475	16	(18)	684	45	(35)
Total	2,336	54	(39)	2,250	68	(59)

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 2018	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
Issue of ordinary shares – share option schemes	1,021	–	7
Purchase of own shares	–	–	–
At 31 December 2019	782,099	195	2,614

The ordinary shares have a par value of 25p per share (2018: 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. 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 2019 was £11m (2018: £11m).

Notes to the company financial statements

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2018	5,994	16
Release of treasury shares	(2,769)	(28)
At 31 December 2018	3,225	(12)
Purchase of treasury shares	**6,100**	**52**
Release of treasury shares	**(6,067)**	**(61)**
At 31 December 2019	**3,258**	**(21)**

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 (2018: £0.8m). At 31 December 2019, the market value of the company's treasury shares was £21m (2018: £30m). The gross book value of the shares at 31 December 2019 amounts to £24m. This value has been netted off with contributions received from operating companies of £45m, resulting in a net credit value of £21m.

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 (2018: £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 £104m (2018: £105m) and interest and guarantee fees receivable from subsidiaries for the year of £91m (2018: £105m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £45m (2018: £59m). Management fees receivable from subsidiaries in respect of centrally provided services amounted to £35m (2018: £35m). Dividends received from subsidiaries were £803m (2018: £nil).

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 2019 was £48m (2018: £nil). 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 2019. Key management personnel compensation is disclosed in note 36 to the consolidated 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 2019 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
ATI Professional Development LLC	US	4
Atkey Finance Limited	IE	7
Axis Finance Inc.	US	4
Camsaw, Inc.	US	4
CAMSAWUSA, Inc.	US	31
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 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 Nevada, LLC	US	34
Connections Academy of New Mexico, LLC	US	35
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
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
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 II limited	CN	56
Globe Fearon Inc.	US	19
Guangzhou Crescent Software Co., Ltd†	CN	64
Heinemann Education Botswana (Publishers) (Proprietary) Limited	BW	65
IndiaCan Education Private Limited	IN	2
Integral 7, Inc.	US	4
INTELLIPRO, INC.	US	14
Kagiso Education Pty Ltd*	ZA	50
Knowledge Analysis Technologies, LLC	US	20
LCCIEB Training Consultancy., Ltd	CN	69
LessonLab, Inc.	US	19
Lignum Oil Company	US	4
LION SG PTE. LTD	SG	5
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 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
Lumerit Education, LLC	US	44
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
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	8
Pearson Education do Brasil Ltda	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

Notes to the company financial statements

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 Four Limited†	UK	1
Pearson Funding plc†	UK	1
Pearson Holdings Inc.	US	4
Pearson Holdings Southern Africa (Pty) Limited	ZA	50
Pearson Hungary LLC	HU	27
Pearson India Education Services Private Limited	IN	2
Pearson India Support Services Private Limited*	IN	18
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	68
Pearson Lanka (Private) Limited	LK	67
Pearson Lanka Support Services (Private) Limited	LK	13
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.5 Limited	UK	1
Pearson Loan Finance No. 6 Limited	UK	1
Pearson Loan Finance Unlimited	UK	1
Pearson Longman Uganda Limited	UG	46
Pearson Malaysia Sdn. Bhd.	MY	62
Pearson Management Services Limited†	UK	1
Pearson Management Services Philippines Inc.	PH	36
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 Phoenix Pty Ltd	AU	51
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	29
Penguin Capital, LLC	US	4
Phumelela Publishers (Pty) Ltd*	ZA	50
PN Holdings Inc.	US	4
ProctorCam, Inc.	US	33
PT Efficient English Services	ID	89
PVNT Limited	UK	1
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
Sparrow Phoenix Pty Ltd	AU	25
Spear Insurance Company Limited†	BM	48
Stark Verlag GmbH	DE	88
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
Vue Testing Services Israel Ltd	IL	49
Vue Testing Services Korea Limited	KR	38
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	The HIVE, 3rd Floor, No 44, Pilliayar Koil Street, Jawaharlal Nehru Road, Anna Nagar, Chennai, TN 600040, 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	Evergreen House North, Grafton Place, London, NW1 32DX England
7	1st Floor The Liffey Trust Centre, 117-126 Sheriff Street Upper, Dublin 1, Ireland
8	Unit 3, Lot 20613, Gaborone, Botswana
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, 21093-2264, United States
12	No 1400, Francisco Matarazzo Avenue 7th and 8th floor, São Paulo, SP, 05001-903, Brazil
13	#1, 3, 5th Floor, East Tower, World Trade Centre, Echelon Square, Colombo, O1, Sri Lanka
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, e 2, Sala 10, Parque Cidade Campinas, City of Campinas, São Paulo 13069-036, Brazil
18	7th Floor, SDB2, ODC 7, 8 & 9, Survey No.01 ELCOT IT/ ITES-SEZ, Shollinganallur, Chennai, TN, TN 600119, India
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	500, 401, Calle de la Tanca Edificio Ochoa, San Juan, 00901-1969, Puerto Rico
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	N-94, S-2 Outer Ring Road Panchsheel Park, Panchsheel Club, New Delhi, South Delhi, DL 110017, India
25	Suite 201, 25 Cooper Street, Surry Hills, NSW, 2010, Australia
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	4 Zalogou Str., 15343 Agia Paraskevi, Athens, Greece
29	27/F Trident Tower, 312 Sen. Gil Puyat Avenue, Makati City, Metro Manila, Philippines
30	C T Corporation System, 128 State St #3, Augusta, ME, 04330, United States
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

Registered office address	
33	National Registered Agents, inc., 160 Greentree Dr Ste 101, Dover, Kent, DE, 19904, 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	7/F North Tower, Rockwell Business Center COR. Sheridan & United Street, Brgy. Highway Hills, Mandaluyong, Philippines
37	10 Gewerbestrasse, Cham, 6330, 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, 388 State St Suite 420, 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	Plot 8, Berkley Road, Old Kampala, Uganda
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, 2711 Centerville Road, Suite 400, 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	MAGA ONE-Level 22, No. 200, Nawala Road, Narahenpita, Colombo 05, 11222, Sri Lanka
68	1-5-15, Kanda-Sarugakucho, Chiyoda-ku, Tokyo, Japan
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	16, 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	Nida Kule Kozyatagi, Kozatagi Mahallesi, Degirmen Sokak No:18, Kat:6, D:15 Kadikoy 34742, Istanbul, 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

Notes to the company financial statements

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	23.06	7
eAdvance Proprietary Limited‡	ZA	29.03	8
Institute for Private Education & Training KSCC*	KU	49.02	9
Karadi Path learning Company Private Limited‡	IN	24.96	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, 2711 Centerville Road, Suite 400, 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, United States
17	28/F, 1063 King's Road, Quarry Bay, Hong Kong

Five-year summary

All figures in £ millions	2015	2016	2017	2018	2019
Sales: By geography					
North America	2,940	2,981	2,929	2,784	**2,534**
Core	815	803	815	806	**838**
Growth	713	768	769	539	**497**
Continuing	4,468	4,552	4,513	4,129	**3,869**
Discontinued	312	–	–	–	**–**
Total sales	4,780	4,552	4,513	4,129	**3,869**
Adjusted operating profit: By geography					
North America	480	420	394	362	**361**
Core	105	57	50	57	**92**
Growth	(3)	29	38	59	**63**
Penguin Random House	90	129	94	68	**65**
Continuing	672	635	576	546	**581**
Discontinued	51	–	–	–	–
Total adjusted operating profit	723	635	576	546	**581**

All figures in £ millions	2015	2016	2017	2018	2019
Operating margin – continuing	15.0%	13.9%	12.8%	13.2%	**15.0%**
Adjusted earnings					
Total adjusted operating profit	723	635	576	546	**581**
Net finance costs	(46)	(59)	(79)	(24)	**(41)**
Income tax	(105)	(95)	(55)	27	**(89)**
Non-controlling interest	–	(2)	(2)	(2)	**(2)**
Adjusted earnings	572	479	440	547	**449**
Weighted average number of shares (millions)	813.3	814.8	813.4	778.1	**777.0**
Adjusted earnings per share	70.3p	58.8p	54.1p	70.3p	**57.8p**

Prior periods have not been restated to reflect the adoption of IFRS 15 and IFRS 9 in 2018 and IFRS 16 in 2019.

Five-year summary

All figures in £ millions	2015	2016	2017	2018	2019
Cash flow					
Operating cash flow	435	663	669	513	**418**
Operating cash conversion	60%	104%	116%	94%	**72%**
Operating free cash flow	255	549	525	448	**345**
Operating free cash flow per share	31.4p	67.4p	64.5p	57.6p	**44.4p**
Free cash flow	152	310	227	473	**213**
Free cash flow per share	18.7p	38.0p	27.9p	60.8p	**27.4p**
Net assets	6,418	4,348	4,021	4,525	**4,323**
Net debt	654	1,092	432	143	**1,016**
Return on invested capital					
Total adjusted operating profit	723	635	576	546	**581**
Operating tax paid	(129)	(63)	(75)	(43)	**(9)**
Return	594	572	501	503	**572**
Gross basis:					
Average invested capital	10,317	11,464	11,568	10,672	**11,096**
Return on invested capital	5.8%	5.0%	4.3%	4.7%	**5.2%**
Net basis:					
Average invested capital	9,422	7,906	8,126	7,544	**8,097**
Return on invested capital	6.3%	7.2%	6.2%	6.7%	**7.1%**
Dividend per share	52.0p	52.0p	17.0p	18.5p	**19.5p**

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 p29-34, 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 sales (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 sales excluded 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 2019	2,534	838	497	**3,869**
Statutory sales 2018	2,784	806	539	**4,129**
Statutory sales (decrease)/increase	(250)	32	(42)	**(260)**
Comprising:				
Underlying (decrease)/increase	(64)	37	17	**(10)**
Portfolio changes	(289)	(2)	(56)	**(347)**
Exchange differences	103	(3)	(3)	**97**
Statutory sales (decrease)/increase	(250)	32	(42)	**(260)**
Statutory (decrease)/increase	(9)%	4%	(8)%	**(6)%**
Constant exchange rate (decrease)/increase	(13)%	4%	(7)%	**(9)%**
Underlying (decrease)/increase	(3)%	5%	4%	**0%**

Financial key performance indicators

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; and the impact of UK pension GMP equalisation in 2018. 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 excluded 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	2019	2018
Operating profit	**275**	553
Cost of major restructuring	**159**	102
Other net gains and losses	**(16)**	(230)
Intangible charges	**163**	113
UK pension GMP equalisation	**–**	8
Adjusted operating profit	**581**	546

All figures in £ millions	North America	Core	Growth	PRH	Total
Adjusted operating profit (decrease)/increase	(1)	35	4	(3)	**35**
Comprising:					
Underlying (decrease)/increase	(11)	33	11	(1)	**32**
Portfolio changes	(24)	–	(13)	–	**(37)**
Impact of new accounting standards (IFRS 16 see note 1b)	14	5	6	–	**25**
Exchange differences	20	(3)	–	(2)	**15**
Adjusted operating profit (decrease)/increase	(1)	35	4	(3)	**35**
Constant exchange rate (decrease)/increase	(6)%	67%	7%	(1)%	**4%**
Underlying increase	(3)%	58%	24%	(1)%	**6%**

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.

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 was excluded as this related to historical circumstances.

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	2019	2018
Profit for the year	**266**	590
Non-controlling interest	**(2)**	(2)
Cost of major restructuring	**159**	102
Other net gains and losses	**(16)**	(230)
Intangible charges	**163**	113
Other net finance income	**2**	31
UK pension GMP equalisation	**–**	8
Tax	**(123)**	(65)
Adjusted earnings	**449**	547
Weighted average number of shares (millions)	**777.0**	778.1
Adjusted earnings per share	**57.8p**	70.3p

Return on invested capital

Return on invested capital (ROIC) is included as a non-GAAP measure as it is used 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. The adoption of IFRS 16 has impacted adjusted operating profit and average tangible fixed assets in 2019, however the overall impact on ROIC is not material.

All figures in £ millions	2019 Gross	2018 Gross	2019 Net	2018 Net
Adjusted operating profit	**581**	546	**581**	546
Operating tax paid	**(9)**	(43)	**(9)**	(43)
Return	**572**	503	**572**	503
Average goodwill	**6,645**	6,675	**3,646**	3,547
Average other non-current intangibles	**2,394**	2,438	**2,394**	2,438
Average intangible assets – pre-publication	**889**	999	**889**	999
Average tangible fixed assets and working capital	**1,168**	560	**1,168**	560
Average invested capital	**11,096**	10,672	**8,097**	7,544
Return on invested capital	**5.2%**	4.7%	**7.1%**	6.7%

Financial key performance indicators

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 (including leased assets) and intangible software assets; plus proceeds from the sale of property, plant and equipment and intangible software assets; 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	2019	2018
Net cash generated from operations	480	547
Dividends from joint ventures and associates	64	117
Re-capitalisation dividends from Penguin Random House	–	(50)
Purchase of property, plant and equipment	(55)	(74)
Acquisition of new right-of-use lease assets	(64)	–
Purchase of intangible software assets	(138)	(130)
Proceeds from sale of property, plant and equipment and intangible software assets	1	128
Disposal of right-of-use lease assets	17	–
Investment income	2	–
Net costs paid for/(proceeds from) major restructuring	111	(25)
Operating cash flow	**418**	513

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 cash generation by the Group.

All figures in £ millions	2019	2018
Adjusted operating profit	581	546
Operating cash flow	418	513
Cash conversion	**72%**	94%

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 adjusted earnings before interest, tax, depreciation and amortisation (EBITDA)

For information, the net debt/adjusted EBITDA ratio is shown as a non-GAAP measure as it is commonly used by investors to measure balance sheet strength. Adjusted EBITDA is calculated as adjusted operating profit less depreciation on property, plant and equipment, right-of-use assets and less amortisation on intangible software assets.

All figures in £ millions	2019	2018
Adjusted operating profit	581	546
Depreciation (excluding items included in 'cost of major restructuring')	122	66
Amortisation on intangible software assets (excluding items included in 'cost of major restructuring')	101	87
Adjusted EBITDA	**804**	699
Cash and cash equivalents	437	568
Investment in finance lease receivable	196	–
Derivative financial instruments	15	9
Bank loans and overdrafts	(3)	(43)
Revolving credit facility	(230)	–
Bonds	(593)	(672)
Lease liabilities	(838)	(5)
Net debt	**(1,016)**	(143)
Net debt/adjusted EBITDA ratio	**1.3x**	0.2x

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.
- 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.

Connections Academy: The Connections Academy online school programme for grades K-12 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 K-12 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 Young Learners: 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.

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Shareholder information online

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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

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2019 dividends

	Payment date	Amount per share
Interim	13 September 2019	6 pence
Final[1]	7 May 2020	13.5 pence

1 Subject to approval by shareholders at the Annual General Meeting.

2020 financial calendar

Ex-dividend date	**26 March**
Record date	**27 March**
Last date for dividend reinvestment election	**16 April**
Annual General Meeting	**24 April**
Payment date for dividend and share purchase date for dividend reinvestment	**7 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*.

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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 email 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.

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/share-management/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.

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. "Remote proctoring" is often synonymous with "online proctoring". Pearson VUE's online proctoring solution is called OnVUE.

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 customised, effective, and scalable assessments that measure 21st century skills and inform instruction throughout the school year. We also partner with test providers to deliver their paper and/or online assessments. 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 US.

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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.

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/share-management/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.

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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.

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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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