Pearson

Digital learning

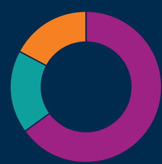
Pearson Annual report and accounts 2016

ALWAYS LEARNING

Performance in 2016

Sales

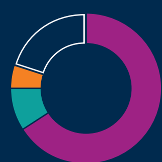
£4,552m (+2%)



North America	65%	£2,981m
Core	18%	£803m
Growth	17%	£768m

Adjusted operating profit

£635m (-12%)



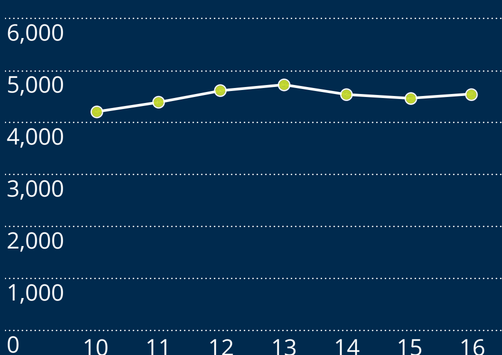
North America	66%	£420m
Core	9%	£57m
Growth	5%	£29m
Penguin Random House	20%	£129m

Adjusted earnings per share
-16%

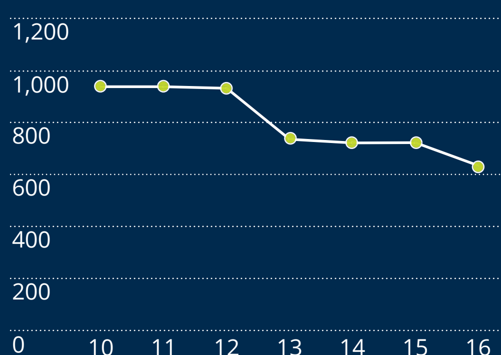
Operating cash flow
+52%

Dividend
52.0p

Sales £m



Adjusted operating profit £m



Key performance indicators

A selection of our financial key performance indicators (KPIs) are shown here. Our full KPIs have been revised this year to reflect and measure our broader business progress.

See our **full KPIs** on p36

Percentage growth 2016 vs. 2015 is quoted on a headline basis.

About this report

Key to icons Throughout this report icons indicate content related to strategy, performance and remuneration, and if there's more to read online.

P Performance
S Strategy
R Remuneration
Online

Online reporting Visit our online report centre at pearson.com/ar2016.html

Integrated reporting In this year's report we have applied some of the International Integrated Reporting Council's (IIRC's) principles. We aim to build on this in future reporting.

In addition, our **sustainability reporting** provides greater detail on how our business operates ethically and sustainably in the wider world.

Visit pearson.com/sustainability to read more.

Strategy and performance reporting
The strategic report up to and including p55 is formed of three sections: 'Overview', 'Our strategy in action' and 'Our performance', and was approved for issue by the board on 14 March 2017 and signed on its behalf by:

Coram Williams Chief financial officer

Pearson's mission

At Pearson we have a simple mission: to help people make progress in their lives through learning.

We are focusing on the changing needs of the world's education markets, while measuring this progress against *key performance indicators* P spanning financial objectives, business measures and sustainability targets.

Our performance against these measures is summarised opposite and explained throughout this report.

Key achievements in 2016

£275m cost reduction to make Pearson a leaner, more focused company

£700m+ organic investment in our portfolio of products and services to drive digital transformation

Increase in digital and services revenues to 68%

In this report

Strategic report

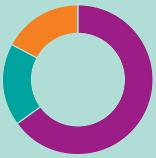
About Pearson

Pearson is the world's learning company, providing a range of products and services to help people across different learning stages make measurable progress in their lives.

Where we operate

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

Sales by geographies



North America	65%	£2,981m
Core	18%	£803m
Growth	17%	£768m
Total sales		£4,552m

North America

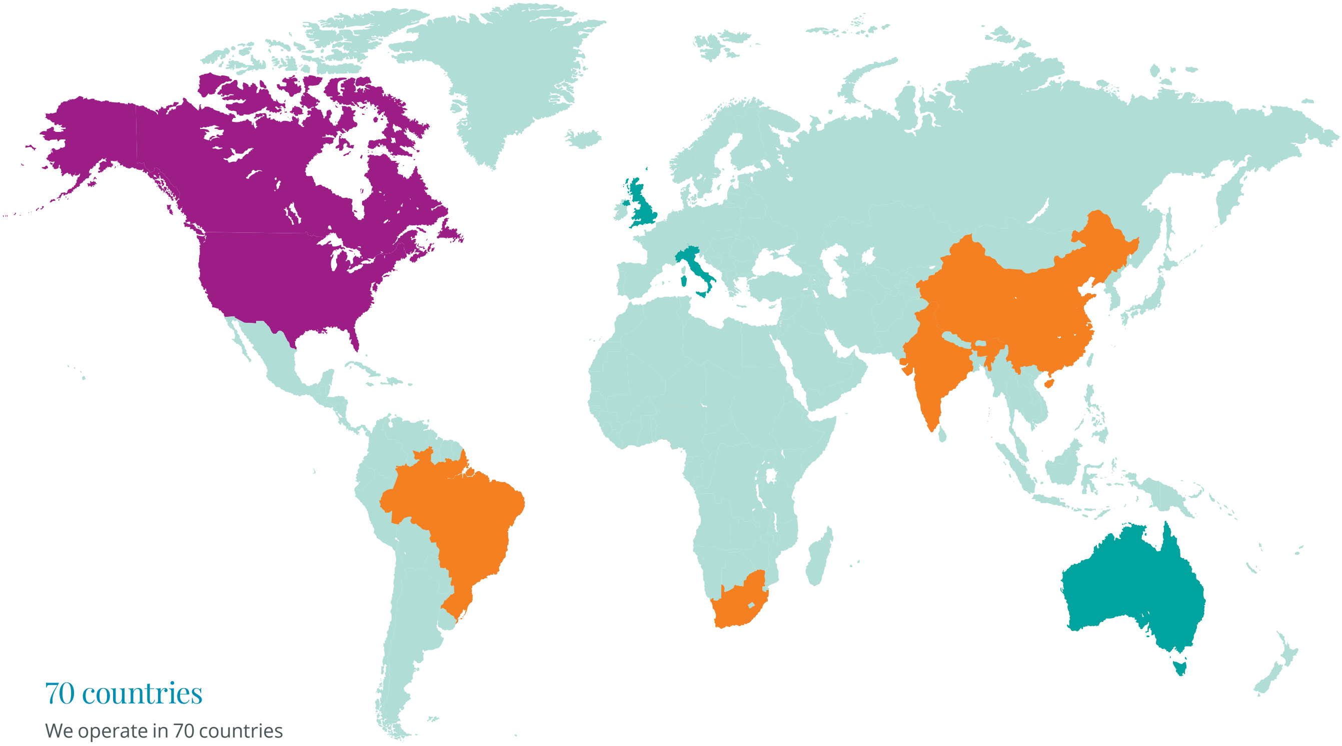
Our largest market includes all 50 US states and Canada.

Core markets

Our international business in established and mature education markets including the UK, Australia and Italy.

Growth markets

Our growth markets in emerging and developing economies, with investment priorities in Brazil, China, India and South Africa.



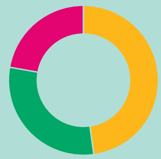
70 countries

We operate in 70 countries worldwide, with a focus on the markets above.

What we offer

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

Sales by products and services



Courseware	48%	£2,200m
Assessment	30%	£1,344m
Services	22%	£1,008m
Total sales		£4,552m

Content

We provide world-leading educational content for use in both traditional and digital learning.

Revel

An interactive learning environment that enables students to read, practise and study in one continuous experience.

274,361

Revel registrations in 2016

Bug Club

A dynamic school phonics reading programme teaching children to read, through an online reading world, print books and comics.

enVisionMATH2:0

A comprehensive maths curriculum supporting millions of students offering the flexibility of print, digital or blended instruction at all grade levels.

Assessment

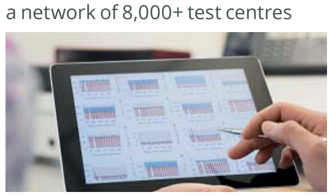
We provide assessment services to measure and validate learner progress, and to certify competency.

Pearson VUE

Helps individuals prepare for their next educational or career opportunity through credentials that verify the skills and learning they need.

14.9 million

summative tests delivered through a network of 8,000+ test centres



UK qualifications

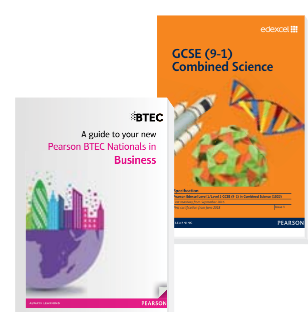
Pearson is the UK's largest awarding body, offering both academic and vocational qualifications.

5.43 million

GCSE/A level papers marked in 2016

1.01 million

BTEC registrations



Services

We provide integrated services that help educational institutions improve learner outcomes.

Online programme management

We partner with colleges and universities to extend the reach of their degree programmes by scaling online.

45+ global partnerships

Virtual schools

Connections Academy is an accredited, online education programme offering students everything they need to reach their full potential.

72,958

full-time equivalent students in 2016

Chairman's introduction

"In my first full year as chairman, I have met a great number of our shareholders in person to discuss our strategy and plans. This will be a priority for me again in 2017 as we move forward together. The board has been fully engaged with the management's review of the business and our plans to return Pearson back to growth."

Sidney Taurel
Chairman

Dear shareholders,

2016 has been a difficult year for Pearson shareholders. The challenges facing the business that we thought would begin to dissipate have become more acute, and as a consequence, we have cut both the short-term outlook for our profits and the future dividends we can return to shareholders. Clearly, this is disappointing for everyone involved in the company.

The management team has a clear view of the issues we face, particularly in our largest division, US higher education courseware. There is a rigorous plan to address the challenges, and to accelerate the transition to a more digital, more sustainable organisation. As we complete this transition, we will create more stable and predictable revenues for Pearson, and ultimately create growth opportunities.

Priorities for the year ahead

When companies face severe tests, it is important to act with clarity.

The goals I set out last year – to pursue fewer, bigger opportunities, to simplify the company, to run Pearson efficiently and to allocate capital responsibly – are more important than ever.

I will continue to support our management team to stay focused on our strategic growth objectives. This means ensuring we are totally focused on businesses which deliver our core capabilities – content, assessment and services. It means creating products which are scalable and replicable across the globe. And it requires us to move more quickly to digital business models.

All this will lead to faster progress in our high-growth businesses, such as virtual schools and online programme management while also stabilising our largest content and assessment businesses.

We will continue to forge successful partnerships – combining our expertise with that of schools, colleges, universities and franchise partners to meet the biggest needs and seize the largest opportunities in education.

Becoming a simpler, more focused business

In 2015, Pearson sold the Financial Times and its stake in The Economist Group, to become a more focused company. We are now taking the final step towards focusing 100% on education, through our decision to exit our stake in Penguin Random House.

Like the decision to sell our news businesses, our announcement to plan to exit Penguin Random House is a strategic decision that was not taken lightly. Penguin Random House is a high-quality business with a rich heritage, and has contributed greatly to Pearson for nearly 50 years. Any deal will be in the best editorial and commercial interests of Penguin Random House, as well as for Pearson shareholders – and as and when we part ways, we will become leaner and more focused.

The board will continue to work with management to focus on simplification across Pearson. In 2016, we successfully delivered a 10% reduction in the cost base, and began to build global platforms for finance, marketing, e-commerce and other key processes. As the business continues to become better integrated, we will be introducing more global tools and platforms, and better ways of working.

We will continue to reduce our exposure to large-scale direct delivery services which have fewer synergies with the rest of our portfolio, and focus increasingly on more scalable online, virtual and blended services, across our portfolio.

We will continue to focus on cost control and will be managing our cost base very tightly and efficiently. The board will also continue to support the team to ensure capital is allocated in an appropriate way for our fellow shareholders. With our lower profit expectations for the next two years, we made the difficult decision to rebase our dividend from 2017 onwards. We will use the proceeds generated in exiting Penguin Random House to maintain a strong balance sheet, invest in our business and to return excess capital to shareholders, while retaining a solid, investment grade credit rating.

In my first full year as chairman, I have met a great number of our shareholders in person to discuss our strategy and plans. This will be a priority for me again in 2017 as we move forward together. The board has been fully engaged with the management's review of the business and our plans to return Pearson back to growth. We will continue to apply our digital expertise and understanding of the North American market in the important coming period.

What the future holds

Difficult periods such as the one we are currently experiencing are tests of a company's character, and any business with the longevity Pearson has will undergo challenges from generation to generation.

Great companies – ones which stand the test of time – harness these moments and the urgency they create to renew their purpose and their strategies for growth in a new or changing context.

Governance at Pearson

Leadership & effectiveness

Board members challenge and debate strategy, performance, responsibility and accountability to ensure that the decisions we make are robust. Board activity and performance is assessed annually.

Accountability

Detailed risk assessment and management information shapes all strategic and operational decisions, with clearly defined board and management responsibilities and processes.

Engagement

Building strong relationships with our diverse stakeholders is crucial to our sustainable success. We aim to engage through many forums, and channels, to build trust.

See our Governance report on p56–81

Remuneration

Our remuneration policy aligns with strategy and adapts to market conditions and performance.

See our Remuneration report on p82–106

Education is a crucial sector which requires improvement right around the globe. We draw great confidence from the fact that Pearson's products meet the needs of millions of students and teachers every single day. We already have world-class content, world-class authors and an ability to work at scale that is unparalleled in the sector. We have maintained our leading share of content.

Digital offers significant opportunities for companies involved in education – areas like new digital services for universities, online degree programmes and virtual schools give us much more long-term growth potential than the traditional textbook. The board is confident that Pearson is well-placed to seize these opportunities in the long term.

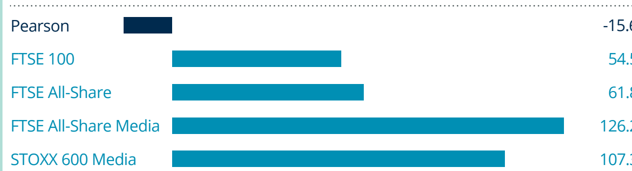
With market leading positions, and the most widely used digital products in higher education, Pearson is in a strong position to weather the storms better than others, and be the leading digital education company.

Sidney Taurel Chairman

Key performance indicators P

Total shareholder return: Five years % change

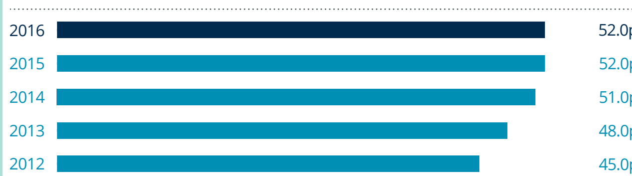
-15.6%



Five year TSR in 2016 was -15.6% which compares to a 54.5% return on the FTSE 100 Index of large UK listed companies. Our recent shareprice performance has been disappointing but we are confident that the plans and strategy laid out in this report will make Pearson a simpler, stronger company, and that they set the company up for a sustained period of growth and value creation.

Dividend per share in fiscal year Pence

52.0p



We held dividends flat at the 2015 level at 52p per share. The dividend will be rebased in 2017 to reflect portfolio changes, increased product investment, and our outlook for 2017.

See our other financial KPIs on p30-33
See our non-financial KPIs on p37

CEO's strategic overview

"The long-term opportunity in education remains hugely significant."

John Fallon
Chief executive

Dear shareholders,

2016 was a tough year for Pearson. We saw our biggest market – US higher education courseware – shrink again, as a result of three factors: declining college enrolments, changes in the buying patterns of students and a correction in inventory levels carried by distributors and bookstore chains.

In retrospect, we failed to see the accelerated level of disruption taking place in the US market. This disruption affected the whole sector, not just Pearson – but led to an 18% underlying decline in revenues for our largest business.

We announced in January 2017 that we would not achieve our previously set 2018 profit target, and will rebase our dividend from 2017 onwards.

We also announced a number of steps to accelerate our digital transition, protecting existing revenues and growing new ones, while managing the ongoing decline in print sales.

We will weather these challenges as well as, if not better than, our competitors. Digital now represents 50% of Pearson's higher education courseware revenues, and is growing steadily, even at a time when college enrolments are declining. By the end of this decade, the balance will be 75:25. Our digital higher education products are roughly twice as popular as those of our competitors.

As a natural consequence of our lower profits expectations, we have also taken a significant non-cash write-down of goodwill of £2,548m, as part of our annual impairment review. The goodwill relates to our North American businesses, and in particular the 1998 acquisition of Simon & Schuster Education and the 2000 acquisition of NCS.

All this has been difficult for Pearson shareholders. However, we remain committed to returning the company to growth and to building a stronger, more durable business.

Pearson has demonstrated competitive spirit, resilience and progress on many fronts even in the tough conditions noted above. We performed well in our major markets and announced a number of new digital products and new partnerships to help reach more learners. We delivered our restructuring and cost savings programme in full and, thanks to careful cost management, hit our 2016 profit goal.

Three key trends in our markets

Online education

To meet the demand for more flexible, digital and effective education, schools, colleges and universities are increasingly seeking partnership models which enable them to reach more learners, scale their teaching online and improve their productivity.

Personalised learning

Through the move to online education, rapid advances in technology are also enabling individual, adaptive learning to take place at scale. The rise of artificial intelligence and virtual reality in the classroom brings exciting new opportunities for learners, schools, colleges and educators, and will help increase student engagement and course completion and, ultimately, improve learning outcomes.

Employability

In a world where 500 million people are out of work but four in 10 employers are unable to find qualified candidates to fill open roles, the link between learning and earning is more crucial than ever before. Students are focused on gaining the skills they need to get better jobs and more rewarding careers, while re-skilling and up-skilling are taking place in the shifting digital economy.

We are achieving important synergies across Pearson in terms of our product platforms and enabling technologies – helping to run the company more smoothly and efficiently.

We are creating an increasingly digital and services-based business. US student assessment contributed more in profit than a year ago despite a 22% underlying decline in revenues.

We have made our emerging market Growth businesses profitable again, with a more durable platform for future success. In our Core business – incorporating markets such as the UK, Australia and parts of continental Europe – we are managing a huge programme of change in UK qualifications, and setting the business up for future success. We are growing well in virtual schooling, online degrees for universities, and English language testing; all promising parts of our future.

This report highlights a number of ways we are drawing on the potential of technology to make meaningful improvements to learning, alongside our partners.

Our strategy can be expressed as an equation:

CONTENT + ASSESSMENT = More effective teaching and personalised learning at scale

Powered by services and technology

Pearson's strategy – 100% focused on education

The long-term opportunity in education remains significant. Around the world, 500 million young people and adults are out of work, yet 40% of employers are unable to find qualified candidates to fill open positions.[1] The social and economic changes being wrought by technology, ageing populations and globalisation will only increase the value of high-quality education. Much of our work relates to meeting these new needs – whether through our vocational qualifications and apprenticeship programmes in the UK, or offering workforce development partnerships to some of America's largest employers.

Pearson serves the needs of millions of students and teachers by combining world-class educational content and assessment with the promise of new technologies and cutting-edge new educational services.

In 2016, Pearson continued to invest significantly in research and expertise for education products. Our courseware – educational materials, in print, blended and digital formats – now combines the very best content with learning design and technology to create great user experiences and better learning outcomes. Our MyLabs software now adapts to prompt college students with hints about what to study next, and gives early alerts to teachers when their students are in danger of falling behind.

1. *The Economist*, April 2013.

How our strategy creates value S

Our goal is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, powered by services and technology.

Short-term priorities

- Simplify our portfolio
- Control costs
- Invest in the biggest opportunities in education

Strategic growth drivers

Develop digital & services
See p14-15

Build market presence
See p16-17

Deliver measurable outcomes
See p18-19

Our constant goals

Our strategy will deliver growth by:

- building a sustainable business;
- being a trusted partner; and
- reaching more learners;

to create long-term value.

Sustainability plan 2020
See p20-27

CEO's strategic overview

Our qualifications and assessment services are cutting edge. We help to measure progress and analyse insights about the achievements and abilities of learners all over the world. In 2016, we ran 23.6 million online tests in the US alone – and helped teachers create millions more of their own short, formative assessments, to check student progress and learning.

Our digital teaching and learning services combine these capabilities and focus on extending educational access and improving outcomes – through virtual schools and online degree programmes, we are creating digital products that are more reliable and enjoyable for the students that use them. These will in turn create new opportunities to grow.

The process of making, selling and servicing our products means that we are in daily contact with more educators than any other commercial organisation in the world. We understand the realities of running schools and universities, and teaching students of all ages and backgrounds. That understanding means Pearson is well placed to assist schools and universities in their transition from analogue to predominantly digital learning.

Personalised learning in action

Our products are increasingly driven by the concept of personalised learning, and our goal is to help educators reach every student in a way that meets their individual needs. New technologies are enabling Pearson to make personalised learning a reality for millions of students and teachers: analytics, which provide decision-making insights to teachers and students; adaptive capabilities, that intelligently adjust to the needs of each student based on their knowledge, skills, attributes or behaviours; and implementation services, that support educators to successfully integrate digital tools into their teaching.

Millions of students already experience adaptive learning every day with our products, but we have major plans to step up these capabilities. In October 2016, we announced a partnership with IBM to integrate their advanced cognitive computing capabilities into Pearson's products. Together, we plan to provide college students with a virtual tutor, powered by artificial intelligence techniques to help increase engagement, provide educators with better tools and ultimately help drive completion rates. We will be piloting the product in colleges across America in 2017 – and over time we see the potential to reach millions of students around the world with better, more engaging teaching.

The digital opportunity

The colleges and universities with whom we work still teach primarily face to face, in physical buildings, which limits their own scale and reach – but this is starting to change. Technology now enables them to reach far more students, with teaching and learning happening virtually, online, as well as in the physical classroom.

We are partnering with universities on three continents with services including course and programme design and development, student recruitment and retention, and related platforms and technologies. These services help our partners reach more students, ensure more of those students are successful in their studies, and help those partners run their operations more effectively.

We already have more than 40 of these partnerships in the US and Australia. In 2016, we began our first online degree partnership in the UK with King's College London, helping to create online master's degrees in Psychology and Law. We expect to announce further partnerships with leading universities in 2017.

Executive team

We are managed by a board of directors and I, as chief executive, am responsible to the board and lead through an executive team.

- **Coram Williams** Chief financial officer
- **Michael Barber** Chief education advisor
  stepping down in March 2017
- **Tim Bozik** President, global product
- **Rod Bristow** President, core markets
- **Kevin Capitani** President, North America
- **Giovanni Giovannelli** President, growth markets
- **Albert Hitchcock** Chief technology and operations officer
- **Kate James** Chief corporate affairs and global marketing officer
- **Bjarne Tellmann** General counsel and chief legal officer
  joined executive in 2017
- **Bob Whelan** President, assessments
- **Melinda Wolfe** Chief human resources officer

For more on our governance structure, see p63

Our priorities for 2017

Pearson needs to achieve a number of important goals in 2017 to fuel our return to sustainable growth.

Our competitive performance has been strong even in the face of market challenges – you can read more about this on p38-43. In 2017, we will be focused on holding or gaining share in all our major markets – from seeking improvements in US higher education to building on the rapid growth we have achieved with virtual schools, online degrees, professional testing and the Pearson Test of English.

Having made Pearson a more focused business and lowered operating costs significantly over the past three years, we will also continue to make Pearson simpler, more efficient and effective. We will further rationalise our platforms and tools, supply chain process and property portfolio; improve our efficacy and the speed with which we launch new product features; and ensure our digital and marketing capabilities are optimised and effective. These investments in stronger simpler platforms and in better learning outcomes should all contribute to better user experiences for the millions of teachers and students we serve. You can read more on our approach to sustainability on p20-27 and our efficacy reporting commitments on p18-19.

Our employees bring diverse talents to Pearson, and learning and social impact matter for our staff as much as those we serve. In 2017, we will continue to identify and retain the best talent across Pearson, building a talent pipeline for key roles and promoting employee programmes that contribute to career development. We are also intent on building Pearson's culture and our brand, which we relaunched in 2016, to position Pearson as a force for good with all the stakeholders with whom we work – recognising the value of our core business as much as our important partnerships through Project Literacy and with Save the Children, Unicef and others. You can read more about this on p20.

The achievement of these core aims will help us to meet our financial targets: achieving our 2017 budget, investing in Pearson's growth, maintaining our financial strength through a period of change and volatility, and improving returns to shareholders.

The year ahead

2016 was a challenging year for Pearson. We have been hit hard by pressures in US higher education, which will continue into 2017 and 2018. We are acting quickly to build a more sustainable, digital business less exposed to volatility.

Across Pearson we have strong businesses delivering steady profits in educational content and assessment. We have others which are growing fast from a smaller base, meeting new needs as education itself evolves.

We are creating a more digital, services-led company that can maximise opportunities – and mitigate threats – by making education more accessible, affordable and effective for far more people. We are making Pearson a more efficient company, with digital services that support a new generation of personalised learning and which create subscription-style business models for us to renew and repeat sales.

This is challenging, but exciting work. Pearson will continue to focus on fewer, larger opportunities, to manage our cost base tightly and to make Pearson a simpler, more efficient company. Over time, we will deliver a more sustainable, more profitable business, delivering better educational outcomes for learners.

Thank you for your support of Pearson.

John Fallon
Chief executive

Penguin Random House

Penguin has been an important part of Pearson for many years, and our decision in 2012 to combine it with Random House, creating the world's largest consumer publisher has been vindicated by its continued creative and commercial success.

Our recent announcement of our intention to exit our 47% stake of the combined business reflects an intention that we will now focus entirely on our education strategy.

Should Bertelsmann choose to buy Pearson's stake we will reinvest the proceeds to maintain a strong balance sheet, invest in our business and return excess capital to you, our shareholders, while retaining a solid investment grade credit rating.

Penguin Random House

Learn more about our *Strategy in action* on the following 18 pages.

Our strategy in action

Pearson's strategy is to combine world-class capabilities in content and assessment with technology and services, to enable more effective teaching and personalised learning at scale.

Over time, this strategy will provide us with a larger market opportunity, a sharper focus on faster-growing markets, and stronger financial returns.

In this section

Our business model

Our inputs

Financial
- Free cash flow from prior periods
- Financial resources allocated for investment

People and culture
- Talented team
- Experience and skills
- History and values
- Ways of working

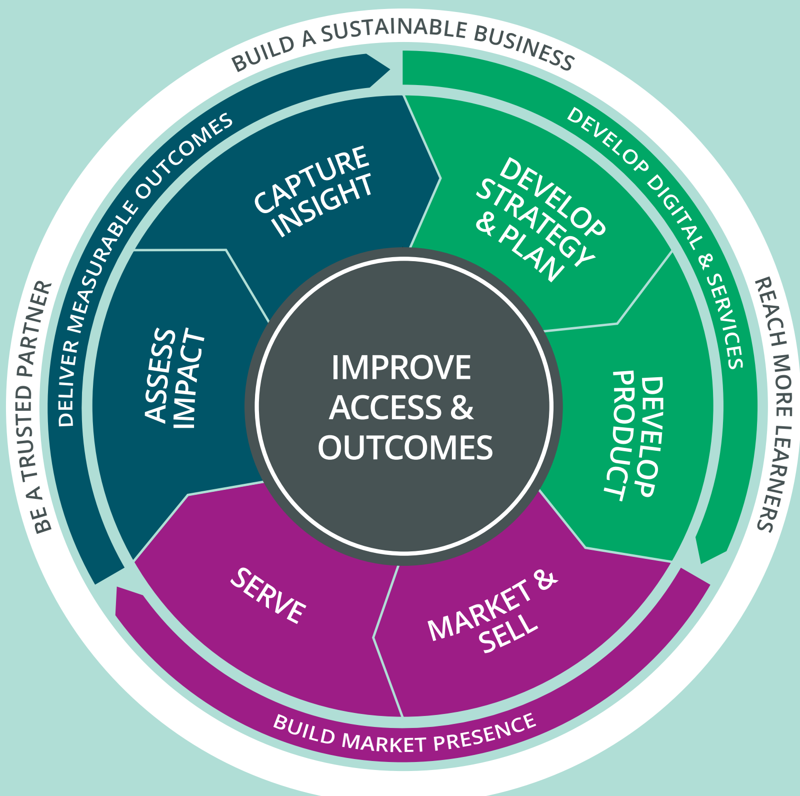
Intellectual
- Intellectual property
- Content and systems
- Innovative technologies
- Market and customer insight
- Brand

Global infrastructure
- Products and services
- Technology platforms
- Property and facilities
- Materials and equipment
- Market presence

External relationships
- Supply chain and strategic partners
- Customers, teachers and learners
- Regulators
- Communities

Our business model

We believe that a company must deliver value for society in order to be successful in the long term. We create sustainable value by developing products and services that meet learner needs most effectively. As a result, our business makes an important contribution to generating inclusive economic growth.



Strategic growth drivers S

See p14–19

Develop digital & services

Our goal is to improve access and outcomes in education through our world-class capabilities in content and assessment, powered by services and technology.

Build market presence

Our aim is to build our market-leading presence in North America, the UK and other key markets.

Deliver measurable outcomes

Our efficacy programme is our long-term commitment to delivering measurable impact. It informs all strategic decision-making across Pearson.

Sustainability plan 2020 S

See p20-27

Value-creating activities We create value for stakeholders by developing innovative products and services that enable people to make progress in their lives through learning. Below we explain how our 'inputs' connect across our business to create long-term value.

DEVELOP DIGITAL & SERVICES

See p14–15

DEVELOP STRATEGY & PLAN

Creating value: Product and market strategy set our priorities for greatest growth and impact. To create value, this is dependent on our people, our relationships with world-class authors and researchers, and our intellectual capital insights gained from educators.

DEVELOP PRODUCT

Creating value: Products are developed with insight from markets, to best meet local needs and opportunities. This depends on investment, insights and our ability to scale.

BUILD MARKET PRESENCE

See p16–17

MARKET & SELL

Creating value: Sales, branding and marketing functions build on our presence and reputation. This is dependent on our global infrastructure, our relationships and our people to create value, and financial investment to create growth.

SERVE

Creating value: Customer service and support creates valuable long-term relationships. This depends on our global infrastructure, people, content and our relationships to create value and sustained growth.

DELIVER MEASURABLE OUTCOMES

See p18–19

ASSESS IMPACT

Creating value: Measuring and improving impact informs all strategic decisions, targeting areas with greatest potential need. To create value, this depends on investment in people, global infrastructure and systems that measure product efficacy.

CAPTURE INSIGHT

Creating value: Understanding customer and learner needs focuses investment on growth and impact opportunities. This depends on our people and intellectual capital to deliver insights that shape strategic capital allocation which will drive long-term value.

Our outcomes

Financial

- Revenue and earnings
- More efficient operations
- Dividends to shareholders
- Taxes to the government
- Free cash flow (for investment)

People and culture

- Employee engagement
- Employee development and retention
- Health and wellness
- Diversity and equality

Intellectual

- More effective and scalable learning solutions
- Improved content and systems
- Measurable effects of our products and services
- New products and services

Global infrastructure

- Sustainable production
- Expanded product reach
- Improved technologies
- Lower global greenhouse gas (GHG) emissions
- Climate awareness and action

External relationships

- More accessible and affordable education
- Employability, 21st Century skills and job creation
- Stronger reputation and relationships
- Cultural diversity and gender empowerment
- Social cohesion

Our strategy in action

STRATEGIC GROWTH DRIVER

Develop digital & services

Our strategy is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, and services *powered by technology*. This will be focused on where we see the greatest potential for growth and scalability, and increasingly *driven by our expertise in adaptive and personalised learning*, enabling educators to be even more effective in reaching their students.

Strategy in action

Direct digital access partnership with Kentucky State University

In 2016, Pearson partnered with Kentucky State University (KSU) to launch an eTextbook initiative to improve student success and increase affordability. The partnership identified Pearson digital course materials that supported 85–90% of KSU's undergraduate courses. The University now purchases direct digital access to Pearson content for all of its students to use on those courses, from day one of class.

148
digital direct access contracts signed by Pearson across North America in 2016 with strong pipeline in place for 2017

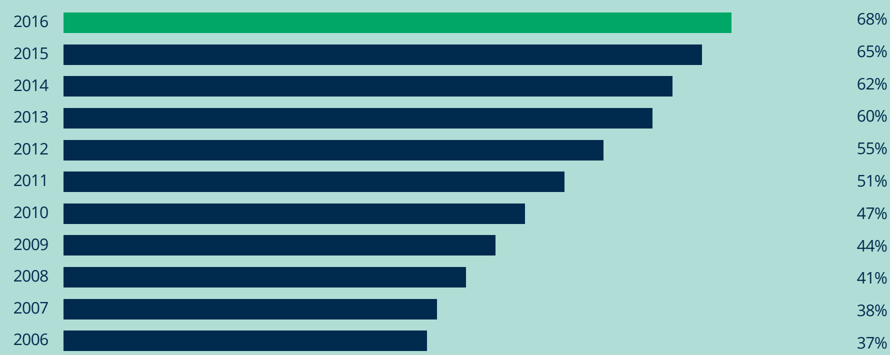
1,736
students served at Kentucky State University

"If students are prepared for class, they begin the semester with a good foundation and are more successful than students who are not prepared. It also reduces the time it takes for students to earn a degree as well as their debt rates."

Dr Candice Love Jackson Acting Vice President, Academic Affairs, Kentucky State University

Digital & services revenue growth

Digital & services revenues (% of sales)



Purpose

The demand for accessible, affordable and effective education is greater than ever. Globally, more than a billion children and adults are held back by inadequate learning resources, unemployment or illiteracy.

Meanwhile the costs of learning continue to rise, governments find it harder than ever to deliver high-quality education fairly to all, and nearly half of employers struggle to find the qualified candidates they need.

We already have the expertise and the market insights, and we are investing in innovative learning services and assessment tools that can have a positive impact on the lives of the greatest number of people.

One of the biggest opportunities for Pearson – and for our customers and learners – is the ongoing digital revolution, which offers profoundly new and innovative ways to address the biggest challenges in education. Pearson is embracing this digital revolution with next generation technology applied to the production of our future product offerings. We will be able to respond to market needs quicker than ever before with our global learning platform allowing us to innovate and integrate our solutions with a platform-powered approach, and offering a world class experience to our learners. We are building an environment that makes our products and services ever more accessible, secure and stable.

Progress and priorities

The transition to digital has its challenges – as we experienced in 2016 in Pearson's largest market, US higher education courseware. We are increasing investment in our service capabilities and our global learning platform, which will remove barriers to faster product innovation, accelerate our product roadmap and drive faster adoption of institution-wide digital direct access for Pearson courseware. We are also pricing our digital content for rental far more competitively – cutting the prices of around 2,000 eText works – and piloting our own print rental programme. As a result, by 2020, our goal for our US higher education courseware business is to be 75% digital and we should have not just a growing business again but a much better quality one.

As well as creating challenges, digital enables Pearson to partner with educational institutions in order to scale online through new and exciting services. Our online programme management business, which partners with universities to take courses 100% online demonstrates this trend, and is the fastest-growing part of Pearson. In 2016, our individual course enrolments for online programmes reached almost 315,000 – up from over 265,000 in 2015. We also grew our total student base by 10% to over 70,000.

Digital is also making our assessment businesses more efficient and better able to serve institutions, teachers and students.

In 2016, we delivered 23.6 million online summative tests to school age students in the US, and a further 14.9 million computer-based tests around the world for professional certification through Pearson VUE. Applying digital technologies makes the setting and marking of our assessments quicker, more secure and more reliable.

Pearson partners with IBM Watson to provide virtual tutor tutoring capabilities

In 2016, IBM Watson and Pearson announced a new global education alliance to make Watson's cognitive capabilities available to millions of college students and professors.

Combining IBM's cognitive capabilities with Pearson's digital learning products will give students a more immersive learning experience with their college courses, an easy way to get help and insights when they need it and provide instructors with insights about how well their students are learning.

Learn more at www.ibm.com/watson/education/announcements/pearson/ (ibm.co/pearson)

STRATEGIC GROWTH DRIVER

Build market presence

One of our key strategic drivers is to build our *market-leading presence in North America, the UK and other key markets*. We also aim to build *our leading presence in select developing markets* to meet the growing global demand for education, while reducing the geographical complexity of Pearson in order to focus on *fewer, bigger opportunities in education*.

Strategy in action

International growth in online programme management

We're building sustainable, lasting partnerships with top academic institutions in the US and, increasingly, internationally. We have over 45 partners and support more than 250 online degree programmes in the US. In Australia, we partner with Monash University and Griffith University and our UK online programme management business is growing rapidly with a strong 2017 pipeline in place following the launch of our first partnership with King's College London in 2016.

Total course enrolments	Total US students
2016	2016
315,000	70,400
2015: 265,000	2015: 62,592

"We are delighted to be partnering with Pearson which has a global reputation for online education provision. The partnership will help us grow our international student base by offering more programmes to a wider student community across a technology-enabled world."

Professor Ed Byrne AC, President & Principal, King's College London

Leading positions in key markets

We hold strong market positions across our major products and services. Select examples outlined include our US higher education courseware business; UK qualifications; and the fastest growing part of Pearson, online programme management.

UK qualifications
A level – 2016 market share

24.3%

GCSE – 2016 market share

28.7%

Source: Ofqual

US higher education courseware
12 month market share to January 2017

40.4%

Source: MPI, BMO

Online programme management (OPM)
2016 market share (gross revenue)

26%

Source: Deutsche Bank Online Higher Education report, Capital IQ, company websites, Eduventures, Pearson

Purpose

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

We do this through providing content and assessment powered by services and technology. Our educational materials in print, blended and digital format, combined with learning design and technology, lead to better user experiences and learning outcomes. Our assessment capabilities ensure we capture information and insights about learners' achievements, abilities and progressions.

Over time, this leads to better outcomes, larger opportunities in our markets, a sharper focus on fewer bigger opportunities and stronger financial returns for shareholders.

We are fully focused on executing our corporate strategy, and holding and gaining market share in all our major markets.

Progress and priorities

Pearson continues to make progress on holding or gaining market share in our major markets and in 2017 our priorities are clear.

In our largest market, US higher education courseware, we will defend this business through increased investment in our digital capabilities, product development and roll-out; focus on expanding direct digital access contracts; and through the roll-out of our ebook rental programme and print textbook rental pilot. We will also optimise our US K-12 learning portfolio.

We will continue the stabilisation of our US assessment business, where we secured some key wins in 2016, including winning back a one-year contract to score School Assessment Tests in Tennessee.

Outside of North America, we will look to win share in the stabilising UK assessment business. At a time of ongoing structural change, teachers and students value the quality and stability that Pearson can provide.

In Growth markets, we will continue the turnaround of our key geographies – among them Brazil, China and South Africa – which returned to profit.

We will be building our clinical assessment business and looking for continued growth in Pearson VUE, our professional assessment business that secured strong wins in 2016 including being awarded a contract extension to administer the UK driving theory test for the Driver and Vehicle Standards Agency (DVSA).

English remains a key focus and we will be driving growth in English Language Testing and Pearson Test of Academic English – a business that saw the number of test-takers almost double in 2016.

Equally, we will be focused on expanding our virtual schools business, Connections, and our online programme management business – one of the fastest-growing parts of the company. This is a business that has seen double-digit growth in recent years and we expect this to continue as more universities see the benefits of scaling online.

PTE Academic

The English test trusted by universities, colleges and governments around the world.

www.pearsonPTE.com

Connections Academy

Fully accredited online public schools for students in grades K–12.

www.connectionsacademy.com

Pearson VUE

The leader in computer-based testing and certification.

www.pearsonVUE.com

STRATEGIC GROWTH DRIVER

Deliver measurable outcomes

Our strategy is to *improve access and outcomes in education*. In other words, we want to help more learners learn more. Efficacy is becoming more deeply embedded into our strategy and is *helping drive faster improvement* in our content, assessment, services and technology. We are the only education company committed to efficacy with such rigour and at such scale and depth.

Strategy in action

How efficacy supports strategy

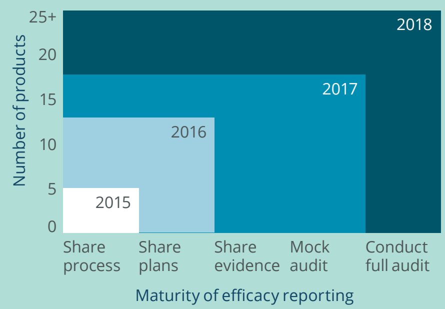
Since we launched our commitment to report on the efficacy of our products back in 2013, efficacy has grown from a framework and an initiative to a core operating principle and practice. Our efficacy and research work influences our products and approach to customers, and, ultimately, through measurable impact will enable us to achieve our mission – to help people make progress in their lives through learning. Our efficacy strategy can be broken down into three areas.

- › Product improvement – Our work, including efficacy reviews, impact evaluations, product analytics and educational research, helps product teams to identify areas where improvements benefiting learners can be made.
- › Efficacy reporting – We have continued to increase the breadth and depth of our public efficacy reporting; we are reporting on more products and looking in more detail at the impact those products are having.
- › Efficacy growth and impact goals – We launched these goals last year, stating our commitment to reaching and positively impacting 200 million learners annually with increasingly effective products. Put simply we want to help more learners, learn more.

Overview
Our strategy in action
Our performance
Governance
Financial statements

Efficacy progress

As we work towards meeting our 2018 commitment, to report publicly on the learner outcomes delivered by our products and to audit those efficacy reports in the same fashion that we audit our financials, this year we are increasing the number of reports and depth of those reports as well as subjecting those reports to a mock audit to make sure we are prepared for the real thing next year.



94%

of product improvements identified by efficacy reviews are being implemented on track with plans.

82%

of product impact evaluations are progressing in line with study plans.

Purpose

Our mission as a company is to help people make progress in their lives through learning. To achieve this, we must define the outcomes that those people want to achieve; measure the impact that our products and services have in reaching those outcomes; and use those insights to continuously improve our products and services and customer relationships. Having a positive impact on the outcomes of learners is what motivates us and it is through demonstrating this impact that we will be commercially successful.

Progress and priorities

Product improvement

We have gathered more robust evidence of impact than ever before as can be seen in our efficacy reports (for more information visit www.pearson.com/efficacy-and-research.html). We are now starting new product development with a stronger foundation in educational research basing our product designs on best practice highlighted by research. We are also embracing the concept of continuous improvement in product and service development leading to meaningful improvements in outcomes.

In 2017, we will continue to gather evidence of the impact that an increasingly large number of our products have on learner outcomes. We will ensure that insights generated by educational research or analytics are built into product development roadmaps. We will also aim to increase the consistency of the implementation of our products and services. Our aim is to eventually cover all products with this approach positioning more of our portfolio for sustainable growth.

Efficacy reporting

We have built on our efficacy reports from 2015 to 2016 to create nine new reports that illustrate how our products impact learner outcomes, with more to follow across 2017. This year's reports are the most rigorous and insightful we have produced. They serve as the final dry run in preparation for next year's fully audited efficacy reports.

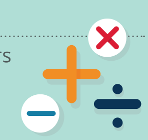
Next year we will further increase the number of products that we are providing public efficacy reports for and for the first time we will subject all of our efficacy reports to a third-party external audit.

Efficacy growth and impact goals

We have set annual targets for both the impact our products and services will have and the number of learners that they will reach. We are measuring the success of our businesses against their progress on these targets to help more learners learn more.

Moving forward, we will track our progress against the targets that we have set for both the impact our products and services are having and how many learners those products and services are reaching. We will also continue to embed these goals within our business processes so that they are progressively used to influence management decisions.

MyLab Math



Evidence suggests that learners double their odds of passing math if they use MyLab Math for developmental math.

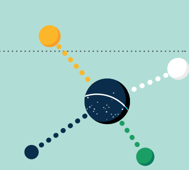
www.pearsonmylabandmastering.com

Bug Club

After 5.5 months, students are three months ahead in spelling compared with their peers

www.pearsonglobalschools.com

Sistemas



Learners out-performed their peers in similar schools on every subject tested.

http://br.pearson.com

SUSTAINABILITY PLAN 2020

Sustainability

Sustainability is *critical to achieving our mission* to help people make progress in their lives through learning. It is also *critical to our long-term competitiveness*. Being ethical and embracing sustainability is fundamental to our commercial success. In turn, a stronger and more sustainable Pearson will allow us to help people progress.

Strategy in action: Reach more learners

Every Child Learning

Every Child Learning is a partnership between Pearson and Save the Children to research and develop solutions for delivering education in emergencies. Starting with Syrian refugees and vulnerable children in Jordan, the ambition is to adapt, scale and use these solutions to deliver effective education in other emergency situations. We are also working to raise awareness of the urgency around improving education for children affected by conflict.

£500,000
donated to fund two educational centres in Amman, Jordan

£1 million
invested by Pearson in research and product development

› Ethnography and local research phase completed

› £2m: Pearson helped raise for Save the Children's work through *The Sunday Times* Christmas Appeals in 2015 and 2016

Image: *Children play at the Save the Children "Rainbow Kindergarten".*
Photography: Hannah Maule-Ffinch/Save the Children.

Sustainability plan

Building a sustainable business is critical to achieving our mission and ensuring our long-term competitiveness. Our customers, employees, partners and learners expect us to uphold the highest business standards, to continuously enhance the quality of our products, and to contribute to their communities.

To help achieve this, we have three sustainability pillars:

1 Be a trusted partner

Strategic intent

- Operate responsibly, ethically and transparently
- Treat learners, customers and partners with integrity and honesty
- Respect and progress our employees
- Contribute to our communities
- Consult our stakeholders
- Progressively improve environmental stewardship

2 Reach more learners

Strategic intent

- Innovate to improve access to quality education
- Enhance affordability and accessibility of our offerings
- Collaborate to improve access to quality education

3 Shape the future of education

Strategic intent

- Measurably improve learning outcomes
- Foster 21st Century skills and competencies
- Contribute to research and knowledge
- Engage with others to promote quality education

Our plan aligns with the United Nations Sustainable Development Goals (SDGs) creating better outcomes for customers and society, and stronger financial returns for shareholders.

4 – Quality education

8 – Decent work and economic growth

10 – Reduced inequalities

Sustainability plan

Last year we adopted our new sustainability plan – our five-year vision to create value for our customers, shareholders and society. The sustainability plan is built around three pillars, shown above, and is aligned to the United Nations SDGs.

We are working to integrate the sustainability plan into our commercial strategy. This provides a foundation for continuing to build sustainability into Pearson's business functions.

We will again disclose a detailed review of our 2016 performance when we publish our sustainability report later this year.

In the rest of this section, we will report on our material issues, how those issues relate to our Group risk management process at Pearson, sustainability governance, aspects of the three pillars and our performance in sustainability rankings.

Our material issues

Based on an analysis of the areas of most concern to our external stakeholders and a review of our company policies, activities and priorities, we identified 19 issues that are most relevant to the sustainability of the business. Through further consultation with senior leaders at Pearson, we narrowed these down to nine issues we believe are most material at this time. We consulted with external experts to confirm our prioritisation.

These issues, which represent a mix of both opportunities for growth as well as risks to revenue, are shown on the matrix on p22, plotting stakeholder concern and business impact. We have mapped all 19 issues that are the focus of our sustainability plan against the risks being monitored through our enterprise risk management process. You can read more about our risk management process and details of principal risks on p44-55.

As some material issues are business opportunities, not all 19 are included in the alignment mapping.

Our approach to these issues will also be described in more detail when we publish our Sustainability Report.

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 p78.

The Pearson executive drives implementation of business strategy, including responding to our sustainability issues. The responsible business leadership council oversees the development of the strategy on behalf of the board. It is chaired by our chief corporate affairs and global marketing officer and comprises senior leaders from across the business.

Our strategy in action: sustainability

Our material issues

Materiality matrix

The following matrix shows how we mapped our 19 issues, and highlights the nine that we have deemed to be the most material for the purpose of our sustainability strategy.

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

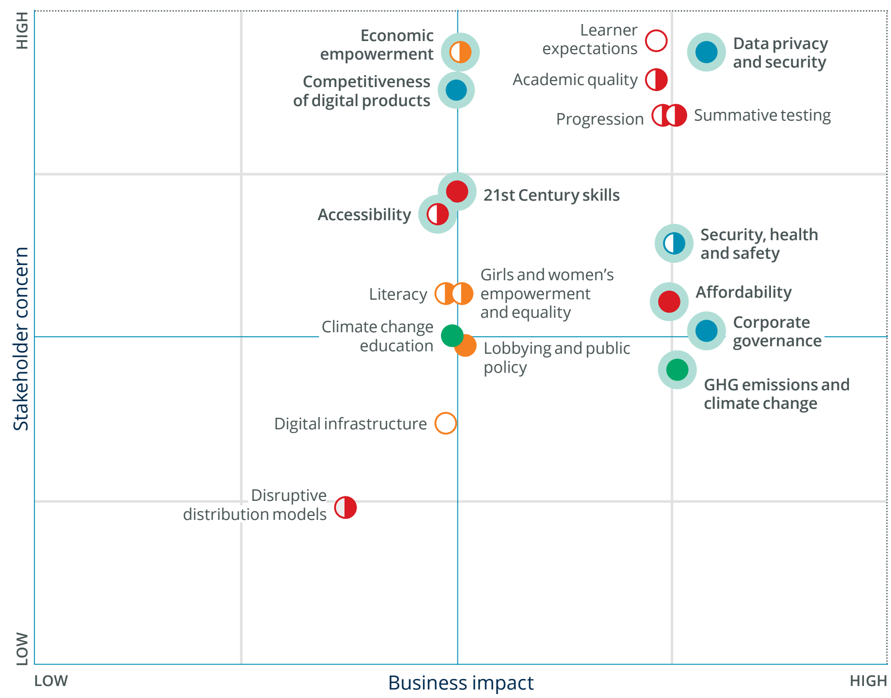
Key to material issues

Nine material issues
in our sustainability plan and reporting

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

Degree of control

High Medium Low



Alignment of material issues to principal and other Pearson risks

Sustainability report 2015 **Material issues**	Annual report 2016 **Principal risk**	**Group risk**	**Business area risk monitoring**		
Disruptive distribution models	2	YES	› Global Product › Core › Growth	› North America › Social, Environmental and Ethical (SEE)	
Competitiveness of digital products	2				
Affordability	2				
Learner expectations	2				
Academic quality	2				
Summative testing	5	YES	› Assessment	› Core	
Lobbying and public policy	4	YES	› Core › Growth	› North America › Assessment	
Data privacy and security	12	YES	› Core › Growth › North America	› Assessment › Global Product	› Legal › Tech & Ops
Digital infrastructure	8	YES	› North America	› Global Product	› Tech & Ops
Security, health and safety	6	YES	› Core › Growth	› HR › SEE	› Assessment*
Accessibility	–	–	› Assessment*	› Legal*	› SEE
GHG emissions and climate change	–	–	› SEE		

See Principal risks and uncertainties, p47

As part of our risk management process, Group risks are tracked across all business areas, geographies and functions.

* Emerging risk

1 Be a trusted partner

Value our customers and partners

Pearson has a set of commitments across a range of social, community and human rights principles that defines responsible business for us:

- Ensure that our products and services are inclusive, appropriate in content to the age, location and ability of the learner and are easy and safe to use and access
- Respect and protect how we use and share data entrusted to us by learners and our customers. More information on our approach to data privacy and security can be found in the Principal risks and uncertainties section (p47-55)
- Extend our commitments on labour standards, human rights and environmental responsibility to include our suppliers, franchisees and other business partners. This includes a concern across the value chain for ensuring our activities are free from slavery, servitude, forced or compulsory labour and human trafficking. A statement on the steps taken by Pearson to combat modern slavery was approved by the board and can be viewed on the Pearson website (www.pearson.com)
- Provide opportunities for Pearson people to be good citizens and to get involved in their local communities and to contribute to social impact causes
- Deliver against our targets to make more efficient use of resources and on our response to climate change.

Pearson has in place policies to support recognised human rights principles. These include safeguarding, non-discrimination and health and safety. As a founder signatory to the UN Global Compact, we have also made a series of commitments to the Universal Declaration of Human Rights, the International Labour Organization declaration on the fundamental principles and rights at work, the Rio Declaration on Environment and Development and to reflect a zero tolerance approach to bribery and corruption.

Our primary responsibility to learners is through the products and services we sell and how we extend our reach. Our work on improving learning outcomes (p18-19) describes the progress we have made.

Respect our employees and help them to progress

Our commitments to our people as a responsible employer are to:

- Inform, support and equip colleagues to work collaboratively. As part of our commitment to internal learning and development, we have launched Pearson U, designed for employees to take charge of their career growth through learning. This complements Milo, our global platform for learning and development, which saw employees complete over 160,000 courses in 2016
- Encourage and reward high performance, nurturing talent and creating a culture where all are able to realise their individual potential
- Provide a safe and healthy work environment for our employees and the learners we serve. In 2016, Pearson secured the RoSPA Silver Award for our health and safety performance. See the Principal risks and uncertainties section on p47-55 for more detail on how we manage this issue
- Help our employees understand how we are performing as a company, including how global and sector trends might affect them. During 2016, we undertook our restructuring plan which reduced the total Pearson employee base by around 10%. We provided comprehensive information on the trends behind that decision, regular communication with comprehensive detail on process for affected teams, consultation and support for colleagues leaving the company.

This year has seen Pearson manage considerable amounts of change. Through this, we've increased our investment in new platforms and digital products, and continued to simplify the way we work.

Employee engagement survey

Our 2016 engagement survey confirmed that our employees:

- Share a strong belief in our mission and purpose, and feel proud of what we do. They're committed to improving learning outcomes
- Value Pearson's commitment to diversity and social impact, and feel supported by the company on these issues
- Respect their colleagues and feel supported by their managers.

Actions

Our employees called for	Pearson response
More opportunities within Pearson to learn new skills and to develop careers	We have launched Pearson U, bringing together people, programmes and activities to help employees grow their careers with additional focused learning opportunities to come in 2017
More clarity on Pearson's overall strategy	We have set our strategy as being to combine world class capabilities in content and assessment with technology and services, to enable more effective teaching and personalised learning at scale
A greater focus on workload	We committed to employees to focus on doing fewer things, better
Our leaders to do a better job of communicating simply, openly and working together better	We will more closely align performance goals of senior leaders to ensure there is transparency and accountability for all to drive success for the company

Our strategy in action: sustainability

In this period of change, employee engagement remains a priority.

Our values are underpinned by the Pearson Code of Conduct which sets out the legal, ethical, social and environmental standards of behaviour we expect from our employees.

We make sure everyone is aware of the Code and to confirm they have read it, understood it and to affirm they will comply with it. The Code was last circulated in April 2015 and it is a mandatory part of our onboarding process for all new Pearson employees to similarly certify to abide by the Code. During 2016, we introduced a new Code of Conduct e-learning course which was the centrepiece of a month-long focus on the Code of Conduct. The Code was refreshed in 2016 as part of a regular annual review and will again be circulated to every Pearson employee in 2017. We have maintained our aim for 99% of employees to sign up to the Code.

Many of the areas covered by the Code of Conduct are supported by detailed policies and procedures. For example, anti-bribery and corruption, health and safety, and safeguarding. Learn more about these in our section on Principal risks and uncertainties (p47-55).

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

In 2016, we had 107 concerns (119 in 2015). These were investigated and where possible, the outcome shared with the reporter. As with previous years, the majority of the concerns related to HR practices. Material concerns are reported to the Pearson audit committee.

Respect and progress our employees: Diversity, equality and inclusion

At Pearson, we value the power of difference. The unique skills, perspectives and backgrounds of each employee are integral to our success, helping us be more innovative and to create effective solutions for learners around the world. Our aim is to foster a work environment that is inclusive, diverse, and where people can be themselves.

Employee engagement survey	2015	2016
Work in an environment that values diversity	76%	**79%**

Highlights of our activity include:

- Launch of a new global diversity & inclusion (D&I) team
- Involved over 4,000 employees in seven global employee resource networks. The seven networks are for women, parents, veterans, Latinos, the LGBT community, people with disabilities and employees of black and/or African ancestry along with their allies
- Over 1,200 people completed D&I related training courses on topics such as unconscious bias, gender intelligence and harassment prevention
- For a fourth year, achieved a perfect score of 100% in the 2016 Corporate Equality Index run by LGBT advocacy group, the Human Rights Campaign
- We work to ensure that appropriate procedures, training and support are in place for people with disabilities to ensure fair access to career progression opportunities. One of our seven employee resource groups is Pearson Able – its remit is to improve company practice for learners and employees.

Values

Our values continue to be embedded into performance management, which means all employees are assessed and rewarded for acting consistently with them. They are also the foundation for our leadership learning programmes.

Values	Behaviour
Brave Takes bold and decisive action to deliver ambitious outcomes, and champions a culture of high performance	› Shows determination and courage in the face of obstacles and setbacks › Offers ideas or opinions without fear of criticism or professional risk › Sets high standards for own and others' performance
Imaginative Looks beyond their immediate job both inside and outside of Pearson and introduces new ways of seeing, thinking and working	› Assesses complex issues from multiple angles and addresses problems that don't have clear solutions or outcomes › Offers creative ideas and innovative solutions to solve problems and address opportunities › Takes a broad perspective, to identify opportunities and solutions
Decent Listens, encourages and respects difference; treats all people fairly, with honesty and transparency	› Is honest, transparent and straightforward when working with others › Builds trusting relationships with a broad range of people inside and outside Pearson › Looks for and includes diverse viewpoints and talents of others
Accountable Drives results by owning the solution, getting the right people involved and delivering on promises	› Takes ownership of own work, and drives to successful completion and closure › Identifies and involves others to accomplish individual and Group outcomes › Follows through on commitments

Progressively improve environmental stewardship

Climate change remains a focus for us as one of the most serious issues facing the planet, and GHG emissions is one of our material issues. Minimising our environmental impact is not just the right thing to do; it helps deliver cost savings.

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

Our strategy focuses on:

- Reduction: We achieved a 40% reduction in operational emissions as at the end of 2016 compared with a 2009 base year
- Renewables: We maintained our record of purchasing 100% of the electricity we use from renewable sources and generate our own renewable electricity at six of our sites
- Offset: Since 2009, we have now protected over 1,450 hectares of forest. One of our offset providers – the Woodland Trust – has provided offsets equivalent to those generated by the printing of this annual report.

During 2016, Pearson was again recertified against the Carbon Trust Standard for our global operations. We were the second ever organisation to secure the standard which recognises leadership in measuring, managing and reducing year-on-year carbon emissions. We also continue to be certified against ISO 14001, the environmental management standard in the UK and Australia.

Paper use in textbooks remains an important environmental issue for us. We focus on sustainability of supply, being efficient in how we use paper and on promoting responsible forest management.

Our paper use management includes:

- A policy on environmental sourcing of paper
- Discussing our approach with suppliers, customers, environmental groups and investors
- Active membership of industry bodies dedicated to responsible forest management
- Holding Forest Stewardship Council (FSC) chain of custody in the UK, as does LSC Communications, our outsource partner in North America, allowing books in those markets to carry the FSC label.

We will publish full details of our environmental performance including other important emissions such as water use and embedded carbon dioxide in purchased raw materials in our 2016 environment report.

Actively contribute to the communities where we work

In 2016, our investment in social impact was £6.8m or 1.2% of pre-tax profits.

The Pearson approach to social impact is to invest in a small number of social impact campaigns as well as to help our employees to get involved in local communities and to support good causes.

Our award-winning flagship campaign is Project Literacy. Founded and convened by Pearson, the global campaign brings together not for profits and companies with a shared aim of bringing the power of words to the world, by building partnerships and driving action. Pearson is also working with the America's Promise Alliance to increase the number of students who graduate from high school in the United States.

Our people are our best ambassadors and advocates. We support them to give time and money to invest in communities where they work as well as in social impact causes around the world.

Key performance indicators P
Gender diversity

Women in Pearson %

	2014	2015	2016	No.
Board of Directors	30%	33%	**30%**	**3**
Senior leadership*	35%	34%	**32%**	**38**
All employees	58%	59%	**60%**	**21,420**

* Two reporting lines from the chief executive

30% of our board members are female, a higher percentage than the 25% target set by Lord Davies in 2015. We are a founder member of the 30% Club and also participate in its cross-company mentoring programme which helps the development of talented mid-career women. Women in Learning and Leadership (Will) is our largest global employee resource network.

Key performance indicators P
GHG emissions

Metric tonnes of CO_2e

Emissions from	2014	2015	2016
Combustion of fuel and operation of facilities (GHG Protocol Scope 1)	25,027	22,343	**19,093**
Electricity, heat, steam and cooling purchased for own use (GHG Protocol Scope 2)	104,715	88,831	**77,579**
Emissions relating to air and rail travel, electricity transmission, waste and water (GHG Protocol scope 3)	32,668	35,644	**29,714**
Total	**162,410**	**146,368**	**126,385**

Intensity ratios	2014	2015	2016
Scope 1 and 2/sales revenue	26.6	24.8	**21.2**
Scope 1 and 2/FTE	3.17	2.7	**2.95**

Methodology We have reported on all of the emission sources required under the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013. These sources fall within our consolidated financial statement. We do not have responsibility for any emission sources that are not included in our consolidated statement. The method we have used to calculate GHG emissions is the GHG Protocol Corporate Accounting and Reporting Standard (revised edition), using the location-based scope 2 calculation method, together with the latest emission factors from recognised public sources including, but not limited to, Defra, 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 tables has been independently verified by Corporate Citizenship.

Our strategy in action: sustainability

2 Reach more learners

Objectives

We have a long-term growth objective to reach 200 million learners annually by 2025 outlined on p18.

Achieving this will require innovation in all aspects of our business. For example, we have:

- Adopted the Pearson product lifecycle – a consistent approach and set of tools to help product development teams focus on the needs of the learner and on improving learner outcomes
- Continued to invest in innovative education start-ups through the Pearson Affordable Learning Fund; the fund targets students from low-income families and has investments in South Africa, Nigeria, Ghana, India and the Philippines
- Mapped the investment needs to integrate accessibility standards into existing products while committing to apply those into new product development
- Launched the Tomorrow's Markets Incubator, a £1m initiative to help Pearson bring new products and services to low-income learners in an affordable and accessible way
- Worked to expand access to quality education for girls and women. We continue to partner with international non-governmental organisation (NGO) Camfed, in a project funded by the UK Department of International Development and supported by relevant national Ministries of Education, to transform educational opportunities for girls from low-income communities in Zimbabwe and Tanzania. The Camfed Learner Guide programme, developed in partnership with Pearson, trains young women graduates to return to their local schools to deliver vital life skills lessons to marginalised children. To complement this, Pearson is now awarding BTEC vocational qualifications for Camfed's Learner Guide alumnae.

Global Learning programme

In schools in England, we are leading a programme funded by the UK Government that helps teachers to deliver effective teaching and learning about development and global issues. Targeting children aged 8 to 14, the GLP offers resources and guidance for teachers aimed at helping children to understand their place in the world and to develop an ethos encouraging empathy, fairness and respect.

Project Literacy

Project Literacy is Pearson's flagship social impact campaign and supports all three of the company's sustainability pillars – be a trusted partner, reach more learners, and shape the future of education.

Project Literacy has one overarching ambition: to make significant and sustainable advances in the fight against illiteracy by 2030 so that all people – regardless of geography, language, race, class or gender – have the opportunity to fulfil their potential through the power of words.

Being a trusted partner

Partnerships are essential to achieving the campaign's ambition to close the global literacy gap. Through Project Literacy, we have demonstrated Pearson's capacity to convene partners across business, civil society and government – and from sectors that we may think have little in common with each other, from economists to healthcare practitioners to gender activists to teachers. We have teamed up with more than 90 partners to date – partners as diverse as Room to Read, Doctors of the World, The Hunger Project, Microsoft, the Unreasonable Group and the United Nations Educational, Scientific and Cultural organization (UNESCO).

Together, we are working to: raise awareness and mobilise action; advance best practice; and innovate for new solutions to combat illiteracy.

Reaching more learners

Since we launched the campaign in early 2015, we have facilitated more than 15,000 volunteer referrals to partner organisations, and contributed $8.7 million in funding for solutions, with a primary focus on the US, UK, Brazil and India. Overall, through our current partners and programming, an estimated 700,000 adults, parents and children will benefit from Pearson's support.

Shaping the future of education

As a cross-sector movement representing diverse communities and interests around the world, Project Literacy has an opportunity to use the power of its collective voice to push for change at the local, national and multi-national levels – whether it's through organised petitions or by participating in forums and advisory bodies to influence policy. Pearson, on behalf of Project Literacy, was invited by the UNESCO to join a 30-member committee – the Global Alliance for Literacy – to advise the UN on its implementation strategy on literacy within the Sustainable Development Goals framework.

In addition to influencing policy, Project Literacy is also helping enrich the body of knowledge through targeted research and sector analyses with partners like UNESCO and Results for Development to help advance global best practices.

Campaign highlights (2015 & 2016)

$8.7million
in funding for solutions

700,000
beneficiaries (adults, parents & children)

5 prestigious awards
including Cannes Lion Grand Prix

3 Shape the future of education

Objectives

We are constantly working to develop better, more effective approaches to learning and we actively engage with diverse stakeholders to share our insights and learn from others. Our work in these areas focuses on: improving learning outcomes, fostering 21st Century skills and competencies, contributing to research and knowledge and promoting collective action on global education and development challenges.

We are committed to researching, measuring and reporting on the efficacy of our products and services to ensure that they are helping to achieve and improve learning outcomes (see p18-19 for more).

Our employability initiatives aim to equip learners with the 21st Century skills they need to obtain decent work and build their careers. In addition to core academic competencies, we help learners develop and demonstrate relevant vocational skills by offering industry-recognised certifications and developing training programmes with partner organisations like Cisco, Adobe and Microsoft.

Our efforts to foster cross-sector collaboration include:

- Helping to strengthen education systems through leadership roles and active engagement with the Global Partnership for Education and the World Economic Forum
- Advancing the role of the private sector in global education and development through the Global Business Coalition for Education and Business Fights Poverty
- Promoting and accelerating the UN Sustainable Development Goals agenda with the Business and Sustainable Development Commission.

Tomorrow's Markets Incubator

Last year, we launched the Tomorrow's Markets Incubator. Starting with a £1m investment, the incubator is designed to help Pearson employees bring new product ideas to market, which have the potential to profitably serve learners in low-income or underserved communities at scale. The incubator supports employees in developing and testing their business models, while also helping them build and widen their own product development expertise.

The response from employees exceeded expectations and the incubator is currently supporting 17 teams globally to explore their ideas further. These ideas are digital and blended solutions and the diverse focus areas include programmes to help prison inmates in the US gain jobs upon release, language learning for refugees, and improving the mathematics skills of low-income students in South Africa.

17 teams funded
by the Tomorrow's Markets Incubator to explore their ideas further

Our performance sustainability rankings

One way we assess how we are doing as a sustainable business is to maintain our position in key indices and benchmarks of social responsibility.

Dow Jones Sustainability Indexes

2016	Silver Class
2015	Bronze Class
2014	Bronze Class
2013	Silver Class
2012	Gold Class

CR INDEX 2016 Business in the Community

2016	94%
2015	95%
2014	Platinum*
2013	Platinum
2012	Platinum*

2016 was the final year of the CR Index *retained

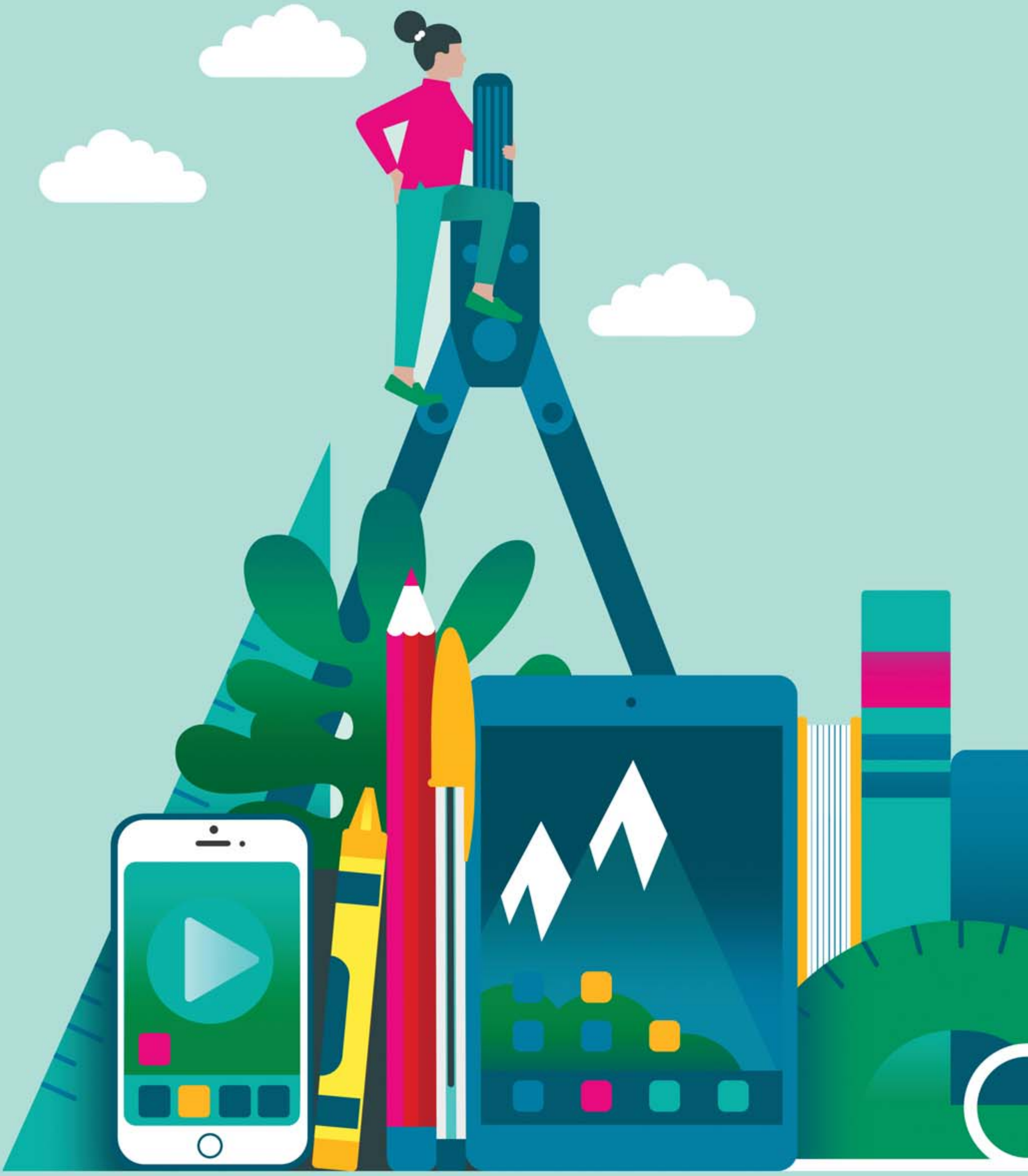
FTSE4Good

2016	Yes
2015	Yes
2014	Yes
2013	Yes
2012	Yes

Yes signifies inclusion in FTSE4Good

World's 100 Most Sustainable Companies

2016	Yes
2015	Yes
2014	Yes



Our performance

Structural pressures in some markets together with cyclical and transitional issues have led to a challenging operating environment for Pearson. To remain focused on the biggest opportunities in global education, whilst dealing with challenging markets, we have made significant portfolio and management changes, undertaken a major restructuring which has exceeded its cost savings objectives, embarked on a broad-based simplification programme and continued to invest more than £700m per year in our portfolio of products and services.

We have been investing steadily to develop new digital products and services, and forge broader partnerships with academic institutions, that enable us to capitalise on our scale and harness the opportunities in global education.

In this section

Financial review

"In 2016, Pearson's sales increased by £84m in headline terms to £4.6bn. Total continuing adjusted operating profit fell £37m to £635m."

Coram Williams
Chief financial officer

Profit and loss statement

In 2016, Pearson's sales increased by £84m in headline terms to £4.6bn. Total continuing adjusted operating profit fell £37m to £635m (2015: £672m).

Currency movements, primarily from the depreciation of sterling against the US dollar during the period, increased sales by £486m and operating profits by £106m.

At constant exchange rates (i.e., stripping out the impact of those currency movements), our sales fell by 9% primarily due to weakness in US higher education courseware, US K-12 assessment and courseware and UK student assessment; and continuing adjusted operating profit fell by 21% due to lower revenues.

The effect of disposals reduced sales by £63m and continuing adjusted operating profits by £2m.

Stripping out the impact of portfolio changes and currency movements, revenues were down 8% in underlying terms while adjusted operating profit fell 21%.

Net interest payable in 2016 was £59m, compared with £46m in 2015. Interest rose due to the weakness of sterling against largely dollar denominated debt and lower released accrued interest payments following agreement on historical tax positions.

Our adjusted tax rate in 2016 was 16.5% (2015: 15.5%). The increase in tax rate was primarily due to a smaller benefit from adjustments arising from the agreement of historical tax positions, partially offset by a larger proportion of total adjusted profits coming from joint ventures and associates, from which tax has already been deducted.

Adjusted earnings per share were 58.8p (2015: 70.3p).

Cash generation

Headline operating cash flow increased by £228m to £663m and operating cash conversion rose to 104% from 60% due to lower cash incentive payments and tight working capital control.

Return on invested capital

Our return on average invested capital was 5.0% (2015: 5.8%) primarily due to lower adjusted operating profit.

Statutory results

Our statutory results showed a loss for the year after tax of £2,335m, including an impairment of goodwill of £2,548m, reflecting trading pressures in our North American businesses.

Financial summary

Business performance

£ millions	2016	2015	Headline growth	CER growth	Underlying growth
Sales	**4,552**	4,468	2%	(9)%	(8)%
Adjusted operating profit – continuing operations	**635**	672	(6)%	(21)%	(21)%
Adjusted operating profit	**635**	723	(12)%	(27)%	(21)%
Adjusted earnings per share	**58.8p**	70.3p	(16)%		
Operating cash flow	**663**	435	52%		
Net debt	**(1,092)**	(654)	(67)%		

Growth rates are stated on a constant exchange rate (CER) basis unless otherwise stated. Where quoted, underlying growth rates exclude both currency movements and portfolio changes. Unless otherwise stated, in 2015 sales exclude FT Group, while total adjusted operating profits include FT Group. Continuing operations exclude FT Group.

Statutory results

£ millions	2016	2015	Headline growth
Sales	**4,552**	4,468	2%
Operating (loss)/profit	**(2,497)**	(404)	
Loss before tax	**(2,557)**	(433)	
(Loss)/profit for the year	**(2,335)**	823	
Basic (loss)/earnings per share	**(286.8)p**	101.2p	
Cash generated from operations	**522**	518	1%
Dividend per share	**52p**	52p	0%

The business performance measures are non-GAAP measures and are included as they are key financial measures used by management to evaluate performance and also for investors to track the underlying operational performance of the Group. Reconciliations to the equivalent statutory heading under IFRS are included in the corporate and operating measures on p194-195.

Balance sheet

Our net debt increased to £1,092m (2015: £654m) reflecting the strengthening of the US dollar relative to sterling and restructuring costs. Pearson's net debt/EBITDA ratio remains solid at 1.4x (2015: 0.8x).

Dividend

The board is proposing a final dividend of 34p, which results in an overall 2016 dividend of 52p, flat on 2015, subject to shareholder approval.

2017 outlook

In 2017, we expect to report adjusted operating profit of between £570m and £630m. This reflects the impact of the in-year benefits from the 2016 restructuring offset by ongoing challenging conditions in US higher education courseware, the costs of the employee incentive pool, other operational factors (including dual running costs as we rationalise our technology infrastructure, cost inflation and increased investment relating to new product launches) and the impact of some small disposals of sub-scale businesses.

We expect adjusted earnings per share to be between 48.5p and 55.5p, after an interest charge of £74m and a tax rate of approximately 20%. This guidance is based on our current portfolio of businesses and exchange rates on 31 December 2016.

The major factors behind this guidance are as follows:

Trading conditions

In North America, our largest market, our guidance for 2017 is based on assumptions of further declines in enrolment and other pressures in the US higher education courseware market. The top of the range implies that this is offset as the impact of the 2016 inventory correction at key channel partners partially unwinds, with lower returns resulting in net revenue growth in our US higher education courseware business of approximately 1%. The bottom of our guidance range assumes that inventory levels continue to fall resulting in a 7% net revenue decline. In both cases, we assume an underlying decline in demand of between 6% and 7% for US higher education courseware.

Elsewhere in North America, we anticipate modest declines in school courseware revenues reflecting a slightly larger adoption market offset by our lower participation rate due to our earlier decision not to compete in the current California English Language Arts (ELA) adoption; and flat revenues in Open Territories reflecting a smaller impact from new products after a very successful 2016. We expect some continued pressure on testing revenues in North America due to the annualisation of contract losses announced in 2015 and the roll-off of temporary contracts won in 2016, together with a further shift to digital tests which reduces revenue but benefits margins. We expect Connections Education to see double-digit growth in enrolment partially offset by some virtual school partners choosing to take some non-core services in-house. We expect online programme management and professional certification to continue to grow well.

In our Core markets (which include the UK, Italy and Australia), we anticipate: flat revenues with continued growth in Pearson Test of English Academic and in online programme management due to programme additions and new customer

Key performance indicators P
Maintain long-term growth

See a summary of all our KPIs on p36-37

Sales, £m, headline

£4,552m +2%

Sales grew in headline terms but fell 9% at CER in 2016 reflecting the declines in print in US higher education courseware and School Assessment in the UK and US. Over the last five years sales have grown at an average annual rate of 0.7% reflecting long term growth in digital and services and strength in the dollar relative to sterling, partially offset by pressure on print revenues, recent cyclical and policy factors and adverse FX movements in emerging markets.

Total adjusted operating profit, £m, headline

£635m -12%

Total adjusted operating profit fell 12% in headline terms and has fallen at a compound annual rate of 7.5% since 2011 reflecting pressure on revenues in higher margin businesses, portfolio changes and increased investment in digital and services, partially offset by growth in digital and services and the benefits of restructuring.

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wins; growth in UK school and higher education courseware due to a strong slate of new products aligned with Pearson qualifications; offset by modest declines in UK student assessment, where revenue is expected to lag behind the greater stability that we are now seeing in vocational course registrations; together with business exits and weakness in smaller markets.

In our Growth markets (which include Brazil, China, India and South Africa), we expect a modest increase in revenues; with growth in China driven by new product offerings and centre openings at Wall Street English; in South Africa due to improving enrolments in CTI, our private university; and in Brazil on evidence of greater economic stability. We expect courseware businesses across Growth to grow well on new product launches, offsetting some business exits as we focus on fewer, larger opportunities.

In Penguin Random House, we anticipate a broadly level publishing performance.

Portfolio changes

We completed the sale of a number of small subscale businesses which, combined, have the effect of reducing 2017 adjusted operating profit by £10m.

Other operational factors

Incentive compensation

Group incentive compensation increased by £55m in 2016, lower than the budgeted £110m reflecting the weakness of performance versus budget. The incentive pool will be budgeted in full in 2017 to ensure our workforce is properly incentivised.

Currency movements

In 2016, Pearson generated approximately 62% of its sales in the US, 7% in Greater China, 5% in the euro zone, 3% in Brazil, 3% in Canada, 2% in Australia, 2% in South Africa and 1% in India, and our guidance is based on exchange rates at 31 December 2016.

Debt repayment

To ensure efficient use of the cash balances we held at 31 December 2016, we announced that we will trigger the early repayment option on our $550m 6.25% Global dollar bonds 2018.

Interest and tax

We expect our interest charge to be £74m (2016: £59m) due to currency movements and increases in US dollar LIBOR.

We expect an adjusted tax rate of approximately 20% on our total adjusted profit (which includes the post-tax contribution from Penguin Random House).

Other financial information

Net finance costs

£ millions	2016	2015
Net interest payable	**(59)**	(46)
Finance income in respect of employee benefit plans	**11**	4
Other net finance (costs)/income	**(12)**	13
Net finance costs	**(60)**	(29)

Net interest payable in 2016 was £59m, compared to £46m in 2015. The majority of the movement in net interest payable was due to a one-off release of accrued interest in 2015 following agreement of historical tax positions. The most significant element of the net interest payable figure is interest on bond debt with the impact of interest on tax provisions and interest receivable offsetting each other. Interest on bond debt was in line with the prior year, with the savings from bond repayments offset by the impact of rising US dollar interest rates.

Key performance indicators P
Deliver sustainable returns

See a summary of all our KPIs on p36-37

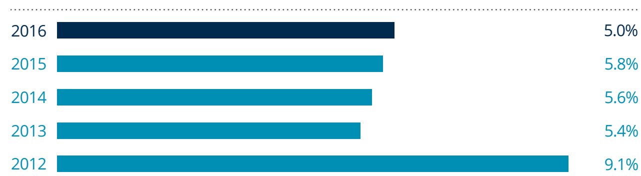
Total adjusted earnings per share, £m, headline

58.8p -16%

Total adjusted earnings per share (EPS) is down 16% year on year in 2016 reflecting lower profitability, exchange rate movements and a slightly higher tax rate than 2015. Over five years, EPS has declined at an average annual rate of 7.3% reflecting pressure on revenues in higher margin businesses, increased investment in digital and services and portfolio changes, partially offset by growth in digital and services.

Return on invested capital, %, headline

5.0% -0.8 percentage points



Return on invested capital (ROIC) fell 0.8 percentage points to 5.0% in 2016 reflecting lower operating profit.

The increase in finance income in respect of employee benefit plans is a reflection of the more favourable funding position at the end of 2015. Both the loss in 2016 and the gain in 2015 in other net finance costs mainly relate to foreign exchange differences on unhedged cash and cash equivalents and other financial instruments.

Capital risk

The Group's objectives when managing capital are:

- to safeguard the Group's ability to continue as a going concern and retain financial flexibility by maintaining a well managed balance sheet
- to provide returns for shareholders and benefits for other stakeholders
- to maintain a solid investment grade credit rating.

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

Net debt

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

£ millions	2016	2015
Cash and cash equivalents	**1,459**	1,703
Marketable securities	**10**	28
Net derivative financial instruments	**(93)**	(55)
Bonds	**(2,420)**	(2,284)
Bank loans and overdrafts	**(39)**	(38)
Finance leases	**(9)**	(8)
Net debt	**(1,092)**	(654)

Balance sheet net debt continues to benefit from the retention of proceeds from the sales of the Financial Times and the Economist. Despite the low balance sheet gearing, the Group has significant operating lease liabilities which are not currently included as balance sheet liabilities but are included by the credit rating agencies within debt.

The largest contribution to the increase in the sterling value of our net debt was from retranslation of the Group's dollar denominated debt from \$1.47 : £1 at 31 December 2015 to \$1.23 : £1 at 31 December 2016. The Group holds dollar debt as a natural hedge of the Group's largest earnings generating region, North America. Investment in capital expenditure and one-off restructuring charges resulted in negative cash flow for the year which represented the balance of the movement in net debt.

Liquidity and funding

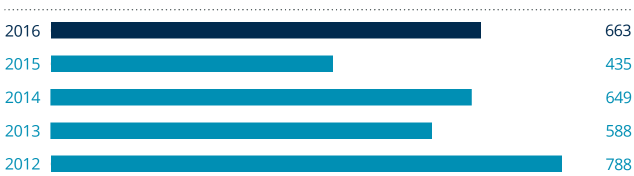
The Group had a strong liquidity position at 31 December 2016, with over £1.4bn of cash and an undrawn US dollar denominated Revolving Credit Facility due in 2021 of \$1.75bn (at 31 December 2015, the Group had cash of over £1.7bn and an undrawn Revolving Credit Facility due 2020 of \$1.75bn). To ensure efficient use of the Group's cash balances, we announced on 24 February that we will trigger the early repayment option on our \$550m 6.25% Global dollar bonds 2018.

Key performance indicator P
Manage cash position effectively

See a summary of all our KPIs on p36-37

Operating cash flow, £m, headline

£663m +52%



Operating cash increased to £663m in 2016 reflecting good cash conversion due to tight management of working capital and lower incentive payments in 2016. Over five years, operating cash flow has declined at an average rate of 7.6% per annum reflecting pressure on revenues in higher margin businesses, increased investment in digital and services and portfolio changes, partially offset by growth in digital and services and the benefits of restructuring.

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At the same time as the bond is repaid, we will unwind the associated interest rate swaps which convert the bond to a floating rate of US dollar libor + 1.81%. The transactions will result in a modest premium payable in 2017, which was included in our interest guidance of £74m in 2017.

Taxation

Our tax rate in 2016 was 16.5% (2015: 15.5%). The increase in tax rate was primarily due a smaller benefit from adjustments arising from the agreement of historical tax positions, partially offset by profits from joint ventures and associates, from which tax has already been deducted, being a larger proportion of total adjusted profits.

The reported tax benefit on a statutory basis in 2016 was £222m (8.7%) compared with a benefit of £81m (18.7%) in 2015. The statutory tax benefit in 2016 is mainly due to the release of deferred tax liabilities relating to tax deductible goodwill that has been impaired. The statutory tax benefit in 2015 was mainly due to benefits arising on the increase in intangible charges. Operating tax paid in 2016 was £63m compared with £129m in 2015.

Discontinued operations

Discontinued operations in 2015 relate to the sale of the Financial Times and the Group's 50% interest in The Economist. The Economist sale was substantially completed in October 2015 and realised a gain of £473m before tax. The remaining interest in The Economist was held at fair value and subsequently sold in the first half of 2016 without realising any further gain or loss. The sale of the Financial Times completed on 30 November 2015 and realised a gain of £711m before tax. The gains on these transactions and the results for 2015 to the respective sale dates have been included in discontinued operations.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The gain on translation of £913m in 2016 compares with a loss in 2015 of £69m and has arisen due to the strength of the US dollar and many other currencies relative to sterling. In 2016, sterling weakened relative to many of the currencies that Pearson is exposed to. A significant proportion of the Group's operations are based in the US and the US dollar strengthened significantly in 2016 from an opening rate of £1:$1.47 to a closing rate at the end of 2016 of £1:$1.23. At the end of 2015, the US dollar had strengthened in comparison with the opening rate moving from £1:$1.56 to £1:$1.47 but this effect was more than offset by weakness in other currencies.

Also included in other comprehensive income in 2016 is an actuarial loss of £276m in relation to post-retirement plans of the Group and our share of the post-retirement plans of Penguin Random House (PRH). The loss mainly arises from the unfavourable impact of changes in the assumptions used to value the liabilities in the plans which in aggregate exceeded favourable returns on plan assets. The loss in 2016 compares with an actuarial gain in 2015 of £118m.

Dividends

The dividend accounted for in our 2016 financial statements totalling £424m represents the final dividend in respect of 2015 (34.0p) and the interim dividend for 2016 (18.0p). We are proposing a final dividend for 2016 of 34.0p, bringing the total paid and payable in respect of 2016 to 52.0p. This final 2016 dividend, which was approved by the board in February 2017, is subject to approval at the forthcoming AGM and will be charged against 2017 profits. For 2016, the dividend is covered 1.1 times by adjusted earnings.

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 for continuing operations amounted to £70m in 2016 (2015: £81m) of which a charge of £81m (2015: £85m) was reported in adjusted operating profit and an income of £11m (2015: £4m) was reported against other net finance costs.

The overall surplus on the UK Group pension plan of £337m at the end of 2015 has decreased to a surplus of £158m at the end of 2016. The movement has arisen principally due to lower discount rates used to value the liabilities partially offset by continuing asset returns and deficit funding. As a consequence of the disposal of the FT Group in 2015, we have agreed to accelerate the funding of the UK Group pension plan and as a result the plan is expected to be fully funded on a 'self sufficiency' basis by 2019, inclusive of payments in 2017 in relation to the PRH merger in 2013, currently estimated at £225m.

In total, our worldwide net position in respect of pensions and other post-retirement benefits decreased from a net asset of £198m at the end of 2015 to a net asset of £19m at the end of 2016.

Goodwill and Intangible assets

At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, we revised our strategic plans and our estimates for future cash flows and as a consequence made an impairment to North American goodwill of £2,548m.

In 2015, following economic and market deterioration in the Group's operations in emerging markets and ongoing cyclical and policy related pressures in the Group's mature market operations we impaired intangible assets in North America by £282m, in Core markets by £37m and in Growth markets by £530m.

Acquisitions and disposals

There were no significant acquisitions in 2016 or 2015. In 2016 we closed our English language schools in Germany and also sold the Pearson English Business Solutions business. These two disposals together with other smaller disposal related items gave rise to an aggregate loss of £25m.

During 2015 the Group disposed of its interest in the FT Group including its 50% share of the Economist. The Financial Times sale to Nikkei was completed on 30 November 2015 for consideration of £858m and realised a gain on sale of £711m before a tax charge of £49m. The sale of our 50% share of the Economist Group to EXOR was substantially completed on 16 October 2015. The value of the investment in the Economist on Pearson's books was not significant and there was no tax on the transaction with the result that the gain on sale of £473m largely reflects the proceeds received. Both the gain on the FT and the Economist were reflected in discontinued operations in 2015. Other disposals reflected in continuing operations in 2015 include the gain on sale of PowerSchool of £30m and net losses of £17m from the sale and write down of smaller non-core businesses and investments.

Return on invested capital (ROIC)

Our ROIC is calculated as total adjusted operating profit less cash tax, expressed as a percentage of average gross invested capital. ROIC decreased from 5.8% in 2015 to 5.0% in 2016. The movement largely reflects lower profit in the year partly offset by reduced tax payments.

Related party transactions

Transactions with related parties are shown in note 35 of the financial statements.

Post balance sheet events

On 18 January 2017, we announced the intention to issue an exit notice to Bertelsmann regarding the 47% associate interest in PRH with a view to selling the stake or recapitalising the business and extracting a dividend.

On 24 February, we announced the intention to trigger the early repayment option on our $550m 6.25% Global dollar bonds 2018. There were no other significant post balance sheet events.

Coram Williams
Chief financial officer

Key performance indicators

We measure our progress against three broad categories of KPIs: financial objectives, business measures and sustainability measures.

The business measures category has been introduced this year to monitor our progress in simplifying our operations while strengthening our brand, culture and reputation.

These two pages summarise performance against all of these KPIs. More details on the performance, trends and factors influencing select KPIs are described within the relevant sections throughout the report.

(R) Linked to directors' remuneration

Note: For 2016 we have rationalised our KPIs to reflect our priorities in transforming the business. Our strategic growth drivers are explained on p14-19 and progress will be reviewed throughout 2017.

The KPIs are non-GAAP measures and are included as they are key financial measures used by management to evaluate performance and also for investors to track the underlying operational performance of the Group. Reconciliations to the equivalent statutory heading under IFRS are included in the corporate and operating measures on p194-195.

FINANCIAL OBJECTIVES

Maintain long-term growth

Indicator	Underlying performance	Reference
Sales (R)	-8%	See p31
Total adjusted operating profit (R)	-21%	See p31

Deliver sustainable returns

Indicator	Headline performance	Reference
Total adjusted earnings (R)	-16%	See p32
Return on invested capital	-0.8 percentage points	See p32
One-year total shareholder return	-18.2%	See p5
Dividend per share	unchanged	See p5

Manage our cash position

Indicator	Headline performance	Reference
Operating cash flow (R)	+52 %	See p33

BUSINESS MEASURES

Transform the business

Indicator	Performance
Cost savings	£275m
Global headcount reduction	4,600

Talent and employee engagement

Indicator	Performance
Employees who are proud to work for Pearson	68%
Employees inspired by Pearson's purpose	74%

Pearson employee engagement survey, 2016

Strengthen brand and reputation

Indicator	Performance
Awareness of Pearson amongst teachers, learners and parents	57%
Favourability of those aware of Pearson	88%

Pearson brand tracker survey of key markets, 2016

SUSTAINABILITY MEASURES

Deliver gender diversity

Indicator	Performance	Reference
Female board members	30%	See p25
Female senior managers	32%	See p25
Female employees	60%	See p25

Reduce our carbon footprint

Indicator	Performance	Reference
Global greenhouse gas emissions CO_2e tonnes	126,385 -13.7%	See p25

Maintain community investment

Indicator	Performance
Target 1% or more of pre-tax profits	£6.8m +1.2%

Operating performance

North America

Market summary

Our largest market includes all 50 US states and Canada.

Contribution to Group revenues

65%

Sales

£2,981m

Adjusted operating profit

£420m

Key efficacy finding

5x

Increase in probability of students passing remedial college math through use of MyLab Math (from 10% to 53%).

In 2016, we expanded our efficacy agenda to include every one of our strategic priorities in North America. We are beginning to generate compelling findings and using research insights to drive product improvement. This investment will help us reach more learners and have greater impact.

Revenues rose 1% in headline terms benefiting from a stronger US dollar, but declined 10% in underlying terms due to a significant decline in US higher education courseware, together with anticipated declines in school assessment, due to previously announced contract losses and in school courseware, due to a smaller adoption market and our lower participation rate, partially offset by growth in professional certification, virtual and blended schools and online programme management.

Adjusted operating profits fell 13% in headline terms and 28% at CER and underlying due primarily to the impact of lower sales in US higher education courseware.

Courseware

In school courseware, revenue declined 10% with a smaller new Adoption Market and our lower participation rate partially offset by good growth and market share gains in Open Territories resulting from new product launches. Our new adoption participation rate fell from over 90% in 2015 to 64% in 2016 due to our decision not to compete for the California Grades K-8 English Language Arts (ELA) adoption with a core basal programme. We won an estimated 30% share of adoptions competed for (31% in 2015) and 19% of total new adoption expenditure of $470m (29% of $730m in 2015) driven by strong performance in Indiana Math and Social Studies and South Carolina Science and Social Studies. In Open Territories, we grew strongly benefiting from our new MyPerspectives programme in Grades 6–12 ELA, ReadyGen, Investigations 3.0, the extension of enVisionMATH to cover Grades 6–8 and growth in our digital reading intervention programme, iLit.

In higher education courseware, total US college enrolments fell 1.4%, with combined two-year public and four-year for-profit enrolments declining 5.0%, affected by rising employment rates and regulatory change impacting the for-profit and developmental learning sectors, partially offset by modest growth in combined enrolments at four-year public and private not-for-profit institutions. Net revenues in our US higher education courseware business declined an unprecedented 18% during the year. We estimate 2% of this decline was driven by lower enrolment, particularly in Community College and among older students; 3–4% by an accelerated impact from rental in the secondary market; and approximately 12% due to an inventory correction in the channel reflecting the cumulative impact of these factors in prior years. Underlying market share trends remained stable and our market share in the 12 months to January 2017 was 40.4%.

During 2016, we performed strongly in Science and Business & Economics with key titles including: *Applying, Biochemistry: Concepts & Connections 1e*; Amerman, *Human Anatomy & Physiology 1e*; Marieb, *Human Anatomy & Physiology 10e*; Young, Freedman,

Deb's story

United States
Connections Education

"For the past year, I have had the privilege of serving as principal of Troy Intersect Virtual Academy in Troy, Michigan. Previously I was not impressed with K-12 online education.

Working with the students and educators of Intersect and the staff at Pearson Online & Blended Learning has changed my perception about virtual learning.

I discovered that not all online programmes are alike. With Troy School District's high academic standards, I now understand why it selected Pearson Online & Blended Learning's programme for our online students. The curriculum is rigorous and equal to the academic expectations of our district. Students are well supported by certified online teachers and tutors, and they have access to a full-time district counsellor, classroom teacher, classroom para-pro and principal.

Most of my personal and professional friends are amazed at my attitude change about K-12 online learning. My involvement with Pearson Online & Blended Learning's well-developed programme has helped me to understand that one education model does not meet the needs of all students."

Deb MacDonald Linford
Principal, Troy Intersect Virtual School

University Physics 14e and Parkin, *Economics 12e*. Global digital registrations of MyLab and related products grew 2%. In North America, digital registrations grew 2% with good growth in Science, Business & Economics and Revel partly offset by continued softness in Developmental Mathematics. Skill Builder Adaptive Practice, our in-house adaptive homework solution launched in over 60 titles in 2016.

Faculty-generated studies indicate that the use of MyLab, Mastering and Revel programmes, as part of a broader course redesign, can support improvements in student test scores and lower institutional cost. Findings from an efficacy study suggest that students in Developmental Mathematics courses who increased their number of homework and quiz attempts in MyMathLab-Developmental increased their odds of passing; and that users of MyLab Writing who complete seven topics or more increase their final exam scores by 14%. In another study at a mid-sized university in the Midwest, during the 2015-2016 academic year, students using My IT Lab were able to raise their exam scores by half a letter grade for every seven additional activities attempted. In institutional courseware solutions, Pearson signed 148 large-scale, enterprise adoptions of direct digital access (DDA), where content is purchased via an upfront course fee and integrated with university IT systems. New signings in the year included University of Tennessee – Knoxville and Kentucky State University.

Assessment

In school assessment (State and National Assessments), revenues declined 22% due to previously announced contract losses. The states of Arkansas, Mississippi and Ohio discontinued PARCC assessments and we ceased to administer the majority of the current Texas STAAR contract, as announced in 2015. We replaced the loss from Massachusetts leaving PARCC by winning a five-year sub-contract to deliver Massachusetts' new custom assessment. We were awarded a one-year emergency contract in Tennessee to score and report 2016 state assessments. Kentucky renewed a contract with Pearson for two years to provide its state assessments in Math, English Language Arts, and Science. Arizona extended Pearson's contract to provide the English language learner assessments for the 2016–2017 school year, while Colorado extended a contract with Pearson to provide PARCC, science and social studies assessments. We won new contracts in Delaware for social studies assessment and a sub-contract to develop high school math and English language arts assessments in Louisiana. We delivered 23.6 million standardised online tests to K-12 students, a reduction of 11% from 2015 due to overall reduction in test counts across contracts. Paper-based standardised test volumes fell 33% to 21.9 million. Digital tests on Pearson's TestNav platform now account for over 52% of our testing volumes. We launched *aimswebPlusTM*, an update to our leading formative assessment platform, first launched in 2000.

In professional certification, revenues grew 7% with VUE global test volume up 3% to almost 15 million, boosted by continued growth in IT, professional, US teacher certification programmes and strong growth in GED (General Educational Development, the high school equivalency test that is part of a joint venture with the American Council on Education. We renewed our contracts with the Computing Technology Industry Association (CompTIA) for three years, the Florida Department of Business & Professional Regulation for five years, the American Register of Radiologic Technologists (ARRT) for seven years and a contract to administer insurance back office licensing services in North Carolina for five years.

Clinical assessment sales declined 1% following the strong performance over the previous two years driven by the introduction of the fifth edition of the *Wechsler Intelligence Scale for Children* (WISC-V). *Behavior Assessment for Children 3e* (BASC) continues to see strong growth; and Q-Interactive, Pearson's digital solution for clinical assessment administration, saw continued strong growth in licence sales with sub-test administrations up more than 80% over the same period last year.

Kelley & Courtlyn's story

United States
Connections Education

Texas twins Kelley and Courtlyn Ranly were looking for an education option that would both challenge them academically and allow them the time needed to compete in rodeo competitions when they found online public school Texas Connections Academy.

With the flexibility of online school, both students were able to pursue their passion for rodeo, volunteer at a local veterinary clinic, act as Texas 4-H Livestock Ambassadors, and show their sheep and goats at stock shows throughout the state. The twins have amassed more than 100 awards for their extracurricular activities. Courtlyn and Kelley currently attend Texas A&M University as animal science majors, with the shared goal of one day opening a veterinary clinic together.

> "We wanted our daughters to be challenged, we wanted them to have the opportunity to excel, experience and grow as much as possible, because these years are formative years that will help determine what kind of an adult they are going to be,"

says Miki Ranly, their mother.

Kelley and Courtlyn Ranly
Graduates – Texas Connections Academy

Operating performance

Services

Connections Education, our virtual school business, served nearly 73,000 full-time equivalent students through full-time virtual and blended school programmes, up 6% on last year. Connections revenues grew 8%. Five new full-time online, statewide, partner schools opened for the 2016–17 school year in Arkansas, Washington, Colorado, Pennsylvania and New Mexico. The 2016 Connections Education Parent Satisfaction Survey showed strong results with 92% of families with students enrolled in full-time online partner schools stating that they would recommend the schools to others.

In Pearson Online Services, our higher education OPM business, course enrolments grew strongly, up over 19% to more than 314,000, boosted by strong growth in Arizona State University Online, new partners and programme extensions. We signed 11 new programmes in 2016 including two new partners: Eastern Gateway Community College in collaboration with American Federation of State, County and Municipal Employees, and we took over an existing suite of online Nursing programmes with Duquesne University. Strong growth in OPM was partially offset by a decline in Learning Studio, which is currently being retired. Overall revenues grew 5%.

Core

Market summary

Our international business in established and mature education markets including the UK, Australia and Italy.

Contribution to Group revenues

18%

Sales

£803m

Adjusted operating profit

£57m

Key efficacy finding

3 months

Number of months Bug Club readers are ahead in word recognition when compared with others, after 12 months of use.

In 2016, we took significant steps forward in Core in measuring and improving the efficacy of our digital courseware, assessments, and services. All of our highest priority products and services are making progress on the path to efficacy.

Revenues declined 1% in headline terms, were down 7% at CER reflecting the closure of Wall Street English Germany, disposal of other sub-scale businesses and the transfer of some smaller businesses to our Growth segment, and declined 4% in underlying terms, primarily due to expected declines in vocational course registrations in UK schools and courseware. This was partially offset by strong growth in English assessments in Australia and OPM services in the UK and Australia. Adjusted operating profit declined 51% primarily due to lower revenues in UK student assessment.

Courseware

Courseware revenues declined 7%. In-school revenues declined in smaller markets in Europe and Africa, in Australia as we exited a number of sub-scale market segments and in UK primary due to a smaller adoption cycle, partially offset by growth in secondary in the UK due to new product launches aligned with our qualifications and the successful delivery of The Crunch food project in partnership with the Wellcome Trust. In higher education courseware, revenues declined in smaller markets, in Australia due to phasing and in the UK as we exited sub-scale market segments. In the UK, 2.1 million pupils are now using a Pearson digital service on ActiveLearn Primary, including Bug Club, up from 1.8 million a year ago. In a randomised

Kumar's story

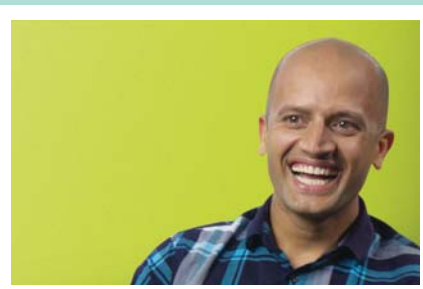
Australia
Pearson Test of English (PTE)Academic

Kumar Kufle grew up in eastern Nepal. As a child he would walk to and from school every day, which was a two to three-hour round trip. When Kumar was nine years old, he saw a Western tourist couple carrying their child on their back. The child was the same age as Kumar, and at the time Kumar was carrying a heavy load that would have weighed more than his own body weight. This experience made Kumar curious about the Western world and inspired him to learn English.

"Since then I always had a dream to learn English."

Kumar learnt English at boarding school and came to Australia to study further.

"I took my PTE Academic test for my graduate visa. I chose PTE Academic because it's got better availability for tests. It is fairer because it's got automated scoring, and I got my score results back faster. I got the result that I needed… and enrolled in a professional year programme. Now I am doing an internship in finance in a multinational company."



Kumar Kufle

control trial, where its impact was periodically assessed, Bug Club was shown to have made a highly statistically significant impact on pupils' reading, vocabulary and spelling performance, with a greater positive impact in schools with a higher proportion of children receiving free school meals.

Assessment

In higher education and school assessment, revenues fell 10%. UK qualifications have been impacted by government policy, where changes to accountability measures have led to lower vocational registrations. As expected, BTEC Firsts registrations in UK schools have begun to stabilise, though overall BTEC and apprenticeship registrations continued to fall in 2016 albeit at a slower rate. GCSE and GCE entries for summer 2016 declined modestly compared with 2015, primarily due to lower AS level entries as a result of a policy-driven shift to more linear courses. We successfully delivered the National Curriculum Test for 2016, marking 3.4 million scripts and successfully implemented the transition from levels to scaled scores.

Clinical assessment grew 9% with Australian revenues benefiting from strong growth in the new edition of the WISC-V.

At VUE, revenues declined 1% due to the initial impact of contract renewals. We were awarded contracts: to continue to administer the UK driving theory test for the UK DVSA for four years from September 2016; to continue to provide testing services to the Construction Industry Training Board for four years from April 2017; and to administer the UK Clinical Aptitude Test for five years from January 2017. In France, VUE was awarded a new licence by the Délégation à la Sécurité et à la Circulation Routières (DSCR) du Ministere de l'Intérieur to be one of the providers administering the country's computer-based driving theory exam throughout France.

The Pearson Test of English (PTE) Academic saw continued strong growth in global test volumes with the Australian Department of Immigration and Border Protection and New Zealand immigration accepting the test for proof of English ability for a range of student visas. The number of professional associations using PTE Academic to credential English language standards of their members continued to grow and now includes the Australian Nursing & Midwifery Accreditation Council. All Australian and NZ universities now accept PTE Academic for admissions purposes, as do most of the UK and Canadian universities, and a growing number of US institutions including Harvard Business School, Yale and Wharton Business School.

Services

In higher education services, revenues grew 12%. Our OPM revenues grew 74%. In Australia, we saw strong growth due to our successful partnership with Monash University, led by the Graduate Diploma in Psychology, now one of Monash's largest postgraduate courses. Our partnership with Griffith University remains strong, with performance driven mainly by the MBA course. In the UK, our ongoing OPM partnership with King's College London saw us commence teaching in early 2016 of several post graduate Psychology and Law programmes. We have signed an additional partnership with Manchester Metropolitan University to launch three online postgraduate degrees in Business Studies in 2017, and have also partnered with another Russell Group University to launch a wide range of online postgraduate programmes over the next four years.

Wall Street English revenues grew strongly in Italy as we opened new centres and rolled out the New Student Experience (NSE) in all centres in the country. The NSE delivers a next generation Wall Street English service with adaptive, personalised learning incorporating Pearson's Global Scale of English. We announced the closure of our unprofitable Wall Street English schools in Germany.

Market spotlight

Australia
Partnerships

Pearson partnered with independent, not-for-profit public policy institute the McKell Institute in Australia to launch *No Mind Left Behind* – a research report examining the education system in Australia.

Report author and policy officer at the McKell Institute Marieke D'Cruz said:

"The report indexes education opportunity in Australia by electorate, plus makes recommendations to government on how to improve the education system – from early childhood to lifelong learning. Pearson was as passionate as us to ensure the report was an independent output, and we welcome one of their first forays into the education debate in Australia."

Marieke D'Cruz

Operating performance

Growth

Market summary

Our growth markets in emerging and developing economies with investment priorities in Brazil, China, India and South Africa.

Contribution to Group revenues

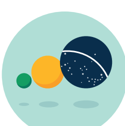
17%

Sales

£768m

Adjusted operating profit

£29m



Key efficacy finding

28 points

Positive score differential between our NAME sistema students and their peers in similar schools. The difference equates to roughly one level higher on the national exam.

In 2016, we invested in new products that will deliver better outcomes for more learners across K-12, English, and Higher Education. These products will help improve access to quality education that helps people make progress in their lives.

Revenues grew 8% in headline terms, were flat at CER reflecting the transfer of some smaller business from Core partially offset by the sale of smaller sub-scale businesses and down 1% in underlying terms. In China, growth in adult English language learning and English courseware was partly offset by declines in English test preparation. In Brazil, revenues declined due to enrolment declines in our English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to our previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015. Excluding the impact of the exit from this agreement, underlying revenues in Growth were up 1%.

Adjusted operating profit increased £32m to a profit of £29m reflecting the benefits of restructuring and the absence of a contract termination charge in the Middle East which impacted the first half of 2015.

Courseware

Courseware revenues grew 8%, due to strong growth in school textbook sales in South Africa and English language courseware in China, Argentina and Mexico partially offset by weakness in Brazil.

We saw strong growth in registrations for MyEnglishLab boosted by new editions of key titles such as *Speakout* and *Top Notch*. Middle East school courseware declined as a result of macroeconomic pressure and lower purchases from key international school clients.

Services

In China, growth in Wall Street English (WSE) was offset by declines at Global Education. Enrolments grew 8% at WSE, to 72,500. We launched the New Student Experience across all 68 WSE China centres, opened two new retail centres in Beijing and Shenzhen and a new corporate training centre in Shenzhen. In global education, we transferred two cities to franchisees. Underlying revenue declined with lower enrolments partially offset by an ongoing shift to more premium courses with smaller class sizes.

In Brazil, student enrolment in our sistemas business fell 9% due to attrition in NAME and Dom Bosco partially offset by new students at COC. Revenues grew slightly due to improved mix. Revenues in English language learning fell due to challenging economic conditions, partially offset by an increased footprint for our leading brand in language learning, Wizard, where new school openings expanded the number of franchise schools by 7% to 2,392.

Phumudzo's story

South Africa
The Pearson Institute

Phumudzo Madzhie (26) is a successful businessman, investor, philanthropist, motivational speaker, financial literacy activist and alumnus of the Pearson Institute. He studied a Business Administration degree followed by Honours in Business Management.

Phumudzo is the youngest franchisee in the history of the Mike's Kitchen Group, responsible for strategic planning, all major investment decisions and organisational development. He is also one of the 40 young South Africans who were selected to participate in the 2016 Mandela Washington Fellowship for Young African Leaders.

Phumudzo believes he had an advantage by completing his studies at Pearson Institute.

"A whole world opened up in a way. It was not just theoretical, it was more practical. It is not just about what you learn today, it's about how you apply it tomorrow. I am currently doing my MBA and I am sailing through it because of the structure I learnt from Pearson Institute."

Phumudzo Madzhie

At our public sistema NAME, an efficacy study suggested that, after controlling for all of the identified student and school level factors, grade 5 NAME students significantly outperformed comparison students by 28 points in mathematics equating to one level higher attainment in the state Prova Brasil assessment. In another study at our largest private sistema COC, students scored significantly higher than students in similar non-COC schools in writing, natural sciences, humanities, language, and mathematics.

In South Africa, student enrolment at CTI Education Group and Pearson Institute of Higher Education fell by 25% to 8,500 driven primarily by tightening consumer credit affecting enrolment rates.

In India, Pearson MyPedia, an inside service 'sistema' solution for schools comprising print and digital content, assessments and academic support services, expanded to over 200 schools with approximately 56,000 learners in its first full year since launch. PTE Academic saw nearly 50% growth in the volume of tests taken.

Penguin Random House

Penguin Random House

Pearson owns 47% of Penguin Random House, the first truly global consumer book publishing company.

Penguin Random House delivered a strong profit performance in 2016 with continued net benefits from the merger integration.

Revenues declined after a very strong performance in 2015, which was boosted by the success of multi-million sellers *Grey* and *The Girl on the Train,* and due to the anticipated industry-wide decrease in ebook purchases following 2015's industry-wide digital-terms changes. Revenues in 2016 benefited from strong sales of *The Girl on the Train* by Paula Hawkins, in its second year of publication, and Jojo Moyes's *Me Before You* and *After You,* together with broad resilience of print books, including growing print sales online and increased demand for audio books.

The US business published 585 *New York Times* print and ebook bestsellers in 2016 (2015: 584). The division benefited from multi-million copy successes of *The Girl on the Train* and two novels from Jojo Moyes. Additional number one adult titles were *The Whistler* by John Grisham; *Night School* by Lee Child; *Fool Me Once* by Harlan Coben; *When Breath Becomes Air* by Paul Kalanithi; and Ina Garten's *Cooking For Jeffrey*. Children's authors who extended their outstanding sales in 2016 included Dr. Seuss and Roald Dahl, whose *The BFG* benefited from a movie tie-in; Rick Yancey; James Dashner; Drew Daywalt; Oliver Jeffers; and R. J. Palacio.

The UK business published 202 titles on the *Sunday Times* bestseller lists (2015: 201). The division's top-selling hardback was *Night School* by Lee Child. *The Girl On The Train* sold over three million copies in multi-formats, and *Me Before You* and *After You* cumulatively sold more than 2.5 million. Top-performing children's franchises were Roald Dahl and the tenth volume in Jeff Kinney's *Diary Of A Wimpy Kid* series.

Penguin Random House completed the sale of its travel-content division, Fodors, to Internet Brands, an online media and technology company, on 30 June 2016, and transferred the ownership of Random House Studio, its film and television development and production division, to a division of Bertelsmann.

The integration of Penguin and Random House continued to provide benefits in 2016 including net benefits from the first full year of systems and warehouse combinations in North America and in Spain and Latin America.

Penguin Random House fiction and nonfiction authors with highly anticipated new books in 2017 include Dan Brown, Ron Chernow, Lee Child, Harlan Coben, Janet Evanovich, Ken Follett, John Grisham, Paula Hawkins, Jeff Kinney, Dean Koontz, Nigella Lawson, John le Carré, James Patterson, Philip Pullman, Sheryl Sandberg, John Sanford, Danielle Steel and Rick Yancey, as well as new Star Wars™ and LEGO® movie tie-in titles.

Market spotlight

South Africa
Partnerships

Central to Pearson South Africa's transformation agenda is building partnerships within the educational landscape – government departments and NGOs – with the common purpose of making a measurable difference in the lives of learners across society, particularly in the area of literacy.

Mrs Tongo, principal of Luzuko Primary School in Gugulethu, where Pearson volunteers dedicated every Friday to small group reading sessions with Xhosa-speaking Grade 1 learners for 2016, notes:

"It is clear that Pearson has transformed our community. Parents did not want to send their children to our school, but the learners have gone home and told the families how they read in small groups with Pearson people who come specially to spend time with us. The children and community feel that we matter. We feel valued. Thank you Pearson."

Mrs Tongo principal of Luzuko Primary School

Risk management

Pearson has a structured enterprise risk management (ERM) framework to support the identification and effective management of risks across Pearson.

The goal of our risk management approach continues to be to support Pearson in meeting its strategic and operational objectives, as set out in the chief executive's overview on p6–9, by ensuring that key business risks are identified, assessed and mitigated.

A discussion of the principal risks facing Pearson and mitigating factors can be found on p47–55 below. Our aim is to manage risks, understanding that many risks are external in nature and cannot therefore be fully controlled.

Our risk management framework

The diagram below, How we manage risk, shows our approach to risk management across Pearson and is being used not only to identify, assess and mitigate risk, but also to support our efforts to embed risk management best practice approaches across all levels of the business.

Our ERM framework has been developed to be aligned with international standards (COSO and ISO 31000) and it aids our compliance with the Financial Reporting Council's (FRC) UK Corporate Governance Code guidance on risk management.

Our journey

At the end of 2014, we completed a review of our risk management maturity in the following key areas of our framework against the revised 2014 UK Corporate Governance Code: foundations, managing risk, culture and working with third parties. We set maturity targets and made improvements towards meeting those in 2015. Our approach in 2016 remained consistent with the prior year in that we continued to further develop and embed the risk management framework, supported by the board and the audit committee.

We reassessed our risk management maturity against the targets we set ourselves and also set further targets for 2017, with plans in place to achieve these.

Foundations

Risk foundations cover all the elements which underpin successful ERM and risk management more broadly, across Pearson. It covers risk governance and oversight, policy, the risk framework itself and the risk management process, roles and responsibilities, risk appetite and our approach to working with third parties.

Governance, roles and responsibilities

The board, assisted by the assurance the audit committee provides, oversees the ERM framework, validates the target risk appetite for each key risk, monitors risk status and mitigation plans and verifies the viability statement process. Day-to-day enterprise risk management is undertaken by a dedicated ERM team, accountable to the board and audit committee.

For a list of the responsibilities of each, see p76 in the governance section.

How we manage risk

Our risk management framework is used to assess and drive consistent improvements in risk management across Pearson.

Policy and process

An ERM policy, along with the risk framework and supporting guidance, remained in place throughout 2016. The policy outlines our commitments to managing risk in accordance with international standards such as ISO 31000:2009, the COSO Framework and FRC's UK Corporate Governance Code guidance on risk management. To meet our commitments, all employees are required to be responsible and accountable for managing risk as reasonably practical within their area of responsibility. These standards are considered a minimum requirement and individual Pearson entities can tailor these, provided they do not conflict with the policy.

The effectiveness of the risk management process is assessed yearly in the annual effectiveness review, covered in more detail on p76 in the governance section.

Risk appetite

Risk appetite is defined as the degree of risk the board is prepared to accept in order for Pearson to achieve its strategy and goals and helps determine the level of mitigation and/or contingency plans put in place to reduce a risk. Examples of risks where we have a very low risk appetite and take as much action as we are able to try to avoid and eliminate risk are those where we are complying with applicable laws such as anti-bribery and corruption or the safety and security of learners. For strategic risks, such as business transformation and change, these are opportunities as well as risks and we recognise the need to take well-informed and well-managed risks in order to achieve our strategic goals.

Pearson's leadership team sets the risk appetite and target for each key company-wide risk, as well as for risks in their individual businesses. Early in the year, these targets were reassessed against the current risk rating by the executive risk owner, then validated by the audit committee and the Pearson board.

Risk appetite targets form the baseline against which risk assessments are performed and risk monitoring takes place, as well as support decision-making regarding risk treatment (outlined in more detail under Managing risk).

Third parties

Managing the risks associated with third parties is a key element of the ERM framework. Drivers include outsourcing, franchising, legal and regulatory focus, global supply chains as well as customer, consumer and investor expectations. The same core risk process applies: identify and prioritise, assess, mitigate and monitor. In 2016, we set up a cross-Pearson Group to better coordinate our approach to managing the risks associated with third parties, ensure improved consistency and raise awareness.

Managing risk

Risk context

The risk context sets the criteria against which the risks are assessed. It defines the external and internal parameters to be taken into account when identifying and assessing risk, as well as the scope of the risk management process (described earlier in this section).

The risk management policy, framework and supporting guidance includes a guide to risk assessment, how to determine risk probability and assess impact as well as instructions on how to translate these into an overall risk rating. Adaptations of these matrices, tailored for a specific business area, are in use and align with those in Pearson's ERM policy.

Risk in action case study – Pearson Test of English (PTE)

How risk management adds value to strategic and day-to-day business decision making

Following recent rapid growth of PTE, one of our successful global products, further work was needed to prevent any risks associated with future delivery, in order to ensure that quality was maintained and to avoid reputational risk.

Risk governance

A cross-company programme was set up in 2016, with workstreams based around identified risks and recommending actions in time for strategy decision-making in September. Each workstream owner was tasked with setting up their own working group to identify risks relating to their area, presenting these back for debate by the wider group, along with proposed recommendations for resolving them.

Risk treatment

Identified risks were rated in terms of their impact on the business in order to support their prioritisation and recommended courses of action were divided into two categories:

'Compliance' risks – potential areas that needed to be tackled in order to ensure ongoing secure delivery. These are risks for which we typically have a low risk appetite and were the highest priority to resolve.

'Opportunity' risks – these recommendations (sometimes requiring further investment) were identified as areas we needed to tackle to accelerate future growth of the product. We typically have a higher risk appetite for 'opportunity' risks.

A high-level summary of the risks and mitigation plans formed part of a strategic paper for the Pearson executive to make better informed decisions on the future strategic direction of (and related investment in) PTE.

Risk monitoring

Tracking the full set of recommendations will be part of business-as-usual in 2017, monitored by a cross-functional governance board who will also continue to identify opportunities for continuous improvement.

Risk management

Risk assessment

The identification and mitigation of significant business risks are the responsibility of senior management and leadership teams for each business area, supported by the ERM team. Throughout the year (twice as a minimum), key risks are identified using a bottom up and top down approach through discussions with each business area, identifying new risks as well as reassessing those already being monitored, including any known emerging risks. Horizon scanning takes place throughout the year to aid the identification of new risks.

Risks are categorised into four main areas: strategy and change, operational, financial, and legal and compliance.

- Strategic – relating to the high-level plans and goals that are aligned with and support our strategy. This category is the most likely to contain risks that are also opportunities and therefore likely to have a higher risk appetite
- Operational – involving people, systems and processes
- Financial – involving financial planning, investments, budgeting, potential losses of and exposures to Pearson's assets
- Legal and compliance – relating to the adherence to applicable laws and regulations. Risks in this category typically have a very low risk appetite.

The probability of a risk materialising (on a scale from 'rare' to 'almost certain') and the potential impact (from 'insignificant' to 'severe') of each risk is rated using existing criteria. Then the adequacy of action plans to address any remaining control gaps is assessed. A risk appetite is also agreed upon for each risk (aligning with the appetite for key company-wide risks where appropriate).

Risk treatment

Once assessed, the most appropriate course of action for each risk is decided. This can include risk avoidance such as not starting a particular activity; implementing mitigation or contingency plans to change the probability or reduce the impact of a risk; taking on increasing risk in order to pursue an opportunity, or sharing the risk with another party or parties. The risk treatment is arrived at by comparing the residual risk rating (i.e. the combination of probability vs. impact once existing controls are taken into account) against the target risk appetite. Those with the largest gap require the greatest focus in terms of mitigation planning and ongoing monitoring.

Risk monitoring

In 2016, all identified Pearson-wide top risks were reassessed at least semi-annually against target risk appetite by Pearson leadership and senior management stakeholders. Risk discussions focus on where there is either a) the greatest change in risk ratings or b) the biggest gaps between the current risk rating and the target risk appetite, with the emphasis for the latter on the strength of mitigation plans in place.

Risk updates are submitted to the board and audit committee twice per year and include an assessment of the probability and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness. The risks where there are the greatest gaps between target appetite and current rating, or the greatest change, are highlighted. This gives the board the opportunity to review, challenge and validate the effectiveness of Pearson's approach to risk management.

Information on the top risks for the next level down (i.e. for each business area), was also included in the ERM risk reporting. You can read more about how the business manages risk in the Embedding risk section under Culture below.

In addition, a series of risk deep dives took place at audit committees and board meetings throughout the year which focused on specific risks. You can read more about risk deep dives in the chairman of the audit committee's letter on p71-72, covering the following risks: business transformation, data privacy and information security, anti-bribery and corruption, and tax.

Culture

The ERM risk framework is also used to drive the integration of risk management approaches into the culture of the organisation, supported by the board, audit committee and leadership across the business. We continued to focus on and strengthen our risk culture throughout the year.

Communication and awareness

The ERM team is committed to raising awareness of the importance of risk management and how employees can better manage risk day-to-day. The ERM team presented at leadership and team meetings regularly throughout the year, increased the ERM stakeholder group for the second consecutive year, as well as carried out specific scenario-based risk training.

Our Code of Conduct remained in place throughout 2016 to drive ethical and risk aware behaviours across the organisation. Online training on ethics and compliance has been developed, with a focus in 2016 on awareness raising.

Embedding risk

One of the key areas of focus for the ERM team in 2016 was improving the embedding of risk management across the wider organisation, driving best practices down below the Group risk level, to support strategic and operational decision-making.

All Pearson's business functions had their own risk map in place by the end of 2016, with risk information such as ownership and mitigation plans captured for each. Some teams already have detailed risk registers and processes for the next levels down. Just as for the company-wide risks, the risk process follows the framework for identifying, assessing, treating and monitoring risk and each risk is also assigned a risk appetite. Business areas monitor their own risks at least twice a year in line with ERM reporting (as these assessments help underpin the assessment of company-wide risks).

Risk assessments were also undertaken throughout the year on a number of strategic initiatives. The case study Risk in action (p45) describes one of these in greater detail, showing how risk governance and assessment supported business decision-making and led to value creation in 2016.

Continuous improvement

The risk framework sets the ERM team's strategy and is used, in conjunction with the maturity self-assessment, to set the team goals for each year. It is continually reviewed for its relevance and to identify any further areas for improvement. Many of the improvements made in 2016 have been highlighted in this section, such as the case study Risk in action (p45) and the progress made embedding risk management across the business.

Principal risks and uncertainties

The board of directors confirms that is has undertaken a robust assessment throughout 2016 of the principal risks facing the company, in accordance with provision C.2.1 of the 2014 UK Corporate Governance Code.

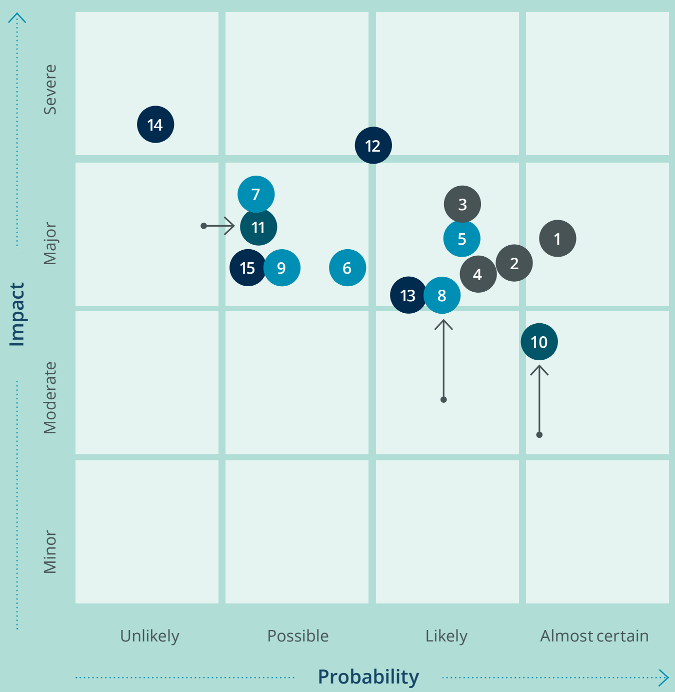
Our principal risks
(as of 31 December 2016)

Listed in the table below (and shown on the adjacent risk map) are the most significant risks that may affect Pearson's future. A longer list of company-wide key risks, plus emerging risks, was monitored and reviewed 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 identified as principal risks.

The following principal risks also relate to the material issues considered in the 2015 sustainability report: products and services, testing failure, political and regulatory risk, data privacy, information security, customer digital experience, and safety and corporate security. You can read more about sustainability, including a comparison table of sustainability material issues and principal, company-wide and other business risks on p22.

The risk acquisitions, divestments and joint ventures is no longer a principal risk: just as in 2016, acquisitions are a lower priority in 2017 and not likely to be material. There may be some separation or execution risk with certain divestments, but we do not expect such risk to be material. In 2016, we completed the separation of the FT and we undertook corporate transactions to de-risk the business, which in some cases resulted in exiting countries with greater compliance risk. We expect a similar approach in 2017, looking at ways to reduce our exposure to non-core businesses. We have announced our intention to issue an exit notice to Bertelsmann regarding the 47% associate interest in PRH with a view to selling the stake or recapitalising the business and extracting a dividend.

Principal risks: levels and 2016 change



Key

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

→ **Indicates change in 2016**

For more information see principal risks and uncertainties tables p48-55.

Strategy & change	Executive responsibility
1 **Business transformation and change**	Chief executive officer
2 **Products and services**	President, global product
3 **Talent**	Chief human resources officer
4 **Political and regulatory risk**	Chief corporate affairs and global marketing officer

Operational	Executive responsibility
5 **Testing failure**	President, assessments
6 **Safety and corporate security**	Chief human resources officer
7 **Safeguarding and protection**	President, assessments
8 **Customer digital experience**	President, global product Chief technology and operations officer
9 **Business continuity**	Chief financial officer

Financial	Executive responsibility
10 **Tax**	Chief financial officer
11 **Treasury**	Chief financial officer

Legal & compliance	Executive responsibility
12 **Data privacy and information security**	Chief technology and operations officer General counsel
13 **Intellectual property**	General counsel
14 **Anti-bribery and corruption**	Chief financial officer
15 **Competition law**	General counsel

Overview
Our strategy in action
Our performance
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Principal risks and uncertainties

Strategy & change

1 Business transformation and change[1]

The pace and scope of our business transformation initiatives increase our execution risk that benefits may not be fully realised, costs may increase, or that our business-as-usual activities may be impacted and do not perform in line with expectations.

S Link to strategic goals
Develop digital & services
Build market presence
Deliver measurable outcomes

1 Incorporates 'Data quality and integrity'.

2016 activities

As highlighted in the chairman's introduction on p4, 2016 continued to be a year of transformation and change for Pearson, supported by the board. The restructure and associated cost savings programme announced at the start of the year was delivered in full in 2016. The first implementation of The Enabling Programme – a programme of work to deliver a single Pearson-wide solution to integrate our data, systems and processes across HR, finance, procurement and supply chain – went live in the UK.

Key to the success of our change programmes is the quality of data (reported as a separate principal risk in 2015). The unavailability of timely, complete and accurate data limits informed decision-making and increases the risk of noncompliance with legal, regulatory and reporting requirements.

Controls

- Project and change management best practices
- Enhanced governance and reporting, including monthly updates on the most significant change initiatives to the Pearson executive, board and audit committee
- Monthly assurance reporting on the programmes.

2017 plans

In 2017, business transformation and change initiatives will be supporting our strategic goal to accelerate our digital transition in higher education, to manage the print decline, and to reshape our portfolio.

A key pillar in our strategy, as emphasised in the CEO's strategic overview on p7, is underpinning our content and assessment with our technology and services. We are speeding up work to simplify our global learning platform and enhancing our courseware service capabilities.

We will also continue with the next phase of The Enabling Programme to further progress the simplification of our business (the importance of which our chairman highlights on p4), reduce costs and improve our data capabilities. The focus will be on customer and product master data as core to all systems and businesses.

See CEO's strategic overview on p6-9.

2 Products and services[2]

Failure to accelerate our shift to digital by developing and delivering (to time and quality) market leading global products and services that will have the biggest impact on learners and drive growth; ensuring Pearson offers products to market at the right price and with a deal structure that remains competitive as well as supports our strategy.

S Link to strategic goals
Develop digital & services
Build market presence
Deliver measurable outcomes

2 Referred to as 'Digital and services evolution and market forces' in the 2015 annual report.

2016 activities

This risk remains one of our highest as it is central to our growth strategy. The end of 2016 saw unprecedented declines in our US higher education courseware business (as described in full in the Performance section on p38) which we failed to adequately anticipate and build into our forecasts.

Significant activity took place in 2016 to mitigate this risk and support the growth of Pearson. We have combined our lines of business for courseware into a single product organisation, as well as rationalised and integrated our product development capabilities to focus on learning and user experience design, and more adaptive, personalised learning in next generation courseware and online services. In 2016, we completed initial portfolio reviews on global school, US higher education courseware and higher education managed services, capturing opportunities for shifts in focus and better differentiation.

The Global Product Lifecycle continues to be embedded across Pearson to enable visibility and transparency into our product investment decisions using the Global Product Lifecycle stages and gates, data-driven decision-making and incremental funding principles.

Controls

- Separate school, higher education and English product teams brought together into one global product organisation
- Product Development Lifecycle
- Product and portfolio councils launched
- Product portfolio management approach and benefits articulated.

2017 plans

Turning this risk into an opportunity – successfully accelerating our shift to digital as well as investing in and delivering the right products and services – is key to successful business performance in 2017.

In the CEO's strategic overview on pages 6-9, we have laid out our strategy in more detail. Key elements that relate to the products and services risk are:

Accelerating work to simplify our product learning platform and enhancing our courseware service capabilities with £50m of additional investment, which will remove barriers to faster product innovation, accelerate our product roadmap by two years and drive faster adoption of institution-wide digital direct access for Pearson courseware.

Increasing our participation in the courseware rental market, by:

a. Reducing eBook rental prices by up to 50% across 2,000 titles – making digital rental the best option for price-conscious students,

b. Launching our own print rental programme, piloting with an initial group of 50 titles made available through Pearson's approved rental partners, and ensuring Pearson is paid more often for the usage of our courseware. If successful, we will scale this programme rapidly.

See Develop digital & services on p14.

Strategy & change

3 Talent

Failure to attract, retain and develop staff, including adapting to new skill sets required to run the business.

S Link to strategic goals
Develop digital & services
Build market presence
Deliver measurable outcomes

2016 activities

The restructure and associated cost savings programme announced at the start of the year was delivered in full in 2016.

We have successfully recruited in-demand skill sets in support of our strategic goals to accelerate the shift to digital, including the appointment of global leaders to lead both the business and the transformation efforts in North America. Throughout the year, we have continued to promote our internal talent filling 45% of our open roles with internal staff.

Controls

- Globally consistent performance, talent and succession management approaches established
- Annual global employee engagement survey conducted with follow-up action plans in place
- Retention data is monitored on a monthly basis
- Exit interviews are conducted and monitored globally to identify any trends and concerns
- Learning programmes now offered on a single platform with access to new content for all staff.

2017 plans

Over 60% of our staff completed the engagement survey. The results of the survey have been shared with all line managers and action planning will take place at the start of 2017. Each member of the Pearson executive will work in partnership with human resources and corporate affairs to build business-level action plans.

See p23 in Sustainability for more on the engagement survey.

Oversight of succession plans and development planning has been improved with rigorous quarterly talent reviews implemented for 2017.

Further learning programmes will be launched within our Pearson U learning platform with a strong emphasis on leadership and technology.

4 Political and regulatory risk

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

S Link to strategic goals
Build market presence

2016 activities

Work was undertaken in 2016 to ensure that we can more proactively identify and mitigate political/regulatory risk that had the potential to impact Pearson globally; bringing greater co-ordination, clarity and consistency to our work; building political and institutional relations, and increasing our ability to receive and respond to external intelligence.

In June 2016, a UK referendum voted in favour of leaving the EU. A risk assessment of impacts arising from this was carried out and continues on an ongoing basis. There has been no significant downside for Pearson identified so far following the result of the referendum. The main risk arising at this stage for Pearson is the resulting overall uncertainty.

2017 plans

Following the inauguration of a new President of the US, in 2017 Pearson will continue to implement its state strategy which will ensure engagement with new office holders. We will build on the groundwork already done in Washington, DC and state capitals throughout the US to position Pearson as a leader in the education space and to establish the company as a key partner for Governors and state legislators as they pursue their economic agendas. This work will focus on Congress, the Administration, and in priority state capitals.

In the UK, 2017 is a year of major qualification and accountability changes. Our focus is on working with government, regulator and other stakeholders to demonstrate the professionalism and solidity of the system. We have increased engagement with Department for Education officials ahead of major periods of change (key moments include summer Key Stage 2, GCSE and A Level 2017 results).

We will continue to assess the potential impacts of the UK's decision to leave the EU as the model that will replace our membership becomes clearer.

Principal risks and uncertainties

Operational

5 Testing failure

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

S Link to strategic goals
Build market presence
Deliver measurable outcomes

2016 activities

Pearson is an education content, assessment and related services company and, as such, managing this risk remains a priority. In the UK, the summer exam series was delivered more smoothly than the previous year as a result of mitigating actions taken. Action plans were put in place for US schools assessment, for example to mitigate against future outages and disruption.

Controls

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

- Robust quality assurance procedures and controls
- Oversight of contract performance
- Investment in technology, project management and skills development of our people, including software security controls, system monitoring, pre-deployment testing, change controls and the use of root cause analysis procedures to learn from incidents and prevent recurrence.

2017 plans

Investigation is under way to mitigate risks around compatibility and responsiveness of our assessment tools by using cloud and web services.

The migration and retirement of legacy systems in use will continue.

Plans are being developed to upgrade Pearson's bespoke online marking system – ePEN in the UK in 2017 and to continue with mitigating actions put in place in the 2016 summer series in the meantime.

6 Safety and corporate security

Risk to safety and security due to increasing local and global threats.

2016 activities

Good progress was made in 2016 towards achieving our three-year health and safety strategy. The implementation of health and safety standards continued, plus health and safety reviews have now been formally included in management review processes in our businesses.

During 2016, the travel security programme was reviewed and a revised process implemented to include improved traveller communications. The Travel ASSIST app was also updated to allow access for the circa 44,000 associates, including assessors, examiners and validators, who will be able to see their itinerary, country information and alerts. The importance of continuing to develop and extend this was evidenced during the Hoboken train incident in September 2016, when 37 travellers in the area were successfully contacted via the travel management tool.

Controls

- Up-to-date global health and safety policy in place
- Management review processes are established with key leadership groups
- Incident data collected globally every six months.

2017 plans

The ongoing focus of health and safety will be the implementation of the three-year strategy which in 2017 will include enhancing our incident reporting procedures and processes globally.

Travel security improvements will continue towards automation, smoother communications and feedback from travellers. Security risk assessments will take place to review physical security measures at key facilities, and a corporate security policy, strategy and guidelines will be delivered.

7 Safeguarding and protection

Failure to adequately protect children and learners, particularly in our direct delivery businesses.

2016 activities

We continue to take safeguarding as a fundamental obligation to our young learners and a high priority. Safeguarding training was reviewed in 2016 and indicated good take-up and positive feedback regarding the content. Safer Schools materials have been developed in partnership with University College London (UCL), which will be rolled out to the relevant businesses, and development of a sexual harassment policy for our further education businesses commenced.

Controls

- Safeguarding committee established
- Metrics regarding safeguarding reports and training collected
- Safeguarding policy and training.

2017 plans

We will continue to develop and question our practices around safeguarding in 2017, including developing external validation for our safeguarding strategy. The Safer Schools materials will be implemented in relevant businesses, as will the new sexual harassment policy.

Operational

8 Customer digital experience[3]

Challenges with reliability and availability of customer facing systems could result in incidents of poor customer digital experience and impact our customer service responsiveness.

Increase in impact

Link to strategic goals
Develop digital & services
Build market presence
Deliver measurable outcomes

3 Referred to as 'Customer facing systems' in the 2015 annual report, reworded to reflect that this risk includes customer support as well as the actual system as part of the overall experience.

2016 activities

Managing this risk is critical to achieving our strategic goal of accelerating our shift to digital products and services, and crucially, becoming a trusted partner. We will only succeed if robust platforms and responsive customer support service underpin our content, assessment and services. The risk increased in 2016 due to the fact that, despite a comparably good customer back-to-school in 2016, there were issues in the area of our subscription management system (SMS) which negatively impacted our North American customers' ability to easily access our systems. The initial issues have been addressed.

Controls

- Real-time monitoring of systems (for service disruptions) and reporting of operational performance used to identify issues
- Project management disciplines in place to ensure enhancements and new products meet required standards.

2017 plans

Further investment is being made in 2017 in our global learning platform with products being developed on it for testing. Read more on this in 'our strategy in action' section on p14-15.

Mitigations are being put in place to prevent a reoccurrence of the 2016 back-to-school issues for customers, which are described further in the Develop digital and services section on p15.

Continued focus on customer service quality and responsiveness with specialised service for specific customer groups. We continue to invest in training agents to ensure that they are ready to handle the broad range of issues faced by learners and educators. We have also improved escalation processes so that we can be more responsive to complex issues that require engagement from product engineering teams.

9 Business continuity

Failure to have plans in place or plans are not properly executed. Crisis management and technology disaster recovery (DR) plans may not be comprehensive across the whole enterprise.

Link to strategic goals
Develop digital & services

2016 activities

A revised business resilience policy and supporting guidance was developed in 2016, identifying our exposure and risk as they relate to key products, sites, services and supply chain. A common crisis management framework was implemented, with training and scenario sessions running during 2016.

Pearson won an external award for Business Continuity/Resilience Team of the Year, in recognition of the ongoing efforts and shifting focus from traditional business continuity towards resilience management.

Technology incidents are dealt with reactively and proactive closure of known DR gaps is prioritised based upon the importance of products and systems. Data centres are being consolidated, including greater use of cloud solutions. A schedule is in place for testing the DR of data centres.

Controls

- Business resilience governance group has been established, meeting quarterly, with senior leaders from across the business
- Key enterprise systems developed during 2016 (the Enabling Programme, oneCRM, and Identity and Access Management) have all been delivered with 'high availability' requirements to provide resilience
- Product Lifecycle includes an explicit checkpoint to ensure appropriate resilience is built into new products.

2017 plans

Key Pearson locations identified that will be the priority for 2017 to ensure business resilience plans are in place and tested.

Crisis management training will continue across 2017.

Work continues to address any gaps in the DR arrangements for legacy systems where appropriate. Further data centre consolidation and migration to cloud services.

Principal risks and uncertainties

Financial

10 Tax

Legislative change caused by the OECD Base Erosion and Profit Shifting initiative, the UK exit from the EU, US tax reform or domestic government initiatives, potentially in response to the ongoing EU anti tax abuse activities, results in a higher effective tax rate, double taxation and/or negative reputational impact.

Increase in impact

2016 activities

This risk has slightly increased during 2016 due to pending legislative changes, and the definition of the risk was reworded to take into account the external focus on transparency, linked to greater scrutiny and the potential for reputational damage. Plans are being put in place to manage the implementation of these legislative changes.

Controls

- Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders, in line with our broader fiduciary duties. We are committed to complying with all statutory obligations, to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy
- Oversight of tax strategy is within the remit of the audit committee, which receives a report on this topic at least once a year. All of the audit committee members are independent non-executive directors. The chief financial officer is responsible for tax strategy; the conduct of our tax affairs and the management of tax risk are delegated to a global team of tax professionals. See p133 for details of tax accounting policy
- Media and public scrutiny on tax issues continues to be actively monitored by group tax and corporate affairs.

2017 plans

Continued close monitoring with advisers on proposed and potential legislation changes and possible impacts.

Potential impact of the UK's decision to leave the EU, and the inauguration of a new President in the US are being closely monitored. There could be significant changes to the US and UK tax regimes including VAT and withholding tax. It is too early to know what these changes will be, or any impact they may have.

Media and public scrutiny on tax issues will continue to be actively monitored by group tax and corporate affairs.

11 Treasury

Failure to manage treasury financial risk (e.g. FX, interest rate, counterparty and operational risk).

Slight increase in probability

2016 activities

Treasury slightly increased in 2016 and remains a major risk as Pearson has net debt of £1.1bn which periodically needs refinancing, and faces the possibility of the loss of cash balances in the event of a bank failure. Pearson also faces the possibility of losses due to changes in FX or interest rates adversely affecting the organisation.

However, the probability of a major issue is relatively low due to the spread of debt maturities, the cautious approach to counterparty credit risk and the strong liquidity position. Pearson finished the year with over £1bn of cash and sufficient access to funds to be able to repay its $850 million in maturities in 2018 with the additional possibility of funds from the PRH disposal or recapitalisation.

The potential impacts of the UK's exit from the EU, such as market and FX volatility, were closely monitored throughout 2016 (which will continue in 2017).

2017 plans

During January 2017, the Group's credit ratings with Moody's and Standard and Poors were modified from Baa2/BBB (stable) to Baa2/BBB (negative outlook). This is not expected to restrict short-term capital market access if this was required.

In 2017, we will continue to operate in line with our treasury policy. More on this can be found in note 19, starting on p160.

Legal & compliance

12 Data privacy and information security

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

S Link to strategic goals
Develop digital & services

2016 activities

Risk concerning cyber security and data privacy remains high due to complex external factors, including increasingly sophisticated attack strategies, as well as Pearson's ongoing transition to digital products, services and cloud adoption. There are also upcoming increased regulatory obligations under the new EU data privacy law, the General Data Protection Regulation (GDPR), which will apply from May 2018 and introduce more onerous privacy obligations and more stringent penalties for non-compliance. The data privacy and information security offices worked together in 2016 on the bulletproofing and critical product programme to ensure that appropriate security and privacy controls are built in.

Data privacy

Actively worked to mitigate the risk through continued efforts on our privacy programme, in particular the roll-out of global policies and training, deploying new vendor and programme privacy impact assessment processes, and developing specialist privacy toolkits to help employees better manage privacy risks.

Controls

- Established data privacy office
- Data privacy policy and annual training
- Monitoring by the Data Privacy Council
- Privacy impact assessments in place.

Information security

The information security programme continued in 2016 to close gaps where risk has been identified, such as undertaking security impact assessments and putting in place remediation plans. Work continued towards global PCI compliance to avoid potential for severe fines and potential loss of contract revenue.

Controls

- Established information security office
- Up-to-date security policies and awareness training in place
- Ongoing monitoring for potential malicious attacks on our infrastructure and systems
- Ongoing firewall management activities
- Automated security exception management
- Vendor contract reviewed and approved for appropriate security controls.

2017 plans

The data privacy and information security improvement programmes that commenced in 2015 will continue throughout 2017 and will implement critical processes to drive best practices.

The joint activity on bulletproofing and critical products programme will continue, for example ensuring that the new global learning platform is 'secure by design'.

The data privacy programme will progress changes required to comply with the GDPR ready for it to take effect in May 2018. As Pearson operates across several EU Member States, Pearson will still need to comply with GDPR even when the UK leaves the European Union. The data privacy office will continue to monitor plans for the UK's departure from the EU and, if necessary, will adapt its privacy programme to take into account any new UK-specific privacy developments.

Principal risks and uncertainties

Legal & compliance

13 Intellectual property, including rights, permissions and royalties

Failure or lack of practical ability to adequately manage, procure, register, monitor, protect and/or properly license our intellectual property rights (including patents, trademarks and general copyright) in our brands, content and technology may prevent us from enforcing our rights against competitors' to protect our market share.

Failure to obtain permissions, or to comply with the terms of permissions, for copyrighted or otherwise protected materials such as photos resulting in potential litigation; risk of authors alleging improper calculations or payments of royalties.

S Link to strategic goals
Develop digital & services

2016 activities

In 2016, we rolled out the new Pearson brand with its protection greatly improved by expanding word mark protection to 80 new countries and filing for logo in 150 countries. A global brand database was also fully implemented to support this. The patent governance programme was revamped in 2016 and a stronger framework to protect intellectual property (IP) was established.

Work began in 2016 to evaluate new royalty and business practices. We also began to implement a global three-tier strategy guiding third-party assets (e.g. images, text, rich media) rights acquisition as well as a more stringent rights review and reclearance process.

Controls

- Policies in place to manage and protect our intellectual property
- Cooperation with trade associations
- Monitoring of technology and legal advances
- Patent programme in place.

2017 plans

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

In 2017, we will start to implement the newly developed royalty and business practices. A new rights management system is being developed for roll-out in the UK, US and Canada during 2017 and 2018.

14 Anti-bribery and corruption (ABC)

Failure to effectively manage risks associated with compliance to global and local ABC legislation.

S Link to strategic goals
Build market presence

2016 activities

Internal procedures and controls, including training, continue to improve, which should mitigate the impact as part of an 'adequate procedures' defence, in the event that an undetected ABC matter arises. The audit committee reviewed the results of a self-assessment of the ABC programme, supplemented by internal audit and external independent review (see p72). Overall, this indicated an effective framework to be in place.

Pearson's ABC infrastructure includes a network of local compliance officers based in country, being mainly members of the legal team. These officers have assumed responsibility for ABC compliance in their respective businesses, and function as the 'eyes and ears' of the organisation with the oversight of the central compliance and legal teams.

In addition to ongoing face-to-face training for higher risk groups, a compliance awareness campaign took place in December 2016 which included ABC, to coincide with UN International Anti-Corruption Day. ABC certification was rolled out across all higher risk markets in 2016.

Controls

- Policy and guidance updated, although no change to Pearson's 'zero tolerance' principle
- Code of Conduct certification and training in place, which includes a clear statement of ABC policy
- Business Partner Code of Conduct, emphasising ABC compliance
- Local Compliance Officer programme in place and proving successful.

2017 plans

Continue risk assessments in 2017 to ensure that the ABC programme continues to reflect local market and business model risks.

Further develop and deploy risk-based third-party due diligence and monitoring.

Leverage The Enabling Programme's systems and processes to automate and embed improved preventive and detective controls relevant to ABC.

Legal & compliance

15 Competition law

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

S Link to strategic goals
Build market presence

2016 activities

A policy, general training plus supporting guidance were developed in 2016, containing all the measures, indicators and actions required to ensure anti-trust and competition compliance.

Controls

› Policy and guidance published

› Lawyer network launched across Pearson

› Ongoing training and awareness initiatives.

2017 plans

Employee training will continue throughout 2017 and risk assessments are ongoing to monitor compliance with anti-trust and competition legislation.

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 of the annual going concern review. The three-year period corresponds with Pearson's strategic planning process and represents the time over which the company can reasonably predict market dynamics and the likely impact of additions to the product portfolio.

The board discusses the company's strategic plan on an annual basis taking account of a range of factors including market conditions, the principal risks to the Group, product and capital investment levels, as well as available funding. Pearson's strategy and business model are discussed in more detail on p10-27.

The key assumptions which underpin our three-year strategic plan to December 2019 are as follows:

1. There are further declines in enrolments and other downwards pressures in the US higher education courseware market.
2. The 2016 inventory correction with key channel partners partially unwinds.
3. There is increased investment in the product technology platform to accelerate the shift to digital and enhance courseware service capabilities.
4. Increased participation in the courseware rental market is seen.
5. US state testing revenues continue to decline through 2017, as current contracts unwind, before stabilising by the end of the year.
6. The remaining Pearson businesses perform broadly in line with trends seen in 2016 for the next year before returning to modest growth.

In assessing the company's viability for the three years to December 2019, the board analysed a variety of downside scenarios including a scenario where the company is impacted by all principal risks from 2016. The primary modelling overlaid a 'severe but plausible' downside scenario onto the base case strategic plan for the Group, focusing on the impact of the following assumptions and key risks:

› Further declines in enrolments and further channel disruption in US higher education courseware

› Failure to accelerate our shift to digital while continuing to invest in global products and services

› Increased competition from new entrants in School and higher education courseware and higher education online services

› Pricing pressures due to rental impacting higher education courseware

› Revenue shortfalls in growth markets driven by weaker local economic conditions and rationalisation.

The board also stress-tested the impact on our liquidity of all the principal risks listed above 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 2019, based on this assessment, is included alongside the going concern statement on p107.

Governance report

In this section

Governance overview

Sidney Taurel
Chairman

"The board works closely with the executive team to shape Pearson's accelerated strategic shift to digital, bringing independent challenge and scrutiny to plans, with a focus on ensuring long-term sustainability of the business."

In this Governance section

Dear shareholders,

During times of change, good governance is paramount. As a board we organise our work around five major themes where we believe we can add value: governance and risk, strategy, performance, leadership and people, and shareholder engagement. A summary of the key items covered by the board throughout the year appears on p64, and I have set out below further detail on our particular areas of focus during 2016.

Leadership & effectiveness

See full section on p60-69

In a year of continued business transformation and sectoral challenges, strategic review and planning has been an important feature of the board's agenda through 2016. Working with external advisers, the board oversaw a strategic review of Pearson's business portfolio, leading to our decision to simplify the business, including a reduction in our exposure to large-scale direct delivery businesses. The strategic review assisted the board in identifying areas of the business in which to capitalise on synergies, and helped us in making strategic and tactical decisions, including the acceleration of our higher education business towards digital and the decision to move towards a rental model for higher education textbooks.

In February 2016, we introduced a new dashboard and key milestones report showing performance against certain KPIs which align with the priorities of the executive team. This monthly report gives the board oversight of a broad range of performance and operational matters including financials, major projects, competitive performance, digital transformation, talent and succession, brand and impact on education. The report is provided to the board on a monthly basis, with progress against the KPIs being reviewed at every board meeting and particular items examined in detail through the course of the year.

To ensure robust oversight and continuing refinement of our corporate governance framework, we reconstituted our nomination committee with effect from 1 January 2017 as the nomination & governance committee, to be chaired by our senior independent director, Vivienne Cox. In addition to the normal nomination and succession planning focus, the committee will also have oversight of, and will devise and consider plans for, matters such as board evaluation, diversity and compliance with applicable governance frameworks, with its recommendations being escalated to the full board for formal adoption as necessary.

The board's priorities moving forward are to continue to monitor the company's strategic and tactical actions related to the refocusing of the business, to implement previously signposted portfolio decisions, to keep under review the cost base, to rebase the dividend appropriately, and to effect an optimal capital allocation, particularly following the outcome of negotiations regarding our investment in Penguin Random House, to ensure long-term sustainability. We will also continue to work closely with the executive team to ensure ongoing leadership development.

Board and management composition

The Pearson board consists of senior executive management alongside a strong team of non-executive directors drawn from successful international businesses and education institutions with experience of corporate strategy, finance, education, emerging markets, technology and consumer marketing. Our non-executive directors, who bring a strong independent viewpoint, complement the executive perspectives of John Fallon and Coram Williams. In addition, we invite members of the Pearson executive (PEM) to attend a number of the board's sessions each year to bring insights and thoughts from across the business, such as at the board's strategy meetings in Minnesota and New Jersey.

As is best practice, we continually assess and refresh the board to ensure that we maintain an appropriate balance and diversity of skills and experience. In January 2016, Lincoln Wallen joined the board as a non-executive director bringing with him a wealth of digital and technology experience, and has since joined the audit and reputation & responsibility committees. The board works well together and all directors continue to make a significant contribution, including our most recent additions.

During the year, the board focused on talent and succession planning for the PEM, and we will continue increasing our involvement in both the development of our existing leaders and ensuring the right new additions are brought into our leadership and talent pool.

Accountability

See full section on p70–77

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

Engagement

See full section on p78–81

I engaged with shareholders throughout the year to understand their varying perspectives on Pearson's performance and strategy, and Elizabeth Corley, chair of our remuneration committee, led a programme of engagement to seek investor views on our proposed directors' remuneration policy. John Fallon and Coram Williams also joined with senior leaders from our higher education business to host Pearson's first dedicated investor day in eight years, allowing shareholders to experience for themselves our products and technology, and examine the market in greater detail. In common with most large, public companies, we have a wider range of stakeholders than just traditional investors, and our reputation & responsibility committee has oversight of our sustainability and social impact initiatives, government and public affairs matters, and engagement with the education community.

Remuneration

See full section on p82–106

Our remuneration policy was reviewed in 2016–17 to align with the company's updated strategy, as well as to reflect changes happening externally in our markets and ongoing changes we are making internally, and will be put to shareholders for approval in a binding vote at the 2017 AGM. We intend to operate executive remuneration in line with the new policy, should it be approved, in 2017. This year's annual report on remuneration also refers to further incremental changes we have made in line with policy in 2016 to better align executive director compensation with our long-term goals.

UK Corporate Governance Code

This year, we are reporting against the 2014 edition of the UK Corporate Governance Code (the Code). The board believes that during 2016 the company was in full compliance with all relevant provisions of the Code. See p73 for our position on audit tendering and rotation.

A detailed account of the provisions of the Code can be found on the FRC's website at www.frc.org.uk and we encourage readers to view our compliance schedule on the company website at www.pearson.com/governance

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 Annual General Meeting.

Sidney Taurel
Chairman

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Board of directors

Chairman

N R

Sidney Taurel Chairman
aged 68, appointed 1 January 2016

Sidney has over 40 years of experience in business and finance, and is currently a board director and chairman of the compensation committee at IBM Corporation. Sidney is an advisory board member at pharmaceutical firms Takeda Pharmaceutical and Almirall. He was chief executive officer of global pharmaceutical firm Eli Lilly and Company from 1998 until 2008, chairman of the business 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. Sidney has 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.

Key to committees

A Audit

R Remuneration

N Nomination & governance

○ Committee chair

RR Reputation & responsibility

Executive directors

John Fallon Chief executive
aged 54, appointed 3 October 2012

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

Coram Williams Chief financial officer
aged 43, appointed 1 August 2015

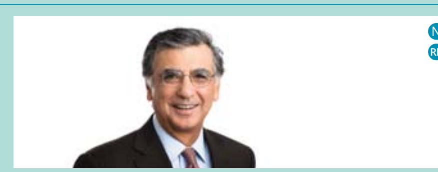
Coram joined Pearson in 2003 and has held a number of senior positions including finance and operations director for Pearson's English Language Teaching business in Europe, Middle East & Africa, interim president of Pearson Education Italia and head of financial planning and analysis for Pearson. In 2008, Coram became CFO of The Penguin Group and was latterly appointed CFO of Penguin Random House in 2013. Coram trained at Arthur Andersen, and subsequently worked in both the auditing and consulting practices of the firm. He is a non-executive director of the Guardian Media Group.

Non-executive directors

A RR

Linda Lorimer Non-executive director
aged 64, appointed 1 July 2013

Linda spent almost 40 years serving higher education. She retired from Yale in spring 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 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. Previously, Linda was president of Randolph-Macon Woman's College and chair of the board of the Association of American Colleges and Universities. She also served on the boards of several public companies, including as presiding director of the McGraw-Hill companies. She is a member of the Trilateral Commission and the Council on Foreign Relations.



N RR

Harish Manwani Non-executive director
aged 63, appointed 1 October 2013

Harish has an extensive background in emerging markets and senior experience in a successful global organisation. He was previously chief operating officer of consumer products company Unilever, having joined the company in 1976 as a marketing management trainee in India, and held senior management roles around the world, including North America, Latin America, Europe, Africa and Asia. He is non-executive chairman of Hindustan Unilever Limited in India, and serves on the boards of Whirlpool Corporation, Qualcomm Inc. and Nielsen Holdings. He is also on the board of the Indian School of Business and the Economic Development Board (EDB) of Singapore, and is global executive advisor at Blackstone Private Equity.

Non-executive directors

Elizabeth Corley, CBE Non-executive director
aged 60, appointed 1 May 2014

Elizabeth is non-executive vice chair of Allianz Global Investors, where she was chief executive officer, initially for Europe then globally, from 2005 to 2016. She was previously at Merrill Lynch Investment Managers and Coopers & Lybrand. Elizabeth is a director of the FICC Markets Standards Board, a member of the ESMA stakeholder group and the advisory council of TheCityUK. She is a non-executive director of BAE Systems plc and the Financial Reporting Council. In addition, she is a member of FEAM's management committee, the CFA Institute Board of Governors, the Committee of 200 and a trustee of the British Museum. She is a fellow of the CFA UK Society and the Royal Society of Arts and is also a crime fiction author.

Vivienne Cox, CBE Senior independent director
aged 57, 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 non-executive director of Stena International and chairman of the supervisory board of Vallourec, a leader in the seamless steel pipe markets. She is also non-executive director at pharmaceutical company GlaxoSmithKline plc. She is lead independent director at the UK Department for International Development.

Josh Lewis Non-executive director
aged 54, appointed 1 March 2011

Josh's experience spans finance, education and the development of digital enterprises. He is the 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. 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, with associations including New Leaders, New Classrooms, and the Bill & Melinda Gates Foundation. He is also a non-executive director of several enterprises in the fin-tech/data, education and other sectors.

Non-executive directors

Tim Score Non-executive director
aged 56, appointed 1 January 2015

Tim has extensive experience of the technology sector in both developed and emerging markets, having served as chief financial officer of ARM Holdings plc, the world's leading semiconductor IP company, a position he held for 13 years. He is an experienced non-executive director and currently sits on the boards of The British Land Company plc and HM Treasury. 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, BTR plc and others.

Lincoln Wallen Non-executive director
aged 56, appointed 1 January 2016

Lincoln is CEO of DWA Nova, a software-as-a-service company born out of DreamWorks Animation Studios in Los Angeles. He has worked at DreamWorks Animation for nine years in a variety of roles including chief technology officer and head of animation technology. He was formerly CTO at Electronic Arts Mobile where he was instrumental in shaping EA's approach to the mobile business. Lincoln's early career involved 20 years of professional IT and mathematics research, including a reader in Computer Science at Oxford. Lincoln graduated from Durham University in 1981 with a BSc in Mathematics and Physics, before completing his PhD in Artificial Intelligence at the University of Edinburgh. Lincoln is a non-executive director of the Smith Institute, an advisory board member of Hewlett Packard Enterprise and a member of the STEM Advisory Committee of the National Academy Foundation.

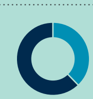
Pearson board members bring a wide range of experience, skills and backgrounds which complement our strategy.

Executive experience of chairman and non-executive directors

Digital/technology experience

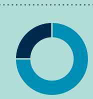
50%

Education/learning experience



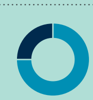
38%

North American markets experience



75%

Emerging markets experience



75%

Board governance and activities

Board of directors

Composition of the board The board consists of the chairman, Sidney Taurel, two executive directors: the chief executive, John Fallon, and chief financial officer, Coram Williams, and seven independent non-executive directors.

Chairman and chief executive There is a defined split of responsibilities between the chairman and the chief executive. The roles and responsibilities of the chairman and chief executive are clearly defined, set out in writing and reviewed and agreed by the board on an annual basis.

Chairman's significant commitments In April 2016, the chairman stepped down from his position as a non-executive director of McGraw Hill Financial, Inc. There were no other changes to the chairman's significant commitments during 2016. On 1 January 2017, Mr Taurel also stepped down from his role as a senior adviser at the global investment bank, Moelis & Co.

Independence of chairman In accordance with the Code, Sidney Taurel was considered to be independent upon his appointment as chairman on 1 January 2016.

Non-executive directors Harish Manwani currently serves on five listed company boards, including Pearson, and is chairman of Hindustan Unilever Ltd. We do not believe these appointments impact Mr Manwani's ability to commit to the Pearson board, and he has demonstrated a full attendance record at Pearson since his appointment to the board. However, Mr Manwani has discussed with our chairman his intent to step down from one of these appointments during the next twelve months, and if for any reason that should not happen, then he would not stand for re-election to the Pearson board at our 2018 AGM.

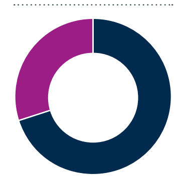
Independence of directors All of the non-executive directors who served during 2016 were considered by the board to be independent for the purposes of the Code. The board reviews the independence of each of the non-executive directors annually. This includes reviewing their external appointments and 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 character or 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.

Conflicts of interest Under the Companies Act 2006 (the Act), directors have a statutory duty to avoid conflicts of interest with the company. The company's Articles of Association (Articles) allow the directors to authorise conflicts of interest. The company has established a procedure to identify actual and potential conflicts of interest, including all directorships or other appointments to,

Roles and composition of the board

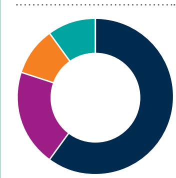
Role	Name	Responsibility
Chairman	Sidney Taurel	The chairman is primarily responsible for the leadership of the board and ensuring its effectiveness. He ensures the board upholds and promotes the highest standards of corporate governance, setting the board's agenda and encouraging open, constructive debate of all agenda items for effective decision-making. He also ensures that shareholders' views are communicated to the board.
Chief executive	John Fallon	The chief executive is responsible for the operational management of the business and for the development and implementation of the company's strategy as agreed by the board and management. He is responsible for developing operational proposals and policies for approval by the board, and promotes Pearson's culture and standards.
Senior independent director	Vivienne Cox	The senior independent director's role includes meeting regularly with the chairman 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 chairman on behalf of the other directors.
Committee chairmen	Tim Score Elizabeth Corley Vivienne Cox Linda Lorimer	The committee chairmen are responsible for leading the board committees and ensuring their effectiveness. They set the committees' agendas, in consultation with the company's management, and report to the board on committee proceedings.
Company secretary	Stephen Jones	The company secretary acts as secretary to the board and its committees, ensuring compliance with board procedures and advising on governance matters. He is responsible, under the direction of the chairman, for ensuring the board receives accurate, timely and clear information. The company secretary supports the chairman in delivery of the corporate governance agenda and organises director inductions and ongoing training.

Gender split of board



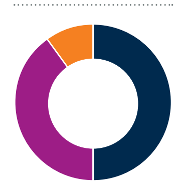
Men 7
Women 3

Nationality of directors



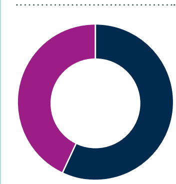
UK 6
US 2
Asia 1
Europe (excl UK) 1

Geographic locations of directors



UK 5
US 4
Asia 1

Length of tenure of non-executive directors



Under 3 years 4
3 to 6 years 3

Governance at Pearson

FLOW OF INFORMATION

Board of directors

Board committees

- Audit committee
- Nomination & governance committee
- Remuneration committee
- Reputation & responsibility committee

Pearson executive management (PEM)

- Chief executive officer
- Chief financial officer
- Chief technology and operations officer
- Chief corporate affairs and global marketing officer
- Chief human resources officer
- Chief education adviser (until March 2017)
- General counsel and chief legal officer
- President, core markets
- President, growth markets
- President, North America
- President, assessments
- President, global product

Operating councils

Operating councils operate primarily at sub-executive level, and have either executive representation or clear reporting lines into the Pearson executive. The councils are established to provide leadership and set Pearson's agenda and organisational policy in cross-functional areas, and are accordingly made up of interested parties from across the business.

Examples include:

› Compliance council

› Responsible business leadership council

Leadership teams

Each member of the Pearson executive is supported by a leadership team in the planning and delivery of that executive's main duties. A leadership team typically consists of senior managers from the particular business area, and the strategic business partners who support them in day-to-day matters including representatives from enabling functions such as finance, HR and legal.

Examples include:

› Core leadership team

› Global corporate affairs and global marketing leadership team

Operational responsibility leaders

Global operations across Pearson

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Board governance and activities

or relationships with, companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Once notified to the chairman or company secretary, such potential conflicts are considered for authorisation by the board at its next scheduled meeting. The relevant director cannot vote on an authorisation resolution, or be counted in the quorum, in relation to the resolution relating to his/her conflict or potential conflict. The board reviews any authorisations granted on an annual basis.

Board meetings

The board met seven times in 2016, with discussions and debates focused on the key strategic issues facing the company. Major items covered by the board in 2016 are shown in the table below.

In addition to the formal meetings, the board meets as necessary to consider matters of a time-sensitive nature.

The role and business of the board

The board is deeply engaged in developing and measuring the company's long-term strategy, performance and values. We believe that it adds a valuable and diverse set of external perspectives and that robust, open debate about significant business issues brings an additional discipline to major decisions.

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

The key responsibilities of the board include:

- Overall leadership of the company and setting the company's values and standards
- 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.

The board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive board papers are circulated to the board and committee members at least one week in advance of each meeting and the board receives regular reports from the chief executive. In addition to meeting papers, a library of current and historic corporate information is made available to directors electronically to support the board's decision-making process. Directors can obtain independent professional advice, at the company's expense, in the performance of their duties as directors. All directors have access to the advice and services of the company secretary.

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 meeting focus during 2016

Area of responsibility	Activity	
Governance & risk	› Annual review of authorised conflicts of interest › Review of division of responsibilities between chairman and chief executive › Brexit – implications and next steps › South African Black Economic Empowerment overview › Penguin Random House – investment update › Shareholder activism and defence plan	› Board evaluation findings › Risk appetite › Enterprise risk management review Read more on p44-46 › Approval of schedule of authority limits › Approval of committee terms of reference › Treasury policy approval
Strategy	› Operating and strategic plan updates › Restructuring plan updates › Strategic planning focusing on markets and portfolio, including dedicated meeting in New Jersey	› Strategy meeting in Minnesota focusing on US higher education courseware and the assessments business Read more on p65 › Interactive product demonstrations
Performance	› 2015 preliminary results and annual report and accounts › Monthly dashboard and milestone reports › Interim results and trading updates › Balance sheet strategy	› 2016 operating plan update › Final and interim dividend proposals › Draft 2017 operating plan and three-year financials
Leadership & people	› Chief executive's goals › Facilitated talent breakfasts at strategy meetings	› Dinner with senior local management at strategy meetings › Talent and succession planning Read more on p69
Shareholders & engagement	› Focus on forthcoming AGM › Review of shareholder issues and voting	› Major shareholders and share register analysis › Review of investor relations strategy and share price performance

Culture and values

Pearson's core values – to be brave, imaginative, decent and accountable – go to the heart of our mission to improve learning outcomes, and the board and employees are committed to demonstrating these characteristics throughout their work and deliberations. The board monitors the culture of the company and levels of employee engagement and advocacy with the assistance of its reputation and responsibility committee and through regular updates from the chief human resources officer. It aims to foster a culture of collaboration, diversity and inclusion at all levels, including by engaging with employees from across Pearson at various events throughout the year.

Board attendance

Directors are encouraged to attend all board and committee meetings but in certain circumstances, such as due to pre-existing business or personal commitments, directors may be unable to attend. In these circumstances, 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 chairman of the board or committee, as appropriate. Individuals' attendance at board and committee meetings is considered, as necessary, as part of the formal annual review of their performance.

The following table sets out the attendance of the company's directors at scheduled board meetings during 2016:

	Board meetings attended
Chairman	
Sidney Taurel	7/7
Executive directors	
John Fallon	7/7
Coram Williams	7/7
Non-executive directors	
Elizabeth Corley	7/7
Vivienne Cox	7/7
Josh Lewis	7/7
Linda Lorimer	7/7
Harish Manwani	7/7
Tim Score	7/7
Lincoln Wallen	7/7

Succession planning

The board considers oversight of succession planning – not only at board and executive management level but for all key positions throughout the business – as one of its prime responsibilities, assisted by the nomination & governance committee.

The company has formal contingency plans in place for 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 chairman and chief executive annually. Succession planning for the board and chair is also considered annually, and as part of the recent restructuring programme, there has been a review of key positions at executive management level.

Read more about Talent and succession planning on p69

Governance in action: Minnesota visit

In June 2016, the board visited Bloomington, Minnesota, where they were hosted by the president of Pearson's assessments business, Bob Whelan.

Bloomington is the headquarters of Pearson's global assessments business which generated 22 % of Pearson's sales in 2016, with approximately 800 employees based there.

Overview of assessments Senior managers led a deep dive into each of the three distinct areas within the assessments business: US school assessment, global clinical assessment, and professional certification. While these are distinct businesses, the board heard about the synergies to be drawn from combining these under the leadership of Mr Whelan, such as an opportunity to share capabilities and platforms. In a focused session led by the chief corporate affairs and global marketing officer, the board discussed the reputational challenges and strategies relating to the testing business.

US higher education courseware Tim Bozik, Don Kilburn and Albert Hitchcock presented to the board on the need to focus primarily on our portfolio, product and the platform strategy that we will deploy to maximise digital adoption of our US higher education courseware over the next three years.

A client perspective The board discussed with the President and CEO of the Graduate Management Admission Council the need to gain a customer's perspective on the shifting global landscape of business education, primarily in postgraduate studies, and associated opportunities and challenges.

Learning in action The board toured a Pearson VUE professional testing centre, following which they took a computer-based test to better understand the customer experience. There was also an opportunity for the board and executive to join local employees to see at first hand the work carried out by two partner organisations, America's Promise Alliance and the Minnesota Literacy Council.

The Pearson community The board met for breakfast with the company's locally based emerging talent. The board also met with local leaders with the aim of advancing shared educational goals, in particular to prepare a diverse population of students for educational and employment success.

Board governance and activities

The board meets with local staff and senior management every time board meetings are held away from the head office, such as during the board's 2016 visits to Bloomington, Minnesota and Hoboken, New Jersey. In addition, a number of London-based employees attended a reception with the board as part of its December meeting schedule. This allows the non-executive directors to share their experience and expertise with employees as well as allowing them to better understand their abilities and motivations, helping them to assess the company's prospects and plans for succession.

Board evaluation

The board evaluation for 2016 was an internal assessment of board performance led by Vivienne Cox, senior independent director. In terms of process, a questionnaire was distributed as an advance indication of the evaluation's proposed areas of focus, following which Ms Cox held an open discussion with each director on an individual basis. Board members' views were sought on a range of areas including boardroom dynamics, strategy, risk, quality of information, market knowledge and board composition.

Feedback and key themes

The evaluation found that the board has a culture of open and transparent discussion, with all directors being able to challenge and question rigorously. The board size and composition was felt to be appropriate for the business, and consideration was given to recruitment of future board members, including the skills, background and experience we might look for in any future non-executive directors, and succession planning for committee chairmen. Board members were in agreement that they should continue to focus on US higher education courseware at every meeting, and that additional measures will be built into the monthly dashboard to monitor this business. The directors also expressed a desire to make use of external expertise in digital technologies and agreed to explore this further. The nomination & governance committee will consider Ms Cox's findings and recommendations in greater detail in early 2017, as they commence planning for the 2017 evaluation which will be conducted on an external basis.

We also took a number of actions in 2016 in response to feedback arising from the directors during the 2015 board evaluation process. You can read more about these actions in the table below.

Progress on findings of 2015 evaluation

Finding	Response / Action taken
Overall, the style and substance of board papers were well liked by the board, although executive summaries are welcome where information is particularly detailed.	Working with senior management, the chairman introduced a monthly dashboard, presenting performance against a range of financial and strategic KPIs, in a simple, consistent and readable style. The company secretarial and strategic development teams have reviewed and amended the format of board papers to bring greater consistency to the style and structure of the papers, including recommending the inclusion of a standard set of strategic information. This will be kept under review to ensure the papers continue to provide the appropriate level of detail in an accessible format.
Reviewing committee composition might allow meetings to run concurrently, allowing the time available to be more effectively used.	The chairman reviewed committee composition with the non-executives and the company secretary during the year. Revised committee compositions were introduced with effect from 1 January 2017 to allow concurrent meetings and more efficient use of available time.
Board dinners are most useful when there is a theme, a topic for discussion or external guests attending.	Whenever possible we hold a dinner for all directors prior to each board meeting. At its February 2016 dinner, the board reviewed its 2015 evaluation exercise and the chief executive discussed changes to the executive team. In June, the board met with community stakeholders and education thought leaders at its Minnesota strategy meeting, and in October the board discussed the upcoming US presidential election with political analysts in New Jersey.
Scheduling and frequency of board meetings generally considered to be appropriate, and there is a preference to set dates well in advance due to the full schedule.	We set our main meeting dates two years in advance in consultation with the board but there will inevitably be occasions where a meeting needs to be called at relatively short notice. On such occasions we facilitate directors joining by telephone or video conference, and try to accommodate time differences in doing so.
The board finds it helpful to receive corporate affairs updates and broker reports.	We have arranged for the regular internal corporate affairs briefing to be shared with non-executives, and the investor relations team provides a cross-section of analyst reports when appropriate to enable the board to keep abreast of market sentiment.
Informal product demonstrations are very useful in helping non-executive directors to better understand the products and customer experience.	We arranged hands-on product demonstrations at the February, June and October board meetings. Led by executive colleagues and product leaders, the board learned about our World Class Qualifications and next generation BTECs, six key products in higher education, and the Pearson VUE assessment methodology. The demonstrations were well received, and we will continue to include similar sessions at future board meetings when the opportunity arises.

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Individual evaluation

In addition to the evaluation of the board as a whole, executives are evaluated each year on their performance against personal objectives under the company's annual incentive plan. The chairman meets with each non-executive director individually on a regular basis and, in assessing the contribution of each, has confirmed that each director continues to make a significant contribution to the business and deliberations of the board. The non-executive directors, led by the senior independent director, also conduct an annual review of the chairman's performance.

Committee evaluation

All committees undertake an annual evaluation process to review their performance and effectiveness. The process involves distribution of questionnaires to committee members, as well as key stakeholders in each committee, seeking views on matters including committee roles and responsibilities, quality and timeliness of meeting materials, opportunity for discussion and debate, dialogue with management and access to independent advice. Responses are then evaluated and presented to the respective committee at a scheduled meeting, with key themes being drawn out for discussion. Read more in the committee reports on the pages that follow.

Directors' training and induction

Directors receive a significant bespoke induction programme and a range of information about Pearson when they join the board. This includes background information on Pearson and details of board procedures, directors' responsibilities and various governance-related issues, including procedures for dealing in Pearson shares and their legal obligations as directors. The induction also typically includes a series of meetings with members of the board, external legal advisers and brokers, the Pearson executive and senior management, presentations regarding the business from senior executives and a briefing on Pearson's investor relations programme.

The induction programme for Lincoln Wallen, our most recently appointed non-executive director, continued into 2016, tailored to his specific areas of focus, and included time with the chief technology and operations officer and president of our North American business, as well as sessions relevant to the board committees he has joined. In addition to matters highlighted above, the induction for our chairman, Sidney Taurel, included attending our North American higher education sales conference, the senior leaders' accelerated growth meeting in Texas, a visit to our Brazilian businesses, and meetings with substantial shareholders throughout the year.

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 chairman. In 2016, the directors and other senior managers were briefed on the effect of the new EU Market Abuse Regulation on the company, and changes to their personal obligations arising from that legislation. Directors can also make use of external courses.

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, judgment is given against the director. The indemnity has been in force for the financial year ended 31 December 2016 and is currently in force.

The company has purchased and maintains directors' and officers' insurance cover against certain legal liabilities and costs for claims in connection with any act or omission by such directors and officers in the execution of their duties.

Board committees

The board has established four formal committees: audit, nomination & governance, remuneration, and reputation & responsibility. The chairmen 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 chairman. In addition to these formal board committees, the standing committee also operates with board-level input.

Learn more about Pearson's governance structure on p63

More committee information:

Audit committee	**p70**
Nomination & governance committee	**p68**
Remuneration committee	**p82**
Reputation & responsibility committee	**p78**
Standing committee	**p64**

The committees focus on their own areas of expertise, enabling the board meetings to focus on governance and risk, strategy, performance, and leadership and people, thereby making the best use of the board's time together as a whole. The committee chairmen report to the full board at each 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.

Nomination & governance committee report

Committee chairman
Vivienne Cox

Members Elizabeth Corley, Vivienne Cox, Josh Lewis, Harish Manwani, Tim Score and Sidney Taurel

"As Pearson focuses on the changing needs of the world's education markets, the committee's role is to ensure the right leadership is in place to steer the company forward."

Committee responsibilities include:

Appointments	Identifying and nominating candidates for board vacancies.
Balance	Ensuring that the board and its committees have the appropriate balance of skills, experience, independence, diversity and knowledge to operate effectively.
Succession	Reviewing the company's leadership needs with a view to ensuring the continued ability of the organisation to compete in the marketplace.
Governance	Review and oversight of Pearson's corporate governance framework, board evaluation and training plans, and board diversity policy.

Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website www.pearson.com/governance

Attendance

Attendance by directors at nomination committee meetings throughout 2016:

	Meetings attended
Sidney Taurel	2/2
Elizabeth Corley	2/2
Vivienne Cox	2/2
Josh Lewis	2/2
Linda Lorimer[1]	2/2
Harish Manwani	2/2
Tim Score	2/2
Lincoln Wallen[1]	2/2

Note 1: Linda Lorimer and Lincoln Wallen stepped down from the nomination committee on 31 December 2016.

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 also oversees talent and succession plans for senior roles.

Board search

Pearson uses a number of leading firms in its board search activities and ensures that we retain good relationships with these firms. However, no appointment or board search activity was undertaken during 2016.

Changes to committee and 2016 activity

During 2016, in response to feedback from the chairman and other members of the board, a comprehensive review was carried out to look at the work done by each committee. The intention was to ensure the board worked effectively and used its time together well. As a result, changes were made to the membership of each committee and the role of the nomination committee was expanded to include corporate governance matters, including board diversity, oversight of the annual board evaluation processes, the company's corporate governance policies and practices, compliance with the Code, and oversight of director induction and training. In respect of its governance remit, the committee will primarily take on the role of reviewing current practices on behalf of the board, and recommending actions or changes for the board's formal approval.

As senior independent director, I have taken on the chairmanship of the committee, with the other members being independent non-executive directors, including the chairmen of the audit and remuneration committees, and the chairman of the board. The chief executive and other senior management attend committee meetings by invitation.

During the year, I was pleased to be invited by Kate James, Pearson's chief corporate affairs and global marketing officer and executive sponsor of our Women in Leadership and Learning network (WILL) to give a virtual talk to employees on career and professional development.

Diversity

The board embraces the Code's underlying principles with regard to board balance and diversity, including gender diversity. The committee ensures that the directors of Pearson demonstrate a broad balance of skills, experience and nationalities, to support Pearson's strategic development and reflect the global nature of our business. Appointments are made on merit and relevant experience, while taking into account the broadest definition of diversity.

We are pleased with the gender diversity of the Pearson board, having exceeded Lord Davies' 2015 target with 30% female representation on the board; however, we note the five recommendations of the Hampton-Alexander Review aimed at continuing to improve the representation of women in the leadership of large listed companies, and we are committed to work towards these. The recommendations include voluntary targets of at least 33% female representation on the board, executive committee and in their direct reports, increased transparency by companies in this regard, and proactive involvement of nomination committees in overseeing progress in these areas.

The chief executive and the chief financial officer are both members of the board. Among the other ten members of the executive team there are two females (20%), although for most of 2016 the percentage was 22% (two members out of nine). The senior leadership team, the two levels of managers reporting to the chief executive, has 32% women. This gives us confidence that we have a strong pipeline of women coming through, and the committee will monitor their development, and the development of all key talent, with care.

We also welcome the Parker Review's recent report into ethnic diversity on UK boards, including the voluntary target of at least one director of colour by 2021, and will consider the report's recommendations carefully when reviewing our board diversity policy and throughout our senior management succession planning process.

Learn more about diversity and inclusion throughout Pearson on p24

Committee aims for 2017

With the committee's expanded remit, we will have a full agenda for 2017, with a particular focus on planning for our three-yearly external board evaluation, reviewing the board's diversity policy and objectives, and ongoing oversight of governance and succession planning activity.

Vivienne Cox
Chairman of nomination & governance committee

Talent and succession planning

At a joint session with the board in April 2016, led by the chief human resources officer, the committee reviewed the talent and leadership implications of the growth and simplification plan, succession planning for chief executive and other Pearson executive roles, development of senior leadership talent, and high potential talent beyond the senior leadership group.

The committee was reminded of Pearson's talent philosophy which relates to the achievement of measurable goals, transparency and the Pearson behaviours – brave, imaginative, decent and accountable. The committee agreed the characteristics to be demonstrated by all leaders, reflecting business priorities.

The committee noted the strengthening of the executive team and a number of expanded roles over the past year as a result of the continuing Group-wide transformation. They reviewed in detail each member of the executive including identifying immediate interim successors for each executive role and discussing the longer term succession pipeline. Diversity in senior roles was discussed and the directors were keen to understand what more could be done to measure diversity and to think about it in its broadest sense and its alignment with the business strategy.

The committee concluded that Pearson has a strong talent bench, noting certain areas for improvement in terms of diversity and the succession pipeline, and offered their assistance as mentors to help in the development of key talent, as and when considered appropriate.

Nomination committee meeting focus during 2016

Area of responsibility	Activity	
Appointments	› Appointment of Linda Lorimer as chairman of reputation & responsibility committee	› Appointment of Vivienne Cox as chairman of nomination & governance committee
Balance	› Reviewing composition and remit of board committees	
Succession	› Succession planning for executive director and executive management roles	› Review of senior management and high potential talent pipeline

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Committee chairman
Tim Score

Members Elizabeth Corley[3], Vivienne Cox, Linda Lorimer, Tim Score and Lincoln Wallen

"As a committee we provide independent scrutiny and challenge in times of strategic shift and operational enhancements throughout Pearson."

Committee responsibilities include oversight of:

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 the performance of the external auditor.
Risk & internal control	Risk management systems and internal control environment including the performance 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 www.pearson.com/governance

Attendance

Attendance by directors at audit committee meetings throughout 2016:

	Meetings attended
Vivienne Cox[1]	2/4
Linda Lorimer	4/4
Tim Score	4/4
Lincoln Wallen[2]	3/3

Note 1: Ms Cox was unable to attend two meetings due to (i) a pre-existing work commitment and (ii) her CBE investiture ceremony. On both occasions, Ms Cox communicated her observations to the committee chairman ahead of the meeting.
Note 2: Mr Wallen joined the audit committee on 1 March 2016.
Note 3: Elizabeth Corley joined the audit committee on 1 January 2017.

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 internal auditor 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 chairman, I report to the full board at every board meeting immediately following a committee meeting. I also work closely with the chief financial officer outside of the formal meeting schedule to ensure robust oversight and challenge in relation to financial control and risk management.

Provision of non-audit services by external auditors

As a committee, we review the independence of the external auditors, including the provision of non-audit services to ensure that there is an appropriate audit relationship and that auditor objectivity and independence are upheld. During 2016, the committee approved revisions to Pearson's external auditor policy to take account of changes to the regulation of non-audit services which may be provided by external auditors. Learn more about auditors' independence on p74 and note 4 to the consolidated financial statements.

Audit committee changes

In March 2016, Lincoln Wallen joined the committee, bringing extensive technology experience; and, as a result of the work conducted by the nomination committee and Mr Taurel to examine the composition and remit of the board's committees, Elizabeth Corley joined the committee with effect from 1 January 2017. As a committee, we have a good balance of skills and knowledge with experience covering all aspects of the sector in which Pearson operates – education, digital and services, and our key geographic markets.

Fair, balanced and understandable reporting

We are mindful of the Code's provision C.1.1 relating to fair, balanced and understandable reporting and we build sufficient time into our annual report timetable to ensure that the full board receives sufficient opportunity to review, consider and comment on the report as it progresses. Learn more about fair, balanced and understandable reporting on 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 2016, 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 p47-55

Business transformation

Ongoing business transformation is one of Pearson's key risks and opportunities. The Enabling Programme (TEP) is an important operational simplification project covering Pearson's key enterprise resource planning technology and processes including financial and HR systems and processes, and the committee received an update at each meeting as TEP progressed during the year. The key area of focus for the committee throughout the year was oversight of the implementation in the UK, which was the first sector of Pearson to go live, acting as a pilot for some of the global design decisions. Of particular importance before go-live were the complexities in Pearson's business model, the number of key interfaces and the need to address the customer-facing platforms as a priority. The committee focused on the schedule and risks to the UK go-live in relation to integration, design and build, and data, considering how those could be mitigated. They reviewed the operation of the TEP steering committee and agreed upon the timing and scope of PwC's external assurance work to complement the Group's own programme assurance activities.

The HR systems go-live took place in the UK without major issue. The main finance system go-live in the UK took place in July 2016, and the committee continued to monitor TEP as the systems became embedded into business practices, noting that issues had been experienced due in part to complex data transition. These were addressed in a methodical manner, with customer and year end issues being the priority. The committee discussed with management the lessons learned from the UK implementation, and heard how those would help to shape the governance structure for the US deployment with plans having been developed to de-risk the US implementation and to phase it over a longer period, expected to start in Q4 2017, with the rest of world implementation pushed back for 12 months. The committee will continue to consider TEP at each meeting as the project progresses throughout 2017.
Learn more about The Enabling Programme on p48

Data security and data privacy

The committee held deep dives with the chief technology & operations officer, chief information security officer and chief privacy officer to examine progress made in the second year of enhancements, and consider where efforts should be focused. A number of actions had been taken to strengthen the security of Pearson's technology estate, which increased visibility over the infrastructure and improved resilience to external attacks. The committee discussed the company's approach to dealing with information security and data privacy in legacy products, and how these would be addressed in products in the development pipeline. They heard how technology and legal teams had conducted a detailed review of Pearson's top products, including all of the key US and UK school assessment products and covering at least half

Audit committee meeting focus during 2016

Area of responsibility	Activity		
Reporting	› Accounting and technical updates › Impact of legal claims and regulatory issues on financial reporting › Fair, balanced and understandable, Going concern and viability statements	› 2015 annual report and accounts: preliminary announcement, financial statements and income statement	› Form 20-F and related disclosures including annual Sarbanes-Oxley Act section 404 attestation of financial reporting internal controls › Review of interim results and trading updates
Policy	› Accounting matters and Group accounting policies	› Analysis supporting viability statement Read more on p55 › Annual review and approval of external auditor policy	› Annual review of treasury policy and strategy › Tax strategy
External audit	› Provision of non-audit services by PwC › Receipt of external auditors' report on Form 20-F and year-end audit › Half year review	› Reappointment of external auditors › Confirmation of auditor independence › 2016 external audit plan › Plans for audit tender	› Remuneration and engagement letter of external auditors › Review opinion on interim results › Review of the effectiveness of external auditors
Risk & internal control	› Internal audit activity reports and review of key findings › Enterprise risk management Read more on p44-46 › 2017 internal audit plan › Legacy product review	› Assessment of the effectiveness of internal control environment and risk management systems › Business resiliency, including crisis management › Health and safety	› Risk deep dives: data security; data privacy; anti-bribery and corruption; tax › Data security incident reporting › Legal risk review › Royalties update › Oversight of The Enabling Programme
Compliance & governance	› Fraud, whistleblowing reports and Code of Conduct matters › The Enabling Programme › Schedule of authorities	› Compliance with UK Corporate Governance Code › Compliance with SEC and NYSE requirements including Sarbanes-Oxley Act	› Review of the committee's terms of reference › Review of the effectiveness of the committee and the Group internal audit function

Audit committee report

of Pearson's digital revenues, and had developed a detailed risk management plan. Awareness and training campaigns continued to be rolled out to employees on both data security and data privacy, as employee education and cultural change would be key in ensuring integrity of systems and protection of data, and the company's data privacy governance continued to develop through implementation of new Group-wide policies and data privacy network.

Anti-bribery and corruption (ABC)

The committee received an update on the global landscape for ABC regulatory enforcement actions, highlighting an increasing focus in Brazil, India and China, where Pearson has a number of businesses. The committee heard that Pearson has in place a good global ABC framework that is working effectively, and noted that a particular focus area for 2017 would be third-party risk, including review of due diligence on partners and the supply chain.

Pearson's ABC infrastructure includes a network of local compliance officers based in-country, being mainly members of the legal team. These officers have assumed responsibility for ABC compliance in their respective businesses, and function as the 'eyes and ears' of the organisation with the oversight of the central compliance and legal teams. The committee also reviewed ongoing work to train employees throughout the business in ABC matters, and noted that momentum continues to build within the organisation, thanks in part to the establishment of a cross-functional compliance council and co-ordinated communication and awareness campaigns.

Tax

At a risk deep dive into Pearson's tax strategy led by the senior vice president (SVP) tax, the committee discussed the complexities and uncertainties in the global tax environment, noting that UK and US tax reform was possible as a result of the UK's decision to leave the European Union and the new administration in the US, as well as the EU's clarification on its perception of 'inappropriate tax benefits' in a number of jurisdictions, although the nature of any regime changes and the likely impact on Pearson was still very unclear. Management confirmed that they were fully prepared to review Pearson's Group tax strategy in 2017 if required as the exact position began to take shape. The committee noted that for the major countries in which Pearson operates the overall tax function was centralised and strong control operated from the Group tax function. For other countries tax controls are de-centralised in terms of day-to-day oversight, but the senior tax management team maintained good relationships with operations throughout the world and were well informed as to the tax position and possible risks across Pearson's global businesses.

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, internal controls and risk management procedures, reviewed the non-audit services provided by PwC and considered any significant legal claims and regulatory issues in the context of their impact on financial reporting.

In February 2017, the committee also considered the 2016 annual report and accounts, including the preliminary announcement, financial statements, strategic report and directors' report.

Learn more about the key activities of the audit committee on p71

Additional meeting attendees

In addition to the committee members, advisers and executives from across the business also attended meetings during the year, as outlined in the table below. This gives the committee direct contact with key leadership. The chairman and chief executive each attend at least one meeting per year, and the chief executive also attends for discussion of matters with an operational focus. The committee also met regularly in private with the external auditors and the SVP internal audit and compliance.

Attendees	Meetings attended
Chief financial officer	**4/4**
Legal counsel	**4/4**
SVP internal audit and compliance	**4/4**
SVP group finance	**4/4**
SVP finance, group reporting	**4/4**
Vice president compliance and risk assurance	**4/4**
Company secretary	**4/4**

Audit committee training

The committee receives regular technical updates as well as specific or personal training as appropriate. In July 2016, PwC led a training session for the committee on regulatory updates, culture and behaviours.

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.

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 public organisations. Tim Score, who assumed the chairmanship of the committee in April 2015, is the company's designated financial expert, having recent and relevant financial experience, and is an Associate Chartered Accountant. He also serves as audit committee chairman for The British Land Company plc. The qualifications and relevant experience of the other committee members are detailed on p60-61

Committee evaluation

The committee undertakes an annual evaluation process to review its own performance and effectiveness, as well as that of the external auditors and Pearson's internal audit function.

In reviewing its own effectiveness, the committee sought input from its members, the chairman, the lead external audit partner, and senior executives. The responses illustrated an effective committee, which uses its time well and has an appropriate focus on the key issues.

External audit

Oversight of external auditors

The committee reviews and recommends to the board the appointment of the external auditors, taking account of the views of management.

The committee reviewed the effectiveness and independence of the external auditors during 2016, as it does every year, and remains satisfied that the auditors provide effective independent challenge to management.

The external auditor review was conducted by distributing a questionnaire to key audit stakeholders including members of the audit committee, the chief executive, chief financial officer, company secretary, SVP internal audit and compliance, SVP finance for each business area and other heads of corporate functions. Overall, responses to the questionnaire were very positive, indicating an effective external audit process.

In addition, in accordance with Pearson's external auditor policy, internal audit performs an annual assessment of audit fees, services and independence. Both the preceding review and the internal audit review are considered by the committee in forming its recommendation to the board in respect of the appointment and compensation of the external auditors.

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. In any event, the external auditors are required to rotate the audit partner responsible for the Pearson audit every five years. The current lead audit partner rotated onto Pearson's audit in 2013.

Audit tendering and rotation

Pearson's last audit tender was in respect of the 1996 year end, and resulted in the appointment of Price Waterhouse as auditors. Developments at an EU level regarding mandatory audit rotation for listed companies have changed the UK landscape on audit tendering and rotation. The committee has reviewed the timetable for tendering and has taken into account relevant regulation and guidance. EU regulations and the ruling by the Competition and Markets Authority (CMA) impose mandatory tendering and rotation requirements, with EU rules requiring a new auditor to be appointed no later than for the 2024 financial year end.

In considering the appropriate audit tender timetable for Pearson in light of these requirements, the committee has also taken account of the significant business change being experienced by the Group and is monitoring the extent to which the Group is drawing upon the services of other accounting firms. As noted elsewhere within this report, a series of programmes is underway throughout Pearson to implement major efficiency improvements across all our enabling functions – technology, finance, HR – to bring the general and administrative costs of running Pearson more in line with global best practice. These include a major transformation programme – The Enabling Programme (TEP) – which includes the implementation of new financial systems and changes to our transaction processing and control activities, which launched in the UK during 2016, and is expected to be rolled out throughout our businesses by 2020. Pearson is supported in these changes, such as in project assurance matters, and more broadly, by external advisers including accounting firms.

In its report last year, the committee expressed its intention to initiate a tender process during 2018, in order for the auditor selected to be in place in time for the audit of the financial year ending 31 December 2018. Due to the status of TEP and the involvement of accounting firms advising on TEP and other change projects, the committee is of the opinion that the level of disruption likely with a change of auditor, as well as the focus required by finance and management teams to conduct the tender process thoroughly and effectively, may unduly impact the Group and would not be in the best interests of shareholders. The committee therefore agreed at its meeting in December 2016 that it was appropriate in the current circumstances to defer the timing of the audit tender for the foreseeable future.

It is the current expectation of the committee that an audit tender process will commence in 2022 in order for the auditor selected as a result of the tender to be appointed for the financial year ending 31 December 2023. It would be our intention to look to accelerate this timing if feasible and appropriate following the completion of TEP, and we would communicate any change in our plans to shareholders in advance of any decision. For the reasons outlined above, the committee considers this timing to be in the best interests of Pearson's shareholders and will continue to monitor this annually in light of the effectiveness and independence of the current auditors, as well as considering whether the timing remains appropriate in light of business developments.

Once the next audit tender occurs, Pearson will adopt a policy of putting the audit contract out to tender at least every ten years.

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 2016. Learn more about Auditors' independence and non-audit services on p74

Review of the external audit

During the year, the committee discussed the planning, conduct and conclusions of the external audit as it proceeded.

At the July 2016 audit committee meeting, the committee discussed and approved the external audit plan and reviewed the key risks of misstatement of Pearson's financial statements, which were updated at the December 2016 committee meeting.

Audit committee report

The table opposite sets out the significant issues considered by the audit 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 2016 and again at the conclusion of their audit of the financial statements for the full year in February 2017.

All the significant issues were areas of focus for the auditors. Learn more in the Independent auditors' report on p114-121

In December 2016, the committee discussed with the auditors the status of their work, focusing in particular on internal controls and Sarbanes-Oxley testing, and covering the significant issues outlined below.

As the auditors concluded their audit, they explained to the committee:

- Their work in evaluating management's goodwill impairment exercise
- Their focus on segments, cash-generating units (CGUs) and goodwill impairment and the related impact of Pearson's transformation
- The work they had conducted over revenue, to apply independent oversight and assess several complex revenue contracts, including judgements in relation to provisions for returns
- The work they had done to understand Pearson's tax strategy and identify business and legislative risks, to evaluate key underlying assumptions and assess the recoverability of deferred tax assets
- Their evaluation of the recoverability of investments in digital platforms and pre-publication assets
- 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 the company's going concern and viability statement reports
- Their assessment of the amounts disclosed as arising from the major restructuring programme in 2016.

The auditors also reported to the committee the misstatements that they had found in the course of their work, which were insignificant, and the committee confirmed that there were no material items remaining unadjusted in these financial statements.

Auditors' independence

In line with best practice, our relationship with PwC is governed by our external auditors policy, which is reviewed and approved annually by the audit committee. The policy establishes procedures to ensure the auditors' independence is not compromised, as well as defining those non-audit services that PwC may or may not provide to Pearson. These allowable services are in accordance with relevant UK and US legislation.

The audit committee approves all audit and non-audit services provided by PwC. Our policy on the use of the external auditors for non-audit services has been updated to reflect 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 now expressly prohibit the provision of certain tax, HR and other services by our external auditor. We will continue to review non-audit services on a case by case basis, including the effectiveness and appropriateness of our updated policy. The policy on provision of non-audit services by external auditors in use in 2016 was in line with previous FRC requirements. Where appropriate, during 2016, services were tendered prior to a decision being made as to whether to award work to the auditors.

The audit committee receives regular reports summarising the amount of fees paid to the auditors. During 2016, Pearson spent £1.4m less on non-audit fees with PwC compared with 2015, due to a reduction in billing on tax services and on the Efficacy programme. For 2016, non-audit fees represented 35% of external audit fees (57% in 2015).

For all non-audit work in 2016, 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 external auditors policy. To assist in ensuring that independence and objectivity is maintained, for forward-looking tax advisory and due diligence work PwC assigns a different partner from the one leading the external audit.

Significant non-audit work performed by PwC during 2016 included:

- Audit-related work in relation to potential and actual corporate finance transactions
- Tax compliance services related to a routine audit by the US Internal Revenue Service
- Tax advisory work on a number of UK, US and international tax matters
- Consulting services related to the establishment of an auditable efficacy framework
- Audit of IT general controls mandated by contractual commitments.

A full statement of the fees for audit and non-audit services is provided in note 4 to the consolidated financial statements on p140.

Tim Score
Chairman of audit committee

Significant issues

Area of focus	Issue	Action taken by audit committee	Outcome
Impairment reviews Read more in note 11 on p147-150	Pearson carries significant goodwill intangible asset balances. There is judgement exercised in the identification of CGUs and the process of allocating goodwill to CGUs and aggregate CGUs and in the assumptions underlying the impairment review. In 2016, Pearson made further significant impairments to goodwill in its North American business.	› The committee considered the results of the Group's annual goodwill impairment review and the key assumptions which are considered to be the cash flows derived from strategic and operating plans, long-term growth rates and the weighted average cost of capital. The committee considered the sensitivities to changes in assumptions and the related disclosures required by IAS 36 'Impairment of Assets'. The committee noted that a significant impairment had arisen in North America as a result of revised expectations for cash flows associated with the US higher education courseware business over the strategic plan period. The committee also considered sensitivity to assumptions in relation to other businesses.	› Annual impairment review finalised with confirmation of impairment in the North America business and sufficient headroom in other CGUs.
Revenue recognition	Pearson has a number of revenue streams where revenue recognition practices are complex and management assumptions and estimates are necessary.	› The committee regularly reviews revenue recognition practice and the underlying assumptions and estimates. In addition, the committee has visibility of internal audit findings relating to revenue recognition controls and processes and routinely monitors the views of external auditors on revenue recognition issues. During the year, the committee continued to monitor the impact of the new revenue recognition standard, IFRS 15 'Revenue from Contracts with Customers', and noted progress on the conversion project including the identification of potential changes to revenue recognition models across the key revenue streams. The committee noted that the standard would be adopted by Pearson in 2018 and considered the transition options permitted under the standard.	› Assumptions underlying revenue recognition were reviewed and challenged and considered to be appropriate. Progress on the project to convert to IFRS 15 and initial findings were reviewed.
Tax	There are a number of issues in different countries where management judgements and assumptions are made as to the correct tax treatment.	› The committee considered Pearson's approach to tax provisioning. Pearson operates in a large number of countries and, accordingly, its earnings are subject to tax in many jurisdictions. The judgement in relation to tax provisioning is a combination of the committee's assessment of the specific open tax issues and also a review of the time periods in which Pearson's tax affairs are open to enquiry by local tax inspectors in jurisdictions where it has a larger taxable presence. The committee addressed this matter through the presentation of two management reports on Pearson's tax affairs by the head of Group tax and through a presentation of the external auditors' assessment of the company's tax provisioning.	› The committee was satisfied with Pearson's approach to tax provisioning taking account of the views of management and the assessment of the external auditors.
Restructuring	Pearson announced a significant restructuring programme in early January 2016. There are a number of accounting judgements to be made regarding categorisation and timing of recognition of cost.	› The committee reviewed progress on the restructuring programme and considered the judgements required in accounting for the costs of redundancy, property rationalisation, renegotiation of supplier contracts and closure of certain systems, platforms and products. The committee also considered the disclosure of restructuring in Pearson's adjusted measures.	› The committee confirmed that the accounting and disclosure for the restructuring programme was appropriate.
Returns	In light of significant returns in the period, we reviewed our policy on reserving for returns.	› The committee considered return provisioning for the higher education courseware business following a high level of returns from retailers during the year. The returns methodology for this business was changed to focus more on customer and channel rather than academic discipline.	› Assumptions underlying the new returns reserve methodology were reviewed and agreed as being more appropriate in the light of recent developments.

Risk governance and control

Control environment

The board of directors 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 of directors confirms that it has conducted a review of the effectiveness of Pearson's systems of risk management and internal control in accordance with provision C.2.3 of the Code and the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (FRC Guidance). These systems have been operating throughout the year and to the date of this report.

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, and receives reports on the efficiency and effectiveness of internal controls. Each business area, including the corporate centre, maintains internal controls and procedures appropriate to its structure, business environment and risk assessment, while complying with company-wide policies, standards and guidelines.

Internal control and risk management

Our internal controls and risk oversight are monitored and continually improved to ensure their compliance with FRC Guidance. Our risk journey is described more thoroughly in the risk management section on p44-46.

Pearson's board of directors are ultimately accountable for effective risk management in Pearson and determine our strategic approach to risk. They agree risk appetite targets early in the year, receive and review semi-annual reports on the ERM process and the status of top Group-level risks.

They are 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 risks, supported by the ERM team. Risk ownership was included in Pearson executive leadership goals for 2016 where appropriate
- 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 ERM 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 Group-level risks reported by the ERM team and they present 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, determining which are principal to the company and how risk is being embedded in our culture) is outlined in more detail in the risk management section of the annual report on p44-46.

Financial management and reporting

There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the board of directors. Monthly financial information, including trading results, balance sheets, cash flow statements, 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.

We have 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, through a finance compliance function.

These controls include those over external financial reporting which are documented and tested in accordance with the requirements of 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 and compliance, and members include the chief financial officer, general counsel, vice president investor relations, 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.

The effectiveness of key financial controls is subject to management review and self-certification and independent evaluation by the external auditors.

Internal audit

Pearson has an in-house internal audit function, supported by co-source agreements to augment our in-house resources, for example providing specific subject matter expertise or language skills. 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 of internal audit, risk and compliance reports formally to both the chairman of the audit committee and the chief financial officer and internal audit's mandate is reviewed annually by the audit committee.

The internal audit plan is approved annually by the audit committee. Completion and changes to the plan are also reviewed and approved by the audit committee throughout the year. The internal audit plan is aligned to our greatest areas of risk as identified by the enterprise risk management process, and the audit committee considers issues and risks arising from internal audits. Management action plans to improve internal controls and to mitigate risks, or both, are agreed with the business area after each audit. Formal management self-assessments allow internal audit to monitor business areas' progress in implementing management action plans agreed as part of internal audits to resolve any control deficiencies. Progress of management action plans is reported to the audit committee at each meeting. Internal audit has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. Regular reports on the findings and emerging themes identified through internal audits are provided to executive management and, via the audit committee, to the board.

The SVP internal audit and compliance oversees compliance with our Code of Conduct and works with senior legal and human resources personnel to investigate any reported incidents including ethical, corruption and fraud allegations. The audit committee is provided with an update of all significant matters received through our whistleblowing reporting system, together with an annual review of the effectiveness of this system. The Pearson anti-bribery and corruption programme provides the framework to support our compliance with various anti-bribery and corruption regulations such as the UK Bribery Act 2010 and the US Foreign Corrupt Practices Act.

Treasury management

The treasury department operates within policies approved by the board and its transactions and procedures are subject to regular internal audit. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the chief financial officer and regular reports are prepared for the audit committee and the board. The treasury policy is described in more detail in note 19 to the consolidated financial statements.

Insurance

Pearson reviews its risk financing options regularly to determine how the company's insurable risk exposures are managed and protected. Pearson purchases comprehensive insurance cover and annually reviews coverage, insurers and premium spend, ensuring the programme is fit for purpose and cost-effective.

Pearson's insurance subsidiary, Spear Insurance Company Limited, is used to leverage Pearson's risk retention capability and to achieve a balance between retaining insurance risk and transferring it to external insurers.

Reputation & responsibility committee report

Committee chairman
Linda Lorimer

Members Vivienne Cox, Linda Lorimer, Harish Manwani and Lincoln Wallen[2]

"Our role is to ensure sustainability, learner impact, and stakeholder views remain central to Pearson's mission."

Committee responsibilities include oversight of:

Reputation	Pearson's reputation among major stakeholders, including governments, investors, employees, customers, learners and the education community.
Risk	Oversight of Pearson's approach to reputational risk, including ensuring that clear roles have been assigned for management.
Sustainability	Oversight of 2020 sustainability plan and performance against sustainability goals and commitments.
Brand & culture	Management of the Pearson brand to ensure that its value and reputation are maintained and enhanced. Pearson's approach to monitoring and supporting the values and desired behaviours that form our corporate culture.
Ethics	Ethical business standards, including Pearson's approach to issues relevant to its reputation as a responsible corporate citizen.
Strategy	Strategies, policies and plans related to reputation and responsibility issues and the people, processes and policies that are in place to manage them.

Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website www.pearson.com/governance

Attendance

Attendance by directors at reputation & responsibility committee meetings throughout 2016:

	Meetings attended
Vivienne Cox	4/4
Josh Lewis[1]	4/4
Linda Lorimer	4/4
Harish Manwani	4/4

Note 1: Josh Lewis stepped down from the committee on 31 December 2016
Note 2: Lincoln Wallen joined the committee on 1 January 2017.

Reputation & responsibility committee role

The committee works to advance Pearson's reputation and to maximise the company's positive impact on society and the communities in which we work.

We are committed to promoting Pearson's 2020 sustainability plan, and the committee works in alignment with the company's responsible business leadership council.

Read more about our 2020 sustainability plan on p20-27.

Changes to the committee

As a result of work conducted by the nomination committee and the chairman of the board to examine the composition and remit of the board's committees, Lincoln Wallen has joined the committee with effect from 1 January 2017, with Josh Lewis stepping down.

I am also privileged to take over the chairmanship of the committee from Vivienne Cox, whom I am pleased will remain a member of the committee. Vivienne initiated this committee in 2012, which is now an important part of our governance framework.

Areas of focus during 2016

One of our prime responsibilities is to ensure strategies are in place to manage and improve Pearson's reputation. The US is our largest market, so it is important for the committee to consider regularly our US reputational management strategy. To that end, we held a focused meeting in early 2016, led by the SVP corporate affairs for North America. We examined various aspects of our US strategy, including public policy initiatives, engagement with teachers and educators, community and stakeholder programmes, as well as media and brand work. We received regular updates on our US and global reputational work throughout the year, and in 2017 we intend to hold a similar focused session looking at our reputational management programmes in North America as well as in other key global markets.

Pearson will be reporting publicly, starting in 2018, on the efficacy of our products and services to demonstrate their measurable impact. Throughout 2016, the committee monitored the progress of our external reporting plans; we looked at how we are aligning our efficacy goals with our wider business strategy, and considered examples of product efficacy reports. We were joined for our efficacy sessions by PwC, which is providing external assurance for the efficacy reporting process.

Our recent sustainability report, published in July 2016, identified Pearson's nine most material sustainability issues, and we have introduced a programme of deep dives to consider each of these in turn. Through these sessions the committee will consider the public goals and targets the company is setting to address these issues, and examine their associated reputational impacts. In 2016, we considered the work under way to improve our product accessibility standards, which directly supports our ambition to reach more learners, and looked at the progress made in safeguarding our learners, which aligns with our aim of being a trusted partner.

Read more about our material sustainability issues on p21-22.

Evaluation

During the year, the committee conducted its first effectiveness evaluation. The process involved distribution of a questionnaire to committee members and senior management who regularly attend meetings, to evaluate the committee's performance in line with its terms of reference, and to ensure that the meetings and papers were sufficient to facilitate effective input and challenge to the business. The review found that the committee performs effectively across its remit, with sufficient time allotted to the key areas. The committee has identified some particular areas of focus for 2017, including culture and values, and examining key policy issues on the ground in important geographies outside the US.

Committee aims for 2017

Over the next year we will continue to explore Pearson's nine most material sustainability issues, including employability and 21st Century skills, affordability and economic empowerment. We will hold a deep dive into our reputational and risk management plans for our growth and core markets, evaluate and refine our 2018 efficacy reporting plans and consider performance against our efficacy growth and impact goals. In addition, we will continue to monitor the Pearson culture and employee engagement, particularly in light of the changes and rationalisations throughout the business in 2016, and we will review the progress made by Pearson's ongoing social impact initiatives and partnerships.

Linda Koch Lorimer

Linda Lorimer
Chairman of reputation & responsibility committee

Reputation & responsibility committee meeting focus during 2016

Area of responsibility	Activity
Reputation	› Updates on reputational 'hot topics' at each meeting › US reputational strategy deep dive › Stakeholder engagement in relation to AGM › Overview of UK apprenticeships
Risk	› Overview of reputational risk approach in growth and US markets, through in-country personnel and central corporate affairs team › Regular consideration of reputational risk dashboards › Safeguarding deep dive › Impact of US presidential election– preliminary view
Sustainability	› 2020 sustainability plan and sustainability reporting › Efficacy and research – spotlight on 2018 external efficacy reporting › Efficacy growth and impact goals › Sustainability initiatives including the launch of the 'Alphabet of Illiteracy' campaign and Tomorrow's Markets Incubator for employee intrapreneurs
Brand & culture	› Demonstration of LearnED, Pearson's online digital newsroom
Ethics	› Modern Slavery Act – implications and statement › Consideration of ethical issues in the wider context of reputational risk identification
Strategy	› Social innovation and impact venturing strategy › Pearson Affordable Learning Fund review › Product accessibility deep dive › Environmental strategy update

Stakeholder engagement

Engaging with shareholders

Pearson has an extensive programme of communication with all of its shareholders – large and small, institutional and private.

Shareholder outreach In 2016, we continued with our shareholder outreach programme, seeing approximately 600 institutional and private investors at more than 300 different institutions in Australia, Canada, Dubai, Greater China, Continental Europe, Japan, Singapore, the UK and the US.

Trading updates There are five trading updates each year and the chief executive and chief financial officer present our preliminary and interim results updates. They also attend regular meetings throughout the year with investors in the UK and around the world, tailored to investor requirements, to discuss the performance of the company, the company's strategy, our change programme, structural and cyclical changes in our markets, and risks and opportunities for the future. We also held an investor and analyst day in June 2016. You can read more about this below.

Chairman and non-executive directors The chairman meets regularly with shareholders to understand any issues and concerns they may have. This is in accordance with both the Code and consistent with the duties of investors under the UK Stewardship Code. The non-executive directors meet informally with shareholders both before and after the AGM and respond to shareholder queries and requests as necessary. The chairman ensures that the board is kept informed of investors' and advisers' views on strategy and corporate governance. At each board meeting, the directors consider commentary from advisers on major shareholders' positions and Pearson's share price. In addition, the nomination & governance and remuneration committees consider shareholder views on corporate governance and remuneration matters, respectively, as required.

Consultations During the year, we also consulted with our major shareholders and with shareholder representative bodies on our directors' remuneration policy.

Read about Remuneration on p82-106

Private investors Private investors represent over 80% of the shareholders on our register and we make a concerted effort to engage with them regularly. Shareholders who cannot attend the AGM are invited to e-mail questions to the chairman in advance at chairman-agm@pearson.com

We encourage our private shareholders to become more informed investors and have provided a wealth of information on our website about managing Pearson shareholdings. We also encourage all shareholders, who have not already done so, to register their e-mail

Visit pearson.com

- Investor relations information
- Company announcements and shareholder presentations, webcasts and conference calls
- Past announcements and presentations
- Historical financial performance
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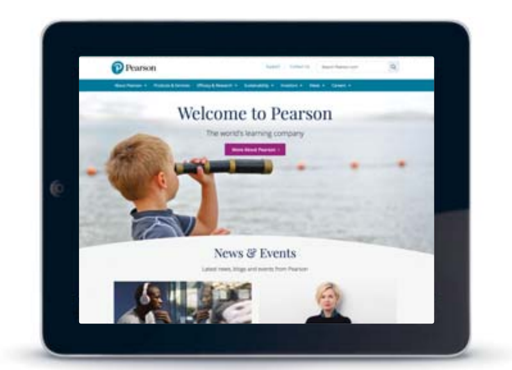

Investor and analyst day

Pearson hosted an investor and analyst information day in June 2016 at its head office in London.

Presentations from the chief executive, chief financial officer, president of North America and other company leaders focused on our US higher education courseware and higher education online services businesses.

The event provided analysts and investors with more information on the market and our strategy, the new products and services we're bringing to market, our sales and marketing capabilities, our ability to implement and our journey along the digital transition.

addresses through our website and with our registrar. This enables them to receive e-mail alerts when trading updates and other important announcements are added to our website. See Shareholder information on p196 or visit our website www.pearson.com/investors/shareholder-information.html

Annual General Meeting

Our AGM, on 5 May 2017, is an opportunity for all shareholders to meet the board and to hear presentations about Pearson's businesses and results.

Share dealing service

Due to its continued popularity we again provided shareholders with smaller holdings the opportunity to use our registrar's low-cost share dealing service, giving them the chance to add to or reduce their stake in Pearson at significantly reduced dealing rates, or to donate shares to charity with ease. This service proved popular with shareholders, and consequently we intend to offer it again at a future date. We believe it is important that our employees have a shared interest in the direction and achievements of Pearson and are pleased to say that a large number of our employees are shareholders in the company.

Engaging with all stakeholders

We post all company announcements on our website, www.pearson.com, as soon as they are released, and key shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes information about all of our businesses, links to their websites and details of our sustainability policies and activities. Learn more about our approach to Sustainability on p20-27

Employee engagement

The board views employee engagement as a key element of its oversight of the company's culture, and an opportunity to become directly involved in leadership and talent development activities.

Board talent breakfasts

The board attended two talent breakfasts during the year, engaging with employees at the overseas meetings in Bloomington and Hoboken. Since their introduction, these sessions have proved consistently popular with the non-executive directors and have evolved to include a broad range of participants, new and long-serving staff, at various levels of seniority within the company and across all areas of the business. At the Hoboken breakfast, employees participated in facilitated discussions with directors and members of the executive, with conversations focused on employee learning and career development to aid the board in their understanding of talent and retention matters. Following the event, the feedback from participants was overwhelmingly positive with many of them indicating that they had felt inspired and that the experience had been both insightful and valuable.

Discovery Days

In 2016, we launched a series of Discovery Days. These employee-only days provide an opportunity to showcase our products while giving staff the chance to learn more about our brand and strategy from senior leaders, engage with Pearson's product experts and participate in a variety of career and personal development activities.

Senior leaders' receptions

On three occasions during the year, the board joined a reception for locally based leaders from product and customer-facing areas of the business as well as corporate functions. These informal occasions provided an opportunity for the board to understand the motivations of colleagues and to discuss some of the day-to-day challenges faced by the business.

> "It is clear that while challenges and change are a constant, the passion to solve the challenges that face us and our customers by doing good, meaningful work drives us all."
>
> **Employee at board talent breakfast**, Hoboken, October 2016

Overview
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Remuneration overview

Committee chairman
Elizabeth Corley

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

"Remuneration outcomes reflect a difficult 2016 for the company and our shareholders. In a challenging environment, we have reviewed policy to ensure that it underpins our strategy to return Pearson to growth. As a result of our review, the remuneration policy remains broadly the same but there are three key changes that will support Pearson's accelerated transition to a more digitally sustainable and efficient business."

Key changes to remuneration policy for 2017

- Introduction of performance metrics linked to strategic imperatives for part of the Annual Incentive Plan
- Reweighting of measures in the Long-Term Incentive Plan
- Updated Total Shareholder Return peer group to ensure that it aligns better with Pearson following the sales of the Financial Times and our share in The Economist.

In this remuneration section

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 shown in the table on p83.

Board committee attendance

The following table shows attendance by directors at committee meetings throughout 2016:

	Remuneration
Elizabeth Corley	6/6
Vivienne Cox[1]	5/6
Josh Lewis	6/6
Tim Score	6/6
Sidney Taurel	6/6

Note 1: Unable to attend one remuneration committee meeting due to personal reasons. Leaves the remuneration committee in 2017.

www.pearson.com/governance

Dear shareholders,

On behalf of the remuneration committee and the board, I am pleased to present the directors' remuneration report for 2016.

I would like to start by recognising that this has been a challenging year for Pearson and our shareholders. Although there has been some positive progress made in a number of priority business areas, the significant decline in the US higher education courseware business means that we no longer expect to reach our prior operating profit goal for 2018. As outlined by the chairman in his introduction, the whole board and company is focused on a rigorous plan to address the challenges, and to accelerate the transition to a more digital and sustainable business.

As we approached both the implementation of our 2016 policy and proposals for the new 2017 policy, the need for effective remuneration and incentive structures to support this has been at the forefront of the remuneration committee's thinking.

During our engagement meetings, several of our shareholders asked about employee retention, resilience and morale so before moving into the main report, I will address this topic briefly. Throughout the year, one of the committee's priorities has been to review the way in which the company attracts and retains the talent needed in the execution of the transformation. We have considered incentive structures and retention plans for the wider management team, which are well aligned to the delivery of our digital strategy and to creating further sustainable efficiencies in our business.

The selective retention plans that were put in place for 2016 have worked well (no executive director participated in these). However, following a nil Annual Incentive Plan (AIP) payout for 2015 in addition to nil vesting of the 2012 Long Term Incentive Plan (LTIP), we were keen to re-evaluate the applicability of both plans for the management population below executive directors to ensure that incentive arrangements were fit for purpose in a company undergoing significant and sustained change. As a result of this, we have approved a much simplified, single management incentive plan for implementation in 2017. The new plan is closely aligned to achievement of business priorities but also has clear linkage to personal objectives. It applies to the Pearson executive management team that reports to the executive directors, and to the senior leadership group, so is not a part of our remuneration policy proposal but we felt that shareholders would appreciate insight to a change that we think enhances both relevance and incentive potential.

Performance outcomes in 2016

Although our 2016 results are in line with the lower end of expectations, and our 2016 restructuring programme was delivered in full and with financial benefits higher than planned, the committee has been mindful in all its deliberations of the consequences of the removal of future guidance to the market and the significant shortfall in courseware sales, notably in North America.

The primary principle of our remuneration policy remains to support the company's strategy which is focused on delivering sustained performance and the creation of long-term value for all stakeholders. Remuneration for executive directors is closely tied to short and long-term objectives that aim to deliver on these commitments while being sensitive to the shareholder experience. Taking all of these considerations into account, the incentive outcomes for our executive directors in 2016 were as follows:

Annual incentive plan summary

As explained in last year's directors' remuneration report, the on-target funding for the 2016 AIP was cut significantly compared to 2015 (a cut of circa one third).

Above threshold performance on a number of measures, including Group EPS, operating profit and operating cash flow, meant that there was a calculated achievement of 55% of base salary for the CEO and 47% of base salary for the CFO. This is on a like-for-like exchange rate; i.e. there is no foreign exchange benefit passed through.

The remuneration committee rigorously reviewed all the AIP performance targets for 2016 given the results outcome. We concluded that the targets had been set on a reasonable basis and that these outcomes reflected annual achievement towards the lower end of guidance for relevant performance indicators. We also assessed the quality of cost reductions and the manner in which the financial targets had been met. We noted that the cost reductions had not compromised the company's increasing investment in digital products and services and that they were contributing to a more efficient and aligned business.

Notwithstanding this, discretion has been exercised to reduce the total AIP funding by 20%. This results in a CEO pay-out reduction from 55% to 44% of base salary and a CFO reduction from 47% to 37% of base salary. This represents 24% and 22% of maximum AIP opportunity for the CEO and CFO respectively.

Long-term incentive summary

The awards made in 2014 under the LTIP are expected to vest without value, the fifth year in which this will have been the case.

The LTIP quantum and targets for 2016 were derived from the 2018 guidance that had been given to the market in January. As the CEO was already very substantially behind comparable market levels of compensation, (and the CFO modestly behind) we did not reduce the LTIP quantum at that point but we did set demanding performance targets aligned to guidance.

Summary of remuneration policy proposals

The committee undertook a wholesale review of our remuneration policy during 2016 to assess whether it remained fit for purpose, taking into account how the company has evolved since the policy was last approved in 2014. We first thought about philosophy and principles for the organisation as a whole and we then distilled this into policy for the executive directors. Central to the review was engaging with our largest shareholders and seeking their input on the future direction of policy. The committee is grateful to those shareholders who took the opportunity to engage with us in this process.

In summary, the committee concluded that the remuneration policy continues to underpin the company's strategic objectives and does not therefore require material change. However, recognising that our growth strategy is contingent on a number of vital, shorter-term strategic initiatives, the committee concluded it appropriate to introduce performance metrics linked to strategic imperatives into

Committee responsibilities:

Determine and review policy

Determine and regularly review the remuneration policies for the executive directors, the presidents and other members of the Pearson executive management (who report directly to the CEO), and overview the approach for the senior leadership group. These policies include base salary, annual and long-term incentives, pension arrangements, any other benefits and termination of employment.

Review and approve implementation

Regularly review the implementation and operation of the remuneration policy for executive management and approve the individual remuneration and benefits packages of the executive directors.

Approve performance related plans

Approve the design of, and determine targets for, any performance-related pay plans operated by the Group for Pearson executive management and approve the total payments to be made under such plans.

Review long-term plans

Review the design of the company's long-term incentive and other share plans operated by the Group and where relevant recommend such plans for approval by the board and shareholders.

Set termination arrangements

Advise and decide on general and specific arrangements in connection with the termination of employment of executive directors.

Review targets

Review and approve corporate goals and objectives relevant to executive directors' remuneration and evaluate the executive directors' performance in light of those goals and objectives.

Determine chairman's remuneration

Delegated responsibility for determining the remuneration and benefits package of the chairman of the board.

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.

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.

Remuneration overview

Remuneration committee meeting focus during 2016

Areas of responsibility	Activities			
Market	Noted Willis Towers Watson's overview of the current remuneration environment	Noted Willis Towers Watson's market data and research on remuneration policy design	Noted Executive Remuneration Working Group report	Noted various updates to investor guidelines on executive compensation
Performance	Noted management's overview of prior year and year to date performance and business plans	Noted and reviewed the status of the outstanding long-term incentive awards based on the current view of likely Pearson financial performance	Noted and reviewed the status of the 2016-17 retention arrangements and impact on voluntary turnover	
Implementation	Reviewed and approved the 2015 annual incentive nil pay-out and 2016 remuneration packages for executive directors Reviewed and approved 2015 annual incentive plan nil pay-out for the Group	Approved nil pay-out under 2013 long-term incentive plan Approved nil pay-out of 2013 annual bonus share matching awards and release of shares	Reviewed and approved 2016 long-term incentive awards for the executive directors and Pearson executive management Noted 2015 long-term incentive awards for senior leaders and managers below Pearson executive management (granted in March 2016)	Noted remuneration packages for new appointments to the Pearson executive management and termination arrangements for leavers Noted the deployment of 2016-17 retention arrangements
Governance	Noted the activity of the standing committee of the board in relation to the operation of the company's equity-based reward programmes	Noted company's use of equity for employee share plans	Reviewed the committee's performance	
Policy	Reviewed remuneration principles and policy and incentive arrangements in the wider organisation and approved a simplification of pay design below the board for 2017 Reviewed directors' remuneration policy ahead of binding vote at 2017 AGM	Reviewed and approved 2015 directors' remuneration report Reviewed and approved pay freeze for 2016 for the Pearson executive management and other senior employees	Reviewed and approved 2016 Pearson annual incentive plan targets Reviewed and approved 2016 individual annual incentive opportunities for the executive directors and Pearson executive management	Reviewed 2016 long-term incentive performance conditions for the executive directors and Pearson executive management Considered approach to 2016 long-term incentive awards for senior leaders and managers below the Pearson executive management
Disclosure and engagement	Considered feedback from Committee Chairman's meetings with key shareholders on 2016 implementation and 2017 policy	Noted shareholder feedback on 2015 directors' remuneration report	Reviewed 2016 Annual General Meeting season, shareholder voting and engagement strategy	Noted template and outline of 2016 report on directors' remuneration and shareholder engagement strategy

See Total single figure remuneration on p89

AIP. Under the proposed new policy up to 25% of the AIP will be measured against strategic imperatives (non-financial metrics). Any pay out in respect of achievement of strategic imperatives will be subject to attaining a minimum level of performance on financial metrics.

In addition, the committee concluded it is appropriate to re-weight the metrics attaching to future LTIP awards to increase the TSR portion, such that earnings per share (EPS) would account for 40% with return on invested capital (ROIC) and relative total shareholder return (TSR) 30% each respectively (currently one half, one third and one sixth).

The current TSR peer group of global media companies would also be replaced with the FTSE 100, of which the company is a constituent. Following a thorough review of alternatives, this was considered the most appropriate comparator group as it represents a comparable investment alternative for shareholders; its constituents are of a comparable size, scale and maturity to Pearson; and are similarly impacted by global macro-economic influences. Adopting a commonly used TSR peer group would also be a simplification to the plan.

It is proposed, subject to approval at the 2017 AGM, that these changes be made effective from the start of the 2017 AIP and LTIP performance periods (January 1).

Finally, there has been an evolution and strengthening of governance, initiated by the Pearson chair, which has a modest remuneration policy impact. In line with other Pearson committees and market practice, non-executive director fees for those on the Nomination & Governance Committee will be set at £15,000 for the committee chairman and £8,000 for committee membership. These would take effect from the date of the 2017 AGM.

Also, in response to the increase in responsibilities associated with the undertakings of the Reputation & Responsibility committee, the committee fees for the chair and membership committee members will increase to £13,000 (£10,000) and £6,000 (£5,000) respectively.

The aggregated increase in non-executive director fees associated with this further strengthening of governance will be in the region of £58,000 per annum.

Summary of proposed changes

For the Annual Incentive Plan (AIP):

- In 2017, financial metrics will account for 75% of total opportunity and will continue to include targets based on Group EPS, operating profit, sales and operating cash flow. Strategic imperatives will account for 25% of total opportunity and will be drawn from three key areas aligned with milestones currently tracked formally by the board. In 2017 our strategic imperatives focus predominantly on competitive performance and transformation. The metrics are drivers of our strategy, growth and simplification plans already communicated to the market. More detail on the metrics is included on p86.

For the Long-term Incentive Plan (LTIP):

- For 2017, LTIP awards shall be contingent on EPS (40%), ROIC (30%) and relative TSR (30%) targets. The awards and the targets will be agreed at the May remuneration committee meeting and fully disclosed in the 2017 report on directors' remuneration.

Both the committee and board strongly believe that the final proposals maintain a strong pay-for-performance relationship and that the 2016 incentive out-turns and approach to implementation of policy in 2017 will best serve the company's future ambitions by incentivising our executive directors to return value to you, our shareholders.

Looking forward to 2017

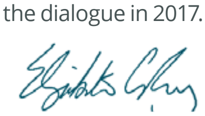
The remuneration committee has decided that the base pay for both the CEO and CFO will not be increased in 2017. This will be the second year of no increase in base salary for either the CEO or CFO. While it is recognised that the CEO is substantially behind market, the committee concluded that this was not a relevant consideration in the current trading environment.

In acknowledgement of the value erosion in the Pearson share price, the remuneration committee intends to reduce the volume of 2017 LTIP awards to the executive directors such that their value is materially lower than prior practice. The eventual scale of this reduction will be judged by reference to all relevant factors prevailing at the award date (in May), including share price. The remuneration committee also notes that the re-weighted 30% TSR element is likely to be significantly out of the money on grant, due to the averaging period used to determine the start point, which is the three-month period to the end of December 2016. We will not be changing this methodology.

If current share price conditions were to continue, the committee might judge that the economic value of the 2017 LTIP grant would be reduced by in the region of 20-25%.

In the current trading environment the committee has exercised its discretion to reduce incentive payment payouts. We remain focused on the need to reflect on shareholder experience in compensation decisions, while at the same time recognising when there is genuinely strong delivery against stretching and demanding performance targets. Pearson is undergoing substantial change as the company delivers on digital transformation and continuously improving efficiency, while at the same time meeting the needs of all our stakeholders. This requires strong and resilient leadership and our policy proposals are designed to provide the appropriate balance of reward for performance and accountability.

My meetings with shareholders have been invaluable in understanding your perspectives and I look forward to continuing the dialogue in 2017.



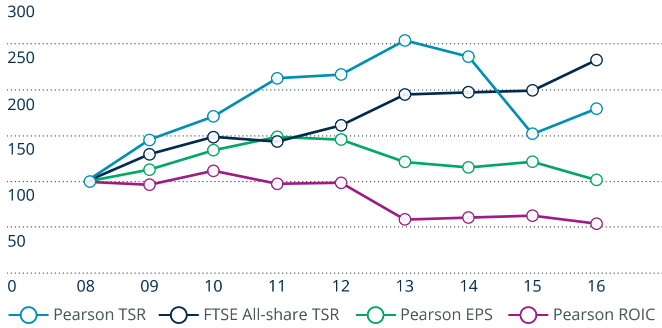
Elizabeth Corley
Chairman of remuneration committee

14 March 2017

Remuneration overview

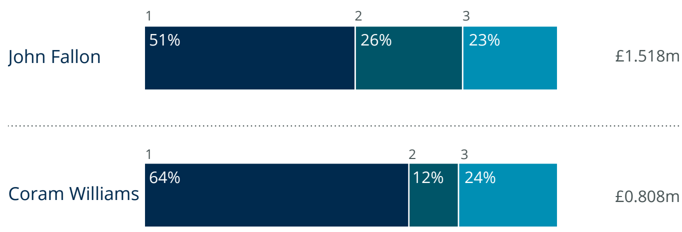
Executive remuneration in 2016

Key performance indicators



Initial value of KPIs has been rebased to 100 for same timeframe as chart on p95.

Executive directors' 2016 single figure breakdown



❶ Base salary ❷ Allowances,benefits and pensions ❸ Annual incentives ❹ Long term incentives

See p95 for alignment of pay with Total Shareholder Return

Summary of policy changes

A summary of the material changes to be introduced in the new policy is provided below. More comprehensive detail immediately follows in the future policy table.

Base salary

Key features of current policy:

Base salary increases not ordinarily more than 10% p.a. with exceptional increases capped at 25% over the normal maximum limit.

Policy changes:

No change.

Allowances and benefits

Key features of current policy:

Total value not ordinarily in excess of 15% of base salary p.a. with exceptional increases capped at 25% above the normal limit.

Policy changes:

No change.

Retirement benefits

Key features of current policy:

New employees are eligible to join the Money Purchase section of the Pearson Group Pension Plan.

Company contributions capped at 16% of pensionable salary or cash in lieu (double the amount of the employee contribution, which is limited according to certain age bands).

Normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health.

Policy changes:

Simplified disclosure to reflect that currently Pearson only has UK executive directors. Detail on US pension provision has been removed but, if needed, provision would be on a consistent basis to a UK new hire.

Annual Incentive Plan (AIP)

Key features of current policy:

Overall limit of 200% of base salary maximum with annual opportunity ordinarily limited to 180% (CEO) and 170% (CFO). Metrics based on:

- Group EPS (30%)
- Operating profit (30%)
- Sales (20%)
- Operating cash flow (20%).

Policy changes:

No change to maximum incentive opportunity.

Introduction of performance metrics linked to strategic imperatives for up to 25% of total annual opportunity. Financial metrics for at least 75% of total annual opportunity, weighted:

- Group EPS (22.5%)
- Operating profit (22.5%)
- Sales (15%)
- Operating cash flow (15%).

Performance metrics linked to strategic imperatives to be subject to attaining a minimum level of performance on financial metrics.

Change in CEO remuneration 2015/16

Base salary	Allowances and benefits
no change	+37%
Annual incentives	**Total**
see note 4	+20%

Change in employee remuneration 2015/16

Base salary	Allowances and benefits
+1%	+7%
Annual incentives	**Total**
+55%	+5%

Note 1 The figures for all employees reflect average salaries and average employee numbers each year at constant exchange rates. Annual incentives include all plans, including sales incentives.

Note 2 The difference in CEO base salary single figure reflects effect of full year of 2015 increase introduced in April 2015. No increase in 2016.

Note 3 CEO allowances and benefits change reflects increase in cost of car benefit and travel expenses of c.£20,000 over 2015.

Note 4 As there was no AIP paid in 2015, relative percentage change for the CEO is incalculable.

Note 5 The increase in allowances and benefits on an average employee basis is inflated by a change in population post-restructuring.

Note 6 As there was no AIP paid in 2015, relative percentage change for employees reflects 2016 Group-wide bonus pay-outs versus a small selection of local plans in 2015.

See full 2017 remuneration policy table for 2017–2020 on p97

Long-Term Incentive Plan (LTIP)

Key features of current policy:

Maximum face value of 400% of base salary with exceptional increases capped at 25% over the normal maximum limit.

Three-year performance period with metrics based on:

- Group EPS (1/2)
- ROIC (1/3)
- Relative TSR (1/6)
- Two year post-vesting holding period.

Policy changes:

No change to maximum incentive opportunity.

No change to performance period or holding period.

Re-weighting of measures to:

- Group EPS (40%)
- ROIC (30%)
- Relative TSR (30%).

In addition, change in TSR peer group from a predominantly media-focused peer group to the FTSE 100 to ensure that it aligns better with Pearson following the sales of the Financial Times and our share in The Economist.

Non-Executive Directors

Policy change:

Change in fee levels for some committees.

Strategic alignment of pay 2017–2020

In addition to financial performance, there are a number of vital, shorter-term initiatives that the board requires the executive directors to deliver that are not fully captured by financial metrics. These initiatives are key both for the achievement of our transformation goals, and for the long-term growth and success of the company.

Our 2017 remuneration policy intends to create a closer linkage between our key strategic imperatives and executive goals, to enhance further the alignment of executive director incentives with shareholder outcomes and sustained shareholder value creation.

Read more comprehensive detail in the future policy table on p98-101 and the Remuneration report on p106

Financial objectives

KPI	Incentive scheme
Drive revenue growth	
Sales	AIP
Deliver sustainable returns	
Total adjusted earnings per share	AIP / LTIP
Operating profit	AIP
Return on invested capital	LTIP
Total shareholder return	LTIP
Manage our cash position effectively	
Operating cash flow	AIP

Strategic imperatives

KPI	Incentive scheme
Competitive performance	
Holding or gaining share in major markets	AIP
Higher Education direct/ecommerce sales to consumers	
Transformation	
Delivery of Enabling Programme milestones to upgrade the customer experience, accelerate the digital transformation and the delivery of on-going cost, efficiency and process transformations	AIP
Culture, talent & brand	
Improvement in brand favourability and year-on-year improvement in employee engagement survey scores	AIP

Each metric will be measured, using third party data or externally audited internal data (where third party data is not available or applicable).

Performance metrics linked to strategic imperatives can be selected annually to support Pearson's transformation strategy.

2016 remuneration report

This report comprises a number of sections:

Where required under current regulations, the tables marked * have been subject to audit.

The remuneration committee in 2016

Role	Name	Title
Chairman	Elizabeth Corley	Independent non-executive directors
	Vivienne Cox	
	Josh Lewis	
	Tim Score	
	Sidney Taurel	Chairman of the board
Internal advisers	John Fallon	Chief executive
	Coram Williams	Chief financial officer
	Melinda Wolfe	Chief human resources officer
	Stuart Nolan	SVP, reward
	Stephen Jones	Company secretary
External advisers	Willis Towers Watson	

Sidney Taurel was a member of the committee throughout 2016 as permitted under the UK Corporate Governance Code.

Annual remuneration report

The remuneration committee presents the annual remuneration report, which will be put to shareholders, along with the annual statement, as an advisory (non-binding) vote at the Annual General Meeting to be held on 5 May 2017.

Remuneration compliance

This report was compiled in accordance with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and was approved by the board of directors on 14 March 2017. The committee believes that the company has complied with the provisions regarding remuneration matters contained within the UK Corporate Governance Code.

Internal advisers John Fallon (Chief executive), Coram Williams (Chief financial officer), Melinda Wolfe (Chief human resources officer), Stuart Nolan (SVP, reward) and Stephen Jones (Company secretary) provided important assistance to the committee during the year. They attended meetings of the committee, although none of them were involved in any decisions relating to his or her own remuneration.

To ensure that the committee receives independent advice, Willis Towers Watson supplies survey data and advises on market trends, long-term incentives and other general remuneration matters. Willis Towers Watson was selected and appointed by the committee through a formal tendering process. Willis Towers Watson also advised the company on health and welfare benefits in the US and provided consulting advice directly to certain Pearson operating companies. Willis Towers Watson is a member of the Remuneration Consultants' Group, the body that oversees the Code of Conduct in relation to executive remuneration consulting in the UK. During the year, Willis Towers Watson was paid fees for advice to the committee, which were charged on a time spent basis, of £224,000. This can be split £90,000 for annual standing matters and £134,000 for policy-related work. As part of its annual review of its performance and effectiveness, the committee remains satisfied that Willis Towers Watson's advice was objective and independent and that Willis Towers Watson's provision of other services in no way compromises its independence.

Committee performance

Annually, the committee reviews its own performance, constitution, and charter and terms of reference to ensure it is operating at maximum effectiveness and recommends any changes it considers necessary to the board for approval. The committee participated in a survey to review its performance and effectiveness in July 2016, looking at areas such as the clarity of roles and responsibilities, the composition of the committee, the use of time, the quality and timeliness of meeting materials, the opportunity for discussion and debate, dialogue with management and shareholders and access to independent advice. Whilst the committee concluded that it was broadly operating effectively, there were a number of improvements identified for the year ahead, such as:

- Greater dialogue with management and external remuneration consultants between meetings
- Advance meeting materials to be clearer and more concise.

Minor amendments were made to the committee's terms of reference on 23 February 2017 and are available on the Governance page of the company's website.

Voting at the 2016 Annual General Meeting

The following table summarises the details of votes cast in respect of the resolutions on the report on directors' remuneration at the 2016 Annual General Meeting and the previous policy vote at the 2014 Annual General Meeting.

Annual remuneration votes

● Votes for (90.19% of votes cast) **562,809,279**

● Votes against (9.81% of votes cast) **61,245,352**

624,054,631
Total votes cast
(76% of issued share capital)

615,189
Votes withheld (abstentions)

Previous directors' remuneration policy vote

● Votes for (95.76% of votes cast) **517,308,446**

● Votes against (4.24% of votes cast) **22,905,879**

540,214,325
Total votes cast
(66% of issued share capital)

6,004,239
Votes withheld (abstentions)

As in previous years and as required by law, details of the voting on all resolutions at the 2017 Annual General Meeting will be announced via the RNS and posted on the Pearson website following the Annual General Meeting.

Single total figure of remuneration and prior year comparison

Total aggregate emoluments for executive and non-executive directors were £3.528m in 2016. These emoluments are included within the total employee benefit expense in note 5 to the financial statements (p141).

Executive directors

The remuneration received by executive directors in respect of the financial years ended 31 December 2016 and 31 December 2015 is set out below.

Executive director remuneration

Element of remuneration £000s	John Fallon		Coram Williams		Total	
	2016	2015	2016	2015*	2016	2015
Base salary	**780**	776	**515**	258	**1,295**	1,034
Allowances and benefits	**85**	62	**53**	0	**138**	62
Travel	**48**	28	**22**	0	**70**	28
Healthcare	**2**	2	**1**	0	**3**	2
Risk	**35**	32	**0**	0	**35**	32
Relocation	**–**	–	**30**	–	**30**	–
Annual incentives	**343**	0	**193**	0	**536**	0
Pay-out (% of maximum)	**24%**	0%	**22%**	0%	**–**	–
Pay-out (% of target)	**44%**	0%	**44%**	0%	**–**	–
Pay-out (% of salary)	**44%**	0%	**37%**	0%	**–**	–
Long-term incentives	**0**	54	**–**	–	**0**	54
LTIP	**0**	0	**–**	–	**0**	0
Dividends	**0**	46	**–**	–	**0**	46
WWSFS	**0**	8	**–**	–	**0**	8
Retirement benefits	**310**	371	**47**	18	**357**	389
Defined benefit accrual	**107**	169	**47**	18	**154**	187
Allowances in lieu of benefits	**203**	202	**–**	–	**203**	202
Total remuneration	**1,518**	1,263	**808**	276	**2,326**	1,539

See summary of remuneration policy on p98

*part year

Remuneration report

Notes to single figure table

Single total figure of remuneration

In accordance with the regulations, we show a single total figure of remuneration, which includes retirement benefits and long-term incentives in addition to the other elements of remuneration that have been shown in previous reports.

Base salary

In accordance with policy, the committee considered reports from the chief executive on general morale and chief human resources officer on retention, employee engagement and effectiveness of reward plans. For 2016, the company had reiterated its starting principles that base compensation provides the appropriate rate of remuneration for the job, taking into account relevant recruitment markets, business sectors and geographic regions and that total remuneration should reward both short and long-term results, delivering competitive rewards for target performance, but higher rewards for exceptional company performance. For the US and UK, the budget guideline issued for adjustments to base pay for 2016 was 1%. For other markets, local inflation rates and market conditions were taken into account for setting budget guidelines for base pay adjustments. However, in 2016 there was a general pay freeze for all senior management including executive directors. The difference in CEO base salary single figure reflects effect of full year of 2015 increase introduced in April 2015.

Allowances and benefits

Travel benefits comprise company car, car allowance, private use of a driver and reimbursements of a taxable nature resulting from business travel and engagements. Health benefits comprise healthcare, health assessment and gym subsidy. Risk benefits comprise additional life cover and long-term disability insurance. In addition to the above benefits and allowances, executive directors may also participate in company benefit or policy arrangements that have no taxable value.

Annual incentives

For more detail, see table below. Annual incentives for the directors are funded by Pearson global annual financial and non-financial KPIs, and pay-outs take into account individual performance against personal objectives. For more detail, see below.

Long-term incentives

The single figure of remuneration for 2016 includes all long-term incentive awards that were subject to a performance condition where the performance period ended, or was substantially (but not fully) completed, at 31 December 2016, and awards where the performance condition has been satisfied but where the release of shares is subject to a further holding period. The same methodology has been applied for the single figure of remuneration for 2015. In 2016, the performance conditions for the 2014 Long-Term Incentive Plan (LTIP) were not met and so this award will not vest in 2017.

Worldwide Save For Shares

No share options became exercisable during 2016.

Executive directors' annual incentive payments in 2016

As explained in last year's directors' remuneration report, the on-target funding for the 2016 AIP was cut significantly compared to 2015 (a cut of circa one third).

Above threshold performance on a number of measures, including Group EPS, operating profit and operating cash flow, meant that there was a calculated achievement of 55% of base salary for the CEO and 47% of base salary for the CFO. This is on a like-for-like exchange rate; i.e. there is no foreign exchange benefit passed through.

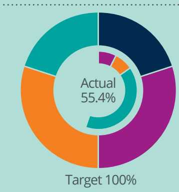
The remuneration committee rigorously reviewed all the AIP performance targets for 2016 given the results outcome. We concluded that the targets had been set on a reasonable basis and that these outcomes reflected annual achievement towards the lower end of guidance for relevant performance indicators. We also assessed the quality of cost reductions and the manner in which the financial targets had been met. We noted that the cost reductions had not compromised the company's increasing investment in digital products and services and that they were contributing to a more efficient and aligned business.

Notwithstanding this, discretion has been exercised to reduce the total AIP funding by 20%. This results in a CEO pay-out reduction from 55% to 44% of base salary and a CFO reduction from 47% to 37% of base salary. This represents 24% and 22% of maximum AIP opportunity for the CEO and CFO respectively.

For 2016, annual incentives were funded by Pearson global annual financial results based on the performance measures set out below. Individual pay-outs take into account performance against personal objectives. Actual performance against the financial targets for 2016, and the respective AIP pool funding level, were as follows:

Measures	Target funding	Threshold for 2016	Target for 2016	Maximum for 2016	Actual performance in 2016	Funding in 2016 (% of target)
Group sales (£m)	20%	4,622	4,895	4,958	4,552	0.0%
Operating profit after restructuring (£m)	30%	226	426	506	284	7.5%
Group EPS (p)	30%	52.1	70.3	77.7	57.6	7.9%
Operating cash flow after restructuring (£m)	20%	219	410	492	496	40.0%
Total	100%					55.4%

Weighting ratio



Executive director	Group funding	Adjusted funding	Target AIP as % of salary	Actual % of salary in 2016	% of maximum AIP for 2016	Final payout in 2016 (000s)
John Fallon	55%	44%	100%	44%	24%	£343,332
Coram Williams	55%	44%	85%	37%	22%	£192,610
Total						£535,942

Note 1: To align the AIP with the specific restructuring achievements required in 2016, operating profit after the cost of restructuring was added to the metrics with a 30% weighting.

Note 2: As operating cash flow after restructuring exceeded the stretch target, this element achieved a calculated maximum pay-out.

Note 3: Targets shown like-for-like with actual performance, based on actual exchange rates for 2016 and constant portfolio.

Note 4: Actual performance figures in the table above do not reconcile to those elsewhere in the report and accounts as they include adjustments that would be needed to reflect further bonus accruals should the calculated pay-out level have been awarded.

Long-term incentives

The status of outstanding awards under the Long-Term Incentive Plan (LTIP) and performance against the performance conditions as at 31 December 2016 are described in the table below. For each executive director, details of awards under the LTIP that were awarded, vested, released, lapsed or held during 2016 and notes to this table and the following table are provided overleaf.

Status of outstanding awards under the Long-Term Incentive Plan

Long-Term Incentive Plan (LTIP)

Date of award	Share price on date of award	Vesting date	Performance measures	Weighting	Performance period	Pay-out at threshold	Pay-out at maximum	Actual performance	% of award vested	Status
3 May 2016	805.0p	3 May 2019	Relative TSR	1/6	1 Jan 2016 to 31 Dec 2018	25% at median	100% at upper quartile	–	–	Outstanding subject to performance
			ROIC	1/3	2018	25% for ROIC of 5.5%	100% for ROIC of 6.7%			
			EPS	1/2	2018	25% for EPS 61.4p	25% for EPS 78.3p			
1 May 2015 (1 Aug 2015)	1,337.0p	1 May 2018 (1 Aug 2018)	Relative TSR	1/6	1 Jan 2015 to 31 Dec 2017	25% at median	100% at upper quartile	–	–	Outstanding subject to performance
			ROIC	1/3	2017	25% for ROIC of 6.5%	100% for ROIC of 7.5%			
			EPS growth	1/2	2017 compared with 2014	25% for EPS growth of 6.0%	100% for EPS growth of 12.0%			
1 May 2014	1,102.0p	1 May 2017	Relative TSR	1/6	1 Jan 2014 to 31 Dec 2016	30% at median	100% at upper quartile	31st percentile	Nil	Estimated to lapse in 2017
			ROIC	1/3	2016	30% for ROIC of 6.5%	100% for ROIC of 7.5%	5.0%	Nil	Will lapse in 2017
			EPS growth	1/2	2016 compared with 2013	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	-5.7%	Nil	Will lapse in 2017

Note 1 As noted in the 2015 report, the final Annual Bonus Share Matching Plan (ABSMP) award lapsed in 2016.

Note 2 2016 LTIP award targets linked to market guidance issued January 2016.

Remuneration report

Movements in directors' interests in share awards during 2016

Plan	Date of award	Vesting date	Number of shares as at 1 Jan 2016	Awarded	Released	Dividends awarded and released	Lapsed	Number of shares as at 31 Dec 2016	Status
John Fallon									
LTIP	3 May 2016	3 May 2019	0	383,000				383,000	Outstanding subject to performance
	1 May 2015	1 May 2018	230,000					230,000	Outstanding subject to performance
	1 May 2014	1 May 2017	274,000				274,000	0	Expected to lapse in 2017
Total			**504,000**	**383,000**	**0**	**0**	**274,000**	**613,000**	
Coram Williams									
LTIP	3 May 2016	3 May 2019	0	222,000				222,000	Outstanding subject to performance
	1 Aug 2015	1 Aug 2018	129,000					129,000	Outstanding subject to performance
Total			**129,000**	**222,000**	**0**	**0**	**0**	**351,000**	

Note 1: For all awards, Pearson's reported financial results for the relevant period were used to measure performance and no discretion has been exercised.

Note 2: Vested means where awards are no longer subject to performance conditions. Released means where shares have been transferred to participants. Held means where awards have vested but shares are held pending release on the relevant anniversary of the award date. Outstanding means awards that have been granted but are still subject to the achievement of performance conditions. Dividends refers to dividend equivalent shares that have been added without performance conditions to vested shares under the LTIP and released immediately on award.

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

Note 4: TSR is measured relative to the constituents of the FTSE World Media Index over a three-year period.

Note 5: The 2014 award is expected to lapse, subject to confirmation of the TSR outcome.

Note 6: The value of shares included in the single figure of remuneration is the number of shares multiplied by the share price on release.

Note 7: Coram Williams' 2015 award was made on his appointment to the board on 1 August 2015 and will vest three years from this date on 1 August 2018, subject to the same performance conditions and holding periods as for other executives.

Note 8: The value of the LTIP awards in 2016 for the executive directors is shown below, based on the relevant (spot rate) share price on the date of award also shown:

Director	Date of award	Vesting date	Number of shares	Face value	Face value (% of base salary)	Value for threshold performance (% of 2016 salary)	Share price at date of award
John Fallon	**3 May 16**	**3 May 19**	**383,000**	**£3,083,150**	**395%**	**99%**	**805.0p**
Coram Williams	**3 May 16**	**3 May 19**	**222,000**	**£1,787,100**	**347%**	**87%**	**805.0p**

Movements in directors' interests in share options during 2016

John Fallon also holds options under the Worldwide Save For Shares plan as follows:

Director	Date of grant	Number of shares under option held as at 31 Dec 2016	Option price	Earliest exercise date	Expiry date	Vesting in 2016 single figure £
John Fallon	**30 Apr 2014**	**1,109**	**811.2p**	**1 Aug 2017**	**1 Feb 2018**	**0**

Note 1: No variations to terms and conditions of share options were made during the year.

Note 2: Acquisition of shares under the Worldwide Save For Shares plan is not subject to a performance condition.

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 £000	Other pension costs to the company over the period £000	Other allowances in lieu of pension £000	Total annual value in 2016 £000	Normal retirement age	Accrued pension at 31 Dec 16 £000
John Fallon	107	–	203	310	62	96
Coram Williams	47	–	–	47	62	28

Note 1: The accrued pension at 31 December 2016 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2016. It relates to the pension payable from the UK plan.

Note 2: The value of defined benefit over the period comprises the defined benefit input value, less inflation, less individual contribution.

Note 3: Other pension costs to the company over the period comprise contributions to defined contribution arrangements for UK benefits.

Note 4: Other allowances in lieu of pension represent the cash allowances paid in lieu of the previous FURBS arrangements.

Note 5: Total annual value is the sum of the previous three columns.

Plans

John Fallon – Pearson Group Pension Plan

Accrual rate of 1/30th of pensionable salary per annum, restricted to the plan earnings cap (£150,600 per annum in 2016/17). In addition, he received a taxable and non-pensionable cash supplement. There are no enhanced early retirement benefits.

Coram Williams – Pearson Group Pension Plan

Accrual rate of 1/60th of pensionable salary per annum , restricted to the plan earnings cap (£150,600 per annum in 2016/17), with continuous service with a service gap. There are no enhanced early retirement benefits.

Chairman and non-executive director remuneration

The remuneration paid to the chairman and non-executive directors in respect of the financial years ended 31 December 2016 and 31 December 2015 are as follows:

	2016						2015					
Director £000s	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total
Sidney Taurel	500	–	–	–	16	516	–	–	–	–	–	–
Elizabeth Corley	70	22	–	–	0	92	70	15	3	–	1	89
Vivienne Cox	70	10	25	22	3	130	70	10	25	22	5	132
Josh Lewis	70	–	15	–	10	95	70	–	10	–	12	92
Linda Lorimer	70	–	20	–	4	94	70	–	20	–	7	97
Harish Manwani	70	–	5	–	3	78	70	–	5	–	5	80
Tim Score	70	28	10	–	3	111	70	19	7	–	1	97
Lincoln Wallen	70	–	13	–	3	86	–	–	–	–	–	–
Total	990	60	88	22	42	1,202	420	44	70	22	31	587

Note: Taxable benefits refer to travel, accommodation and subsistence expenses incurred while attending board meetings during 2016 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.

Payments to former directors

There were no payments made to former directors in 2016.

Payments for loss of office

There were no payments for loss of office made to or agreed for directors in 2016.

Remuneration report

Directors' interests in shares and value of shareholdings

Directors' interests

The share interests of the directors and their connected persons are as follows:

Director	Ordinary shares at 31 Dec 16	Conditional shares at 31 Dec 16	Total number of ordinary and conditional shares at 31 Dec 16	Current shareholding	Current value (% salary)	Guideline (% salary)	Guideline met
Chairman							
Sidney Taurel	50,000	–	–	50,000	–	–	–
Executive directors							
John Fallon	303,056	613,000	916,056	303,056	265%	300%	Yes(see note)
Coram Williams	10,010	351,000	361,010	10,010	13%	200%	n/a
Non-executive directors							
Elizabeth Corley	3,956			3,956			
Vivienne Cox	3,980	–		3,980	–	–	–
Josh Lewis	9,214	–		9,214	–	–	–
Linda Lorimer	4,099	–		4,099	–	–	–
Harish Manwani	5,393	–		5,393	–	–	–
Tim Score	7,990	–		7,990	–	–	–
Lincoln Wallen	1,903			1,903			

Note 1: Conditional shares means unvested shares which remain subject to performance conditions and continuing employment for a pre-defined period.

Note 2: The current value of the executive directors' current shareholdings is based on the closing market value of Pearson shares of 682.0p on 1 March 2017 against base salaries at 31 December 2016. The shareholding guidelines do not apply to the chairman and non-executive directors.

Note 3: 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 4: The market price on 31 December 2016 was 818.5p per share and the range during the year was 657.5p to 975p.

Note 5: Coram Williams has five years from the date of his appointment as an executive director to reach the shareholding guideline.

Note 6: Ordinary shares do not include any shares vested but held pending release under a restricted share plan.

Note 7: John Fallon has met the shareholding guideline. However, as a result of the decrease in share price in January 2017, the current value of his shareholding is less than 300% of salary. He has not sold any shares during 2016 and the number of ordinary shares held has increased from 293,056 at 31 December 2015.

Interests of directors and value of shareholdings £

● Ordinary shares ● Conditional shares ▲ Shareholding guideline

Shareholding guidelines

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership and to align further the interests of executives and shareholders. With effect from 2014, target holding is 300% of salary for the chief executive and 200% of salary for the other executive directors. Shares that count towards these guidelines include any shares held unencumbered by the executive, 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. With effect from 2014, these guidelines were extended to include all members of the Pearson executive management at 100% of salary.

Once met, the guideline is not re-tested, other than when shares are sold.

The shareholding guidelines do not apply to the chairman and non-executive directors. However, a minimum of 25% of the basic non-executive directors' fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

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 Long-Term Incentive Plan, 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. At 31 December 2016, stock awards to be satisfied by new-issue equity granted in the last ten years under all Pearson share plans amounted to 1.9% of the company's issued share capital. No stock awards granted in the last ten years under executive or discretionary share plans will be satisfied by new-issue equity. In addition, for existing shares, no more than 5% of Pearson equity may be held in trust at any time. Against this limit, shares held in trust at 31 December 2016 amounted to 0.9% of the company's issued share capital. The headroom available for all Pearson plans, executive or discretionary, and shares held in trust is as follows:

Headroom	2016	2015	2014
All Pearson plans	**8.1%**	8.4%	8.3%
Executive or discretionary plans	**5.0%**	5.0%	5.0%
Shares held in trust	**4.1%**	4.2%	4.1%

Executive directors' non-executive directorships

Coram Williams is engaged as a NED of Guardian Media Group plc under a letter of appointment dated 14 December 2016. Although he formally joined the board on 26 January 2017 his remuneration is payable from 1 January 2017 recognising time spent in preparation and induction. His remuneration is at the rate of £34,000 p.a., rising to £39,000 p.a. from 1 April 2017 when he will become chair of the audit committee. In accordance with our policy, Coram is permitted to retain these fees.

Historical performance and remuneration

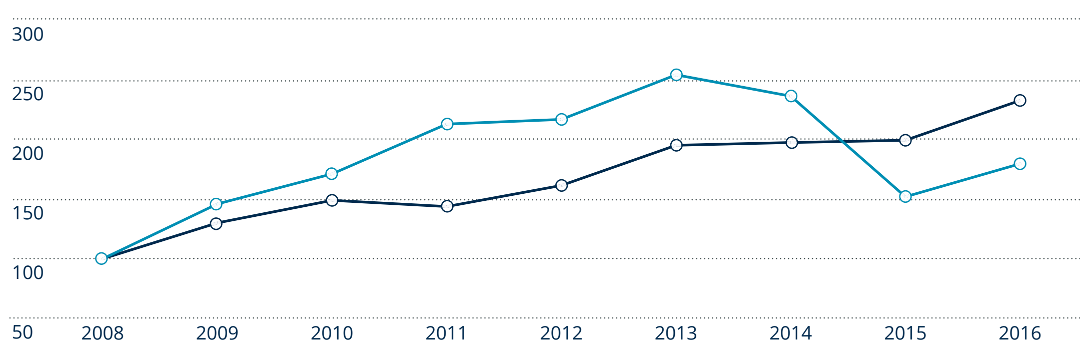
Total shareholder return performance

We set out below Pearson's total shareholder return (TSR) performance relative to the FTSE All-Share index on an annual basis over the eight-year period 2008 to 2016. This comparison has been chosen because the FTSE All-Share represents the broad market index within which Pearson shares are traded. TSR is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends (source: DataStream).

In accordance with the reporting regulations, this section also presents Pearson's TSR performance alongside the single figure of total remuneration for the CEO over the last eight years and a summary of the variable pay outcomes relative to the prevailing maximum at the time. The table below summarises the total remuneration for the CEO over the last eight years, and the outcomes of annual and long-term incentive plans as a proportion of maximum.

Total shareholder return £

Pearson TSR
FTSE All-share TSR



CEO remuneration	Marjorie Scardino				John Fallon			
Total remuneration (single figure, £000s)	6,370	8,466	8,340	5,330	1,727	1,895	1,263	**1,518**
Annual incentive – incumbent (% of maximum)	91.3%	92.1%	75.7%	24.2%	34.3%	50.5%	Nil	**24.4%**
Long-term incentive – incumbent (% of maximum)	80.0%	97.5%	68.3%	36.7%	Nil	Nil	Nil	**Nil**

Annual incentive is the actual annual incentive received by the incumbent as a percentage of maximum opportunity.

Long-term incentive is the pay-out of performance related restricted shares under the Long-Term Incentive Plan 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 – John Fallon: John Fallon's total remuneration opportunity is lower than that of the previous incumbent. Variable pay-outs under the annual and Long-Term Incentive Plans reflect performance for the relevant periods.

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Comparative information

The following information is intended to provide additional context regarding the total remuneration for executive directors.

Relative percentage change in remuneration for CEO

The following table sets out the change between 2015 and 2016 in three elements of remuneration for the CEO, in comparison to the average for all employees. Whilst the committee reviews base pay for the CEO relative to the broader employee population, benefits are driven by local practices and eligibility is determined by level and individual circumstances which do not lend themselves to comparison.

Change in CEO remuneration 2015/16

Base salary	Allowances and benefits
no change	+37%
Annual incentives	**Total**
see note 4	+20%

Change in employee remuneration 2015/16

Base salary	Allowances and benefits
+1%	+7%
Annual incentives	**Total**
+55%	+5%

Note 1 The figures for all employees reflect average salaries and average employee numbers each year at constant exchange rates. Annual incentives include all plans, including sales incentives.

Note 2 The difference in CEO base salary single figure reflects effect of full year of 2015 increase introduced in April 2015. No increase in 2016.

Note 3 CEO allowances and benefits change reflects increase in cost of car benefit and travel expenses of c.£20,000 over 2015.

Note 4 As there was no AIP paid in 2015, relative percentage change for the CEO is incalculable.

Note 5 The increase in allowances and benefits on an average employee basis is inflated by a change in population post-restructuring.

Note 6 As there was no AIP paid in 2015, relative percentage change for employees reflects 2016 Group-wide bonus pay-outs versus a small selection of local plans in 2015.

Relative importance of pay spend

The committee considers directors' remuneration in the context of the company's allocation and disbursement of resources to different stakeholders. In particular, we chose 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.

			Change	
All figures in £ millions	2016	2015	£m	%
Operating profit	**635**	723	-88	**-12%**
Dividends	**424**	423	1	**0%**
Total wages and salaries	**1,661**	1,507	154	**10%**

Note 1: 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 2016 were 32,719 (2015: 37,265). Further details are set out in note 5 to the financial statements on p141.

Note 3: Total wages and salaries would be -1% at constant exchange rates. Excluding redundancies and bonuses this would be -12% at constant exchange rates.

2017 remuneration policy

The remuneration committee presents the 2017 directors' remuneration policy (2017 policy), which will be put to shareholders for binding vote at the Annual General Meeting to be held on 5 May 2017. Subject to shareholder approval, the effective date of this policy will be 5 May 2017. However, it is proposed, subject to approval at the AGM, that changes to executive director incentives be made effective from the start of the 2017 performance periods. The intention of the committee is that the policy will remain in place for three years from the date of its approval.

We have evolved our remuneration policy to match our updated remuneration principles:

1 Sustainability and affordability

Funded through results; strong link to sustainable performance, cost control and appropriate capital allocation.

2 Pay for performance

Pay mix focuses on variable pay; aligned fully with KPIs: EPS; operating profit; sales; operating cash flow; total shareholder return and return on invested capital.

3 Flexibility

Performance metrics linked to strategic imperatives can be selected annually to give us the agility to "move more quickly" in support of Pearson's transformation strategy.

4 Alignment

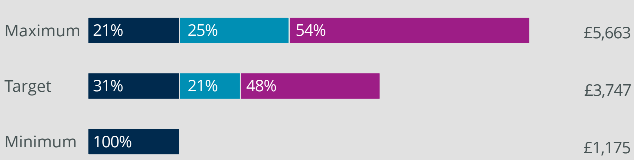
Incentive plans are designed to reflect sustainable value creation in our drive for growth and efficiency through "becoming a simpler, more focused business".

5 Reward for sustainable company performance

Stretching financial and strategic business imperative metrics support delivery of strategy.

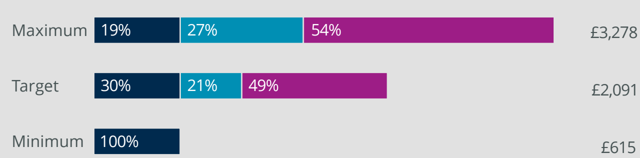
Pay and performance scenario analysis

Chief executive officer (John Fallon) £000



- Base salary, allowances, benefits and pension
- Annual incentive
- Long-term incentives

Chief financial officer (Coram Williams) £000

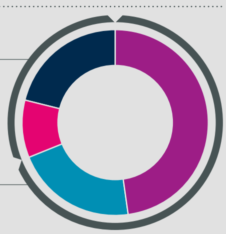


- Base salary, allowances, benefits and pension
- Annual incentive
- Long-term incentives

CEO fixed vs variable at target

Fixed
- Base salary 21%
- Pension and benefits 10%

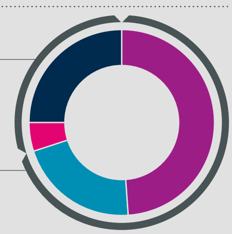
Variable
- Annual incentive 21%
- Long-term incentives 48%



CFO fixed vs variable at target

Fixed
- Base salary 25%
- Pension and benefits 5%

Variable
- Annual incentive 21%
- Long-term incentives 49%



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 2017 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 officer 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.

Performance scenario	Elements of remuneration and assumptions
Maximum	2017 base salary; allowances, benefits and retirement benefits at the same percentage of base salary as in 2016; maximum individual annual incentive as per policy; maximum value of 2016 long-term incentive award
Target	2017 base salary; allowances, benefits and retirement benefits at the same percentage of base salary as in 2016; target individual annual incentive as per policy; target value of 2016 long-term incentive award (Willis Towers Watson's independent assessment of the expected value of the award i.e. the net present value taking into account all the conditions)
Minimum	2017 base salary; allowances, benefits and retirement benefits at the same percentage of base salary as in 2016; no annual or long-term incentives

Note The value of long-term incentives does not take into account dividend awards that are payable on the release of restricted shares nor any changes in share price. Nor does this infer a precedent for future LTIP awards in 2017 onwards which will be implementation decisions in each year. See p106 for more information on 2017 awards.

Remuneration policy

Future policy table for executive directors

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different strategic objectives. Total remuneration is normally reviewed annually in the context of business performance and conditions prevailing, and is routinely benchmarked against total remuneration for similar positions in comparable companies.

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 may be set in sterling or the local currency of the country in which the director is based.

Base salaries are normally reviewed annually for the following year 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; and individual performance.

For benchmarking purposes, we review remuneration by reference to different comparator groups. We look at survey data from: select UK human capital intensive businesses; and UK and US 'media convergence' companies with a focus on digital, information services and technology. These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Willis Towers Watson, use to make comparisons on remuneration takes this variation in size into account. We also look at publicly disclosed and proxy data for global media convergence comparators with a focus on media and technology and consider base salary levels within the broader FTSE 100. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

Base salaries are paid in cash via the regular employee payroll (monthly in the UK and every two weeks in the US) and are subject to all necessary withholdings.

No malus or clawback provisions apply to base salary.

Opportunity

Base salary increases for executive directors will not ordinarily exceed 10% per annum and will take account of the base salary increases elsewhere within the company.

The committee will retain the discretion to deliver base salary increases up to 25% over the normal maximum limit in specific individual situations including internal promotions and material changes to the business or the role. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favour among those consulted.

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.

There is no relevant performance period.

Allowances and benefits

Purpose and link to strategy

- Help to recruit and retain.
- Reflect local competitive market.

Operation

Allowances and benefits comprise cash allowances and non-cash benefits and inter alia include: travel-related benefits (comprising company car, car allowance and private use of a driver); health-related benefits (comprising healthcare, health assessment and gym subsidy); and risk benefits (comprising additional life cover and long-term disability insurance that are not covered by the company's retirement plans). Allowances may also include, where appropriate, location and market premium and housing allowance although no continuing director is in receipt of such allowances. Allowances and benefits received in 2016 are set out in the annual remuneration report.

Directors are also covered by the company's directors' and officers' liability insurance and an indemnity in respect of certain third-party liabilities.

Other benefits may be offered on the same terms as to other employees.

Allowances and benefits do not form part of pensionable earnings.

No malus or clawback provisions apply to allowances and benefits.

Opportunity

The provision and level of cash allowances and non-cash benefits are competitive and appropriate in the context of the local market.

The total value of cash allowances and non-cash benefits for executive directors will not ordinarily exceed 15% of base salary in any year, other than in the case of increases in the cost of benefits that are outside Pearson's control and changes in benefit providers. The committee will retain the further discretion to deliver a total value of benefits up to 25% above the normal limit in specific individual situations including changes in individual circumstances such as health status and changes in the role such as relocation. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favour among those consulted.

Executive directors are also eligible to participate in savings-related share acquisition programmes in the UK, US and rest of world, which are not subject to any performance conditions, on the same terms as other employees.

Performance conditions and period

None.

There is no relevant performance period.

Retirement benefits

Purpose and link to strategy

- Help to recruit and retain.
- Recognise long-term commitment to the company.

Operation

New employees in the UK are eligible to join the Money Purchase 2003 section of the Pearson Group Pension Plan.

Under the Money Purchase 2003 section of the Pearson Group Pension Plan, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the company and the employee make contributions into a pension fund. Account balances are used to provide benefits at retirement. Pensions for a member's spouse, dependent children and/or nominated financial dependants are payable on death.

Depending on when they joined the company, directors may participate in the Final Pay section of the Pearson Group Pension Plan, which is closed to new members.

Under the Final Pay section of the Pearson Group Pension Plan, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the employee makes a contribution of 5% of pensionable salary and the pension fund builds up based on final pensionable salary and pensionable service. The accrued pension is reduced on retirement prior to age 60. Pensions for a member's spouse, dependent children and/or nominated financial dependants are payable on death.

Executive directors may be entitled to additional pension benefits to take account of the cap on the amount of benefits that can be provided from the all-employee pension arrangements in the UK.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at 6 April 2006, was abolished by the Finance Act 2004. However, the Pearson Group Pension Plan has retained its own 'cap', which will increase annually in line with the UK government's Retail Prices Index (All Items). The cap was £150,600 as at 6 April 2016.

UK executive directors who are, or become, affected by the lifetime allowance or new hires who opt out of membership of the plan may be provided with a cash supplement of normally up to 26% of salary as an alternative to further accrual of pension benefits.

No malus or clawback provisions apply to retirement benefits.

Opportunity

In the UK, company contributions for eligible employees to the Money Purchase 2003 section of the Pearson Group Pension Plan amount up to 16% of pensionable salary (double the amount of the employee contribution, which is limited according to certain age bands).

John Fallon is a member of the Final Pay section of the Pearson Group 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.

The company has no ongoing financial liabilities in respect of the FURBS.

Coram Williams is a member of the Final Pay section of the Pearson Group Pension Plan with continuous service with a service gap. His pension accrual rate is 1/60th of pensionable salary per annum, restricted to the plan earnings cap.

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 will 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.

Performance conditions and period

None.

There is no relevant performance period.

Remuneration policy

Annual incentives

Purpose and link to strategy

- Motivate the achievement of annual business goals and personal objectives.
- Provide a focus on key financial metrics.
- Reward individual contribution to the success of the company.
- Align to strategy execution priorities.

Operation

Annual incentive does not form part of pensionable earnings.

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.

The plan is designed to incentivise and reward underlying performance. Actual results are 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.

Annual incentive plans are discretionary. The committee reserves the right to adjust payments up or down before they are made if it believes exceptional factors warrant doing so. The committee may in exceptional circumstances make a special award where it is satisfied that the normal operation of the annual incentive does not provide an appropriate incentive or reward to participants.

The committee also reserves the right as a form of malus to adjust payments before they are made if special circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.

The committee also reserves, in the same special circumstances, a right to reclaim or claw back payments or awards that have already been made.

Opportunity

Annual incentives will not exceed 200% of base salary.

For the chief executive officer, the individual maximum incentive opportunity that will apply for 2017 is 180% of base salary and 170% for the chief financial officer (which are the same opportunities as applied for 2016).

There is normally no pay-out for performance at threshold.

Performance conditions and period

The committee has the discretion to select the performance measures, targets and relative weightings from year to year to ensure continuing alignment with strategy and to ensure targets are sufficiently stretching.

The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the annual incentive pays out in full.

The funding of annual incentives will normally be related to the performance against financial and strategic imperatives performance targets. For 2017 and onwards, financial metrics will normally account for at least 75% of the total annual opportunity and be related to the performance against targets for Pearson's adjusted earnings per share and/or operating profit, sales, and operating cash flow. For 2017, the weightings will be: adjusted earnings per share 22.5%, operating profit 22.5%, sales 15% and operating cash flow 15%. The remaining total annual opportunity will be subject to performance metrics linked to strategic imperatives set by the committee as it considers appropriate in each year. These will be linked to:

Strategic imperatives

KPI
Competitive performance › Holding or gaining share in major markets › Higher Education direct/ecommerce sales to consumers
Transformation › Delivery of Enabling Programme milestones to upgrade the customer experience, accelerate the digital transformation and the delivery of on-going cost, efficiency and process transformations
Culture, talent & brand › Improvement in brand favourability and year-on-year improvement in employee engagement survey scores

Each metric will be measured, using third party data or externally audited internal data (where third party data is not available or applicable).

Performance metrics linked to strategic imperatives can be selected annually to support Pearson's transformation strategy.

A pay-out will only be made if a minimum level of performance has been achieved under the financial metrics, as determined by the committee each year.

Annual incentive pay-outs will also take into account individual performance against personal objectives. Personal objectives are agreed with the chief executive (or, in the case of the chief executive, the chairman) and may be functional, operational, strategic and non-financial and include, inter alia, objectives relating to environmental, social and governance issues.

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.

Long-term incentives

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 restricted shares are made on an annual basis.

Awards of restricted shares for executive directors vest on a sliding scale based on performance against stretching corporate performance targets measured at the end of the three-year performance period.

Performance will continue to be tested over three years and 75% of the vested shares will be released at that point. However, there is a mandatory restriction on participants' ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further two years. Furthermore, participants' rights to the release of the 25% of the vested shares will be subject to continued employment over the same period.

Where shares vest, participants also receive additional shares representing the gross value of dividends that would have been paid on these shares during the performance period and reinvested.

The plan permits awards of restricted shares to be made that are not subject to performance conditions to satisfy reward and retention objectives. However, other than in the circumstances described in the recruitment section of this policy below, it is the company's policy not to award restricted shares to executive directors without performance conditions.

The Long-Term Incentive Plan also provides for the grant of stock options. While it is not the committee's intention to grant stock options in 2017 or the foreseeable future, the committee believes that it should retain the flexibility of granting stock options in addition to, or instead of, restricted stock awards in the right circumstances. Any decision by the committee to grant stock options in the future would take account of best practice prevailing at the time. The committee would consult with shareholders before granting stock options to executive directors.

Pearson's reported financial results for the relevant periods are used to measure performance.

The committee reserves the right to adjust pay-outs up or down before they are released taking into account exceptional factors that distort underlying business performance or if it believes exceptional factors warrant doing so. In making such adjustments, the committee is guided by the principle of aligning shareholder and management interests.

The committee also reserves the right as a form of malus to adjust pay-outs before they are released if exceptional circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.

The committee also reserves, in the same special circumstances, a right to reclaim or claw back payouts or awards that have already been released.

Opportunity

We set the level of individual awards by taking into account:

- The face value of individual awards at the time of grant, assuming that performance targets are met in full
- Market practice for comparable companies and market assessments of total remuneration from our independent advisers
- Individual roles and responsibilities
- Company and individual performance.

Restricted share awards to executive directors may normally be made up to a maximum face value of 400% of base salary. Awards in excess of 400% of base salary (and up to 25% over the normal maximum limit) may be made in exceptional circumstances, for example, for retention purposes or to reflect particular business situations. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favour among those consulted.

The committee retains flexibility to make exceptional awards of up to 25% above the normal limit in specific circumstances. The reasons for any such exceptional awards will be disclosed in the annual report for the year in which they are made.

The value of awards at pay-out is subject to the extent to which performance and any other conditions are met and the share price at the time of vesting.

While it is not the committee's intention to grant stock options in 2017 or the foreseeable future, the maximum value of stock option awards would be the equivalent expected value of, and in place of, the maximum restricted share awards set out above, based on an independent assessment of their net present value taking into account all the conditions.

Performance conditions and period

The committee will determine the performance measures, weightings and targets governing an award of restricted 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 pay-out is achieved and a maximum at or above which the award pays out in full. The proportion of the award that vests at threshold level of performance under each performance condition is 25%.

For 2017 and onwards, awards will normally be subject to the achievement of targets for earnings per share, return on invested capital and relative total shareholder return. For 2017, and following shareholder consultation, the weighting of the performance metrics within the Pearson Long-Term Incentive Plan will be changed to 40% earnings per share, 30% return on invested capital and 30% relative total shareholder return (previously, one half, one third and one sixth, respectively).

As with restricted shares, the committee will determine the performance conditions that apply to any awards of stock options prior to grant. The intention would be that these conditions would be the same as apply to restricted shares.

Total shareholder return (TSR) is the return to shareholders from any growth in Pearson's share price and reinvested dividends over the performance period. For long-term incentive awards made in 2017 and onwards, TSR will be measured relative to the constituents of the FTSE 100 over a three-year period. Companies that drop out of the index are normally excluded i.e. only companies in the index for the entire period are counted. Share price is averaged over three months at the start and end of the performance period. Dividends are treated as reinvested on the ex-dividend date, in line with the Datastream methodology. The vesting of shares based on relative TSR is subject to the committee satisfying itself that the recorded TSR is a genuine reflection of the underlying financial performance of the business.

Return on invested capital (ROIC) is adjusted operating profit less cash tax expressed as a percentage of gross invested capital (net operating assets plus gross goodwill).

Adjusted earnings per share (EPS) is calculated by dividing the adjusted earnings attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding any ordinary shares purchased by the company and held in trust (see note 8 of the consolidated financial statements for a detailed description of adjusted earnings per share).

The performance period is three years.

Remuneration policy

Notes to the policy table

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.

In the case of annual incentives, the committee identified sales, earnings per share, 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.

In the case of long-term incentives, the committee judged the following to be most closely matched to sustained delivery of strategy and alignment with shareholders' interests: earnings per share rewards the delivery of the desired outcomes from our strategic growth objectives and is imperative if we are 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. We selected total shareholder return relative to the constituents of the FTSE 100 because, in line with many of our shareholders, we considered that part of executive directors' rewards should be linked to 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.

Pre-existing commitments

In addition to the remuneration arrangements described above, Pearson's policy is to honour all pre-existing obligations, commitments or other entitlements that were entered into before the effective date of this policy, including those entered into at a time when the relevant individual was not a director of Pearson or when the terms of those arrangements were consistent with the shareholder approved directors' remuneration policy then in force.

Remuneration policy for other employees

The approach to remuneration for the broader employee population varies by level and geography, but is broadly consistent with that of directors:

- 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
- As part of their overall retirement arrangements, executive directors participate in the same underlying pension arrangements that have been set up for other Pearson employees in the UK
- Many employees participate in some form of cash-based annual incentive, bonus, profit-share or sales commission plan based on annual performance targets and selected senior employees are also eligible to receive share awards. Incentive plans for the Pearson executive management team form the basis of the incentive plans throughout the organisation in the principal operating companies and establish performance measures and standards and set the ceiling for individual incentive opportunities
- Approximately 5% of the company's employees below the Pearson executive management – selected on the basis of their role, performance and potential – currently hold performance or time-vesting shares under the Long-Term Incentive Plan
- All 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.

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.

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 existing employee of the company is promoted to the board, in which case the company will honour all existing contractual commitments including any outstanding share awards, benefit and pension entitlements
- 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 and housing allowance

- Where an individual would be forfeiting valuable variable remuneration in order to join the company, in which case the committee may award appropriate compensation. 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 light of the various legacy pension arrangements enjoyed by the incumbent executive directors, in determining the pension arrangements for any new recruit, the committee expects to offer a defined contribution arrangement with company contributions not exceeding those set out on p99 but would have regard to the recruit's existing arrangements, the market norms in the home country and the existing pension vehicles available within the company.

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.

Pearson expects any new chairman 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. However, in the case of the chairman, the committee may consider it appropriate to offer a remuneration package that differs from that of the existing incumbent if that is necessary to attract the most capable candidate or to reflect the individual's expected duties.

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 compensation in the event of a change of control of Pearson.

It is the company's policy that the company may terminate the chairman's and executive directors' service agreements by giving no more than 12 months' 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 chairman, payment in lieu of notice comprises 100% of the annual fees at the date of termination. In limited circumstances, in addition to making a full payment in lieu of notice, the company may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective hand-over and/or allow time for a successor to be appointed.

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.

On cessation of employment, save as 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:

- Awards that are subject to performance conditions will stay in force as if the participant had not ceased employment and shall vest on the original vesting date
- Awards that are not subject to a performance condition will be released as soon as practicable following cessation of employment
- 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.

On cessation of employment, executive directors, having been notified of participation in an annual incentive plan for the relevant financial year, 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 pay-out will normally be calculated in good faith on the same terms and paid at the same time as for continuing executive directors.

Remuneration policy

Eligibility for allowances and benefits including retirement benefits normally ceases on retirement or on the termination of employment for any other reason.

The rules of Pearson's discretionary share plans 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.

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.

Individual service agreements

Position	Date of agreement	Notice periods	Compensation on termination of employment by the company without notice or cause
Chairman	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)	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 pay 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.

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

In accordance with the committee's charter and terms of reference, the committee's remit includes oversight of certain remuneration matters below that of the chief executive, the other executive directors and other members of the Pearson executive management team. 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 be aware of and respond to best practice guidelines of shareholders and their representative bodies.

In November 2016 we wrote to our key shareholders and the voting advisory agencies, seeking their views on the proposed changes to Pearson's remuneration policy.

The chairman of the Remuneration Committee met or corresponded with a number of our shareholders to understand better their views on our proposals and to answer their questions on why the proposed changes were appropriate.

We received valuable feedback on a number of points, which reflected a significant range of opinions. These matters have been addressed in this policy report.

We are committed to continued engagement going forward and where it concerns the implementation of this policy.

Future policy table for chairman's and non-executive directors' remuneration

The table below summarises policy with respect to the remuneration of the chairman and non-executive directors:

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

The chairman is paid a single fee for all of his responsibilities.

The chairman's fee is set at a level that is competitive with those of chairmen in similar positions in comparable companies. The chairman is not entitled to any annual or long-term incentive, retirement or other employee benefits.

The non-executive directors are paid a basic fee. The chairmen and members of the main board committees and the senior independent director are paid an additional fee to reflect their extra responsibilities. Following a review of the structure of the fees paid to non-executive directors, the board has determined that it would be appropriate to introduce additional fees for membership and chairmanship of the nomination & governance committee. Having taken independent advice from Willis Towers Watson, the fee that has been set by the board reflects the median level within the FTSE 100.

The chairman and the non-executive directors are covered by the company's normal arrangements for directors' and officers' liability insurance and an indemnity in respect of certain third-party liabilities.

The company reimburses the chairman's and non-executive directors' travel and other business expenses and any tax incurred thereon, if applicable.

A minimum of 25% of the chairman'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 acquired quarterly at the prevailing market price with the individual after-tax fee payments.

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

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.

Opportunity

The chairman's fees were reviewed in 2017 and have not been increased since his appointment. Fees for the non-executive directors were last increased with effect from 1 May 2014. Following a review of fees paid to non-executive directors, the board has determined that most fees will remain unchanged, other than a small increase to apply to membership and chairmanship of the reputation & responsibility committee. A fee has also been introduced for the newly formed nomination & governance committee. These changes will take effect from the AGM on 5 May 2017, subject to the approval of this policy.

The structure of non-executive directors' fees with effect from the date of this policy is as follows:

Director	Fee
Non-executive director	£70,000
Chairmanship of audit committee	£27,500
Chairmanship of remuneration committee	£22,000
Chairmanship of reputation & responsibility committee	£10,000 (£13,000 with effect from AGM)
Chairmanship of nomination & governance committee	£15,000 (with effect from AGM)
Membership of audit committee	£15,000
Membership of remuneration committee	£10,000
Membership of reputation & responsibility committee	£5,000 (£6,000 with effect from AGM)
Membership of nomination & governance committee	£8,000 (with effect from AGM)
Senior independent director	£22,000

The maximum opportunity per director depends on individual duties or combination of duties in accordance with this structure. The total fees payable to the non-executive directors (excluding the chairman) 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.

The fee for the chairman remains unchanged at £500,000 per year.

Performance conditions

None.

Performance period

None.

Remuneration report

Information on changes to remuneration for 2017

The committee undertook a wholesale review of our remuneration policy during 2016 to assess whether it remained fit for purpose taking into account how the company has evolved since the policy was last approved in 2014. We first thought about philosophy and principles for the organisation as a whole and we then distilled this into policy for the executive directors and wider management. Central to the review was engaging with our largest shareholders and seeking their input on the future direction of policy. Some specific issues which impact 2017 implementation are described below.

Executive directors' base salaries

We have taken into account general economic and market conditions, specific company conditions, the level of increases made across the company as a whole, the remuneration of executives in similar positions in comparable companies and individual performance. While it is recognised that the CEO is substantially behind market the committee concluded that this was not a relevant consideration in the current trading environment. Base salaries for the CEO and CFO are therefore unchanged.

Annual incentive plan

The key design principles underlying the company's approach to annual incentives for 2017 are:

- A clear, transparent, coherent, consistent, organisation-wide approach to incentives and performance management with common principles for all business units and enabling functions and a strong focus on operational priorities that will drive successful achievement of our strategy
- Subject to shareholder approval of the new policy the AIP will operate in 2017 based on 75% financial metrics and 25% performance metrics linked to strategic imperatives.

Financial metrics will be weighted as follows: Group EPS (22.5%), › Operating profit (22.5%), Sales (15%), Operating cash-flow (15%).

Performance metrics linked to strategic imperatives will focus predominantly on competitive performance and transformation. Any pay out in respect of achievement of strategic imperatives will be subject to attaining a minimum level of performance on financial metrics.

The board considers the performance targets for 2017 to be commercially sensitive. Details of all performance measures, weightings and targets will be disclosed in the annual remuneration report for 2017 unless the committee determines that they remain commercially sensitive.

For the 2017 AIP, the proposed performance metrics linked to strategic imperatives would be drawn from three key areas, all aligned with milestones already tracked formally by the board in a periodic performance dashboard. Each metric would have KPIs against which to be measured, using third party data or externally audited internal data (where third party data is not available or applicable). See the remuneration overview on p87 for more detail on these metrics.

Long-term incentive plan

Subject to shareholder approval of the new policy the LTIP awards in 2017 will be contingent on the following metrics: Group EPS (40%), ROIC (30%), Relative TSR (30%).

The previous TSR comparator group of global media companies will be replaced with the companies comprising the FTSE 100 to ensure that it aligns better with Pearson following the sales of the Financial Times and our share in The Economist.

Performance will continue to be tested over three years and 75% of the vested shares will be released at that point. However, there remains a mandatory restriction on participants' ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further two years. Furthermore, participants' rights to the release of the remaining 25% of the vested shares will continue to be subject to continued employment over the same period.

At the time of writing, the committee has yet to approve the 2017 long-term incentive awards and the associated performance targets for the executive directors. These are expected to be determined at the May remuneration committee meeting.

In acknowledgment of the value erosion in the Pearson share price, the remuneration committee intends to reduce the volume of 2017 LTIP awards to the executive directors such that their value is materially lower than prior practice. The eventual scale of this reduction will be judged by reference to all relevant factors prevailing at the award date, including share price. The remuneration committee also notes that the re-weighted 30% TSR element is likely to be significantly out of the money on grant, due to the averaging period used to determine the start point, which is the three-month period to the end of December 2016. We will not be changing this methodology.

If current share price conditions were to continue, the committee might judge that the economic value of the 2017 LTIP grant would be reduced by circa 20-25%.

Full details of individual awards for the executive directors and the performance targets for 2017 will be set out in the annual remuneration report for 2017.

Chairman and non-executive directors

As already mentioned, there has been an evolution and strengthening of governance which has a modest remuneration policy impact. In line with other Pearson committees, and market practice, non-executive director fees for those on the Nomination & Governance Committee will be £15,000 for the committee chairman and £8,000 for committee membership. These will take effect from the date of the 2017 AGM.

Also, in response to the increase in responsibilities associated with the undertakings of the Reputation & Responsibility committee, the committee fees associated with chair and committee membership will increase to £13,000 (£10,000) and £6,000 (£5,000) respectively.

The aggregated increase in non-executive director fees associated with this further strengthening of governance will be in the region of £58,000 per annum.

The directors' remuneration report has been approved by the board on 14 March 2017 and signed on its behalf by:

Elizabeth Corley

Elizabeth Corley
Chairman of the remuneration committee.

Additional disclosures

Pages 58-110 of this document comprise the directors' report for the year ended 31 December 2016.

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 p55 the board has also reviewed the prospects of Pearson over the three-year period to December 2019 taking account of the company's strategic plans, a 'severe but plausible' downside case and further stress testing based on the principal risks set out on p47-55.

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 2019. Further details of the Group's liquidity are shown in Financial review (see p30-35).

Share capital

Details of share issues are given in note 27 to the consolidated financial statements on p173. 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 2016, 822,126,713 ordinary shares were in issue. At the AGM held on 29 April 2016, the company was authorised, subject to certain conditions, to acquire up to 82,162,378 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 5 May 2017.

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 2016, 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
BlackRock, Inc.	45,041,824	5.48%
Schroders plc	42,151,560	5.12%
Silchester International Investors LLP	41,437,136	5.04%
Ameriprise Financial, Inc. and its group	41,236,375	5.02%

Between 31 December 2016 and 14 March 2017, being the latest practicable date before the publication of this report, the company received further notifications under DTR 5, with the most recent positions being as follows:

- Schroders plc disclosed a holding of 11.17%
- BlackRock, Inc. disclosed a holding of 7.03%, including securities lending (2.36%) and CFD (0.13%)
- Lindsell Train Limited disclosed a holding of 5.035%.

Annual General Meeting

The notice convening the AGM, to be held at 12 noon on Friday, 5 May 2017 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 29 March 2017.

Registered auditors

In accordance with section 489 of the Act, a resolution proposing the reappointment of PricewaterhouseCoopers LLP (PwC) 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 chairman 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.

Additional disclosures

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 7,718,966 shares held as at 31 December 2016. 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 2,950,764 shares held in the Sharestore account and 403,153 shares held in the Global Nominee account as at 31 December 2016. The beneficial owners of shares held in Sharestore are invited to submit voting instructions online at www.shareview.co.uk and Global Nominee participants are invited to submit voting instructions by e-mail to nominee@equiniti.com. If no instructions are given by the beneficial owner by the date specified, the trustees holding these shares will not exercise the voting rights.

Transfer of shares

The board may refuse to register a transfer of a certificated share which is not fully paid, provided that the refusal does not prevent dealings in shares in the company from taking place on an open and proper basis. The board may also refuse to register a transfer of a certificated share unless: (i) the instrument of transfer is lodged, duly stamped (if stampable), at the registered office of the company or any other place decided by the board, and is accompanied by the certificate for the share to which it relates and such other evidence as the board may reasonably require to show the right of the transferor to make the transfer; (ii) it is in respect of only one class of shares; and (iii) it is in favour of not more than four transferees.

Transfers of uncertificated shares must be carried out using CREST and the board can refuse to register a transfer of an uncertificated share in accordance with the regulations governing the operation of CREST.

Variation of rights

If at any time the capital of the company is divided into different classes of shares, the special rights attaching to any class may be varied or revoked either:

(i) with the written consent of the holders of at least 75% in nominal value of the issued shares of the relevant class; or

(ii) with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of the relevant class.

Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any share may be issued with such preferred, deferred, or other special rights, or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the company may from time to time by ordinary resolution determine.

Appointment and replacement of directors

The Articles contain the following provisions in relation to directors:

Directors shall be no less than two in number. Directors may be appointed by the company by ordinary resolution or by the board. A director appointed by the board shall hold office only until the next AGM and shall then be eligible for reappointment, but shall not be taken into account in determining the directors or the number of directors who are to retire by rotation at that meeting. The board may from time to time appoint one or more directors to hold executive office with the company for such period (subject to the provisions of the Act) and upon such terms as the board may decide and may revoke or terminate any appointment so made.

The Articles provide that, at every AGM of the company, at least one-third of the directors shall retire by rotation (or, if their number is not a multiple of three, the number nearest to one-third). The first directors to retire by rotation shall be those who wish to retire and not offer themselves for re-election. Any further directors so to retire shall be those of the other directors subject to retirement by rotation who have been longest in office since they were last re-elected but, as between persons who became or were last re-elected on the same day, those to retire shall (unless they otherwise agree among themselves) be determined by lot. In addition, any director who would not otherwise be required to retire shall retire by rotation at the third AGM after they were last re-elected.

Notwithstanding the provisions of the Articles, the board has resolved that all directors should offer themselves for re-election annually, in accordance with the 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 company's Articles, the Act and any directions given by special resolution, the business of the company will be managed by the board who may exercise all the powers of the company, including powers relating to the issue and/or buying back of shares by the company (subject to any statutory restrictions or restrictions imposed by shareholders in general meeting).

Significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the company:

Under the $1,750,000,000 revolving credit facility agreement dated August 2014 which matures in August 2021 between, among others, the company, Barclays Bank plc (Agent) and the banks and financial institutions named therein as lenders (the Facility), 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.

Additional disclosures

Other statutory information

Other information that is required by the Companies Act 2006 (the Act) to be included in the directors' report, and which is incorporated by reference, can be located as follows:

Summary disclosures index	See more
Dividend recommendation	p34
Financial instruments and financial risk management	p160-162
Important events since year end	p35
Future development of the business	p6-27
Research and development activities	p18-19
Employment of disabled persons	p24
Employee involvement	p23-24
Greenhouse gas emissions	p25

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

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 2016. The full board then had opportunity to review and comment on the report as it progressed.

Representatives from financial reporting, corporate affairs, company secretarial, legal and internal audit and compliance 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.

The audit committee is also available to advise the board on certain aspects of the report, to enable the directors to fulfil their responsibility in this regard. The directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

The directors also confirm that, for each director in office at the date of this report:

- So far as the director is aware, there is no relevant audit information of which the 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 company's auditors are aware of that information.

Directors in office

The following directors were in office during the year and up until signing of the financial statements:

E P L Corley	H Manwani
V Cox	T Score
J J Fallon	S Taurel
S J Lewis	L Wallen
L K Lorimer	C Williams

The directors' report has been approved by the board on 14 March 2017 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 in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group and parent 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 company and the Group and of the profit or loss of the Group for that period.

In preparing these financial statements, the directors are required to:

› Select suitable accounting policies and then apply them consistently

› Make judgements and accounting estimates that are reasonable and prudent

› State whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements

› Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the Group and enable them to ensure that the financial statements and the report on directors' remuneration comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and the Group 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 UK 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 p60-61, confirms that, to the best of their knowledge:

› The Group 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

› 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, together with a description of the principal risks and uncertainties that it faces.

This responsibility statement has been approved by the board on 14 March 2017 and signed on its behalf by

Coram Williams
Chief financial officer

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Financial statements

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Independent auditor's report to the members of Pearson plc

Report on the financial statements

Our 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 as at 31 December 2016 and of the Group's loss and the Group's and the company's cash flows for the year then ended
- The consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union
- The company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006
- The financial statements 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.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the consolidated financial statements, the Group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion, the consolidated financial statements comply with IFRSs as issued by the IASB.

What we have audited

The financial statements, included within the annual report and accounts (the annual report), comprise:

- The consolidated and company balance sheets as at 31 December 2016
- The consolidated income statement and statement of comprehensive income for the year then ended
- The consolidated and company cash flow statement for the year then ended
- The consolidated and company statement of changes in equity for the year then ended
- The notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the annual report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is 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 applicable law.

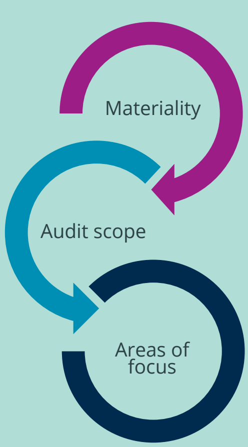
The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)).

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated and company financial statements. In particular, we looked at where management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by management that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as areas of focus in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the consolidated and company financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. For each area of focus below, to the extent relevant, we evaluated the design and tested the operating effectiveness of key internal controls over financial reporting set in place by management, including testing the operation of IT systems from which financial information is generated. Each of the areas of focus below are also referred to in the audit committee report on p71 and p75 and in the accounting policies on p28 to p134. This is not a complete list of all risks identified by our audit.

Our audit approach



Overview

- Overall Group materiality: £23m, which represents 4% of adjusted profit before tax as disclosed in note 8 to the consolidated financial statements. Refer to p118 for further details.
- We conducted work in four key territories: US, UK, Brazil and China. In addition, we obtained an audit opinion on the financial information reported by the associate Penguin Random House (PRH).
- The territories where we conducted audit procedures, together with work performed at corporate functions and consolidated Group level, accounted for approximately: 67% of the Group's revenue; 84% of the Group's loss before tax; and 60% of the Group's adjusted profit before tax.
- We focused on:
  - Revenue recognition including risk of fraud
  - Carrying value of goodwill and intangible assets
  - Returns provision
  - Major restructuring programme
  - Provision for uncertain tax liabilities
  - Recoverability of pre-publication assets
  - Major finance transformation programme

Area of focus	How our audit addressed the area of focus
Revenue recognition including risk of fraud	
Refer to note 1 to the consolidated financial statements There are two types of complex contracts that require significant judgements and estimates, which could be subject to either accidental errors or deliberate fraud: › Multiple element arrangements, such as the sale of physical textbooks accompanied by digital content or supplementary workbooks, where revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its relative fair value › Certain long-term contracts that span year end, where revenue is recognised using estimated percentage of completion based on costs. These include contracts to design, develop and deliver testing and accreditation, and contracts to secure students and support the online delivery of their teaching. These complex contracts generate material deferred revenue and accrued income balances and are areas where misstatements in the underlying assumptions or estimation calculations could have a material effect on the financial statements. In addition, there are material shipments towards the period end from major distribution locations giving rise to the potential risk of a cut-off error.	Where books are sold together with workbooks delivered later or companion digital materials available online, we assessed the basis for allocation of the purchase price between each element based on individual contractual arrangements, and then tested the detailed calculations supporting these revenue deferrals. We found the revenue deferrals to be based on reasonable estimates of the relative fair value of each element and the methods used to calculate the deferrals properly calculated and consistently applied. For a selection of the larger, more judgemental and more recent long-term contracts, covering both testing activities and online delivery of teaching, we read the contracts and assessed the accounting methodologies being applied to calculate the proportion of revenue being recognised. We also tested costs incurred to date and management's estimates of forecast costs and revenues by reference to historical experience and current contract status. Our testing showed that revenue recognition practices are in accordance with Group policies and related accounting standards with appropriate methods for calculating the revenue recognised. Refer to the returns provision areas of focus for our work over the risk of cut-off.
Carrying values of goodwill and intangible assets	
Refer to note 11 to the consolidated financial statements After recording an impairment charge of £2,548m at 31 December 2016, the Group had £2,341m of goodwill and £1,101m of other intangible assets including software, acquired customer lists, contracts and relationships, acquired trademarks and brands and acquired publishing rights. In 2016, the Group's North America business experienced a material decline in sales, most significantly in higher education courseware. As a result, in January 2017, management revised its 2017 operating and strategic plan from which are derived inputs into the Group's fair value less costs of disposal impairment model. This resulted in a £2,548m impairment to the North America aggregated cash-generating unit (CGU). The carrying values of goodwill and intangible assets are dependent on future cash flows of the underlying CGUs and there is a risk that if management does not achieve these cash flows it could give rise to further impairment. This risk increases in periods when the Group's trading performance and projections do not meet prior expectations, such as in 2016. The impairment reviews performed by management contain a number of significant judgements and estimates of which the most significant were forecast sales growth rate (including US enrolment rates, assessment growth rates and the success of new product launches), operating profit forecasts, perpetuity growth rates and discount rates. Changes in these assumptions can result in materially different impairment charges or available headroom.	We obtained management's fair value less costs of disposal impairment model and tested and evaluated the reasonableness of key assumptions, including CGU identification, operating profit forecasts and key inputs to these forecasts, perpetuity growth rates and discount rates. We tested the mathematical integrity of the forecasts and carrying values in management's impairment model and confirmed that management's estimate of each CGU's recoverable amount is appropriately based on the higher of fair value less cost of disposal and value-in-use. Our procedures have been focused on the North America and Core CGUs. We agreed the forecast cash flows to board-approved budgets, assessed how these budgets are compiled and understood key judgements and estimates within them, including short-term growth rates and cost allocations. Specifically for the US higher education courseware business, we understood management's assumptions for the drivers of future sales, including the effect of enrolment levels, and the impact of rental models and second-hand books on sales of new books, and compared these with external data and recent historical trends. We used valuations specialists to assess the perpetuity growth rate and discount rate for each CGU by comparison with third-party information, past performance and relevant risk factors. We also considered management's estimate of disposal costs for reasonableness. As a result of our work, we determined that the quantum of impairment recognised in 2016 was within a reasonable range and supported based on the uncertainties arising in the US higher education courseware business over the strategic plan period. We performed our own sensitivity analyses to understand the impact of reasonable changes in the key assumptions. We agree with management's decision to provide additional disclosures in note 11 of the financial statements given that reasonably possible changes in the assumptions could materially impact the impairment charges or available headroom.

Independent auditor's report to the members of Pearson plc

Area of focus	How our audit addressed the area of focus
Returns provisions	
Refer to note 22 to the consolidated financial statements The Group has provided £159m for sales returns at 31 December 2016. The most significant exposure to potential returns within Pearson arises in the US higher education courseware business. In 2016, Pearson received materially greater book returns from retailers than had been anticipated and provided at 31 December 2015, which management attributed primarily to a correction of inventory levels in the college bookstore channel reflecting lower enrolment, and the impact of rental models eroding sales over time. Management reassessed its approach to providing for returns in response to this experience, adopting a method to assess returns by customer and channel rather than academic discipline. The revised method and assumptions used to calculate returns provisions at 31 December 2016 reflect discussions with retailers, a change in sales force incentives to a 'net sales' basis and materially lower sales into these retailers in the final months of 2016 compared with 2015.	We performed testing over returns provisions in a number of locations, with our focus on the US higher education courseware business due to a high level of returns during 2016. We assessed management's evaluation of the factors giving rise to higher returns in 2016 than had been anticipated at 31 December 2015. We corroborated management's analysis by reviewing 2016 returns history to underlying records, reviewed correspondence and meeting minutes with key retailers and held discussions directly with these retailers in early 2017. We found that management's explanations of the causes and timing of the higher returns were supported. We tested the returns provision calculations at 31 December 2016 and agreed inputs such as historical sales and returns experience to underlying records. We assessed the change in method was likely to be more representative of future returns and reflects the retailer's recent buying trends. We performed detailed testing over shipment and returns levels. This included checking cut-off at year end and evaluating whether any changes in shipping volumes around year end might increase the risk of returns. We corroborated that sales volumes in the final months of 2016 were materially lower than in prior years, and confirmed a change in sales incentive arrangements to a 'net sale' basis. In drawing our conclusions, we considered whether there were indicators of management bias. We concluded that management had adopted methods and reached estimates for future returns that were supportable and appropriate.
Major restructuring programme	
Refer to notes 2, 4 and 8 to the consolidated financial statements In January 2016, management announced a restructuring plan to simplify the business and focus further on their global education strategy. As a result, management recorded a restructuring charge of £338m during 2016. Given the significance of this programme, management has also excluded these costs from their adjusted profit measure.	We have identified no material adjustments in relation to the recording of these costs and we have noted that for the majority of these items there is clear evidence to support the fact that they have arisen as a direct consequence of the Group's restructuring plans. There are certain costs where the classification as restructuring is subjective due to the circumstances in which they have arisen. Based on the audit evidence obtained, we have been able to conclude that, although subjective, there are valid arguments for associating these costs with the restructuring activities undertaken and therefore the classification is reasonable.
Provisions for uncertain tax liabilities	
Refer to notes 7 and 13 to the consolidated financial statements The Group is subject to several tax regimes due to the geographical diversity of its businesses. Management is required to exercise significant judgement in determining the appropriate amount to provide in respect of potential tax exposures and uncertain tax provisions. The most significant of these relate to US tax. Changes in assumptions about the views that might be taken by tax authorities can materially impact the level of provisions recorded in the financial statements.	We engaged with our tax experts and obtained an understanding of the Group's tax strategy to identify tax risks relating to business and legislative developments. To assess the adequacy of the Group's tax provisions, we first recalculated the valuation of tax provisions and determined whether the treatments adopted were in line with the Group's tax policies and had been applied consistently. We then evaluated the key underlying assumptions, particularly in the US and UK. In doing this, we considered the status of recent and current tax authority audits and enquiries, the outturn of previous claims, judgemental positions taken in tax returns and current year estimates and developments in the tax environment. We also evaluated the consistency of management's approach to establishing or changing provision estimates. We were satisfied that management's provision estimates for uncertain tax positions were prepared on a consistent basis with the prior year and were adequately supported.

Area of focus	How our audit addressed the area of focus
Recoverability of pre-publication assets	
Refer to note 20 to the consolidated financial statements The Group has £1,024m of pre-publication assets at 31 December 2016. 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 is further complicated by the transition to digital as the Group invests in new, less proven, inter-linked digital content and platforms.	We have assessed the appropriateness of capitalisation policies and selected a sample of costs deferred to the balance sheet as pre-publication assets to test their magnitude and appropriateness for capitalisation. We have assessed the amortisation profiles of pre-publication assets against cash flows to test that the existing amortisation profiles remained appropriate in light of the transition towards digital products. We challenged the carrying value of certain pre-publication assets where products are yet to be launched, are less proven, or where sales are lower than originally anticipated. We assessed forecast cash flows against historical experience and obtained supporting evidence for management's explanations. We compared short and long-term growth rates to historical trends and expectations. We challenged the life of the assets compared with similar Pearson products and found the Group's policies to be appropriate and consistently applied. While the carrying value of some assets depends on future sales growth, overall we considered the year end carrying values to be supported and in line with the Group's policy.
Major finance transformation programme	
During the year, the Group launched a major finance transformation programme, which will ultimately move to a single Enterprise Resource Planning (ERP) system across the Group. The UK represented the first territory to go live on this platform in 2016. Following go-live, the ERP and associated transaction level controls have taken a period to stabilise, such that some of these controls were not fully effective for the period following go-live.	Given the pervasive impact of this ERP implementation to the UK component audit, we have worked closely with management throughout the go-live process and have performed procedures as follows: › Evaluated management's assessment of risks and design of control activities, and tested the configuration of the new ERP environment › Validated the effectiveness of management's data migration and programme development procedures › Tested the new business processes and operating effectiveness of the controls. Given some of these controls were not fully effective in the period following go-live, we conducted additional substantive procedures, specifically over the occurrence and accuracy of sales and the existence and valuation of debtors. We noted no material adjustments as a result of this testing.

Independent auditor's report to the members of Pearson plc

How we tailored our audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group is organised into three reportable segments, being North America, Core and Growth, plus the associate investment in Penguin Random House. Each segment comprises a number of reporting units. The consolidated financial statements comprise these reporting units plus the Group's centralised functions.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units 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.

During the year, senior members of the Group engagement team visited each of the US, Brazilian and Chinese component audit teams and local client teams; we held a planning meeting attended by partners from the Group engagement team and our UK and US component teams; and have had regular dialogue with component teams throughout the year, including holding clearance meetings with each respective team. We have also performed a review of working papers for all full scope entities and some specified procedure entities.

We identified two reporting units in the US and UK that required an audit of their complete financial information due to their financial significance, plus a further eight reporting units in the US, UK, Brazil and China that required either an audit or specified procedures on certain transactions and balances. We also obtained a full scope audit opinion from PwC Germany on the financial information of the US Penguin Random House associate. The Group consolidation, financial statement disclosures and corporate functions were audited by the Group engagement team. This included our work over derivative financial instruments, hedge accounting, goodwill and intangible assets impairment reviews, litigation, pensions, share-based payments and tax balances.

The reporting units where we performed audit work, together with work performed at corporate functions and consolidated Group level, accounted for approximately 67% of the Group's revenue, 84% of the Group's loss before tax and 60% of the Group's adjusted profit before tax. This is before considering the impact of Group-level monitoring controls and disaggregated analytical review procedures, which covers a number of the Group's smaller and lower risk components that were not directly included in our Group audit scope. Taken together, this approach provided the evidence we needed for our opinion on the consolidated financial statements taken as a whole.

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 on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£23m (2015: £27m)
How we determined it	4% of adjusted profit before tax of £576m
Rationale for benchmark applied	Note 8 of the consolidated financial statements explains that the Group's principal measure of performance is adjusted operating profit (£635m), which excludes costs of major restructuring, other net gains and losses and intangible charges (impairment and acquired intangible asset amortisation), in order to present results from operating activities on a consistent basis. From adjusted operating profit, we deducted net finance costs of £59m (see note 8) because these mainly reflect recurring finance charges. To the resulting adjusted profit before tax, we then applied 4% (rather than the usual 5%) as our materiality calculation was based on an adjusted measure.
Component materiality	For each component in our audit scope, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £3m and £19m.

We agreed with the audit committee that we would report to them misstatements identified during our audit above £2m (2015: £2m), as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the directors' statement, set out on p107, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Group and company have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and company's ability to continue as a going concern.

Other required reporting

Consistency of other information and compliance with applicable requirements

Companies Act 2006 opinions

In our opinion, based on the work undertaken in the course of the audit:

- The information given in the strategic report and the governance report for the financial year for which the financial statements are prepared is consistent with the financial statements
- The strategic report and the governance report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the Group, the company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the strategic report and the governance report. We have nothing to report in this respect.

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

› Information in the annual report is: – materially inconsistent with the information in the audited financial statements; – apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and company acquired in the course of performing our audit; or – otherwise misleading.	We have no exceptions to report.
› The statement given by the directors on p110, in accordance with provision C.1.1 of the UK Corporate Governance Code (the Code), that they consider the annual report taken as a whole to be fair, balanced and understandable and provides the information necessary for 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 acquired in the course of performing our audit.	We have no exceptions to report.
› The section of the annual report on p70 to p75, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the audit committee.	We have no exceptions to report.

Independent auditor's report to the members of Pearson plc

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

› The directors' confirmation on p55 and p107 of the annual report, in accordance with provision C.2.1 of the Code, 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.	We have nothing material to add or to draw attention to.
› The disclosures in the annual report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
› The directors' explanation on p55 and p107 of the annual report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Under the Listing Rules we are required to review the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the directors' 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 Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

Adequacy of accounting records and information and explanations received

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
- 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.

Directors' remuneration

Directors' remuneration report – Companies Act 2006 opinion

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement

Under the Companies Act 2006 we are required to report to you if, in our opinion, a corporate governance statement has not been prepared by the company. We have no exceptions to report arising from this responsibility.

Under the Listing Rules we are required to review the part of the corporate governance statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the statement of directors' responsibilities set out on p111, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- Whether the accounting policies are appropriate to the Group's and the company's circumstances and have been consistently applied and adequately disclosed
- The reasonableness of significant accounting estimates made by the directors
- The overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the strategic report and governance report, we consider whether those reports include the disclosures required by applicable legal requirements.

Stuart Newman
(Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

14 March 2017

Consolidated income statement

Year ended 31 December 2016

All figures in £ millions	Notes	2016	2015
Sales	2	**4,552**	4,468
Cost of goods sold	4	**(2,093)**	(1,981)
Gross profit		**2,459**	2,487
Operating expenses	4	**(2,505)**	(2,094)
Impairment of intangible assets	11	**(2,548)**	(849)
Share of results of joint ventures and associates	12	**97**	52
Operating loss	2	**(2,497)**	(404)
Finance costs	6	**(97)**	(100)
Finance income	6	**37**	71
Loss before tax		**(2,557)**	(433)
Income tax	7	**222**	81
Loss for the year from continuing operations		**(2,335)**	(352)
Profit for the year from discontinued operations	3	**–**	1,175
(Loss)/profit for the year		**(2,335)**	823
Attributable to:			
Equity holders of the company		**(2,337)**	823
Non-controlling interest		**2**	–
(Loss)/earnings per share from continuing and discontinued operations attributable to equity holders of the company during the year (expressed in pence per share)			
– basic	8	**(286.8)p**	101.2p
– diluted	8	**(286.8)p**	101.2p
Loss per share from continuing operations attributable to equity holders of the company during the year (expressed in pence per share)			
– basic	8	**(286.8)p**	(43.3)p
– diluted	8	**(286.8)p**	(43.3)p

Consolidated statement of comprehensive income

Year ended 31 December 2016

All figures in £ millions	Notes	2016	2015
(Loss)/profit for the year		**(2,335)**	823
Items that may be reclassified to the income statement			
Net exchange differences on translation of foreign operations – Group		**910**	(85)
Net exchange differences on translation of foreign operations – associates		**3**	16
Currency translation adjustment disposed – Group		**–**	(10)
Attributable tax	7	**(5)**	5
Items that are not reclassified to the income statement			
Remeasurement of retirement benefit obligations – Group	25	**(268)**	110
Remeasurement of retirement benefit obligations – associates		**(8)**	8
Attributable tax	7	**58**	(24)
Other comprehensive income for the year		**690**	20
Total comprehensive (expense)/income for the year		**(1,645)**	843
Attributable to:			
Equity holders of the company		**(1,648)**	845
Non-controlling interest		**3**	(2)

Consolidated balance sheet

As at 31 December 2016

All figures in £ millions	Notes	2016	2015
Assets			
Non-current assets			
Property, plant and equipment	10	**343**	320
Intangible assets	11	**3,442**	5,164
Investments in joint ventures and associates	12	**1,247**	1,103
Deferred income tax assets	13	**451**	276
Financial assets – derivative financial instruments	16	**171**	78
Retirement benefit assets	25	**158**	337
Other financial assets	15	**65**	143
Trade and other receivables	22	**104**	115
		5,981	7,536
Current assets			
Intangible assets – pre-publication	20	**1,024**	841
Inventories	21	**235**	211
Trade and other receivables	22	**1,357**	1,284
Financial assets – derivative financial instruments	16	**–**	32
Financial assets – marketable securities	14	**10**	28
Cash and cash equivalents (excluding overdrafts)	17	**1,459**	1,703
		4,085	4,099
Total assets		**10,066**	11,635
Liabilities			
Non-current liabilities			
Financial liabilities – borrowings	18	**(2,424)**	(2,048)
Financial liabilities – derivative financial instruments	16	**(264)**	(136)
Deferred income tax liabilities	13	**(466)**	(560)
Retirement benefit obligations	25	**(139)**	(139)
Provisions for other liabilities and charges	23	**(79)**	(71)
Other liabilities	24	**(422)**	(356)
		(3,794)	(3,310)

Consolidated balance sheet continued

As at 31 December 2016

All figures in £ millions	Notes	2016	2015
Current liabilities			
Trade and other liabilities	24	**(1,629)**	(1,390)
Financial liabilities – borrowings	18	**(44)**	(282)
Financial liabilities – derivative financial instruments	16	**–**	(29)
Current income tax liabilities		**(224)**	(164)
Provisions for other liabilities and charges	23	**(27)**	(42)
		(1,924)	(1,907)
Total liabilities		**(5,718)**	(5,217)
Net assets		**4,348**	6,418
Equity			
Share capital	27	**205**	205
Share premium	27	**2,597**	2,590
Treasury shares	28	**(79)**	(72)
Translation reserve		**905**	(7)
Retained earnings		**716**	3,698
Total equity attributable to equity holders of the company		**4,344**	6,414
Non-controlling interest		**4**	4
Total equity		**4,348**	6,418

These financial statements have been approved for issue by the board of directors on 14 March 2017 and signed on its behalf by

Coram Williams
Chief financial officer

Consolidated statement of changes in equity

Year ended 31 December 2016

All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2016	205	2,590	(72)	(7)	3,698	6,414	4	6,418
Loss for the year	–	–	–	–	(2,337)	(2,337)	2	(2,335)
Other comprehensive income	–	–	–	912	(223)	689	1	690
Total comprehensive income	–	–	–	912	(2,560)	(1,648)	3	(1,645)
Equity-settled transactions	–	–	–	–	22	22	–	22
Tax on equity-settled transactions	–	–	–	–	–	–	–	–
Issue of ordinary shares under share option schemes	–	7	–	–	–	7	–	7
Purchase of treasury shares	–	–	(27)	–	–	(27)	–	(27)
Release of treasury shares	–	–	20	–	(20)	–	–	–
Changes in non-controlling interest	–	–	–	–	–	–	(3)	(3)
Dividends	–	–	–	–	(424)	(424)	–	(424)
At 31 December 2016	**205**	**2,597**	**(79)**	**905**	**716**	**4,344**	**4**	**4,348**

All figures in £ millions	Equity attributable to equity holders of the company						Non-controlling interest	Total equity
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total		
At 1 January 2015	205	2,579	(75)	70	3,200	5,979	6	5,985
Profit for the year	–	–	–	–	823	823	–	823
Other comprehensive income	–	–	–	(77)	99	22	(2)	20
Total comprehensive income	–	–	–	(77)	922	845	(2)	843
Equity-settled transactions	–	–	–	–	26	26	–	26
Tax on equity-settled transactions	–	–	–	–	(1)	(1)	–	(1)
Issue of ordinary shares under share option schemes	–	11	–	–	–	11	–	11
Purchase of treasury shares	–	–	(23)	–	–	(23)	–	(23)
Release of treasury shares	–	–	26	–	(26)	–	–	–
Changes in non-controlling interest	–	–	–	–	–	–	–	–
Dividends	–	–	–	–	(423)	(423)	–	(423)
At 31 December 2015	205	2,590	(72)	(7)	3,698	6,414	4	6,418

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. Changes in non-controlling interest in 2016 relate to the buy-back of a non-controlling interest in our South African business.

Consolidated cash flow statement

Year ended 31 December 2016

All figures in £ millions	Notes	2016	2015
Cash flows from operating activities			
Net cash generated from operations	32	**522**	518
Interest paid		**(67)**	(75)
Tax paid		**(45)**	(232)
Net cash generated from operating activities		**410**	211
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	30	**(15)**	(9)
Acquisition of joint ventures and associates		**–**	(11)
Purchase of investments		**(6)**	(7)
Purchase of property, plant and equipment		**(88)**	(86)
Purchase of intangible assets		**(157)**	(161)
Disposal of subsidiaries, net of cash disposed	31	**(54)**	1,030
Proceeds from sale of associates		**4**	379
Proceeds from sale of investments		**92**	13
Proceeds from sale of property, plant and equipment	32	**4**	2
Proceeds from sale of intangible assets		**–**	1
Proceeds from sale of liquid resources		**42**	17
Loans repaid by related parties		**14**	7
Investment in liquid resources		**(24)**	(29)
Interest received		**16**	24
Dividends received from joint ventures and associates		**131**	162
Net cash (used in)/received from investing activities		**(41)**	1,332
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	**7**	11
Purchase of treasury shares	28	**(27)**	(23)
Proceeds from borrowings		**4**	372
Repayment of borrowings		**(249)**	(300)
Finance lease principal payments		**(6)**	(1)
Transactions with non-controlling interest		**(2)**	–
Dividends paid to company's shareholders	9	**(424)**	(423)
Net cash used in financing activities		**(697)**	(364)
Effects of exchange rate changes on cash and cash equivalents		**81**	(19)
Net (decrease)/increase in cash and cash equivalents		**(247)**	1,160
Cash and cash equivalents at beginning of year		**1,671**	511
Cash and cash equivalents at end of year	17	**1,424**	1,671

The consolidated cash flow statement includes discontinued operations (see note 3).

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 14 March 2017.

1. Accounting policies

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

a. Basis of preparation

These consolidated financial statements have been prepared on the going concern basis and in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. In respect of the accounting standards applicable to the Group; there is no difference between EU-adopted and IASB-adopted IFRS.

These consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) to fair value through profit or loss.

1. Interpretations and amendments to published standards effective 2016 The following amendments and interpretations were adopted in 2016:

- Amendments to IAS 19 Employee Benefits – Annual Improvements 2012-2014 cycle
- Amendments to IAS 16 Property Plant and Equipment and IAS 38 Intangible Assets – Clarification of Acceptable Methods of Depreciation and Amortisation
- Amendments to IAS 1 Presentation of Financial Statements – Disclosure Initiative.

In April 2016, IFRS IC rejected a request to add to its agenda an item concerning cash pooling arrangements, specifically addressing when and whether particular cash pooling arrangements would meet the requirements for offsetting in accordance with IAS 32 'Financial Instruments: Presentation'. After consideration of the IFRS IC rejection notice, Pearson has settled many of the balances within its cash pooling arrangements during the first half of 2016 and has chosen to show any residual balances within these arrangements gross in the balance sheet at 31 December 2016. Pearson has considered the prior year comparatives in light of this guidance, and has concluded that those balances at 31 December 2015 that would not meet these requirements for net treatment are immaterial for restatement in the context of the overall presentation of the Group's balance sheet at this date.

The adoption of these new pronouncements from 1 January 2016 does not have a material impact on the consolidated financial statements.

2. Standards, interpretations and amendments to published standards that are not yet effective The Group has not early adopted the following new pronouncements that are not yet effective:

IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities, and makes changes to the current disclosure framework. Management is in the process of assessing the impact of IFRS 9 on the Group, in particular the new guidelines around hedging and the impairment of financial assets.

IFRS 15 'Revenue from Contracts with Customers', effective for annual reporting periods beginning on or after 1 January 2018. The new standard specifies how and when an entity will recognise revenue and requires more detailed disclosures. Management continues to assess the impact of IFRS 15 on the Group. The implementation of IFRS 15 is complex due to the number of different revenue streams that the Group has and due to the fact that the Group's business model is continuing to evolve from print-based products to digital-based products and services. Based on work completed to date, management does not expect IFRS 15 to have a material impact on the amount of revenue to be recognised; however, there could be an impact on the timing of revenue recognition due to enhanced guidance around what constitutes a performance obligation. This may impact the split of revenue between periods within any given year and also between years.

Some of the key impacts of IFRS 15 on current revenue streams are as follows:

- Courseware – revenue from contracts related to the delivery of online content, to which customers have access for a period of time, is currently recognised evenly over that period of time. Under IFRS 15 the definition of a performance obligation may result in that same revenue being recognised at a point in time at the start of the contract, although this would depend on the related hosting obligations
- Assessments – revenue from certain assessments contracts is currently recognised over the period of time between a student signing up for the qualification and the point at which they complete and receive that qualification. Under IFRS 15 the definition of a performance obligation may result in that same revenue being recognised at points in time when certain activities are completed, with the main focus being on the receipt of the final qualification

1. Accounting policies continued

a. Basis of preparation continued

› Services – revenue from certain direct delivery contracts is currently recognised over the period of service delivery. The current revenue recognition methodology may involve the use of assumptions around items such as average usage of online content, the average length of time to complete course modules and the average student drop-out rate. Under IFRS 15 there is enhanced guidance which may impact on how these types of assumptions are calculated.

Management is currently favouring the modified retrospective transition method (sometimes called the cumulative catch-up transition method). Using this method would mean that the cumulative effect of initially applying IFRS 15 would be recognised as an adjustment to the opening balance sheet in the period of initial application. Comparative prior periods would not be adjusted. Additional disclosures would also be presented in the year of initial application to explain the impact of IFRS 15. If the modified retrospective transition method is used then management is also likely to elect to apply the practical expedient for completed contracts. Using this method would not prevent the Group from disclosing the impact on comparative years in narrative format.

IFRS 16 'Leases', effective for annual reporting periods beginning on or after 1 January 2019. The new standard details the requirements for the classification, measurement and recognition of lease arrangements. Adoption of the new standard is likely to have an impact on the Group and management is currently assessing the impact.

IAS 7 'Statement of Cash Flows', effective for annual reporting periods beginning on or after 1 January 2017. The amendments to disclosure requirements aim to assist users of financial statements to evaluate changes in an entity's liabilities arising from financing activities. The Group is currently confirming the impacts of the new requirements which are not expected to be material.

In June 2015, the IASB issued an exposure draft ED/2015/5 'Remeasurement on a Plan Amendment, Curtailment or Settlement/ Availability of a Refund from a Defined Benefit Plan (Proposed Amendments to IAS 19 and IFRIC 14)'. Management is currently evaluating these proposals and although the proposals have not yet been finalised, it should be noted that the current draft, if adopted, may restrict the Group's ability to recognise a pension asset in respect of pension surpluses in its UK defined benefit pension plan. In addition, the current draft may require certain elements of committed minimum funding contributions to be recognised as a liability on the balance sheet.

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:

Consolidation: Business combinations – classification of investments
Intangible assets: Goodwill
Intangible assets: Pre-publication assets
Taxation
Revenue recognition including provisions for returns
Employee benefits: Pensions
Consolidation: Business combinations – determination of fair values (where relevant)

b. 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 1e(1) 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.

Notes to the consolidated financial statements

1. Accounting policies continued

b. 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.

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.

c. Foreign currency translation

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

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

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 $1.33 (2015: $1.53) and the year-end rate was $1.23 (2015: $1.47).

d. 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.

1. Accounting policies continued

e. 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 and significant management judgement. 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 eight years.

4. Acquired intangible assets Acquired intangible assets include customer lists, contracts and relationships, trademarks and brands, publishing rights, content, technology and software rights. These assets are capitalised on acquisition at cost and included in intangible assets. Intangible assets acquired in material business combinations are capitalised at their fair value as determined by an independent valuer. Intangible assets are amortised over their estimated useful lives of between two and 20 years, using an amortisation method that reflects the pattern of their consumption.

5. Pre-publication assets Pre-publication assets represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating lifecycle of the title, with a higher proportion of the amortisation taken in the earlier years.

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 32).

The assessment of the recoverability of pre-publication assets involve 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.

f. Other financial assets

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

g. Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, 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.

h. Royalty advances

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement 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.

Notes to the consolidated financial statements

1. Accounting policies continued

h. Royalty advances continued

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.

i. 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.

j. 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.

k. 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.

l. 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.

Changes in the fair value of derivatives are recognised immediately in finance income or costs. However, derivatives relating to borrowings and certain foreign exchange contracts are designated as part of a hedging transaction. The accounting treatment is summarised below:

Typical reason for designation	Reporting of gains and losses on effective portion of the hedge	Reporting of gains and losses on disposal
Net investment hedge		
The derivative creates a foreign currency liability which is used to hedge changes in the value of a subsidiary which transacts in that currency.	Recognised in other comprehensive income.	On disposal, the accumulated value of gains and losses reported in other comprehensive income is transferred to the income statement.
Fair value hedges		
The derivative transforms the interest profile on debt from fixed rate to floating rate. Changes in the value of the debt as a result of changes in interest rates are offset by equal and opposite changes in the value of the derivative. The Group's debt is all swapped to floating rates and 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.	

1. Accounting policies continued

m. 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 liabilities for anticipated tax audit issues based on management's judgement of the application of tax legislation and best estimates of future settlement amounts. 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 in determining the amounts to be recognised. In particular, significant judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income together with any future tax planning strategies.

n. Employee benefits

1. Pensions The retirement benefit asset and obligation recognised in the balance sheet represents the net of the present value of the defined benefit obligation and the fair value of plan assets at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high-quality corporate bonds which have terms to maturity approximating the terms of the related liability.

When the calculation results in a potential asset, the recognition of that asset is limited to the asset ceiling – that is the present value of any economic benefits available in the form of refunds from the plan or a reduction in future contributions. Management uses judgement to determine the level of refunds available from the plan in recognising an asset.

The determination of the pension cost and defined benefit obligation of the Group's defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth and longevity.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. Net interest is calculated by applying the discount rate to the net defined benefit obligation and is presented as finance costs or finance income.

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

2. Other post-retirement obligations The expected costs of post-retirement medical and life assurance benefits are accrued over the period of employment, using a similar accounting methodology as for defined benefit pension obligations. The liabilities and costs relating to significant other post-retirement obligations are assessed annually by independent qualified actuaries.

3. Share-based payments The fair value of options or shares granted under the Group's share and option plans is recognised as an employee expense after taking into account the Group's best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised.

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

The Group recognises a provision for deferred consideration. Where this is contingent on future performance or a future event, judgement is exercised in establishing the fair value.

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

The provision is based on the present value of future payments for surplus leased properties under non-cancellable operating leases, net of estimated sub-leasing income.

Notes to the consolidated financial statements

1. Accounting policies continued

p. 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 and English language teaching centres around the world as well as the provision of online learning services in partnership with universities and other academic institutions.

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services net of sales taxes, rebates and discounts, and after eliminating sales within the Group.

Revenue from the sale of books is recognised when title passes. A provision for anticipated returns is made based primarily on historical return rates, customer buying patterns and retailer behaviours including stock levels. If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period.

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. Where software is provided under a term licence, revenue is recognised on a straight-line basis over the period of the license.

Revenue from the provision of services to academic institutions, such as programme development, student acquisition, education technology and student support services, is recognised as performance occurs. Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks and uncertainties inherent to long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Percentage of completion is calculated on a cost basis using the proportion of the total estimated costs incurred to date. 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.

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials or online access with textbooks and multiple deliverables within testing or service contracts, revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its relative fair value.

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

Income from recharges of freight and other activities which are incidental to the normal revenue-generating activities is included in other income.

q. Leases

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

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

r. 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.

s. 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.

t. 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.

u. Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1p).

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 (PRH) associate.

The chief operating decision-maker is the Pearson executive.

Continuing operations:

North America Courseware, Assessments and Services businesses in US and Canada.

Core Courseware, Assessments and Services businesses in more mature markets including UK, Australia and Italy.

Growth Courseware, Assessments and Services businesses in emerging markets including Brazil, China, India and South Africa.

The results of the FT Group segment (to 30 November 2015) are shown as discontinued in 2015.

The results for 2015 have been restated to reflect minor changes in management responsibilities between the geographies which were effective from 1 January 2016.

For more detail on the services and products included in each business segment refer to the strategic report.

								2016
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
Continuing operations								
Sales		**2,981**	**803**	**768**	**–**	**–**		**4,552**
Adjusted operating profit		**420**	**57**	**29**	**129**	**–**		**635**
Cost of major restructuring		**(172)**	**(62)**	**(95)**	**(9)**	**–**		**(338)**
Intangible charges		**(2,684)**	**(16)**	**(33)**	**(36)**	**–**		**(2,769)**
Other net gains and losses		**(12)**	**(12)**	**(1)**	**–**	**–**		**(25)**
Operating (loss)/profit		**(2,448)**	**(33)**	**(100)**	**84**	**–**		**(2,497)**
Finance costs	6							**(97)**
Finance income	6							**37**
Loss before tax								**(2,557)**
Income tax	7							**222**
Loss for the year from continuing operations								**(2,335)**
Segment assets		**4,859**	**1,461**	**859**	**–**	**1,640**		**8,819**
Joint ventures	12	**–**	**–**	**2**	**–**	**–**		**2**
Associates	12	**1**	**4**	**–**	**1,240**	**–**		**1,245**
Total assets		**4,860**	**1,465**	**861**	**1,240**	**1,640**		**10,066**
Other segment items								
Share of results of joint ventures and associates	12	**(1)**	**1**	**(1)**	**98**	**–**	**–**	**97**
Capital expenditure	10, 11	**153**	**42**	**51**	**–**	**–**	**–**	**246**
Pre-publication investment	20	**235**	**92**	**68**	**–**	**–**	**–**	**395**
Depreciation	10	**56**	**12**	**27**	**–**	**–**	**–**	**95**
Amortisation	11, 20	**394**	**109**	**116**	**–**	**–**	**–**	**619**
Impairment	11	**2,548**	**–**	**–**	**–**	**–**	**–**	**2,548**

Notes to the consolidated financial statements

2. Segment information continued

All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	2015 Restated Group
Continuing operations								
Sales		2,940	815	713	–	–		4,468
Adjusted operating profit/(loss)		480	105	(3)	90	–		672
Intangible charges		(386)	(79)	(583)	(41)	–		(1,089)
Other net gains and losses		19	(5)	–	(1)	–		13
Operating (loss)/profit		113	21	(586)	48	–		(404)
Finance costs	6							(100)
Finance income	6							71
Loss before tax								(433)
Income tax	7							81
Loss for the year from continuing operations								(352)
Segment assets		6,399	1,573	719	–	1,841		10,532
Joint ventures	12	1	–	3	–	–		4
Associates	12	–	6	–	1,093	–		1,099
Total assets		6,400	1,579	722	1,093	1,841		11,635
Other segment items								
Share of results of joint ventures and associates	12	(9)	–	(3)	64	–	16	68
Capital expenditure	10, 11	136	42	50	–	–	15	243
Pre-publication investment	20	218	63	66	–	–	–	347
Depreciation	10	42	9	18	–	–	6	75
Amortisation	11, 20	338	95	109	–	–	15	557
Impairment	11	282	37	530	–	–	–	849

For further information on adjusted measures above, see note 8.

There were no material inter-segment sales in either 2015 or 2016.

Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables our 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.

In 2016, the definition of adjusted operating profit has been amended to exclude the costs of major restructuring activity. In January 2016, Pearson announced that it was embarking on a restructuring programme to simplify the business, reduce costs and position the company for growth in its major markets. The costs of this programme in 2016 are significant enough to exclude from our adjusted operating profit measure so as to better highlight the underlying performance. Total restructuring in 2016 amounted to £338m and includes costs associated with headcount reductions, property rationalisation and closure or exit from certain systems, platforms, products and supplier and customer relationships. There was no major restructuring in 2015 and accordingly the change has no effect on the comparative adjusted operating profit.

Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are excluded from adjusted operating profit as they distort the performance of the Group. In 2016, the losses in the Core segment mainly relate to the closure of English language schools in Germany and in the North America segment to the sale of the Pearson English Business Solutions business. In 2015, other gains and losses included in discontinued operations relate to the sale of the FT Group including the 50% share of the Economist. Included in other net gains and losses within continuing operations in 2015 in the North America segment is the profit on disposal of PowerSchool net of small losses on other investments.

2. Segment information continued

Charges relating to acquired intangibles, acquisition costs and movements in contingent acquisition consideration are also excluded from adjusted operating profit when relevant as these items reflect past acquisition activity and don't necessarily reflect the current year performance of the Group. In 2016, intangible charges include the impairment of goodwill in the North American business of £2,548m (see note 11).

In 2015, intangible charges included an impairment of goodwill and intangibles in our North American business of £282m, our core business of £37m and our Growth business of £530m.

Corporate costs are allocated to business segments including discontinued operations 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 combination were £10m (2015: £1m) (see note 30).

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 and English language teaching centres around the world as well as the provision of online learning services in partnership with universities and other academic institutions. School Systems includes PowerSchool and Family Education Network, both of which were disposed of during 2015.

	2016			
All figures in £ millions	North America	Core	Growth	Group
Courseware				
School Courseware	418	173	127	718
Higher Education Courseware	1,147	92	60	1,299
English Courseware	21	65	97	183
	1,586	330	284	2,200
Assessments				
School and Higher Education Assessments	378	268	21	667
Clinical Assessments	143	40	–	183
Professional and English Certification	333	112	49	494
	854	420	70	1,344
Services				
School Services	259	6	54	319
Higher Education Services	269	29	46	344
English Services	13	18	314	345
School Systems	–	–	–	–
	541	53	414	1,008
Total	2,981	803	768	4,552

Notes to the consolidated financial statements

2. Segment information continued

All figures in £ millions	North America	Core	Growth	2015 restated Group
Courseware				
School Courseware	406	178	112	696
Higher Education Courseware	1,207	94	57	1,358
English Courseware	22	65	84	171
	1,635	337	253	2,225
Assessments				
School and Higher Education Assessments	420	296	20	736
Clinical Assessments	126	32	–	158
Professional and English Certification	269	95	37	401
	815	423	57	1,295
Services				
School Services	209	1	47	257
Higher Education Services	223	26	70	319
English Services	18	28	286	332
School Systems	40	–	–	40
	490	55	403	948
Total	2,940	815	713	4,468

The Group operates in the following main geographic areas:

All figures in £ millions	Sales 2016	Sales 2015	Non-current assets 2016	Non-current assets 2015
Continuing operations				
UK	**393**	421	**946**	991
Other European countries	**255**	246	**134**	121
US	**2,829**	2,800	**3,351**	5,000
Canada	**118**	107	**268**	235
Asia Pacific	**632**	590	**205**	211
Other countries	**325**	304	**232**	144
Total continuing	**4,552**	4,468	**5,136**	6,702
Discontinued operations				
UK	**–**	134	**–**	–
Other European countries	**–**	64	**–**	–
US	**–**	72	**–**	–
Canada	**–**	2	**–**	–
Asia Pacific	**–**	35	**–**	–
Other countries	**–**	5	**–**	–
Total discontinued	**–**	312	**–**	–
Total	**4,552**	4,780	**5,136**	6,702

2. Segment information continued

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. Discontinued operations

There are no discontinued operations in 2016. All discontinued operations in 2015 relate to the FT Group including the Group's 50% share in the Economist. An analysis of the results and cash flows of discontinued operations is as follows:

	2016	2015
All figures in £ millions	Total	Total
Sales	–	312
Operating profit	–	48
Profit before tax	–	48
Income tax	–	(8)
Profit after tax	–	40
Profit on disposal of The Economist	–	473
Profit on disposal of Financial Times	–	711
Attributable tax expense	–	(49)
Profit for the year from discontinued operations	–	1,175
Operating cash flows	–	31
Investing cash flows	–	3
Total cash flows	–	34

4. Operating expenses

All figures in £ millions	2016	2015
By function:		
Cost of goods sold	**2,093**	1,981
Operating expenses		
Distribution costs	**88**	80
Selling, marketing and product development costs	**908**	895
Administrative and other expenses	**1,240**	1,195
Restructuring costs	**329**	35
Other net gains and losses	**25**	(13)
Other income	**(85)**	(98)
Total net operating expenses	**2,505**	2,094
Impairment of intangible assets	**2,548**	849
Total	**7,146**	4,924

Included in other income is service fee income from Penguin Random House of £4m (2015: £16m). Included in administrative and other expenses are research and efficacy costs of £23m (2015: £33m). In addition to the restructuring costs shown above, there were restructuring costs in Penguin Random House of £9m (2015: £12m).

Notes to the consolidated financial statements

4. Operating expenses continued

All figures in £ millions	Notes	2016	2015
By nature:			
Royalties expensed		**264**	249
Other product costs		**616**	566
Employee benefit expense	5	**1,888**	1,742
Contract labour		**206**	182
Employee related expense		**122**	127
Promotional costs		**217**	163
Depreciation of property, plant and equipment	10	**95**	69
Amortisation of intangible assets – pre-publication	20	**350**	281
Amortisation of intangible assets – software	11	**84**	61
Amortisation of intangible assets – other	11	**185**	199
Impairment of intangible assets	11	**2,548**	849
Property and facilities		**243**	219
Technology and communications		**188**	153
Professional and outsourced services		**378**	262
Other general and administrative costs		**140**	132
Costs capitalised to intangible assets		**(318)**	(219)
Other net gains and losses		**25**	(13)
Other income		**(85)**	(98)
Total		**7,146**	4,924

During the year the Group obtained the following services from the Group's auditors:

All figures in £ millions	2016	2015
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
Other assurance services	**1**	2
Other non-audit services	**1**	1
Total other services	**2**	3
Tax compliance services	**–**	1
Total tax services	**–**	1
Total non-audit services	**2**	4
Total	**9**	10

Reconciliation between audit and non-audit service fees is shown below:

All figures in £ millions	2016	2015
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	**7**	6
Non-audit fees	**2**	4
Total	**9**	10

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Included in non-audit fees are amounts related to carve out audits for disposals of £1m (2015: £1m).

5. Employee information

All figures in £ millions	Notes	2016	2015
Employee benefit expense			
Wages and salaries (including termination benefits)		**1,661**	1,507
Social security costs		**124**	124
Share-based payment costs	26	**22**	26
Retirement benefits – defined contribution plans	25	**67**	66
Retirement benefits – defined benefit plans	25	**16**	19
Other post-retirement medical benefits	25	**(2)**	–
Total		**1,888**	1,742

The details of the emoluments of the directors of Pearson plc are shown in the report on directors' remuneration.

Average number employed	2016	2015
Employee numbers		
North America	**16,841**	19,951
Core	**5,664**	5,936
Growth	**9,868**	11,114
Other	**346**	264
Continuing operations	**32,719**	37,265

The employee benefit expense relating to discontinued operations was £nil (2015: £132m) and the average number employed was nil (2015: 2,282).

6. Net finance costs

All figures in £ millions	Notes	2016	2015
Interest payable		**(74)**	(61)
Net foreign exchange losses		**(21)**	(36)
Derivatives not in hedging relationships		**(2)**	(3)
Finance costs		**(97)**	(100)
Interest receivable		**15**	15
Net finance income in respect of retirement benefits	25	**11**	4
Net foreign exchange gains		**1**	43
Derivatives not in hedging relationships		**10**	9
Finance income		**37**	71
Net finance costs		**(60)**	(29)
Analysed as:			
Net interest payable reflected in adjusted earnings		**(59)**	(46)
Other net finance (costs)/income		**(1)**	17
Total net finance costs		**(60)**	(29)

Included in interest receivable is £1m (2015: £1m) of interest receivable from related parties. There was a net movement of £nil on fair value hedges in 2016 (2015: £nil), comprising a loss of £4m (2015: gain of £22m) on the underlying bonds, offset by a gain of £4m (2015: loss of £22m) on the related derivative financial instruments.

For further information on adjusted measures above, see note 8.

Notes to the consolidated financial statements

7. Income tax

All figures in £ millions	Notes	2016	2015
Current tax			
Charge in respect of current year		**(71)**	(155)
Adjustments in respect of prior years		**32**	42
Total current tax charge		**(39)**	(113)
Deferred tax			
In respect of temporary differences		**277**	185
Other adjustments in respect of prior years		**(16)**	9
Total deferred tax credit	13	**261**	194
Total tax credit		**222**	81

The adjustments in respect of prior years in 2016 primarily arise from revising the previous year's reporting 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. In addition, there is a benefit from changes in estimates of uncertain tax positions. In 2015, the adjustments mainly related to changes in estimates of uncertain tax positions following the agreement of historical tax positions.

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the UK tax rate as follows:

All figures in £ millions	2016	2015
Loss before tax	**(2,557)**	(433)
Tax calculated at UK rate (2016: 20%, 2015: 20.25%)	**511**	88
Effect of overseas tax rates	**424**	52
Joint venture and associate income reported net of tax	**19**	10
Intangible impairment not subject to tax	**(722)**	(60)
Net expense not subject to tax	**(16)**	(6)
Gains and losses on sale of businesses not subject to tax	**15**	(32)
Unutilised tax losses	**(25)**	(22)
Adjustments in respect of prior years	**16**	51
Total tax credit	**222**	81
UK	**46**	(25)
Overseas	**176**	106
Total tax credit	**222**	81
Tax rate reflected in earnings	**8.7%**	18.7%

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.

In 2016 the Group impaired US goodwill (see note 11). The majority of this impairment charge is not deductible for tax purposes. In 2015, the impairment of goodwill and intangibles was deductible for tax purposes in the majority of territories.

7. Income tax continued

The tax rate reflected in adjusted earnings is calculated as follows:

All figures in £ millions	2016	2015
Loss before tax	**(2,557)**	(433)
Adjustments:		
Cost of major restructuring	**338**	–
Other net gains and losses	**25**	(13)
Intangible charges	**2,769**	1,089
Other net finance costs/(income)	**1**	(17)
Adjusted profit before tax – continuing operations	**576**	626
Adjusted profit before tax – discontinued operations	**–**	51
Total adjusted profit before tax	**576**	677
Total tax credit	**222**	81
Adjustments:		
Tax benefit on cost of major restructuring	**(84)**	–
Tax (benefit)/charge on other net gains and losses	**(14)**	40
Tax benefit on intangible charges	**(255)**	(257)
Tax charge on other net finance costs	**–**	7
Tax amortisation benefit on goodwill and intangibles	**36**	33
Adjusted income tax charge – continuing operations	**(95)**	(96)
Adjusted income tax charge – discontinued operations	**–**	(9)
Total adjusted income tax charge	**(95)**	(105)
Tax rate reflected in adjusted earnings	**16.5%**	15.5%

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	2016	2015
Net exchange differences on translation of foreign operations	**(5)**	5
Remeasurement of retirement benefit obligations	**58**	(24)
	53	(19)

A tax charge of £nil (2015: tax charge £1m) relating to share-based payments has been recognised directly in equity.

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. In 2016, the Group has outstanding share options which are anti-dilutive but which could potentially dilute basic earnings per share in the future.

Notes to the consolidated financial statements

8. Earnings per share continued

All figures in £ millions	Notes	2016	2015
Loss for the year from continuing operations		**(2,335)**	(352)
Non-controlling interest		**(2)**	–
Loss from continuing operations		**(2,337)**	(352)
Profit for the year from discontinued operations	3	**–**	1,175
(Loss)/earnings		**(2,337)**	823
Weighted average number of shares (millions)		**814.8**	813.3
Effect of dilutive share options (millions)		**–**	–
Weighted average number of shares (millions) for diluted earnings		**814.8**	813.3
(Loss)/earnings per share from continuing and discontinued operations			
Basic		**(286.8)p**	101.2p
Diluted		**(286.8)p**	101.2p
Loss per share from continuing operations			
Basic		**(286.8)p**	(43.3)p
Diluted		**(286.8)p**	(43.3)p
Earnings per share from discontinued operations			
Basic		**–**	144.5p
Diluted		**–**	144.5p

Adjusted

In order to show results from operating activities on a consistent basis, an adjusted earnings per share is presented. The company'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 financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables our 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, and major restructuring programmes.

The adjusted earnings per share includes both continuing and discontinued businesses on an undiluted basis. The following items are excluded from adjusted earnings:

Cost of major restructuring – In 2016, the definition of adjusted earnings has been amended to exclude the cost of major restructuring activity. In January 2016, Pearson announced that it was embarking on a restructuring programme to simplify the business, reduce costs and position the company for growth in its major markets. The costs of this programme in 2016 are significant enough to exclude from our adjusted earnings measure so as to better highlight the underlying performance. There was no major restructuring in 2015 and accordingly the change has no effect on the comparative adjusted earnings.

Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets and are excluded from adjusted earnings as it is important to highlight their impact on the 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.

Intangible charges and acquisition costs relate only to goodwill and intangible assets acquired through business combinations and the direct costs of acquiring those businesses. We do not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within our adjusted operating profit measure. There were no material acquisition costs in 2016 or 2015.

Other net finance income/costs include finance costs in respect of retirement benefits, finance costs of deferred consideration and foreign exchange and other gains and losses. Finance costs 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. 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. Other net finance costs of Group companies are included in finance costs or finance income as appropriate. Other net finance costs of joint ventures and associates are included within the share of results of joint ventures and associates within operating profit.

8. Earnings per share continued

Adjusted continued

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 for the above items is excluded from adjusted earnings. The following tables reconcile statutory earnings to adjusted earnings.

2016

All figures in £ millions	Statutory income statement	Discontinued operations	Cost of major restructuring	Other net gains and losses	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating (loss)/profit	**(2,497)**	**–**	**338**	**25**	**2,769**	**–**	**–**	**635**
Net finance costs	**(60)**	**–**	**–**	**–**	**–**	**1**	**–**	**(59)**
(Loss)/profit before tax	**(2,557)**	**–**	**338**	**25**	**2,769**	**1**	**–**	**576**
Income tax	**222**	**–**	**(84)**	**(14)**	**(255)**	**–**	**36**	**(95)**
(Loss)/profit for the year from continuing operations	**(2,335)**	**–**	**254**	**11**	**2,514**	**1**	**36**	**481**
(Loss)/Profit for the year from discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
(Loss)/profit for the year	**(2,335)**	**–**	**254**	**11**	**2,514**	**1**	**36**	**481**
Non-controlling interest	**(2)**	**–**	**–**	**–**	**–**	**–**	**–**	**(2)**
(Loss)/earnings	**(2,337)**	**–**	**254**	**11**	**2,514**	**1**	**36**	**479**
Weighted average number of shares (millions)	**814.8**							**814.8**
Weighted average number of shares (millions) for diluted earnings	**814.8**							**814.8**
(Loss)/earnings per share (basic)	**(286.8)p**							**58.8p**
(Loss)/earnings per share (diluted)	**(286.8)p**							**58.8p**

2015

All figures in £ millions	Statutory income statement	Discontinued operations	Costs of major restructuring	Other net gains and losses	Intangible charges	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating (loss)/profit	(404)	51	–	(13)	1,089	–	–	723
Net finance costs	(29)	–	–	–	–	(17)	–	(46)
(Loss)/profit before tax	(433)	51	–	(13)	1,089	(17)	–	677
Income tax	81	(9)	–	40	(257)	7	33	(105)
(Loss)/profit for the year from continuing operations	(352)	42	–	27	832	(10)	33	572
Profit for the year from discontinued operations	1,175	(42)	–	(1,135)	2	–	–	–
Profit for the year	823	–	–	(1,108)	834	(10)	33	572
Non-controlling interest	–	–	–	–	–	–	–	–
Earnings	823	–	–	(1,108)	834	(10)	33	572
Weighted average number of shares (millions)	813.3							813.3
Weighted average number of shares (millions) for diluted earnings	813.3							813.3
Earnings per share (basic)	101.2p							70.3p
Earnings per share (diluted)	101.2p							70.3p

Notes to the consolidated financial statements

9. Dividends

All figures in £ millions	2016	2015
Final paid in respect of prior year 34.0p (2015: 34.0p)	**277**	277
Interim paid in respect of current year 18.0p (2015: 18.0p)	**147**	146
	424	423

The directors are proposing a final dividend in respect of the financial year ended 31 December 2016 of 34.0p per share which will absorb an estimated £278m of shareholders' funds. It will be paid on 12 May 2017 to shareholders who are on the register of members on 7 April 2017. These financial statements do not reflect this dividend.

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2015	388	601	29	1,018
Exchange differences	8	10	1	19
Additions	15	42	25	82
Disposals	(20)	(86)	–	(106)
Disposal through business disposal	(48)	(76)	–	(124)
Reclassifications	16	17	(33)	–
At 31 December 2015	359	508	22	889
Exchange differences	**44**	**83**	**2**	**129**
Additions	**26**	**59**	**4**	**89**
Disposals	**(26)**	**(100)**	**–**	**(126)**
Disposal through business disposal	**(1)**	**(2)**	**–**	**(3)**
Reclassifications	**(4)**	**12**	**(8)**	**–**
At 31 December 2016	**398**	**560**	**20**	**978**

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2015	(231)	(453)	–	(684)
Exchange differences	(5)	(12)	–	(17)
Charge for the year	(22)	(53)	–	(75)
Disposals	18	82	–	100
Disposal through business disposal	48	59	–	107
At 31 December 2015	(192)	(377)	–	(569)
Exchange differences	**(26)**	**(62)**	**–**	**(88)**
Charge for the year	**(34)**	**(61)**	**–**	**(95)**
Disposals	**22**	**95**	**–**	**117**
Reclassifications	**1**	**(1)**	**–**	**–**
At 31 December 2016	**(229)**	**(406)**	**–**	**(635)**
Carrying amounts				
At 1 January 2015	157	148	29	334
At 31 December 2015	167	131	22	320
At 31 December 2016	**169**	**154**	**20**	**343**

10. Property, plant and equipment continued

Depreciation expense of £21m (2015: £19m) has been included in the income statement in cost of goods sold and £74m (2015: £50m) in operating expenses. In 2016, £nil (2015: £6m) relates to discontinued operations.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £10m (2015: £8m).

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 2015	5,030	597	894	308	197	598	7,624
Exchange differences	105	17	25	(17)	(7)	(40)	83
Impairment	(826)	–	–	–	–	–	(826)
Additions – internal development	–	125	–	–	–	–	125
Additions – purchased	–	36	–	–	–	–	36
Disposals	–	(18)	–	(4)	(10)	(29)	(61)
Acquisition through business combination	–	–	–	–	–	1	1
Disposal through business disposal	(175)	(138)	(59)	(6)	–	(21)	(399)
At 31 December 2015	4,134	619	860	281	180	509	6,583
Exchange differences	**752**	**85**	**157**	**65**	**31**	**135**	**1,225**
Impairment	**(2,548)**	**–**	**–**	**–**	**–**	**–**	**(2,548)**
Additions – internal development	**–**	**132**	**–**	**–**	**–**	**–**	**132**
Additions – purchased	**–**	**25**	**–**	**–**	**–**	**–**	**25**
Disposals	**–**	**(49)**	**(37)**	**–**	**–**	**–**	**(86)**
Acquisition through business combination	**3**	**–**		**7**	**–**	**3**	**13**
Disposal through business disposal	**–**	**–**	**(6)**	**–**	**–**	**(47)**	**(53)**
Transfer to intangible assets – pre-publication	**–**	**(14)**	**–**	**–**	**–**	**–**	**(14)**
At 31 December 2016	**2,341**	**798**	**974**	**353**	**211**	**600**	**5,277**

Notes to the consolidated financial statements

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2015	–	(386)	(349)	(122)	(160)	(297)	(1,314)
Exchange differences	–	(14)	(8)	1	6	(6)	(21)
Impairment	–	–	(13)	(1)	(9)	–	(23)
Charge for the year	–	(74)	(99)	(40)	(10)	(53)	(276)
Disposals		18	–	4	10	29	61
Disposal through business disposal	–	99	39	3	–	13	154
At 31 December 2015	–	(357)	(430)	(155)	(163)	(314)	(1,419)
Exchange differences	**–**	**(60)**	**(83)**	**(32)**	**(27)**	**(75)**	**(277)**
Impairment	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Charge for the year	**–**	**(84)**	**(85)**	**(22)**	**(8)**	**(70)**	**(269)**
Disposals	**–**	**38**	**37**	**–**	**–**	**–**	**75**
Disposal through business disposal	**–**	**–**	**6**	**–**	**–**	**47**	**53**
Transfer to intangible assets – pre-publication	**–**	**2**	**–**	**–**	**–**	**–**	**2**
At 31 December 2016	**–**	**(461)**	**(555)**	**(209)**	**(198)**	**(412)**	**(1,835)**
Carrying amounts							
At 1 January 2015	5,030	211	545	186	37	301	6,310
At 31 December 2015	4,134	262	430	126	17	195	5,164
At 31 December 2016	**2,341**	**337**	**419**	**144**	**13**	**188**	**3,442**

Goodwill

The goodwill carrying value of £2,341m 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 and the goodwill on each acquisition 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 £17m (2015: £13m) is included in the income statement in cost of goods sold and £252m (2015: £247m) in operating expenses. In 2016, £nil (2015: £16m) of amortisation relates to discontinued operations.

11. Intangible assets continued

Other intangible assets continued

The range of useful economic lives for each major class of intangible asset (excluding goodwill and software) is shown below:

	2016
Class of intangible asset	Useful economic life
Acquired customer lists, contracts and relationships	**3–20 years**
Acquired trademarks and brands	**2–20 years**
Acquired publishing rights	**5–20 years**
Other intangibles acquired	**2–20 years**

The expected amortisation profile of acquired intangible assets is shown below:

	2016			
All figures in £ millions	One to five years	Six to ten years	More than ten years	Total
Class of intangible asset				
Acquired customer lists, contracts and relationships	**282**	**102**	**35**	**419**
Acquired trademarks and brands	**69**	**48**	**27**	**144**
Acquired publishing rights	**11**	**2**	**–**	**13**
Other intangibles acquired	**139**	**45**	**4**	**188**

Impairment tests for cash-generating units (CGUs) containing goodwill

Impairment tests have been carried out where appropriate as described below.

Following a reorganisation of the business effective 1 January 2014 goodwill was allocated to CGUs, or an aggregation of CGUs, where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs. The carrying value of the goodwill in each of the CGUs, after the impact of impairments, is summarised below:

All figures in £ millions	2016	2015
North America	**1,295**	3,155
Core	**633**	635
Growth (includes Brazil, China, India and South Africa)	**–**	–
Pearson VUE	**413**	344
Financial Times Group	**–**	–
Total	**2,341**	4,134

The recoverable amount of each aggregated CGU is based on fair value less costs of disposal or value in use calculations as appropriate. Goodwill is tested at least annually for impairment. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the US higher education courseware business market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, strategic plans and estimates for future cash flows were revised and we determined during the goodwill impairment review that the fair value less costs of disposal of the North America cash generating unit (CGU) no longer supported the carrying value of this goodwill and as a consequence impaired goodwill by £2,548m. Fair value less cost of disposal was determined using post-tax discount rate of 9.2% for North America. Following the impairment, the recoverable amount of the North America CGU is £2,650m.

Notes to the consolidated financial statements

11. Intangible assets continued

Key assumptions

For the purpose of estimating the fair value less costs of disposal of the CGUs, management has used an income approach based on present value techniques. The calculations use cash flow projections based on financial budgets approved by management covering a five-year period, management's best estimate about future developments and market assumptions. The fair value less costs of disposal measurement is categorised as Level 3 on the fair value hierarchy. The key assumptions used by management in the fair value less costs of disposal calculations were:

Discount rates The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average post-tax discount rates range from 7.9% to 15.5%. 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% (2015: 2.0%) was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historical growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 4.4% and 7.0% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historical growth rates in these markets.

The key assumptions used by management in setting the financial budgets for the initial five-year period were as follows:

Forecast sales growth rates Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key factors include US and UK college enrolment rates, assessment growth rates, the success of new product launches, growth rates and economic conditions in emerging markets and the rate of growth in new services businesses. The five-year sales forecasts use average nominal growth rates between 2.0% and 8.6% for mature markets and between 7.0% and 19.8% for emerging markets with high inflation.

Operating profits Operating profits are forecast based on historical experience of operating margins, adjusted for the impact of changes to product costs and cost-saving initiatives, including the impact of the global restructuring programme benefits from 2016.

Cash conversion Cash conversion is the ratio of operating cash flow to operating profit. Management forecasts cash conversion rates based on historical experience, adjusted for the impact of product investment priorities and the shift to digital and service-based business.

Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates. The carrying value of goodwill in the Growth market CGUs was written down to £nil in 2015. In the North America CGU, goodwill has been written down to fair value less costs of disposal, and any further increase in discount rates or reduction in perpetuity growth rates would give rise to further impairment. A 0.1% increase in discount rates would cause the fair value less costs of disposal of the North America CGU to reduce by £35m and the Core GGU by £16m. A 0.1% reduction in perpetuity growth rates would cause the fair value less costs of disposal of the North America CGU to reduce by £30m and the Core CGU by £14m. The North America CGU which has been written down to fair value less costs of disposal and the Core CGU are highly sensitive to any reductions in short-term cash flows, whether driven by lower sales growth, lower operating profits or lower cash conversion. A 5% reduction in total annual operating profits, spread evenly across all CGUs, would give rise to an impairment of £209m in the North America CGU and £43m in the Core CGU.

2015 impairment tests

In 2015, following significant economic and market deterioration in the Group's operations in emerging markets and ongoing cyclical and policy related pressures in the Group's mature market operations, an impairment of £507m was booked in respect of the Group's Growth operations, representing impairments of £269m in the Brazil CGU, £181m in the China CGU, £48m in the South Africa CGU and £9m in the Other Growth CGU, thereby bringing the carrying value of goodwill in those CGUs down to £nil. Impairments of £10m and £13m were also booked in respect of other acquired intangibles in the South Africa and Other Growth CGUs respectively, bringing their carrying value down to £nil. Impairments of £282m and £37m were also booked in respect of the North America and Core CGUs respectively, bringing the carrying value of the goodwill in those CGUs down to fair value less costs of disposal.

12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2016	2015
Associates	**1,245**	1,099
Joint ventures	**2**	4
Total	**1,247**	1,103

The amounts recognised in the income statement are as follows:

All figures in £ millions	2016	2015
Associates	**98**	72
Joint ventures	**(1)**	(4)
Total	**97**	68

There are no discontinued operations in 2016. Included within the 2015 results are discontinued operations consisting of £17m profit from associates and £1m loss from joint ventures. For further information on discontinued operations and the profit on sale of associates and joint ventures, see notes 3 and 31.

Investment in associates

On 16 October 2015, the Group sold a 39% stake, out of its 50% stake, in The Economist (see note 31 for further information).

The Group has the following material associates:

	Principal place of business	Ownership interest	Nature of relationship	Measurement method
Penguin Random House Ltd	UK/Global	47%	See below	Equity
Penguin Random House LLC	US	47%	See below	Equity

On 1 July 2013, Penguin Random House (PRH) 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. Pearson owns its 47% interest in PRH via 47% interests in each of the two entities listed in the table above. Despite the separate legal structures of the two PRH entities, Pearson regards PRH as one combined global business. Consequently, Pearson discloses PRH as one single operating segment and presents disclosures related to its interests in PRH on a combined basis.

The shareholder agreement includes protective rights for Pearson as the minority shareholder, including rights to dividends. Management considers ownership percentage, board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over PRH and Bertelsmann has the power to direct the relevant activities and therefore control. PRH does not have a quoted market price.

Notes to the consolidated financial statements

12. Investments in joint ventures and associates continued

Investment in associates continued

The summarised financial information of the material associates is detailed below:

All figures in £ millions	2016 Penguin Random House	2015 Penguin Random House	2015 The Economist
Assets			
Current assets	**1,587**	1,354	–
Non-current assets	**1,267**	1,244	–
Liabilities			
Current liabilities	**(1,074)**	(1,034)	–
Non-current liabilities	**(394)**	(358)	–
Net assets	**1,386**	1,206	–
Sales	**2,620**	2,453	276
Profit from continuing operations	**209**	136	–
Profit from discontinued operations	**–**	–	34
Other comprehensive (expense)/income	**(14)**	51	–
Total comprehensive income	**195**	187	34
Dividends received from associate	**131**	142	20

The information above reflects the amounts presented in the financial statements of the associates, adjusted for fair value and similar adjustments. Amounts presented in 2015 for The Economist cover the period up until the date of the partial disposal. The tax on Penguin Random House LLC is settled by the partners. For the purposes of clear and consistent presentation, the tax has been shown in the associate line items in the consolidated income statement and consolidated balance sheet, recording the Group's share of profit after tax consistently for the Penguin Random House associates.

A reconciliation of the summarised financial information to the carrying value of the material associates is shown below:

All figures in £ millions	2016 Penguin Random House	2015 Penguin Random House	2015 The Economist
Opening net assets	**1,206**	1,247	–
Exchange differences	**179**	(1)	–
Profit for the period	**209**	136	34
Other comprehensive (expense)/income	**(14)**	51	–
Dividends, net of tax paid	**(194)**	(229)	(40)
Additions	**–**	2	–
Reversal of distribution from associate in excess of carrying value	**–**	–	(3)
Disposal	**–**	–	9
Closing net assets	**1,386**	1,206	–
Share of net assets	**651**	567	–
Goodwill	**589**	526	–
Carrying value of associate	**1,240**	1,093	–

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	2016	2015
Loss from continuing operations	–	(9)
Total comprehensive expense	**–**	(9)

Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2016 was £33m (2015: £47m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2016 was repaid in its entirety in January 2017.

The Group also has a current asset receivable of £21m (2015: £27m) from Penguin Random House arising from the provision of services. Included in other income (note 4) is £4m (2015: £16m) of service fees.

Investment in joint ventures

Information on joint ventures, all of which are individually immaterial, is detailed below:

All figures in £ millions	2016	2015
Loss from continuing operations	**(1)**	(3)
Loss from discontinued operations	**–**	(1)
Total comprehensive expense	**(1)**	(4)

13. Deferred income tax

All figures in £ millions	2016	2015
Deferred income tax assets	**451**	276
Deferred income tax liabilities	**(466)**	(560)
Net deferred income tax	**(15)**	(284)

Substantially all of the deferred income tax assets are expected to be recovered after more than one year.

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. At 31 December 2016, the Group has unrecognised deferred income tax assets of £32m (2015: £32m) in respect of UK losses, £18m (2015: £11m) in respect of US losses and approximately £95m (2015: £70m) in respect of losses in other territories. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

All figures in £ millions	Notes	2016	2015
At beginning of year		**(284)**	(419)
Exchange differences		**(22)**	(26)
Income statement benefit	7	**261**	196
Disposal through business disposal	31	**(10)**	1
Tax benefit/(charge) to other comprehensive income or equity		**40**	(36)
At end of year		**(15)**	(284)

Included in the income statement above for 2016 is £nil (2015: £2m benefit) relating to discontinued operations.

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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	Other	Total
Deferred income tax assets						
At 1 January 2015	28	44	62	2	159	295
Exchange differences	5	3	4	1	8	21
Income statement charge	(14)	(4)	(3)	52	(67)	(36)
Tax charge to other comprehensive income or equity	–	–	(4)	–	–	(4)
At 31 December 2015	19	43	59	55	100	276
Exchange differences	**3**	**7**	**10**	**15**	**35**	**70**
Income statement (charge)/benefit	**–**	**(15)**	**(1)**	**50**	**75**	**109**
Disposal through business disposal	**–**	**–**	**–**	**(3)**	**(1)**	**(4)**
At 31 December 2016	**22**	**35**	**68**	**117**	**209**	**451**

Deferred tax assets on deferred revenue are net of liabilities in the US which arose on a change in tax treatment agreed in 2015 and which will unwind over 4 years. Other deferred income tax assets include temporary differences on goodwill, share-based payments, inventory and other provisions.

All figures in £ millions	Goodwill and intangibles	Retirement benefit obligations	Other	Total
Deferred income tax liabilities				
At 1 January 2015	(598)	(39)	(77)	(714)
Exchange differences	(41)	–	(6)	(47)
Income statement benefit	180	2	50	232
Disposal through business disposal	1	–	–	1
Tax charge to other comprehensive income or equity	–	(31)	(1)	(32)
At 31 December 2015	(458)	(68)	(34)	(560)
Exchange differences	**(85)**	**–**	**(7)**	**(92)**
Income statement benefit	**144**	**(3)**	**11**	**152**
Disposal through business disposal	**(7)**	**–**	**1**	**(6)**
Tax benefit to other comprehensive income or equity	**–**	**40**	**–**	**40**
At 31 December 2016	**(406)**	**(31)**	**(29)**	**(466)**

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

14. Classification of financial instruments

The accounting classification of each class of the Group's financial assets and their carrying values, is as follows:

All figures in £ millions	Notes	2016 Fair value: Available for sale	2016 Fair value: Derivatives held for trading	2016 Fair value: Derivatives in hedging relationships	2016 Amortised cost: Loans and receivables	2016 Total carrying value	2015 Fair value: Available for sale	2015 Fair value: Derivatives held for trading	2015 Fair value: Derivatives in hedging relationships	2015 Amortised cost: Loans and receivables	2015 Total carrying value
Investments in unlisted securities	15	65	–	–	–	65	143	–	–	–	143
Cash and cash equivalents	17	–	–	–	1,459	1,459	–	–	–	1,703	1,703
Marketable securities		10	–	–	–	10	28	–	–	–	28
Derivative financial instruments	16	–	3	168	–	171	–	29	81	–	110
Trade receivables	22	–	–	–	982	982	–	–	–	963	963
Total financial assets		**75**	**3**	**168**	**2,441**	**2,687**	171	29	81	2,666	2,947

The carrying value of the Group's financial assets is equal to the market value.

The accounting classification of each class of the Group's financial liabilities, together with their carrying values and market values, is as follows:

All figures in £ millions	Notes	2016 Fair value: Derivatives held for trading	2016 Fair value: Derivatives in hedging relationships	2016 Amortised cost: Other liabilities	2016 Total carrying value	2016 Total market value	2015 Fair value: Derivatives held for trading	2015 Fair value: Derivatives in hedging relationships	2015 Amortised cost: Other liabilities	2015 Total carrying value	2015 Total market value
Derivative financial liabilities	16	(7)	(257)	–	(264)	(264)	(36)	(129)	–	(165)	(165)
Trade payables	24	–	–	(333)	(333)	(333)	–	–	(319)	(319)	(319)
Bank loans and overdrafts	18	–	–	(39)	(39)	(39)	–	–	(38)	(38)	(38)
Borrowings due within one year	18	–	–	(5)	(5)	(5)	–	–	(244)	(244)	(244)
Borrowings due after more than one year	18	–	–	(2,424)	(2,424)	(2,385)	–	–	(2,048)	(2,048)	(2,009)
Total financial liabilities		**(7)**	**(257)**	**(2,801)**	**(3,065)**	**(3,026)**	(36)	(129)	(2,649)	(2,814)	(2,775)

Fair value measurement

As shown above, the Group's derivative assets and liabilities and marketable securities are held at fair value.

Financial instruments that are measured subsequently to initial recognition at fair value are grouped into levels 1 to 3, based on the degree to which the fair value is observable, as follows:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Group's derivative assets valued at £171m (2015: £110m) and derivative liabilities valued at £264m (2015: £165m) are classified as level 2. The Group's marketable securities assets valued at £10m (2015: £28m) are classified as level 2. The Group's investments in unlisted securities are valued at £65m (2015: £143m) and are classified as level 3.

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14. Classification of financial instruments continued

Fair value measurement continued

The following table analyses the movements in level 3 fair value remeasurements:

All figures in £ millions	2016 Investments in unlisted securities	2015 Investments in unlisted securities
At beginning of year	**143**	45
Exchange differences	**8**	3
Acquisition of investments	**6**	101
Fair value movements	**–**	–
Disposal of investments	**(92)**	(6)
At end of year	**65**	143

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset and amounts realised on the sale of similar assets. In 2015, the fair value of the 11% stake in The Economist was valued by reference to the disposal transaction terms.

15. Other financial assets

All figures in £ millions	2016	2015
At beginning of year	**143**	54
Exchange differences	**8**	3
Acquisition of investments	**6**	101
Fair value movements	**–**	–
Disposal of investments	**(92)**	(15)
At end of year	**65**	143

Other financial assets comprise unlisted securities of £65m (2015: £143m). In 2015, acquisition of investments includes the remaining 11% stake in The Economist (see note 31 for further information), this investment was disposed in 2016 with no further gain or loss.

16. Derivative financial instruments

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:

	2016			2015		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	**2,157**	**68**	**(4)**	1,952	70	(10)
Interest rate derivatives – not in a hedge relationship	**1,187**	**3**	**(7)**	848	–	(6)
Cross-currency rate derivatives – in a hedge relationship	**1,622**	**100**	**(253)**	1,879	10	(119)
Cross-currency rate derivatives – not in a hedge relationship	**–**	**–**	**–**	120	30	(30)
Total	**4,966**	**171**	**(264)**	4,799	110	(165)
Analysed as expiring:						
In less than one year	**162**	**–**	**–**	324	32	(29)
Later than one year and not later than five years	**2,776**	**86**	**(157)**	1,255	44	(4)
Later than five years	**2,028**	**85**	**(107)**	3,220	34	(132)
Total	**4,966**	**171**	**(264)**	4,799	110	(165)

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

16. Derivative financial instruments continued

The Group has issued fixed rate euro debt, which is converted to floating rates using interest rate swaps and subsequently converted to floating rate US dollar debt using cross-currency swaps. The Group's fixed rate US dollar debt is converted to floating rates using interest rate swaps. The Group receives interest under its debt-related swap contracts to match the interest on the bonds (ranging from a receipt of 1.375% on its euro 2025 notes to 6.25% on its Global dollar bonds 2018) and, in turn, ultimately pays US dollar interest at rates ranging between US Libor + 0.51% to US Libor + 1.82%. In line with the Group's hedging policy, short-term contracts have been used to fix the Libor element for 2017 on $800m at rates between 1.10% and 2.03%.

At the end of 2016, 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 £(1,051)m, sterling £19m and euro £939m (2015: US dollar £(917)m, sterling £102m and euro £759m).

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.

Derivative financial assets and liabilities subject to offsetting arrangements are as follows:

	2016			2015		
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	**30**	**(11)**	**19**	50	(22)	28
Counterparties in a liability position	**141**	**(253)**	**(112)**	60	(143)	(83)
Total as presented in the balance sheet	**171**	**(264)**	**(93)**	110	(165)	(55)

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.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement', the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2016	2015
Cash at bank and in hand	**570**	627
Short-term bank deposits	**889**	1,076
	1,459	1,703

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2016, the currency split of cash and cash equivalents was US dollar 34% (2015: 23%), sterling 40% (2015: 57%), euro 3% (2015: 2%), renminbi 10% (2015: 8%) and other 13% (2015: 10%).

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17. Cash and cash equivalents (excluding overdrafts) continued

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	2016	2015
Cash and cash equivalents – continuing operations	**1,459**	1,703
Bank overdrafts – continuing operations	**(35)**	(32)
	1,424	1,671

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. At 31 December 2016 the offsetting amounts are presented gross in the balance sheet. Offset arrangements in respect of derivatives are shown in note 16.

18. Financial liabilities – borrowings

The Group's current and non-current borrowings are as follows:

All figures in £ millions	2016	2015
Non-current		
6.25% Global dollar bonds 2018 (nominal amount $550m)	**469**	403
4.625% US dollar notes 2018 (nominal amount $300m)	**254**	218
1.875% Euro notes 2021 (nominal amount €500m)	**453**	386
3.75% US dollar notes 2022 (nominal amount $500m)	**407**	342
3.25% US dollar notes 2023 (nominal amount $500m)	**402**	336
1.375% Euro notes 2025 (nominal amount €500m)	**435**	359
Finance lease liabilities	**4**	4
	2,424	2,048
Current		
Due within one year or on-demand:		
4.0% US dollar notes 2016 (nominal amount $350m)	**–**	240
Bank loans and overdrafts	**39**	38
Finance lease liabilities	**5**	4
	44	282
Total borrowings	**2,468**	2,330

Included in the non-current borrowings above is £18m of accrued interest (2015: £15m). Included in the current borrowings above is £nil of accrued interest (2015: £1m).

The maturity of the Group's non-current borrowing is as follows:

All figures in £ millions	2016	2015
Between one and two years	**726**	3
Between two and five years	**454**	622
Over five years	**1,244**	1,423
	2,424	2,048

18. Financial liabilities – borrowings continued

The carrying amounts and market values of borrowings are as follows:

All figures in £ millions	2016 Effective interest rate	2016 Carrying value	2016 Market value	2015 Effective interest rate	2015 Carrying value	2015 Market value
Bank loans and overdrafts	**n/a**	**39**	**39**	n/a	38	38
4.0% US dollar notes 2016	**4.26%**	**–**	**–**	4.26%	240	240
6.25% Global dollar bonds 2018	**6.46%**	**469**	**468**	6.46%	403	405
4.625% US dollar notes 2018	**4.69%**	**254**	**250**	4.69%	218	213
1.875% euro notes 2021	**2.04%**	**453**	**454**	2.04%	386	380
3.75% US dollar notes 2022	**3.94%**	**407**	**396**	3.94%	342	335
3.25% US dollar notes 2023	**3.36%**	**402**	**381**	3.36%	336	322
1.375% euro notes 2025	**1.44%**	**435**	**432**	1.44%	359	350
Finance lease liabilities	**n/a**	**9**	**9**	n/a	8	8
		2,468	**2,429**		2,330	2,291

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings before the effect of derivatives (see notes 16 and 19 for further information on the impact of derivatives) are denominated in the following currencies:

All figures in £ millions	2016	2015
US dollar	**1,559**	1,563
Sterling	**13**	1
Euro	**892**	759
Other	**4**	7
	2,468	2,330

The Group has $1.75bn (£1.4bn) of undrawn capacity on its committed borrowing facilities as at 31 December 2016 (2015: $1.75bn (£1.2bn) undrawn). In addition, there are a number of short-term facilities that are utilised in the normal course of business.

All of the Group's borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

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18. Financial liabilities – borrowings continued

The maturity of the Group's finance lease obligations is as follows:

All figures in £ millions	2016	2015
Finance lease liabilities – minimum lease payments		
Not later than one year	**5**	4
Later than one year and not later than two years	**3**	3
Later than two years and not later than three years	**1**	1
Later than three years and not later than four years	**–**	–
Later than four years and not later than five years	**–**	–
Later than five years	**–**	–
Future finance charges on finance leases	**–**	–
Present value of finance lease liabilities	**9**	8

The present value of finance lease liabilities is as follows:

All figures in £ millions	2016	2015
Not later than one year	**5**	4
Later than one year and not later than five years	**4**	4
Later than five years	**–**	–
	9	8

The carrying amounts of the Group's lease obligations approximate their fair value.

19. Financial risk management

The Group's approach to the management of financial risks together with sensitivity analyses of its financial instruments is set out below.

Treasury policy

Pearson's treasury function has primary responsibility for managing certain financial risks to which the Group is exposed. The Group's treasury policies are approved by the board of Directors annually and the audit committee receives regular reports on the Group's treasury activities, policies and procedures. Pearson's treasury function is not run as a profit centre and does not enter into any transactions for speculative purposes.

The treasury function is permitted to use derivatives for risk management purposes which may include interest rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts, of which interest rate swaps and forward foreign exchange swaps are the most commonly used.

Capital risk

The Group's objectives when managing capital are to:

- Safeguard the Group's ability to continue as a going concern and retain financial flexibility by maintaining a well-managed balance sheet
- Provide returns for shareholders and benefits for other stakeholders
- Maintain a solid investment grade credit rating.

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

19. Financial risk management continued

Net debt

The Group's net debt position is set out below:

All figures in £ millions	2016	2015
Cash and cash equivalents	**1,459**	1,703
Marketable securities	**10**	28
Derivative financial instruments	**(93)**	(55)
Bank loans and overdrafts	**(39)**	(38)
Bonds	**(2,420)**	(2,284)
Finance lease liabilities	**(9)**	(8)
Net debt	**(1,092)**	(654)

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 bond debt is held in US dollars to provide a natural hedge of this exposure and is primarily held at floating rates, which is achieved in two ways:

- Issuing fixed rate US dollar bonds which are swapped to floating rates using interest rate swaps
- Issuing fixed rate euro bonds which are swapped to US dollars and floating rates using cross-currency interest rate swaps.

Interest rate swaps are then used to fix an element of the interest charge for the next 12–24 months, in line with the Group's interest rate hedging policy, which requires a proportion of the Group's gross debt to be fixed. At 31 December 2016, the Group had contracts to fix $800m of debt for the next 12 months (2015: $850m).

Overseas profits are converted to sterling to satisfy sterling cash outflows such as dividends at the prevailing spot rate at the time of the transaction. To the extent the Group has sufficient sterling, US dollars may be held as dollar cash to provide a natural offset to the Group's debt or to satisfy future US dollar cash outflows.

The Group does not have significant cross border foreign exchange transactional exposures.

As at 31 December 2016, the sensitivity of the carrying value of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in unlisted securities	65	–	–	(5)	6
Cash and cash equivalents	1,459	–	–	(79)	97
Marketable securities	10	–	–	–	–
Derivative financial instruments	(93)	(88)	104	10	(12)
Bonds	(2,420)	92	(100)	220	(269)
Other borrowings	(48)	–	–	3	(4)
Other net financial assets	649	–	–	(55)	67
Total financial instruments	**(378)**	**4**	**4**	**94**	**(115)**

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. Other net financial assets comprises trade receivables less trade payables.

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19. Financial risk management continued

Interest and foreign exchange rate management continued

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 £55m higher than the reported figure of £635m at £690m (2015: £16m higher if translated at the year-end 2015 rate instead of the 2015 average rate at £739m compared to a reported figure of £723m). EBITDA translated at year-end closing rates would be £63m higher than the reported figure of £785m at £848m (2015: £19m higher if translated at the year-end 2015 rate instead of the 2015 average rate, at £891m, compared with a reported figure of £872m).

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 repayments of debt at its maturity and identifying an appropriate amount of headroom to provide a reserve against unexpected outflows.

At 31 December 2016, the Group had cash of £1.5bn and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75bn (£1.4bn). At 31 December 2015, the Group had cash of over £1.7bn and an undrawn revolving credit facility due 2020 of $1.75bn (£1.2bn).

The $1.75bn facility contains interest cover and leverage covenants which the Group has complied with for the year ended 31 December 2016.

At the end of 2016, the currency split of the Group's trade payables was US dollar £164m, sterling £67m and other currencies £102m (2015: US dollar £188m, sterling £58m and other currencies £73m) . Trade payables are all due within one year (2015: all due within one year).

The following table analyses the Group's bonds and derivative assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. 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	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 2016								
Bonds	**82**	**1,308**	**1,292**	**2,682**	**1,732**	**–**	**950**	**2,682**
Rate derivatives – inflows	**(103)**	**(1,086)**	**(867)**	**(2,056)**	**(239)**	**(838)**	**(979)**	**(2,056)**
Rate derivatives – outflows	**82**	**1,202**	**891**	**2,175**	**1,308**	**838**	**29**	**2,175**
Total	**61**	**1,424**	**1,316**	**2,801**	**2,801**	**–**	**–**	**2,801**
At 31 December 2015								
Bonds	311	769	1,494	2,574	1,745	–	829	2,574
Rate derivatives – inflows	(218)	(266)	(1,628)	(2,112)	(335)	(858)	(919)	(2,112)
Rate derivatives – outflows	189	202	1,712	2,103	1,155	858	90	2,103
Total	**282**	**705**	**1,578**	**2,565**	**2,565**	**–**	**–**	**2,565**

Financial counterparty risk management

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 ratings 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.

20. Intangible assets – pre-publication

All figures in £ millions	2016	2015
Cost		
At beginning of year	**2,201**	2,138
Exchange differences	**380**	66
Additions	**395**	347
Disposal through business disposal	**(8)**	(90)
Disposals	**(565)**	(260)
Transfer from intangible assets	**14**	–
At end of year	**2,417**	2,201
Amortisation		
At beginning of year	**(1,360)**	(1,318)
Exchange differences	**(250)**	(47)
Charge for the year	**(350)**	(281)
Disposal through business disposal	**4**	26
Disposals	**565**	260
Transfer from intangible assets	**(2)**	–
At end of year	**(1,393)**	(1,360)
Carrying amounts		
At end of year	**1,024**	841

Included in the above are pre-publication assets amounting to £694m (2015: £580m) which will be realised in more than one year.

Amortisation is included in the income statement in cost of goods sold. There was no amortisation within discontinued operations in either year.

Disposal through business disposal amounts in 2016 relate to the disposal of Pearson English Business Solutions and in 2015 to the disposal of PowerSchool. See note 31 for further information.

21. Inventories

All figures in £ millions	2016	2015
Raw materials	**5**	8
Work in progress	**6**	8
Finished goods	**224**	195
	235	211

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £340m (2015: £331m). In 2016, £48m (2015: £33m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

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22. Trade and other receivables

All figures in £ millions	2016	2015
Current		
Trade receivables	**961**	938
Royalty advances	**22**	20
Prepayments	**124**	97
Accrued income	**15**	21
Other receivables	**235**	208
	1,357	1,284
Non-current		
Trade receivables	**21**	25
Royalty advances	**10**	13
Prepayments	**13**	20
Accrued income	**31**	23
Other receivables	**29**	34
	104	115

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns. The movements on the provision for bad and doubtful debts are as follows:

All figures in £ millions	2016	2015
At beginning of year	**(64)**	(73)
Exchange differences	**(17)**	3
Income statement movements	**(53)**	(31)
Utilised	**22**	32
Disposal through business disposal	**–**	5
At end of year	**(112)**	(64)

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	2016	2015
Within due date	**812**	754
Up to three months past due date	**232**	253
Three to six months past due date	**55**	58
Six to nine months past due date	**21**	19
Nine to 12 months past due date	**14**	13
More than 12 months past due date	**7**	16
Total trade receivables	**1,141**	1,113
Less: provision for sales returns	**(159)**	(150)
Net trade receivables	**982**	963

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historical payment profiles. Management believes all the remaining receivable balances are fully recoverable.

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2016	53	6	20	34	113
Exchange differences	**10**	**(2)**	**–**	**11**	**19**
Charged to income statement	**–**	**1**	**–**	**9**	**10**
Released to income statement	**–**	**–**	**–**	**(9)**	**(9)**
Utilised	**(7)**	**(1)**	**(10)**	**(9)**	**(27)**
At 31 December 2016	**56**	**4**	**10**	**36**	**106**

Analysis of provisions:

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
					2016
Current	**6**	**1**	**8**	**12**	**27**
Non-current	**50**	**3**	**2**	**24**	**79**
	56	**4**	**10**	**36**	**106**
					2015
Current	5	3	15	19	42
Non-current	48	3	5	15	71
	53	6	20	34	113

Deferred consideration primarily relates to the formation of a venture in a North America business in 2011. Disposals and closures include liabilities related to the disposal of Penguin. Legal and other includes legal claims, contract disputes and potential contract losses.

24. Trade and other liabilities

All figures in £ millions	2016	2015
Trade payables	**333**	319
Social security and other taxes	**25**	22
Accruals	**507**	371
Deferred income	**883**	766
Interest payable	**31**	19
Other liabilities	**272**	249
	2,051	1,746
Less: non-current portion		
Accruals	**17**	20
Deferred income	**319**	262
Other liabilities	**86**	74
	422	356
Current portion	**1,629**	1,390

The carrying value of the Group’s trade and other liabilities approximates its fair value.

The deferred income balance principally comprises multi-year obligations to deliver workbooks to adoption customers in school businesses; advance payments in assessment, testing and training businesses; subscription income in school and college businesses; and obligations to deliver digital content in future periods.

Notes to the consolidated financial statements

25. Retirement benefit and other post-retirement obligations

Background

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world.

The largest plan is the Pearson Group Pension Plan (UK Group plan) in the UK, which is sectionalised to provide both defined benefit and defined contribution pension benefits. The defined benefit section was closed to new members from 1 November 2006. The defined contribution section, opened in 2003, is open to new and existing employees. Finally, there is a separate section within the UK Group plan set up for auto-enrolment. The defined benefit section of the UK Group plan is a final salary pension plan which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends on the length of service and final pensionable pay. The UK Group plan is funded with benefit payments from trustee-administered funds. The UK Group plan is administered in accordance with the Trust Deed and Rules in the interests of its beneficiaries by Pearson Group Pension Trustee Limited.

At 31 December 2016, the UK Group plan had approximately 25,000 members, analysed in the following table:

All figures in %	Active	Deferred	Pensioners	Total
Defined benefit	**1**	**27**	**34**	**62**
Defined contribution	**9**	**29**	**–**	**38**
Total	**10**	**56**	**34**	**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.

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.

			2016			2015
All figures in %	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	**3.3**	**1.6**	**1.5**	3.1	2.5	2.5
Rate used to discount plan liabilities	**2.5**	**3.8**	**3.9**	3.7	4.0	4.0
Expected rate of increase in salaries	**3.8**	**3.0**	**3.0**	3.6	3.0	3.0
Expected rate of increase for pensions in payment and deferred pensions	**2.2 to 5.1**	**–**	**–**	1.9 to 5.1	–	–
Initial rate of increase in healthcare rate	**–**	**–**	**6.8**	–	–	7.0
Ultimate rate of increase in healthcare rate	**–**	**–**	**5.0**	–	–	5.0

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities. The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.3% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.3% has been used.

The expected rate of increase in salaries has been set at 3.8% for 2016 with a short-term assumption of 2.0% for three years.

For the UK plan, the mortality base table assumptions have been derived from the SAPS 'all pensioners' tables for males and the SAPS 'normal health pensioners' tables for females, adjusted to reflect the observed experience of the plan, with CMI model improvement factors. A 1.5% long-term rate improvement on the CMI model is applied for both males and females.

For the US plans, the mortality table (RP – 2014) and 2014 improvement scale (MP – 2014) with no adjustments have been adopted, reflecting the mortality assumption most prevalent in the US.

25. Retirement benefit and other post-retirement obligations continued

Assumptions continued

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows:

All figures in years	UK 2016	UK 2015	US 2016	US 2015
Male	**23.5**	23.5	**21.2**	21.2
Female	**25.6**	25.6	**23.2**	23.2

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

All figures in years	UK 2016	UK 2015	US 2016	US 2015
Male	**25.5**	25.5	**22.9**	22.9
Female	**27.8**	27.8	**24.9**	24.9

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.

Financial statement information

The amounts recognised in the income statement are as follows:

All figures in £ millions						2016
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	**8**	**2**	**10**	**67**	**–**	**77**
Curtailments	**–**	**–**	**–**	**–**	**(2)**	**(2)**
Administration expenses	**6**	**–**	**6**	**–**	**–**	**6**
Total operating expense	**14**	**2**	**16**	**67**	**(2)**	**81**
Interest on plan assets	**(104)**	**(6)**	**(110)**	**–**	**–**	**(110)**
Interest on plan liabilities	**89**	**7**	**96**	**–**	**3**	**99**
Net finance (income)/expense	**(15)**	**1**	**(14)**	**–**	**3**	**(11)**
Net income statement charge	**(1)**	**3**	**2**	**67**	**1**	**70**

All figures in £ millions						2015
	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	20	2	22	74	–	96
Curtailments	(3)	–	(3)	–	–	(3)
Administration expenses	5	–	5	–	–	5
Total operating expense	22	2	24	74	–	98
Interest on plan assets	(98)	(5)	(103)	–	–	(103)
Interest on plan liabilities	90	7	97	–	2	99
Net finance (income)/expense	(8)	2	(6)	–	2	(4)
Net income statement charge	14	4	18	74	2	94

Included within the 2016 operating expenses are discontinued operations consisting of £nil (2015: £5m charge) relating to defined benefit schemes and a £nil charge (2015: £8m charge) relating to defined contribution schemes.

Notes to the consolidated financial statements

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2016 UK Group plan	2016 Other funded plans	2016 Other unfunded plans	2016 Total	2015 UK Group plan	2015 Other funded plans	2015 Other unfunded plans	2015 Total
Fair value of plan assets	**3,339**	**158**	**–**	**3,497**	2,803	135	–	2,938
Present value of defined benefit obligation	**(3,181)**	**(183)**	**(22)**	**(3,386)**	(2,466)	(157)	(18)	(2,641)
Net pension asset/(liability)	**158**	**(25)**	**(22)**	**111**	337	(22)	(18)	297
Other post-retirement medical benefit obligation				**(77)**				(76)
Other pension accruals				**(15)**				(23)
Net retirement benefit asset				**19**				198
Analysed as:								
Retirement benefit assets				**158**				337
Retirement benefit obligations				**(139)**				(139)

The following (losses)/gains have been recognised in other comprehensive income:

All figures in £ millions	2016	2015
Amounts recognised for defined benefit plans	**(277)**	104
Amounts recognised for post-retirement medical benefit plans	**9**	6
Total recognised in year	**(268)**	110

The fair value of plan assets comprises the following:

All figures in %	2016 UK Group plan	2016 Other funded plans	2016 Total	2015 UK Group plan	2015 Other funded plans	2015 Total
Equities	**2**	**1**	**3**	12	2	14
Bonds	**9**	**1**	**10**	8	2	10
Property	**8**	**–**	**8**	9	–	9
Pooled asset investment funds	**67**	**–**	**67**	50	–	50
Other	**12**	**–**	**12**	17	–	17

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 UK Group plan assets into additional categories and those assets which have a quoted market price in an active market and those that do not:

All figures in %	2016 Quoted market price	2016 No quoted market price	2015 Quoted market price	2015 No quoted market price
UK equities	**–**	**–**	–	1
Non-UK equities	**–**	**3**	11	2
Fixed-interest securities	**10**	**–**	6	–
Index-linked securities	**–**	**–**	4	–
Property	**–**	**8**	–	9
Pooled asset investment funds	**67**	**–**	50	–
Other	**–**	**12**	–	17
Total	**77**	**23**	71	29

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

The liquidity profile of the UK Group plan assets is as follows:

All figures in %	2016	2015
Liquid – call <1 month	**75**	73
Less liquid – call 1–3 months	**–**	2
Liquid – call >3 months	**25**	25

Changes in the values of plan assets and liabilities of the retirement benefit plans are as follows:

	2016			2015		
All figures in £ millions	UK Group plan	Other plans	Total	UK Group plan	Other plans	Total
Fair value of plan assets						
Opening fair value of plan assets	**2,803**	**135**	**2,938**	2,714	164	2,878
Exchange differences	**–**	**24**	**24**	–	2	2
Interest on plan assets	**104**	**6**	**110**	98	5	103
Return on plan assets excluding interest	**445**	**8**	**453**	(8)	(4)	(12)
Contributions by employer	**99**	**2**	**101**	72	5	77
Contributions by employee	**–**	**–**	**–**	2	–	2
Benefits paid	**(112)**	**(17)**	**(129)**	(95)	(17)	(112)
Transfer	**–**	**–**	**–**	20	(20)	–
Closing fair value of plan assets	**3,339**	**158**	**3,497**	2,803	135	2,938
Present value of defined benefit obligation						
Opening defined benefit obligation	**(2466)**	**(175)**	**(2,641)**	(2,524)	(219)	(2,743)
Exchange differences	**–**	**(32)**	**(32)**	–	(3)	(3)
Current service cost	**(8)**	**(2)**	**(10)**	(20)	(2)	(22)
Administration expenses	**(6)**	**–**	**(6)**	(5)	–	(5)
Curtailments	**–**	**–**	**–**	3	–	3
Interest on plan liabilities	**(89)**	**(7)**	**(96)**	(90)	(7)	(97)
Actuarial gains/(losses) – experience	**12**	**–**	**12**	107	2	109
Actuarial gains/(losses) – demographic	**(47)**	**2**	**(45)**	(33)	1	(32)
Actuarial gains/(losses) – financial	**(689)**	**(8)**	**(697)**	33	6	39
Contributions by employee	**–**	**–**	**–**	(2)	–	(2)
Transfer	**–**	**–**	**–**	(30)	30	–
Benefits paid	**112**	**17**	**129**	95	17	112
Closing defined benefit obligation	**(3,181)**	**(205)**	**(3,386)**	(2,466)	(175)	(2,641)

The weighted average duration of the defined benefit obligation is 19.2 years for the UK and 8.1 years for the US.

25. Retirement benefit and other post-retirement obligations continued

Financial statement information continued

Changes in the value of the US PRMB are as follows:

All figures in £ millions	2016	2015
Opening defined benefit obligation	**(76)**	(81)
Exchange differences	**(14)**	(3)
Curtailments	**2**	–
Interest on plan liabilities	**(3)**	(2)
Actuarial gains/(losses) – experience	**8**	2
Actuarial gains/(losses) – demographic	**2**	2
Actuarial gains/(losses) – financial	**(1)**	2
Benefits paid	**5**	4
Closing defined benefit obligation	**(77)**	(76)

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 2015 and this valuation revealed a technical provisions funding shortfall of £27m which was eliminated by contributions paid during 2015.

As a consequence of the disposal of the FT Group, an agreement has been made between Pearson and the plan trustee to accelerate the funding of the plan. As a result, the plan is expected to be fully funded on a 'self-sufficiency' basis by 2019, inclusive of payments in 2017 in relation to the Penguin Random House merger in 2013, currently estimated at £225m. This is a much higher level of funding than technical provisions. As a result, 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 Pearson. A commitment has also been made to maintain that level of funding in future years.

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), inflation-linked property and infrastructure; and return seeking assets, which are assets invested with a longer-term horizon to generate the returns needed to provide the remaining expected cash flows for the beneficiaries, and include diversified growth funds, property and alternative asset classes. The plan's long-term investment strategy allocates 85% to matching assets and 15% to return seeking assets.

Regular contributions to the plan in respect of the defined benefit sections are estimated to be £8m for 2017.

The Group expects to contribute $9m in 2017 and $10m in 2018 to its US defined benefit pension plans.

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:

	2016	
All figures in £ millions	1% increase	1% decrease
Effect:		
(Decrease)/increase in defined benefit obligation – UK Group plan	**(541)**	**727**
(Decrease)/increase in defined benefit obligation – US plan	**(16)**	**19**

25. Retirement benefit and other post-retirement obligations continued

Sensitivities continued

The effect of members living one year more or one year less on the defined benefit obligation is as follows:

	2016	
All figures in £ millions	One year increase	One year decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	**149**	**(152)**
Increase/(decrease) in defined benefit obligation – US plan	**9**	**(9)**

The effect of a half percentage point increase and decrease in the inflation rate is as follows:

	2016	
All figures in £ millions	0.5% increase	0.5% decrease
Effect:		
Increase/(decrease) in defined benefit obligation – UK Group plan	**165**	**166**
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	2016	2015
Pearson plans	**22**	26

Share-based payment charges included in discontinued operations amounted to £nil (2015: £3m). The Group operates the following equity-settled employee option and share plans:

Worldwide Save for Shares Plan Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three or five years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

Employee Stock Purchase Plan In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six-month periods. At the end of the period, the employee has the option to purchase American Depository Receipts (ADRs) with their accumulated funds at a purchase price equal to 85% of the lower of the market prices prevailing at the beginning or end of the period.

Long-Term Incentive Plan This plan was first introduced in 2001, renewed 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 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 senior management in May 2015 and May 2016 vest dependent on relative total shareholder return, return on invested capital and earnings per share growth. Restricted shares awarded to senior management in March 2016 vest dependent on earnings per share growth. Other restricted shares awarded in 2015 and 2016 vest depending on continuing service over a three-year period.

26. Share-based payments continued

The number and weighted average exercise prices of share options granted under the Group's plans are as follows:

	2016 Number of share options 000s	2016 Weighted average exercise price £	2015 Number of share options 000s	2015 Weighted average exercise price £
Outstanding at beginning of year	**3,250**	**9.24**	3,507	8.48
Granted during the year	**1,544**	**6.94**	1,024	11.49
Exercised during the year	**(49)**	**7.07**	(578)	8.78
Forfeited during the year	**(1,695)**	**9.14**	(696)	9.12
Expired during the year	**(72)**	**8.95**	(7)	8.85
Outstanding at end of year	**2,978**	**8.14**	3,250	9.24
Options exercisable at end of year	**247**	**9.06**	138	8.89

Options were exercised regularly throughout the year. The weighted average share price during the year was £8.23 (2015: £11.86). 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:

Range of exercise prices £	2016 Number of share options 000s	2016 Weighted average contractual life Years	2015 Number of share options 000s	2015 Weighted average contractual life Years
0–5	**–**	**–**	–	–
5–10	**2,548**	**2.31**	2,361	2.08
>10	**430**	**2.25**	889	3.26
	2,978	**2.31**	3,250	2.40

In 2016 and 2015, 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:

	2016 Weighted average	2015 Weighted average
Fair value	**£1.01**	£1.99
Weighted average share price	**£7.85**	£13.37
Weighted average exercise price	**£6.94**	£11.49
Expected volatility	**27.38%**	23.00%
Expected life	**3.7 years**	3.7 years
Risk-free rate	**0.58%**	0.90%
Expected dividend yield	**7.49%**	4.44%
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.

26. Share-based payments continued

The following shares were granted under restricted share arrangements:

	2016		2015	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	**6,833**	**8.24**	1,942	12.27

The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. The number of shares expected to vest is adjusted, based on historical experience, to account for potential forfeitures. Participants under the plan are entitled to dividends during the vesting period and therefore the share price is not discounted.

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions are taken into consideration by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2015	819,883	205	2,579
Issue of ordinary shares – share option schemes	1,185	–	11
At 31 December 2015	821,068	205	2,590
Issue of ordinary shares – share option schemes	**1,059**	**–**	**7**
At 31 December 2016	**822,127**	**205**	**2,597**

The ordinary shares have a par value of 25p per share (2015: 25p per share). All issued shares are fully paid. All shares have the same rights.

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings.

The Group reviews its capital structure on a regular basis and will balance its overall capital structure through payments of dividends, new share issues as well as the issue of new debt or the redemption of existing debt in line with the financial risk policies outlined in note 19.

28. Treasury shares

	Pearson plc	
	Number of shares 000s	£m
At 1 January 2015	7,192	75
Purchase of treasury shares	1,987	23
Release of treasury shares	(2,474)	(26)
At 31 December 2015	6,705	72
Purchase of treasury shares	**3,000**	**27**
Release of treasury shares	**(1,986)**	**(20)**
At 31 December 2016	**7,719**	**79**

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 0.9% (2015: 0.8%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

The nominal value of Pearson plc treasury shares amounts to £1.9m (2015: £1.7m).

At 31 December 2016, the market value of Pearson plc treasury shares was £63.2m (2015: £49.3m).

Notes to the consolidated financial statements

29. Other comprehensive income

2016

All figures in £ millions	Attributable to equity holders of the company: 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	**909**	**–**	**909**	**1**	**910**
Net exchange differences on translation of foreign operations – associate	**3**	**–**	**3**	**–**	**3**
Currency translation adjustment disposed – subsidiaries	**–**	**–**	**–**	**–**	**–**
Attributable tax	**–**	**(5)**	**(5)**	**–**	**(5)**
Items that are not reclassified to the income statement					
Remeasurement of retirement benefit obligations – Group	**–**	**(268)**	**(268)**	**–**	**(268)**
Remeasurement of retirement benefit obligations – associate	**–**	**(8)**	**(8)**	**–**	**(8)**
Attributable tax	**–**	**58**	**58**	**–**	**58**
Other comprehensive income/(expense) for the year	**912**	**(223)**	**689**	**1**	**690**

2015

All figures in £ millions	Attributable to equity holders of the company: 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	(83)	–	(83)	(2)	(85)
Net exchange differences on translation of foreign operations – associate	16	–	16	–	16
Currency translation adjustment disposed – subsidiaries	(10)	–	(10)	–	(10)
Attributable tax	–	5	5	–	5
Items that are not reclassified to the income statement					
Remeasurement of retirement benefit obligations – Group	–	110	110	–	110
Remeasurement of retirement benefit obligations – associate	–	8	8	–	8
Attributable tax	–	(24)	(24)	–	(24)
Other comprehensive income/(expense) for the year	(77)	99	22	(2)	20

30. Business combinations

There were no significant acquisitions in 2016 or 2015.

Fair values for the assets and liabilities arising from acquisitions completed in the year are as follows:

All figures in £ millions	Notes	2016 Total fair value	2015 Total fair value
Intangible assets acquired at fair value	11	**10**	1
Net assets acquired at fair value		**10**	1
Goodwill	11	**3**	–
Total		**13**	1
Satisfied by:			
Cash		**(7)**	(1)
Other liabilities		**(6)**	–
Total consideration		**(13)**	(1)

The goodwill arising on these acquisitions results from cost and revenue synergies and from assets and benefits that cannot be separately recognised.

Goodwill of £3m arising on 2016 acquisitions is expected to be deductible for tax purposes. There is no goodwill on 2015 acquisitions.

Intangible assets acquired in 2016 have the following useful economic lives: trademarks and brands 15 years, and other acquired intangibles six years.

All figures in £ millions	2016	2015
Cash flow on acquisitions		
Cash – current year acquisitions	**(7)**	(1)
Deferred payments for prior year acquisitions and other items	**(7)**	(6)
Acquisition costs and other acquisition liabilities paid	**(1)**	(2)
Net cash outflow	**(15)**	(9)

Notes to the consolidated financial statements

31. Disposals including business closures

All figures in £ millions	2016 Total	FT Group	PowerSchool	Other	2015 Total
Disposal of subsidiaries					
Property, plant and equipment	**(3)**	(15)	(2)	–	(17)
Intangible assets	**–**	(46)	(19)	(5)	(70)
Investments in joint ventures and associates	**–**	(8)	–	–	(8)
Intangible assets – pre-publication	**(4)**	–	(64)	–	(64)
Inventories	**–**	(1)	–	–	(1)
Trade and other receivables	**(6)**	(72)	(16)	(3)	(91)
Cash and cash equivalents (excluding overdrafts)	**(9)**	(29)	–	(4)	(33)
Net deferred income tax (assets)/liabilities	**(10)**	(2)	–	3	1
Retirement benefit obligations	**–**	7	–	–	7
Provisions for other liabilities and charges	**–**	2	–	–	2
Trade and other liabilities	**21**	109	35	6	150
Current income tax liabilities	**–**	1	–	–	1
Attributable goodwill	**–**	(50)	(119)	(6)	(175)
Cumulative translation adjustment	**–**	4	6		10
Net assets disposed	**(11)**	(100)	(179)	(9)	(288)
Cash received	**7**	858	222	9	1,089
Costs	**(16)**	(47)	(13)	(9)	(69)
(Loss)/gain on disposal	**(20)**	711	30	(9)	732

All figures in £ millions	2016	2015
Cash flow from disposals		
Cash – current year disposals	**7**	1,089
Cash and cash equivalents disposed	**(9)**	(33)
Costs and other disposal liabilities paid	**(52)**	(26)
Net cash (outflow)/inflow	**(54)**	1,030

In 2016, losses on disposal primarily relate to the disposal of Pearson English Business Solutions and the closure of English language schools in Germany.

Included in the gain on sale of PowerSchool in 2015 is the write down of related software assets of £70m. The write down of the software assets reflects the reduced market opportunity for software which was to be integrated with PowerSchool and the recognition that adoption of such software in US schools is now unlikely to occur at the rate originally envisaged.

In 2016, cost and other disposal liabilities paid of £52m primarily relate to the disposal of the FT Group in 2015.

Disposal of associates

On 16 October 2015, the Group sold a 39% stake, out of its 50% stake, in The Economist resulting in a gain on disposal of £473m. The gain comprises proceeds of £377m, gain on revaluation of remaining 11% investment to fair value of £92m and liabilities disposed of £4m. The remaining investment was fully disposed in 2016 with no further gain or loss.

32. Cash generated from operations

All figures in £ millions	Notes	2016	2015
(Loss)/profit		**(2,335)**	823
Adjustments for:			
Income tax		**(222)**	(24)
Depreciation	10	**95**	75
Amortisation and impairment of acquired intangibles and goodwill	11	**2,733**	1,051
Amortisation of software	11	**84**	74
Net finance costs	6	**60**	29
Share of results of joint ventures and associates	12	**(97)**	(68)
Profit on disposal of subsidiaries, associates, investments and fixed assets		**40**	(1,194)
Net foreign exchange adjustment from transactions		**43**	22
Share-based payment costs	26	**22**	26
Pre-publication		**(19)**	(57)
Inventories		**17**	10
Trade and other receivables		**156**	(99)
Trade and other liabilities		**61**	(80)
Retirement benefit obligations		**(106)**	(57)
Provisions for other liabilities and charges		**(10)**	(13)
Net cash generated from operations		**522**	518
Dividends from joint ventures and associates		**131**	162
Purchase of property, plant and equipment		**(88)**	(86)
Purchase of intangible assets		**(157)**	(161)
Proceeds from sale of property, plant and equipment and intangible assets		**4**	3
Finance lease principal payments		**(6)**	(1)
Special pension contribution		**90**	–
Cost of major restructuring paid		**167**	–
Operating cash flow		**663**	435
Operating tax paid		**(63)**	(129)
Net operating finance costs paid		**(51)**	(51)
Operating free cash flow		**549**	255
Special pension contribution		**(90)**	–
Cost of major restructuring paid		**(167)**	–
Non operating tax received/(paid)		**18**	(103)
Free cash flow		**310**	152
Dividends paid (including to non-controlling interests)		**(424)**	(423)
Net movement of funds from operations		**(114)**	(271)
Acquisitions and disposals		**19**	1,395
Loans repaid/(advanced) (including to related parties)		**14**	7
Purchase of treasury shares	28	**(27)**	(23)
New equity		**7**	11
Other movements on financial instruments		**4**	(1)
Net movement of funds		**(97)**	1,118
Exchange movements on net debt		**(341)**	(133)
Total movement in net debt		**(438)**	985

Notes to the consolidated financial statements

32. 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 measures and have been disclosed as they are part of Pearson's corporate and operating measures. These measures are presented in order to align the cash flows with corresponding adjusted profit measures.

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

All figures in £ millions	2016	2015
Net book amount	**9**	6
Loss on sale of property, plant and equipment	**(5)**	(4)
Proceeds from sale of property, plant and equipment	**4**	2

33. Contingencies

There are contingent Group liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries, joint ventures and associates. In addition, there are contingent liabilities of the Group in respect of 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.

34. Commitments

At the balance sheet date there were no commitments for capital expenditure contracted for but not yet incurred.

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. Lease expenditure charged to the income statement was £186m (2015: £156m).

The future aggregate minimum lease payments in respect of operating leases are as follows:

All figures in £ millions	2016	2015
Not later than one year	**174**	164
Later than one year and not later than two years	**147**	146
Later than two years and not later than three years	**129**	143
Later than three years and not later than four years	**115**	130
Later than four years and not later than five years	**96**	123
Later than five years	**661**	685
	1,322	1,391

In the event that the Group has excess capacity in its leased offices and warehouses it will enter into sub-lease contracts in order to offset the resulting costs. The future aggregate minimum sub-lease payments expected to be received under non-cancellable sub-leases are as follows:

All figures in £ millions	2016
Not later than one year	**44**
Later than one year and not later than two years	**46**
Later than two years and not later than three years	**44**
Later than three years and not later than four years	**39**
Later than four years and not later than five years	**34**
Later than five years	**155**
	362

35. 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 p8). It is this committee which had responsibility for planning, directing and controlling the activities of the Group in 2016. Key management personnel compensation is disclosed below:

All figures in £millions	2016	2015
Short-term employee benefits	**6**	7
Retirement benefits	**1**	1
Share-based payment costs	**1**	1
Total	**8**	9

There were no other material related party transactions. No guarantees have been provided to related parties.

36. Events after the balance sheet date

On 18 January 2017, Pearson announced the intention to issue an exit notice to Bertelsmann regarding the 47% associate investment in PRH with a view to selling the stake or recapitalising the business and extracting a dividend.

On 24 February 2017, Pearson announced the intention to trigger the early repayment option on its $550m 6.25% Global dollar bonds 2018.

There were no other significant post balance sheet events.

37. 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
Blue Wharf Limited	04344573
Edexcel Limited	04496750
Education Development International plc	03914767
Embankment Finance Limited	04460625
Green Wharf Limited	07009228
Icodeon Limited	05068195
Longman Group (Overseas Holdings) Limited	00690236
Major123 Limited	05333023
Pearson Affordable Learning Fund Limited	08038068
Pearson Australia Finance Unlimited	05578463
Pearson Books Limited	02512075
Pearson Brazil Finance Limited	08848874
Pearson Canada Finance Unlimited	05578491
Pearson Dollar Finance plc	05111013
Pearson Dollar Finance Two plc	06507766
Pearson Education Holdings Limited	00210859
Pearson Education Investments Limited	08444933
Pearson Education Limited	00872828
Pearson Funding Four plc	07970304

	Company number
Pearson Funding Two plc	07210654
Pearson in Practice Holdings Limited	06337129
Pearson in Practice Skills Based Learning Limited	03755464
Pearson in Practice Technology Limited	03786989
Pearson International Finance Limited	02496206
Pearson Loan Finance No.2 Unlimited	05632021
Pearson Loan Finance No. 3 Limited	05052661
Pearson Loan Finance No. 4 Limited	02635107
Pearson Loan Finance Unlimited	05144467
Pearson Management Services Limited	00096263
Pearson Overseas Holdings Limited	00145205
Pearson PRH Holdings Limited	08561316
Pearson Real Estate Holdings Limited	09768242
Pearson Services Limited	01341060
Pearson Shared Services Limited	04623186
Testchange Limited	02496240
TQ Catalis Limited	07307943
TQ Clapham Limited	07307925
TQ Global Limited	07802458

Company balance sheet

As at 31 December 2016

All figures in £ millions	Notes	2016	2015
Assets			
Non-current assets			
Investments in subsidiaries	2	**7,441**	7,744
Amounts due from subsidiaries		**133**	3,953
Financial assets – derivative financial instruments	6	**171**	78
Other financial assets	7	**–**	92
		7,745	11,867
Current assets			
Amounts due from subsidiaries		**4,190**	446
Amounts due from related parties		**33**	47
Financial assets – derivative financial instruments	6	**–**	3
Cash and cash equivalents (excluding overdrafts)	4	**867**	1,168
		5,090	1,664
Total assets		**12,835**	13,531
Liabilities			
Non-current liabilities			
Amounts due to subsidiaries		**(3,253)**	(3,760)
Financial liabilities – borrowings	5	**(254)**	(218)
Financial liabilities – derivative financial instruments	6	**(264)**	(136)
		(3,771)	(4,114)
Current liabilities			
Amounts due to subsidiaries		**(3,470)**	(1,431)
Current income tax liabilities		**(52)**	(108)
Financial liabilities – borrowings	5	**(13)**	(580)
Financial liabilities – derivative financial instruments	6	**–**	(29)
Other liabilities		**(4)**	(12)
		(3,539)	(2,160)
Total liabilities		**(7,310)**	(6,274)
Net assets		**5,525**	7,257
Equity			
Share capital	8	**205**	205
Share premium	8	**2,597**	2,590
Treasury shares	9	**(34)**	(27)
Special reserve		**447**	447
Retained earnings – including loss for the year of £1,288m (2015: profit of £1,206m)		**2,310**	4,042
Total equity attributable to equity holders of the company		**5,525**	7,257

These financial statements have been approved for issue by the board of directors on 14 March 2017 and signed on its behalf by

Coram Williams
Chief financial officer

Company statement of changes in equity

Year ended 31 December 2016

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2016	**205**	**2,590**	**(27)**	**447**	**4,042**	**7,257**
Loss for the year	**–**	**–**	**–**	**–**	**(1,288)**	**(1,288)**
Issue of ordinary shares under share option schemes*	**–**	**7**	**–**	**–**	**–**	**7**
Purchase of treasury shares	**–**	**–**	**(27)**	**–**	**–**	**(27)**
Release of treasury shares	**–**	**–**	**20**	**–**	**(20)**	**–**
Dividends	**–**	**–**	**–**	**–**	**(424)**	**(424)**
At 31 December 2016	**205**	**2,597**	**(34)**	**447**	**2,310**	**5,525**

All figures in £ millions	Equity attributable to equity holders of the company					
	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2015	205	2,579	1	447	3,285	6,517
Profit for the year	–	–	–	–	1,206	1,206
Issue of ordinary shares under share option schemes*	–	11	–	–	–	11
Purchase of treasury shares	–	–	(23)	–	–	(23)
Contribution refund to subsidiaries	–	–	(31)	–	–	(31)
Release of treasury shares	–	–	26	–	(26)	–
Dividends	–	–	–	–	(423)	(423)
At 31 December 2015	205	2,590	(27)	447	4,042	7,257

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 (2015: £162m) relating to profit on intra-Group disposals that is not distributable.

* Full details of the share-based payment plans are disclosed in note 26 to the consolidated financial statements.

Company cash flow statement

Year ended 31 December 2016

All figures in £ millions	Notes	2016	2015
Cash flows from operating activities			
Net (loss)/profit		**(1,288)**	1,206
Adjustments for:			
Income tax		**(80)**	(154)
Net finance costs		**7**	68
Impairment charges		**1,337**	736
Profit on disposals		**–**	(279)
Amounts due from/(to) subsidiaries		**748**	(909)
Net cash generated from operations		**724**	668
Interest paid		**(15)**	(56)
Tax received		**24**	289
Net cash generated from operating activities		**733**	901
Cash flows from investing activities			
Disposal of subsidiaries, net of cash disposed		**–**	747
Loans repaid by related parties		**14**	7
Interest received		**11**	11
Net cash received from investing activities		**25**	765
Cash flows from financing activities			
Proceeds from issue of ordinary shares	8	**7**	11
Net purchase of treasury shares		**(27)**	(53)
(Repayment of)/proceeds from borrowings		**(30)**	17
Dividends paid to company's shareholders		**(424)**	(423)
Net cash used in financing activities		**(474)**	(448)
Effects of exchange rate changes on cash and cash equivalents		**(18)**	(14)
Net increase in cash and cash equivalents		**266**	1,204
Cash and cash equivalents at beginning of year		**588**	(616)
Cash and cash equivalents at end of year	4	**854**	588

Notes to the company financial statements

1. Accounting policies

The financial statements on p180-191 comprise the separate financial statements of Pearson plc.

As permitted by section 408 of the Companies Act 2006, only the consolidated income statement and statement of comprehensive income have been presented.

The company has no employees.

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the consolidated financial statements with the addition of the following:

Investments

Investments in subsidiaries are stated at cost less provision for impairment, with the exception of certain hedged investments that are held in a foreign currency and revalued at each balance sheet date.

2. Investments in subsidiaries

All figures in £ millions	2016	2015
At beginning of year	**7,744**	8,740
Subscription for share capital in subsidiaries	**800**	120
Disposals/liquidations	**–**	(444)
Impairments	**(1,337)**	(736)
Currency revaluations	**234**	64
At end of year	**7,441**	7,744

In 2016 and 2015, impairments relate to the carrying value of intermediate holding company investments following impairment reviews and the subsequent impairment of assets in the Pearson plc Group (see note 11 in the Group Financial Statements for further details).

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 and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. 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 company designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in an £88m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £104m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £206m, while a 10% weakening in the value of sterling would increase the carrying value by £139m. 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 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. 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	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 2016								
Bonds	**12**	**249**	**–**	**261**	**261**	**–**	**–**	**261**
Rate derivatives – inflows	**(103)**	**(1,086)**	**(867)**	**(2,056)**	**(239)**	**(838)**	**(979)**	**(2,056)**
Rate derivatives – outflows	**82**	**1,202**	**891**	**2,175**	**1,308**	**838**	**29**	**2,175**
Total	**(9)**	**365**	**24**	**380**	**1,330**	**–**	**(950)**	**380**
At 31 December 2015								
Bonds	9	218	–	227	227	–	–	227
Rate derivatives – inflows	(140)	(266)	(1,628)	(2,034)	(257)	(858)	(919)	(2,034)
Rate derivatives – outflows	141	202	1,712	2,055	1,155	858	42	2,055
Total	**10**	**154**	**84**	**248**	**1,125**	**–**	**(877)**	**248**

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.

Any amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

4. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2016	2015
Cash at bank and in hand	**4**	98
Short-term bank deposits	**863**	1,070
	867	1,168

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2016, the currency split of cash and cash equivalents was US dollar 38% (2015: 10%) and sterling 62% (2015: 90%).

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	2016	2015
Cash and cash equivalents	**867**	1,168
Bank overdrafts	**(13)**	(580)
	854	588

5. Financial liabilities – borrowings

All figures in £ millions	2016	2015
Non-current		
4.625% US dollar notes 2018 (nominal amount $300m)	**254**	218
	254	218
Current		
Due within one year or on demand:		
Bank loans and overdrafts	**13**	580
	13	580
Total borrowings	**267**	798

The maturity of the company's non-current borrowings is as follows:

All figures in £ millions	2016	2015
Between one and two years	**254**	–
Between two and five years	**–**	218
Over five years	**–**	–
	254	218

The carrying amounts and market values of borrowings are as follows:

	2016			2015		
All figures in £ millions	Effective interest rate	Carrying amount	Market value	Effective interest rate	Carrying amount	Market value
Bank loans and overdrafts	**n/a**	**13**	**13**	n/a	580	580
4.625% US dollar notes 2018	**4.69%**	**254**	**250**	4.69%	218	213
		267	**263**		798	793

The market values are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the company's borrowings are denominated in the following currencies:

All figures in £ millions	2016	2015
US dollar	**254**	660
Sterling	**8**	136
Euro	**5**	2
	267	798

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6. Derivative financial instruments

The company's outstanding derivative financial instruments are as follows:

All figures in £ millions	2016 Gross notional amounts	2016 Assets	2016 Liabilities	2015 Gross notional amounts	2015 Assets	2015 Liabilities
Interest rate derivatives – in a fair value hedge relationship	**244**	**10**	**–**	203	70	(10)
Interest rate derivatives – not in a hedge relationship	**3,100**	**61**	**(11)**	2,597	–	(6)
Cross-currency derivatives	**1,622**	**100**	**(253)**	1,924	11	(149)
Total	**4,966**	**171**	**(264)**	4,724	81	(165)
Analysed as expiring:						
In less than one year	**162**	**–**	**–**	249	3	(29)
Later than one year and not later than five years	**2,776**	**86**	**(157)**	1,255	44	(4)
Later than five years	**2,028**	**85**	**(107)**	3,220	34	(132)
Total	**4,966**	**171**	**(264)**	4,724	81	(165)

The carrying value of the above derivative financial instruments equals their fair value. 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. Other financial assets

Other financial assets comprise unlisted securities of £nil (2015: £92m).

8. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2015	819,883	205	2,579
Issue of ordinary shares – share option schemes	1,185	–	11
At 31 December 2015	821,068	205	2,590
Issue of ordinary shares – share option schemes	**1,059**	**–**	**7**
At 31 December 2016	**822,127**	**205**	**2,597**

The ordinary shares have a par value of 25p per share (2015: 25p per share). All issued shares are fully paid. All shares have the same rights.

9. Treasury shares

	Number of shares 000s	£m
At 1 January 2015	7,192	(1)
Purchase of treasury shares	1,987	23
Refund of contribution to subsidiaries	–	31
Release of treasury shares	(2,474)	(26)
At 31 December 2015	6,705	27
Purchase of treasury shares	**3,000**	**27**
Release of treasury shares	**(1,986)**	**(20)**
At 31 December 2016	**7,719**	**34**

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 £1.9m (2015: £1.7m). At 31 December 2016, the market value of the company's treasury shares was £63.2m (2015: £49.3m). The gross book value of the shares at 31 December 2016 amounts to £79m. This value has been netted off with contributions received from operating companies of £45m, resulting in a net debit value of £34m.

10. 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.

11. Audit fees

Statutory audit fees relating to the company were £35,000 (2015: £35,000).

12. 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 £138m (2015: £150m) and interest receivable from subsidiaries for the year of £109m (2015: £82m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £118m (2015: £80m). Management fees receivable from subsidiaries in respect of centrally provided services amounted to £76m (2015: £70m). Dividends received from subsidiaries were £87m (2015: £1,555m).

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 2016 was £33m (2015: £47m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2016 was repaid in its entirety in January 2017.

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 2016. Key management personnel compensation is disclosed in note 35 to the consolidated financial statements.

There were no other material related party transactions. No guarantees have been provided to related parties.

Notes to the company financial statements

13. 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 2016 is disclosed below. Unless otherwise stated, the shares are all indirectly held by Pearson plc. Unless otherwise stated, all wholly-owned and party 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
A Plus Education Solutions Private Limited	IN	2
Addison Wesley Longman, Inc.	US	3
Addison-Wesley Educational Publishers Inc.	US	4
AEL (S) PTE Limited	SG	5
Aldwych Finance Limited	UK	1
America's Choice, Inc.	US	4
ASET Group Limited*	UK	6
ASET Limited*	UK	6
ASET Management Limited*	UK	6
ASET Solutions Limited*	UK	6
ATI Professional Development LLC	US	4
Atkey Finance Limited	IE	7
Axis Finance Inc.	US	4
Beijing Global Education & Technology Co., Ltd.	CN	8
Beijing Wall Street English Training Centre Company Limited	CN	9
Berrisford Finance Limited*	IE	7
Blue Wharf Limited	UK	1
Burmedia Investments Limited*†	UK	6
CA of Michigan, LLC	US	10
Camsaw College Publishing Company, Inc.	US	4
Camsaw, Inc.	US	4
CAMSAWUSA, Inc.	US	11
Casapsi Livraria e Editora Ltda	BR	12
Centro Cultural Americano Franquias e Comércio Ltda.	BR	13
Century Consultants Ltd.	US	14
Certiport China Holding, LLC	US	4
Certiport, Inc.	US	4
Cogmed Systems AB	SE	15
Connections Academy of Alaska, LLC	US	16
Connections Academy of Arizona, LLC	US	17
Connections Academy of Arkansas, LLC	US	18
Connections Academy of California, LLC	US	19
Connections Academy of Colorado, LLC	US	20
Connections Academy of DC, LLC	US	21
Connections Academy of Florida, LLC	US	22
Connections Academy of Georgia, LLC	US	23
Connections Academy of Idaho, LLC	US	24
Connections Academy of Indiana, LLC	US	25
Connections Academy of Iowa, LLC	US	26
Connections Academy of Kansas, LLC	US	27
Connections Academy of Kentucky, LLC	US	28
Connections Academy of Louisiana, LLC	US	29
Connections Academy of Maine, LLC	US	30
Connections Academy of Maryland, LLC	US	31
Connections Academy of Massachusetts LLC	US	3
Connections Academy of Minnesota, LLC	US	32
Connections Academy of Missouri, LLC	US	33
Connections Academy of Nevada, LLC	US	34
Connections Academy of New Jersey, LLC	US	14
Connections Academy of New Mexico, LLC	US	35
Connections Academy of New York, LLC	US	36
Connections Academy of North Carolina, LLC	US	37
Connections Academy of Ohio, LLC	US	38
Connections Academy of Oklahoma, LLC	US	39
Connections Academy of Oregon, LLC	US	40
Connections Academy of Pennsylvania LLC	US	41
Connections Academy of South Carolina, LLC	US	42
Connections Academy of Tennessee, LLC	US	43
Connections Academy of Texas, LLC	US	44
Connections Academy of Utah, L.L.C.	US	45
Connections Academy of Virginia, LLC	US	46
Connections Academy of Washington, LLC	US	47
Connections Academy of Wisconsin LLC	US	48
Connections Academy of Wyoming, LLC	US	49
Connections Education LLC	US	4
Connections Education, Inc.	US	4
CTI Education Group (Pty) Limited	ZA	50
Dale Seymour Publications, Inc.	US	19
Dominie Press, Inc.	US	19
Dorian Finance Limited	IE	7
Dorling Kindersley Australasia Pty Limited	AU	51
E Q L Assessment Limited*	UK	6
EBNT Canada Holdings ULC	CA	127
EBNT Holdings Limited	CA	128
EBNT USA Holdings Inc.	US	4
eCollege.com	US	4
Edexcel Limited†	UK	52
Edexcel South Africa Pty Ltd	ZA	50
Éditions Du Renouveau Pédagogique Inc.	CA	53
Education Development International Plc†	UK	1
Education Resources (Cyprus) Limited	CY	54
Educational Management Group, Inc.	US	55
Educational Resources (HK) Limited	HK	56
Embanet ULC	CA	134
Embanet-Compass Knowledge Group Inc.	US	22
Embankment Finance Limited	UK	1
English Language Learning and Instruction System, Inc.	US	57
eNVQ Limited*	UK	6
Escape Studios Limited	UK	1
Falstaff Holdco Inc.	US	4
Falstaff Inc.	US	58
FastExpress Centro de Idiomas Ltda	BR	59
FBH, Inc.	US	4
Florida Connections Academy, L.L.C.	US	22
Franchise Support & Services, SL	ES	60
Gamma Master China, Limited	HK	61
Global Education & Technology (HK) Limited	HK	56
Global Education & Technology Group Limited	KY	62
Global Elite Education & Technology (Shanghai) Co. Limited	CN	63
Globe Fearon Inc.	US	19
GOAL Limited*	UK	6
Green Wharf Limited	UK	1
Guangzhou Crescent Software Co., Ltd	CN	64
Heinemann Education Botswana (Publishers) (Proprietary) Limited	BW	65
Heinemann Lesotho (Pty) Ltd	LS	66
Icodeon Limited	UK	1
IndiaCan Education Private Limited	IN	2
Integral 7, Inc.	US	4
INTELLIPRO, INC.	US	14
J M Soluções Exportação e Importação Ltda	BR	67
Joint Examining Board Limited*	UK	6
Kagiso Education Pty Ltd	ZA	50
Knowledge Analysis Technologies, LLC	US	20
LCCI International Qualifications (Malaysia) Sdn. Bhd.	MY	68
LCCIEB Training Consultancy., Ltd	CN	69
LessonLab, Inc.	US	19
Lignum Oil Company	US	4
Linx Brasil Distribuidora Ltda.	BR	13
Longman (Malawi) Limited	MW	70
Longman Australasia Pty Ltd	AU	71
Longman Group(Overseas Holdings) Limited	UK	1
Longman Indochina Acquisition, L.L.C.	US	4
Longman Kenya Limited	KE	72
Longman Mocambique Ltda	MZ	135
Longman Swaziland (Pty) Limited	SZ	73
Longman Tanzania Limited	TZ	74
Longman Zambia Educational Publishers Pty Ltd	ZM	75
Longman Zambia Limited	ZM	75
Longman Zimbabwe (Private) Ltd	ZW	76
Longmaned Ecuador S.A.	EC	77
Major123 Limited	UK	78
MeasureUp, LLC	US	4
Midlands Educational Technology Limited*	UK	6
Modern Curriculum Inc.	US	19
Multi Treinamento e Editora Ltda	BR	79
Multilingua Limited*	UK	6
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 Amsterdam Finance Limited*†	UK	1
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 (Asia Pacific) Pte. Ltd.	SG	5

Registered company name	Country of Incorp.	Reg office
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	126
Pearson Charitable Foundation	US	57
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 plc	UK	1
Pearson Educacion de Chile Limitada	CL	89
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 and Assessment, Inc.	US	4
Pearson Education Asia Limited	HK	56
Pearson Education Botswana (Proprietary) Limited	BW	65
Pearson Education do Brasil S.A	BR	129
Pearson Education Hellas SA	GR	130
Pearson Education Holdings Inc.	US	4
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
Pearson Education Taiwan Ltd	TW	101
Pearson Education, Inc.	US	4
Pearson Educational Measurement Canada, Inc.	CA	136
Pearson Educational Publishers, LLC	US	4
Pearson Egitim Cozumleri Tikaret Limited Sirketi	TR	102
Pearson Falstaff (Holdings) Inc.	US	4
Pearson Falstaff Holdco LLC	US	4
Pearson France	FR	103
Pearson Funding Five plc†	UK	1
Pearson Funding Four plc†	UK	1
Pearson Funding One Limited*†	UK	6
Pearson Funding Two plc†	UK	1
Pearson Group FURBS Trustee Limited*†	UK	6
Pearson Group Pension Trustee Limited	UK	1
Pearson Heinemann Limited*	UK	6
Pearson Holdings Inc.	US	4
Pearson Holdings Southern Africa (Pty) Limited	ZA	50
Pearson in Practice ATA Limited*	UK	6
Pearson in Practice Holdings Limited	UK	1

Registered company name	Country of Incorp.	Reg office
Pearson in Practice Skills Based Learning Limited	UK	1
Pearson in Practice Technology Limited	UK	1
Pearson Inc.	US	4
Pearson India Education Services Private Limited	IN	2
Pearson Institute of Higher Education	ZA	50
Pearson International Finance Limited†	UK	1
Pearson Investment Holdings, Inc.	US	4
Pearson IOKI Spółka z ograniczoną odpowiedzialnością	PL	104
Pearson Italia S.p.A	IT	105
Pearson Japan KK	JP	106
Pearson Lanka (Private) Limited	LK	107
Pearson Learning China (HK) Limited	HK	56
Pearson Lesotho (Pty) Ltd	LS	66
Pearson Loan Finance No. 3 Limited	UK	1
Pearson Loan Finance No. 4 Limited	UK	1
Pearson Loan Finance No.2 Unlimited	UK	1
Pearson Loan Finance Unlimited	UK	1
Pearson Longman LLC	US	4
Pearson Longman Uganda Limited	UG	108
Pearson Malaysia Sdn. Bhd.	MY	68
Pearson Management Services Limited†	UK	1
Pearson Management Services Philippines Inc.	PH	109
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	82
Pearson Pension Property Fund Limited	UK	1
Pearson PRH Holdings Limited	UK	1
Pearson Professional Assessments Limited	UK	1
Pearson Publications Inc.	US	4
Pearson Real Estate Holdings Inc.	US	4
Pearson Real Estate Holdings Limited†	UK	1
Pearson Schweiz AG	CH	110
Pearson Services Limited†	UK	1
Pearson Shared Services Limited†	UK	1
Pearson Sweden AB	SE	15
Pearson VUE Philippines, Inc.	PH	111
Peisheng Yucai (Beijing) Technology Development Limited	CN	112
Penguin Capital, LLC	US	4
Peter Honey Publications Ltd*	UK	6
Phumelela Publishers (Pty) Ltd	ZA	50
PN Holdings Inc.	US	4
Prentice-Hall Hispanoamericana SA de CV	MX	91
ProctorCam, Inc.	US	113
PT Efficient English Services	ID	114
Reading Property Holdings LLC	US	115
Rebus Planning Associates, Inc.	US	10
Regents Publishing Co., Inc.	US	58
Reston Publishing Company, Inc.	US	4
Rycade Capital Corporation	US	4
Sector Training Limited*	UK	6
Servicios Administrativos Pearson Educacion S.A. de C.V.	MX	91
Shanghai AWL Education Software Ltd	CN	116
Silver Burdett Ginn Inc.	US	4
Skylight Training and Publishing Inc.	US	55
Smarthinking, Inc.	US	4
Sound Holdings Inc.	US	4

Registered company name	Country of Incorp.	Reg office
Spear Insurance Company Limited†	BM	133
Stark Verlag GmbH	DE	88
Sunnykey International Holdings Limited (BVI)	VG	117
Tecquipment Services Limited*	UK	6
Testchange Limited†	UK	1
The Assessment Company Limited*	UK	6
The Learning Edge International pty Ltd	AU	71
The SIOP Institute LLC	US	118
The Waite Group Inc	US	19
TQ Catalis Limited	UK	78
TQ Clapham Limited	UK	78
TQ Education and Training Limited	UK	78
TQ Education and Training Limited	SA	131
TQ Global Limited	UK	1
TQ Group Limited	UK	78
TQ Holdings Limited	UK	1
TQ Training Limited*	UK	6
TQ Training Services Limited*	UK	6
TQ Trustees Limited*	UK	6
Training for Advancement Holdings Limited*	UK	6
Training for Advancement Limited*	UK	6
Vue Testing Services Israel Ltd	IL	132
Wall Street English Training Centre (Shanghai) Company Limited	CN	119
Wall Street Institute Kft.	HU	120
Wall Street Institute Master Italia Srl	IT	121
WP Group Pension Trustees Limited*	UK	6
WSE Education Brazil Licenciamentos e Cursos de Idiomas Ltda.	BR	122
WSE Training Centre (Guangdong) Co., Ltd.	CN	123
WSI Education GmbH	DE	124
WSI International, Inc.	US	125

* In liquidation

† Directly owned by Pearson plc

Notes to the company financial statements

Subsidiary addresses

The following list includes all Pearson registered offices worldwide. Please see wholly owned subsidiaries list opposite for each subsidiary's registered office code.

	Registered office address
1	80 Strand, London, WC2R 0RL, England
2	4th Floor Software Block, Elnet Software City, TS 140 Block 2 & 9, Rajiv Gandhi Salai, Taramani, Chennai, TN, 600113, India
3	C T Corporation System, 155 Federal St., Suite 700, Boston, MA, 02110, United States
4	The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle, DE, 19801, United States
5	9, #13-01, North Buona Vista Drive, The Metropolis Tower One, 138588, Singapore
6	Acre House, 11-15 William Road, London, NW1 3ER, England
7	1st Floor Riverview House, 21/23 City Quay, Dublin, D02FP21, Ireland
8	Room 02 and 09 Office, 1-4 building D block, Zhongguancun South Street No. 18, Haidian District, Beijing, China
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 Prentice-Hall Corporation System, MA, 7 St. Paul Street, Suite 1660, Baltimore, MD, 21202, United States
12	No 1010, Rua Santo Antonio, Jardim Mexico, City of Itatiba, Sao Paulo, 13253-4000, Brazil
13	Rua Francisco Otaviano 77B, Jardim Chapadao, Campinas, SP, 13070-056, Brazil
14	820, Bear Tavern Road, West Trenton, Mercer, NJ, 08628, United States
15	Gustavslundsvägen 137, 167 51 Bromma, Stockholm, Sweden
16	C T Corporation System, 9360 Glacier Hwy Suite 202, Juneau, AK, 99801, United States
17	C T Corporation System, 3800 N Central Ave Suite 460, Phoenix, AZ, 85012, United States
18	The Corporation Company, 124 West Capitol Avenue, Suite 1900, Little Rock, AR, 72201, United States
19	C T Corporation System, 818 West Seventh Street, Suite 930, Los Angeles, CA, 90017, United States
20	The Corporation Company, 7700 E Arapahoe Rd Suite 220, Centennial, CO, 80112-1268, United States
21	C T Corporation System, 1015 15th Street 10th Floor, Washington, DC, 20005, United States
22	1200, South Pine Island Road, Plantation, FL, 33324, United States
23	1201, Peachtree Street, NE, Atlanta, GA, 30361, United States
24	C T Corporation System, 921 S Orchard Street – Suite G, Boise, Ada County, ID, 83705, United States
25	CT Corporation System, 150 West Market Street, Suite 800, Indianapolis, IN, 46204, United States
26	C T Corporation System, 400 E Court Ave, Des Moines, IA, 50309, United States
27	The Corporation Company, Inc., 112 SW 7th Street, Suite 3C, Topeka, KS, 66603, United States
28	CT Corporation System, 306 W. Main Street, Suite 512, Frankfort, KY, 40601, United States
29	3867, Plaza Tower, 1st Floor, Baton Rouge, LA, 70816, United States
30	C T Corporation System, 128 State St #3, Augusta, ME, 04330, United States
31	7 St. Paul Street, Suite 1660, Baltimore, MD, 21202
32	C T Corporation System Inc., 1010 Dale St N, St Paul, MN, 55117-5603, United States

	Registered office address
33	120, 400, South Central Avenue, Clayton, MO, 63105, United States
34	The Corporation Trust Company of Nevada, 701 S Carson St, Suite 200, Carson City, NV, 89701, United States
35	C T Corporation System, 206 S Coronado Ave, Espanola, NM, 87532-2792, United States
36	CT Corporation, 111 Eighth Avenue, New York, NY 10011, United States
37	CT Corporation System, 160 Mine Lake Ct Suite 200, Raleigh, NC, 27615, United States
38	1300, 1010, East Ninth Street, Cleveland, OH, 44114, United States
39	The Corporation Company, 1833 S Morgan Rd, Oklahoma City, OK, 73128, United States
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	C T Corporation System, 2 Office Park Court, Suite 103, Columbia, SC, 29223, United States
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	1108, E. South Union Ave., Midvale, UT, 84047, United States
46	C T Corporation System, 4701 Cox Road, Suite 285, Glen Allen, Henrico, VA, 23060-0000, United States
47	C T Corporation System, 505 Union Ave SE Suite 120, Olympia, WA, 985010000, United States
48	C T Corporation System, 8020 Excelsior Dr, Suite 200, Madison, WI, 53717, United States
49	C T Corporation System, 1908 Thomas Ave, Cheyenne, WY, 82001, United States
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	Avenida Nacoes Unidas 12901, Brooklin Novo, Loja 146-A, SP, 04578-000, Brazil
60	Tuset 20-24, No. 5, Barcelona, 08006, Spain
61	Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong
62	Maples Corporate Services Limited P. O. Box 309, Ugland House, South Church Street, George Town, Grand Cayman, KY1-1104, Cayman Islands
63	Room 2001-2, Ambassador Road 18, Yangpu District, Shanghai City, China
64	Suite 1503, 1504, 1505, No. 376 Xingang Middle Road, Haizhu 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	Avenida Doutor Cardoso De Melo 1450, Vila Olimpia, 6 Andar Conju, Sao Paulo, SP, 04548-004, Brazil
68	Level 1, Tower 2A, Avenue 5, Bangsar South No 8, Jalan Kerinchi, Kuala Lumpur, 59200, Malaysia
69	Room 305, Building 2, 65555 Shangchuan Road, Pudong District, Shanghai, China

	Registered office address
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, Prov. Pichincha, Ecuador
78	The Pearson Academy of Vocational Training, Bangrave Road, Corby, Northamptonshire, NN17 1NN, England
79	Rodovia Anhanguera, Jardim Salgado Filho, Km 317 + 400M, Ribeirao Preto, SP, 14079-000, Brazil
80	Teikoku Hotel Tower 18F, 1-1-1 Uchi Saiwai-Cho, Chiyoda-ku, Tokyo, Japan
81	Suite 1201, Tower 2, No. 36 North Third Rign East Road, Dongcheng District, Beijing, China
82	268 Munoz Rivera Avenue, Suite 1400, San Juan, 00918, Puerto Rico
83	Suite 1212, 12/F, Tower 2, No. 36 North Third Rign East Road, Dongcheng District, Beijing, China
84	Zone B, 1/F, Digital Content Industrial Park, High Technical & Industrial Development District, Guiyang City, Guizhou Province, China
85	Gatwickstraat 1, Amsterdam, 1043 GK, Netherlands
86	26 Prince Andrew Place, Don Mills, Toronto, ON, M3C 2T8, Canada
87	Vitacura 5950 Comuna de vitacura, Santiago, Chile
88	2, Lilienthalstrasse, Hallbergmoos, 85399, Germany
89	Jose Ananias #505, Macul, Santiago, Chile
90	Carrera 7 Nro 156 – 68, Piso 26, Bogota, Colombia
91	Calle Antonio Dovalijaime #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, 0832-0588 Panama, Panama
93	Calle Río de la Plata N° 152. Piso 5. San Isidro. Lima – Perú
94	28, Ribera del Loira, Madrid, 28042, Spain
95	87/1 Capital Tower Building, All Seasons Place unit 1604 – 6 16th floor, Wireless Road, Lumpini, Pathumwan, Bangkok, Thailand
96	7 F AIA Tower, 16 Tongil-ro 2-gil, Jung-gu, Seoul, 04511, Republic of Korea
97	19 Joule Street, Southern Industrial Area, 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	Ingeniero Butty 240 Piso 5, Buenos Aires, Argentina
101	No 219, Room D, 11F, Sec 3, Beixin Road, New Taipei City, Xindian District, 23143, Taiwan
102	Barbaros Bulvarı. No:149, Dr. Orhan Birman İş Merkezi Kat:3, Gayrettepe Beşiktaş, Istanbul, 34349, Turkey
103	3-15, Immeuble Terra Nova II, Rue Henri Rol Tanguy, Montreuil, 93100, France
104	Ulica Jana Henryka Dąbrowskiego 77A 60-529, Poznań, Poland
105	16, Corso Trapani, Turin, 10100, Italy
106	1-6-1, Roppongi, Minato-ku, Tokyo, Japan
107	Orion City, Irgel Building #752, Colombo, 09, Sri Lanka
108	Plot 8, Berkley Road, Old Kampala, Uganda
109	5th floor The Spark Place, P. Tuazon Street, 10th Ave, Araneta Center, Cubao, Quezon City, Philippines
110	Chollerstrasse 37, 6300 Zug, Switzerland

Registered office address
111 27/F Trident Tower, 312 Sen. Gil Puyat Avenue, Makati City, Metro Manila, Philippines
112 Suite 15A11,Tian Xing Jian Commercial Plaza, No. 47 Fuxing Road, Haidian District, Beijing, China
113 National Registered Agents, inc., 160 Greentree Dr Ste 101, Dover, Kent, DE, 19904, United States
114 30th Floor, Ratu Plaza Office Tower, Jl. Jend. Sudirman Kav 9, Jakarta, 10270, Indonesia
115 C/O Pearson Education, 501 Bolyston St, Boston, MA, 02116, United States
116 Suite 3H, No. 6, Block 2, 365 Nong Xin Hua Road, Changning District, Shanghai City, China
117 Commerce House, Wickhams Cay 1, P.O. Box 3140, Road Town, Tortola, British Virgin Islands
118 P O BOX 905, Carnelian Bay, CA, 96140, United States
119 Zone 1 3F, Jin Mao Tower, No.88 Century Avenue, Pilot Free Trade Zone, Shanghai City, China
120 Hermina út 17. 8th floor, Budapest, 1146, Hungary
121 79, Corso Buenos Aires, Milan, 20124, Italy
122 Rua Alexandre Dumas 1610, Ch Santo Antonio, 1 Subsolo, San Paulo, SP, 04717-004, Brazil
123 2F, No.118 East Ti Yu Road, Tianhe District, Guangzhou, China
124 5, Rosental, Munich, 80331, Germany
125 The Corporation Trust Incorporated, 351 West Camden Street, Baltimore, MD, 21201, United States
126 Ulica Szamocka 8 01-748, Warszawa, Poland
127 Suite 2600, Three Bentall Centre, P.O. Box 49314, 595 Burrard Street, Vancouver, BC, V7X 1L3, Canada
128 44 Chipman Hill, Suite 1000, Saint Jon, NB, E2L 4S6, Canada
129 Rodovia Anhanguera, km 317, 4, Bloco B, módulo 27., Jardim Salgado Filho, Ribeirão, Preto, Zip Code 14.079-000, City of São Paulo, State of São Paulo, Brazil
130 21, Amfitheas Avenue, Paleo Faliro Athens, 17564, Greece
131 King Fahad Road, Olaya, Riyadh, 58774, 11515, Saudi Arabia
132 Derech Ben Gurion 2, BSR Building 9th Floor, Ramat Gan, 52573, Israel
133 Thistle House, 4 Burnaby Street, Hamilton, HM11, Bermuda
134 3500, 855 – 2nd Street, S.W., Calgary, AB, T2P 4K7, Canada
135 Avenida 24 de Julho, Numero 776, Maputo, Mozambique
136 199 Bay Street, Commerce Court West, Suite 2800, Toronto, ON, M5L1A9, Canada

Partly owned subsidiaries

Registered Company Name	Country of Incorp.	% Owned	Reg office
Certiport China Co Ltd	CN	50.69	1
CG Manipal Schools Private Limited	NE	51	2
Chongqing WSE Training Centre Co Ltd	CN	95	3
Educational Publishers LLP	UK	85	4
GED Domains LLC	US	70	5
GED Testing Service LLC	US	70	6
Heilongjiang WSE Training Centre Co Ltd	CN	95	7
Heinemann Publishers (Pty) Ltd	SA	75	8
Maskew Miller Longman (Pty) Limited	SA	75	8
Pearson Education Achievement Solutions (RF) (Pty) Limited	SA	97.3	8
Pearson South Africa (Pty) Ltd	SA	75	8

Associated undertakings

Registered Company Name	Country of Incorp.	% Owned	Reg office
ACT Aspire LLC	US	50	9
Affordable Private Education Center Inc‡	PH	40	10
Avanti Learning Centres Private Limited‡	IN	20.9	11
eAdvance Proprietary Limited‡	ZA	39.57	12
HE Distributions, LLC	US	35.3	13
Institute for Private Education & Training KSCC*	KU	49.02	14
Intellus Learning, Inc.†	US	14.5	15
Karadi Path Education Company Private Limited‡	IN	26.25	16
Learn Capital Special Opportunities Fund I, L.P.‡	US	99.59	22
Learn Capital Venture Partners II, L.P.‡	US	72.93	22
Learn Capital Venture Partners IIIA, L.P.‡	KY	99.00	23
Learn Capital Venture Partners, L.P.‡	US	99.15	22
Omega Schools Franchise Limited	GH	49.05	17
Peking University Pearson (Beijing) Cultural Development Co., Ltd	CN	45	18
Penguin Random House Limited	UK	47	4
Penguin Random House LLC	US	47	9
Scala Higher Education , S.C.	ME	45	19
Scala Latin America S.A.P.I. de C.V.	ME	45	19
Scala Student, S.A. de C.V.	ME	45	19
The Egyptian International Publishing Company-Longman	EG	49	20
Zaya Learning Labs Private Limited‡	IN	20	21

* In liquidation
† Significant influence is based on management's assessment
‡ 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 Lalitpur, Sub-Metropolitan City,-2, Bagmati, Nepal
3 9-4#, Unit 4, 24 Jintang Street, Yuzhong District, Chongqing, China
4 80 Strand, London, WC2R 0RL, England
5 C T Corporation System, 4701 Cox Road, Suite 285, Glen Allen, Henrico, VA, 23060-0000, United States
6 The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle, DE, 19801, United States
7 Room 503, 5F, Xin'an Building, No.238 Xinyang Road, Dao Li District, Harbin, China
8 Auto Atlantic, 4th Floor, Corner Hertzog Boulevard and Heerengracht, Cape Town, 8001, South Africa
9 C/o Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington, Delaware, 19808, United States
10 33rd Floor, Tower One & Exchange Plaza, Ayala Triangle, Ayala Avenue, Makati City, Philippines
11 16 Paschimi Marg, Vasant Vihar, New Delhi, DL, India
12 Office 201, Parktown Quarter, Corner 3rd & 7th Avenue, Parktown North, Johannesburg 2193. South Africa
13 United Corporate Services, Inc., 874 Walker Road Suite C, Dover, Kent, DE, 19904, United States
14 P.O. Box No. 6320, 32038 Hawalli, Kuwait City, Kuwait,
15 United States Corporation Agents, Inc., 300 Delaware Ave Site 210-A, Wilmington, New Castle, DE, 19801, United States
16 3A Dev Regency II, First Main Road, Gandhinagar, Adyar, Chennai, TN, India
17 2nd Floor OTS Building, off Accra-Winneba Road, Kasoa second, Kasoa P.O. Box WJ973, Weija, Accra. Ghana
18 Suite 216, No. 127-1 Zhongguancun North Street, Haidian District, Beijing, China
19 Calz. de la Naranja # 159, Col. Fracc. Industrial Alice Blanco, Naucalpan de Juarez, Edo. De Mex., 53370, Mexico
20 10a Hussein Wassef St, Midan Missaha, Dokki Giza, 12311, Egypt
21 Unit No. 404, New Udyog Mandir 2, Mogul Lane, Mahim(West), Mumbai, MH, 400016, India
22 Incorporating Services, Ltd. 3500 S Dupont Way, Dover, Kent DE, 19901 United States
23 Campbells Corporate Services Limited, Floor 4, Willow House, Cricket Square, Grand Cayman, KY1-9010, Cayman Islands

Five-year summary

All figures in £ millions	2012	2013	2014	2015 Restated	2016
Sales: By geography*					
North America		3,008	2,906	2,940	**2,981**
Core		1,008	910	815	**803**
Growth		712	724	713	**768**
Continuing	4,615	4,728	4,540	4,468	**4,552**
Discontinued	1,497	962	343	312	**–**
Total sales	6,112	5,690	4,883	4,780	**4,552**
Adjusted operating profit: By geography*					
North America		464	444	480	**420**
Core		103	122	105	**57**
Growth		35	32	(3)	**29**
Penguin Random House		50	69	90	**129**
Continuing	785	652	667	672	**635**
Discontinued	147	84	55	51	**–**
Total adjusted operating profit	932	736	722	723	**635**

* Periods prior to 2013 have not been restated to reflect the new organisation structure as there is no appropriate basis for restatement of those periods.

All figures in £ millions	2012	2013	2014	2015	2016
Operating margin – continuing	17.0%	13.8%	14.7%	15.0%	**13.9%**
Adjusted earnings					
Total adjusted operating profit	932	736	722	723	**635**
Net finance costs	(65)	(72)	(64)	(46)	**(59)**
Income tax	(200)	(97)	(118)	(105)	**(95)**
Non-controlling interest	(3)	(1)	1	–	**(2)**
Adjusted earnings	664	566	541	572	**479**
Weighted average number of shares (millions)	804.3	807.8	810.9	813.3	**814.8**
Adjusted earnings per share	82.6p	70.1p	66.7p	70.3p	**58.8p**

All figures in £ millions	2012	2013	2014	2015	2016
Cash flow					
Operating cash flow	788	588	649	435	**663**
Operating cash conversion	85%	80%	90%	60%	**104%**
Operating free cash flow	657	324	413	255	**549**
Operating free cash flow per share	81.7p	40.1p	50.9p	31.4p	**67.4p**
Free cash flow	657	269	413	152	**310**
Free cash flow per share	81.7p	33.3p	50.9p	18.7p	**38.0p**
Net assets	5,710	5,706	5,985	6,418	**4,348**
Net debt	918	1,379	1,639	654	**1,092**
Return on invested capital (gross basis)					
Total adjusted operating profit	932	736	722	723	**635**
Operating tax paid	(65)	(191)	(163)	(129)	**(63)**
Return	867	545	559	594	**572**
Average invested capital	9,578	10,130	9,900	10,317	**11,464**
Return on invested capital	9.1%	5.4%	5.6%	5.8%	**5.0%**
Dividend per share	45.0p	48.0p	51.0p	52.0p	**52.0p**

Corporate and operating measures

The tables below set out the Group's non-GAAP measures and reconcile them to the statutory results. Non-GAAP measures are included as they are key financial measures used by management to evaluate performance and also for investors to track the underlying operational performance of the Group.

Sales – underlying and constant exchange rate

Underlying sales movements exclude the impact of acquisitions and disposals (portfolio changes) and are stated at constant exchange rates. 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 we calculate the additional contribution as the sales made in the period of the current year that corresponds to the pre-acquisition period in the prior year. We also exclude sales made by businesses disposed in either the current year or the prior year. Constant exchange rates are calculated by assuming the average exchange rates in the prior year prevailed throughout the current year. These measures enable management and investors to track more easily, and consistently, the underlying sales performance of the Group.

All figures in £ millions	2016
Underlying decrease	(339)
Portfolio changes	(63)
Exchange differences	486
Total statutory sales increase	**84**
Underlying decrease	(8)%
Constant exchange rate decrease	(9)%

Adjusted income statement

A reconciliation of the statutory income statement to the adjusted income statement is shown in note 8 to the Group financial statements. Note 8 also includes a description of all items included in the reconciliation and an explanation of why each item has been excluded from the adjusted income statement. Continuing adjusted income statement measures can be calculated by excluding the 'discontinued operations' column from the table of adjusted income statements measures in note 8 to the Group financial statements. In 2016 continuing adjusted operating profit is £635m (2015: £672m).

The key adjusted measures used by management and investors are adjusted operating profit and adjusted earnings. These measures are used by management to evaluate performance and allocate resources to business segments. The measures also enable our 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 and major restructuring programmes.

Adjusted operating profit – underlying and constant exchange rate

Underlying adjusted operating profit movements exclude the impact of acquisitions and disposals (portfolio changes) and are stated at constant exchange rates. Portfolio changes and constant exchange rates for profits are calculated in the same way as for sales, as described above. These measures enable management and investors to track more easily, and consistently, the underlying profit performance of the Group.

All figures in £ millions	2016
Underlying decrease	(141)
Portfolio changes	(53)
Exchange differences	106
Total adjusted operating profit decrease	**(88)**
Underlying decrease	(21)%
Constant exchange rate decrease	(27)%

Cash flow measures

The Group uses 3 key cash flow measures – operating cash flow, operating free cash flow and free cash flow.

Operating cash flow is calculated as net cash generated from operations before the cash flow impact of items excluded from the adjusted income statement plus dividends from joint ventures and associates; capital expenditure on property, plant and equipment and intangible software assets; proceeds from the sale of property, plant and equipment and intangible software assets; and less finance lease principal payments. Operating cash flow is reconciled in note 32 of the Group financial statements. Operating cash flow is included as a non-GAAP measure in order to align the cash flows with the corresponding adjusted profit measures.

Cash flow measures continued

In addition to operating cash flow the Group also presents operating free cash flow and free cash flow as non-GAAP measures as they are commonly used by investors to measure the cash performance of the Group.

Operating free cash flow is calculated as operating cash flow less operating tax paid and less operating finance costs paid. Operating free cash flow is reconciled in note 32 of the Group financial statements.

Free cash flow is calculated as operating free cash flow including the cash flow impact of items excluded from the adjusted income statement plus non operating tax received and paid. Free cash flow is reconciled in note 32 of the Group financial statements.

In addition to the 3 key cash flow measures the Group also uses a cash conversion ratio and a free cash flow per share ratio, both of which are reconciled in the table below. These ratios are included as non-GAAP measures as they are used by management and investors to measure underlying cash generation by the Group.

All figures in £ millions	2016	2015
Adjusted operating profit	**635**	723
Operating cash flow	**663**	435
Cash conversion (operating cash flow ÷ adjusted operating profit)	**104%**	60%
Free cash flow	**310**	152
Weighted average number of shares in issue (millions)	**814.8**	813.3
Operating free cash flow per share	**67.4p**	31.4p
Free cash flow per share	**38.0p**	18.7p

Net debt and EBITDA

Net debt is reconciled in Note 19 of the Group financial statements. Earnings before interest, tax, depreciation and amortisation (EBITDA) is calculated as total adjusted operating profit less depreciation on property, plant and equipment and less software amortisation – it is reconciled in the table below. The net debt / EBITDA ratio is included as a non-GAAP measure as it is commonly used by investors to measure balance sheet strength.

All figures in £ millions	2016	2015
Adjusted operating profit	**635**	723
Depreciation (excluding items included in 'major cost of restructuring')	**80**	75
Software amortisation (excluding items included in 'major cost of restructuring')	**70**	74
EBITDA	**785**	872
Net debt	**1,092**	654
Net debt / EBITDA ratio	**1.4x**	0.8x

Return on invested capital

Return on invested capital (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 included as a non-GAAP measure as it is used by management and investors to track investment returns and by management to help inform capital allocation decisions within the business.

All figures in £ millions	2016	2015
Adjusted operating profit	**635**	723
Operating tax paid	**(63)**	(129)
Return	**572**	594
Average goodwill and other intangibles	**9,468**	8,715
Average net operating assets	**1,996**	1,602
Average invested capital	**11,464**	10,317
Return on invested capital	**5.0%**	5.8%

Shareholder information

Pearson ordinary shares are listed on the London Stock Exchange and on the New York Stock Exchange in the form of American Depositary Receipts.

Corporate website

The investors' section of our corporate website www.pearson.com/investors.html provides a wealth of information for shareholders. It is also possible to sign up to receive e-mail alerts for reports and press releases relating to Pearson at www.pearson.com/news/media/email-alert-signup.html

Shareholder information online

Shareholder information can be found on our website www.pearson.com/investors/investor-information.html

Our registrar, Equiniti, also provides a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at www.shareview.co.uk. For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA. Telephone 0371 384 2233* or, for those shareholders with hearing difficulties, textphone number 0371 384 2255*.

Information about the Pearson share price

The company's share price can be found on our website at www.pearson.com. It also appears in the financial columns of the national press.

2016 dividends

	Payment date	Amount per share
Interim	16 September 2016	18 pence
Final	12 May 2017	34 pence

Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0371 384 2043*.

Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0371 384 2268*.

Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to www.shareview.co.uk/dealing or call customer services on 0345 300 0430*.

Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact their telephone dealing helpline on 03456 037 037* or, for online dealing, log on to www.shareview.co.uk/dealing. You will need your shareholder reference number as shown on your share certificate.

A postal dealing service is also available through Equiniti. Please telephone 0371 384 2248* for details or log on to www.shareview.co.uk to download a form.

ShareGift

Shareholders with small holdings of shares, whose value makes them uneconomic to sell, may wish to donate them to ShareGift, the share donation charity (registered charity number 1052686). Further information about ShareGift and the charities it has supported may be obtained from their website, www.ShareGift.org or by contacting them at ShareGift, PO Box 72253, London, SW1P 9LQ.

American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact Bank of New York Mellon, Shareholder Correspondence (ADR), PO Box 30170, College Station, TX 77842-3170, telephone 1 (866) 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively, you may e-mail shrrelations@cpushareownerservices.com

Voting rights for registered ADR holders can be exercised through Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

* Lines open 8.30 am to 5.30 pm Monday to Friday (excluding UK public holidays).

Share register fraud: protecting your investment

Pearson does not contact its shareholders directly to provide recommendation 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/investors/managing-your-shares/share-register-fraud.html

Tips on protecting your shares

- Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation
- Inform our registrar, Equiniti, promptly when you change address
- Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or better still, make arrangements to have the dividend paid directly into your bank account
- Consider holding your shares electronically in a CREST account via a nominee.

2017 financial calendar

Ex-dividend date	**6 April**
Record date	**7 April**
Last date for dividend reinvestment election	**20 April**
Annual General Meeting	**5 May**
Payment date for dividend and share purchase date for dividend reinvestment	**12 May**

Reliance on this document

The intention of this document is to provide information to shareholders and is not designed to be relied upon by any other party or for any other purpose.

Forward-looking statements

Except for the historical information contained herein, the matters discussed in this document include forward-looking statements. In particular, all statements that express forecasts, expectations and projections with respect to future matters, 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 risks and uncertainties because they relate to events and depend on circumstances that will occur in future. They are based on numerous assumptions regarding Pearson's present and future business strategies and the environment in which it will operate in the future. There are a number of factors which could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including a number of factors outside Pearson's control. These include international, national and local conditions, as well as competition. They also include other risks detailed from time to time in Pearson's publicly-filed documents and you are advised to read, in particular, the risk factors set out in this document. Any forward-looking statements speak only as of the date they are made, and Pearson gives no undertaking to update forward-looking statements to reflect any changes in its expectations with regard thereto or any changes to events, conditions or circumstances on which any such statement is based. Readers are cautioned not to place undue reliance on such forward-looking statements.

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Pearson has supported the planting of 71.5 square metres of new native woodland with the Woodland Trust, helping to remove 2.86 metric tonnes of carbon dioxide generated by the production of this report and associated documents.

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