Consolidated income statement
Year ended 31 December 2009

All figures in £ millions	Notes	2009	2008
Continuing operations			
Sales	2	5,624	4,811
Cost of goods sold	4	(2,539)	(2,174)
Gross profit		3,085	2,637
Operating expenses	4	(2,360)	(1,986)
Share of results of joint ventures and associates	12	30	25
Operating profit	2	755	676
Finance costs	6	(122)	(136)
Finance income	6	27	45
Profit before tax		660	585
Income tax	7	(198)	(172)
Profit for the year from continuing operations		462	413
Loss for the year from discontinued operations	3	–	(90)
Profit for the year		462	323
Attributable to:			
Equity holders of the company		425	292
Minority interest		37	31
Earnings per share for profit from continuing and discontinued operations attributable to the equity holders of the company during the year (expressed in pence per share)			
– basic	8	53.2p	36.6p
– diluted	8	53.1p	36.6p
Earnings per share for profit from continuing operations attributable to the equity holders of the company during the year (expressed in pence per share)			
– basic	8	53.2p	47.9p
– diluted	8	53.1p	47.9p

Consolidated statement of comprehensive income
Year ended 31 December 2009

All figures in £ millions	Notes	2009	2008
Profit for the year		462	323
Net exchange differences on translation of foreign operations		(388)	1,125
Currency translation adjustment disposed – subsidiaries		–	49
Currency translation adjustment disposed – joint venture		–	1
Actuarial losses on retirement benefit obligations – Group	25	(299)	(71)
Actuarial losses on retirement benefit obligations – associate	12	(3)	(3)
Net increase in fair values of proportionate holding arising on stepped acquisition		18	–
Taxation on items recognised in other comprehensive income	7	91	9
Other comprehensive (expense)/income for the year		(581)	1,110
Total comprehensive (expense)/income for the year		(119)	1,433
Attributable to:			
Equity holders of the company		(127)	1,327
Minority interest		8	106

Consolidated statement of changes in equity

Year ended 31 December 2009

All figures in £millions	Equity attributable to the equity holders of the company							
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total	Minority interest	Total equity
At 1 January 2009	202	2,505	(222)	586	1,679	4,750	274	5,024
Total comprehensive (expense)/income	–	–	–	(359)	232	(127)	8	(119)
Equity-settled transactions	–	–	–	–	37	37	–	37
Taxation on equity-settled transactions	–	–	–	–	6	6	–	6
Issue of ordinary shares under share option schemes	1	7	–	–	–	8	–	8
Purchase of treasury shares	–	–	(33)	–	–	(33)	–	(33)
Release of treasury shares	–	–	29	–	(29)	–	–	–
Put option over minority interest	–	–	–	–	(23)	(23)	–	(23)
Changes in minority shareholding	–	–	–	–	–	–	24	24
Dividends	–	–	–	–	(273)	(273)	(15)	(288)
At 31 December 2009	203	2,512	(226)	227	1,629	4,345	291	4,636

All figures in £millions	Equity attributable to the equity holders of the company							
	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total	Minority interest	Total equity
At 1 January 2008	202	2,499	(216)	(514)	1,724	3,695	179	3,874
Total comprehensive income	–	–	–	1,100	227	1,327	106	1,433
Equity-settled transactions	–	–	–	–	33	33	–	33
Taxation on equity-settled transactions	–	–	–	–	(7)	(7)	–	(7)
Issue of ordinary shares under share option schemes	–	6	–	–	–	6	–	6
Purchase of treasury shares	–	–	(47)	–	–	(47)	–	(47)
Release of treasury shares	–	–	41	–	(41)	–	–	–
Changes in minority shareholding	–	–	–	–	–	–	6	6
Dividends	–	–	–	–	(257)	(257)	(17)	(274)
At 31 December 2008	202	2,505	(222)	586	1,679	4,750	274	5,024

The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments.

Consolidated balance sheet
As at 31 December 2009

All figures in £ millions	Notes	2009	2008
Assets			
Non-current assets			
Property, plant and equipment	10	388	423
Intangible assets	11	5,129	5,353
Investments in joint ventures and associates	12	30	23
Deferred income tax assets	13	387	372
Financial assets – Derivative financial instruments	16	112	181
Retirement benefit assets	25	–	49
Other financial assets	15	62	63
Other receivables	22	112	152
		6,220	6,616
Current assets			
Intangible assets – Pre-publication	20	650	695
Inventories	21	445	501
Trade and other receivables	22	1,284	1,342
Financial assets – Derivative financial instruments	16	–	3
Financial assets – Marketable securities	14	63	54
Cash and cash equivalents (excluding overdrafts)	17	750	685
		3,192	3,280
Total assets		9,412	9,896
Liabilities			
Non-current liabilities			
Financial liabilities – Borrowings	18	(1,934)	(2,019)
Financial liabilities – Derivative financial instruments	16	(2)	(15)
Deferred income tax liabilities	13	(473)	(447)
Retirement benefit obligations	25	(339)	(167)
Provisions for other liabilities and charges	23	(50)	(33)
Other liabilities	24	(253)	(221)
		(3,051)	(2,902)
Current liabilities			
Trade and other liabilities	24	(1,467)	(1,429)
Financial liabilities – Borrowings	18	(74)	(344)
Financial liabilities – Derivative financial instruments	16	(7)	(5)
Current income tax liabilities		(159)	(136)
Provisions for other liabilities and charges	23	(18)	(56)
		(1,725)	(1,970)
Total liabilities		(4,776)	(4,872)
Net assets		4,636	5,024

Consolidated balance sheet continued

All figures in £ millions	Notes	2009	2008
Equity			
Share capital	27	203	202
Share premium	27	2,512	2,505
Treasury shares	28	(226)	(222)
Translation reserve		227	586
Retained earnings		1,629	1,679
Total equity attributable to equity holders of the company		4,345	4,750
Minority interest		291	274
Total equity		4,636	5,024

These financial statements have been approved for issue by the board of directors on 10 March 2010 and signed on its behalf by

Robin Freestone Chief financial officer

Consolidated cash flow statement
Year ended 31 December 2009

All figures in £ millions	Notes	2009	2008
Cash flows from operating activities			
Net cash generated from operations	31	1,012	894
Interest paid		(90)	(87)
Tax paid		(103)	(89)
Net cash generated from operating activities		819	718
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	29	(208)	(395)
Acquisition of joint ventures and associates		(14)	(5)
Purchase of investments		(10)	(1)
Purchase of property, plant and equipment (PPE)		(62)	(75)
Proceeds from sale of investments		–	5
Proceeds from sale of PPE	31	1	2
Purchase of intangible assets		(58)	(45)
Disposal of subsidiaries, net of cash disposed	30	14	111
Interest received		3	11
Dividends received from joint ventures and associates		22	23
Net cash used in investing activities		(312)	(369)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	8	6
Purchase of treasury shares		(33)	(47)
Proceeds from borrowings		296	455
Liquid resources acquired		(13)	–
Repayment of borrowings		(343)	(275)
Finance lease principal payments		(2)	(3)
Dividends paid to company's shareholders	9	(273)	(257)
Dividends paid to minority interest		(20)	(28)
Net cash used in financing activities		(380)	(149)
Effects of exchange rate changes on cash and cash equivalents		(36)	(103)
Net increase in cash and cash equivalents		91	97
Cash and cash equivalents at beginning of year		589	492
Cash and cash equivalents at end of year	17	680	589

Independent auditors' report to the members of Pearson plc

We have audited the consolidated and company financial statements (together the 'financial statements') of Pearson plc for the year ended 31 December 2009. The consolidated financial statements comprise the consolidated income statement, the consolidated balance sheet, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes to the consolidated financial statements. The company financial statements comprise the company statement of comprehensive income, the company statement of changes in equity, the company balance sheet, the company cash flow statement and the related notes to the company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) 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.

Respective responsibilities of directors and auditors

As explained more fully in the statement of directors' responsibilities set out in the Governance section of the directors' report, 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 the financial statements in accordance with applicable law and International Standards on Auditing (UK and 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.

Scope of the audit of the financial statements

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; and the overall presentation of the financial statements.

Opinion on statements

In our opinion:

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 2009 and of the Group's profit and Group's and company's cash flows for the year then ended;

The consolidated financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;

The company financial statements have been properly prepared in accordance with IFRS as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and

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.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- The part of the report on directors' remuneration to be audited has been properly prepared in accordance with the Companies Act 2006;
- The information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- The information given in the corporate governance statement set out in the Governance section of the directors' report with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- 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 information in the report on directors' remuneration that is described as having been audited are not in agreement with the accounting records and returns; or
- Certain disclosures of directors' remuneration specified by law are not made; or
- We have not received all the information and explanations we require for our audit; or
- A corporate governance statement has not been prepared by the company.

Under the Listing Rules we are required to review:

- The directors' statement set out in the Governance section of the directors' report in relation to going concern; and
- The parts of the corporate governance statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Ranjan Sriskandan (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
10 March 2010

Notes to the consolidated financial statements

General information

Pearson plc (the company) and its subsidiaries (together the Group) are international media businesses covering education, business information and consumer publishing.

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

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

These consolidated financial statements were approved for issue by the board of directors on 10 March 2010.

1. Accounting policies

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

a. Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 1985 and/or the Companies Act 2006 (as applicable) applicable to companies reporting under IFRS. These consolidated financial statements are also prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB). In respect of the accounting standards applicable to the Group there is no difference between EU-adopted and IASB-adopted IFRS. The Group transitioned from UK GAAP to IFRS on 1 January 2003.

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.

1. Interpretations and amendments to published standards effective in 2009

IAS 1 (Revised) 'Presentation of Financial Statements', effective for annual reporting periods beginning on or after 1 January 2009. The amendments require a number of presentational changes including the requirement to present a statement of changes in equity as a primary statement and the introduction of the statement of comprehensive income, which presents all items of recognised income and expense, either in one statement or in two linked statements. Management have elected to present two statements.

Amendments to IAS 23 'Borrowing Costs', effective for annual reporting periods beginning on or after 1 January 2009. The amendment requires capitalisation of borrowing costs that relate to qualifying assets (ones that take a substantial amount of time to get ready for use or sale, with the exception of assets measured at fair value or inventories manufactured in large quantities or on a repetitive basis). Management have assessed that this amendment has no impact on the Group's financial statements as there are currently no material qualifying assets.

Amendments to IFRS 7 'Financial Instruments: Disclosures', effective for annual reporting periods beginning on or after 1 January 2009. The amendments require additional disclosures about fair value measurement and liquidity risk. For financial instruments measured at fair value in the balance sheet disclosure is required, based on observability of inputs, into a three level fair value hierarchy. In addition, a reconciliation between the opening and closing balance for level 3 fair value measurements must be presented, along with significant transfers between the levels of the hierarchy. The amendments also clarify the scope of liquidity risk disclosures. Fair value measurement and liquidity risk disclosures are detailed in note 19.

Amendments to IFRS 2 'Share-based Payment', effective for annual reporting periods beginning on or after 1 January 2009. The amendment clarifies that only service and performance conditions are vesting conditions and that all cancellations, whether Group or counterparty, should be accounted for the same way. Management have determined that this does not have any impact on the financial statements for the Group.

1. Accounting policies continued

a. Basis of preparation continued

1. Interpretations and amendments to published standards effective in 2009 – continued

Amendments to IAS 32 'Financial Instruments: Presentation' and IAS 1 'Presentation of Financial Statements' – Puttable Financial Instruments and Obligations Arising on Liquidation, effective for annual reporting periods beginning on or after 1 January 2009. The amendments require puttable financial instruments or investments that impose on the entity an obligation to another party in respect of a share of net assets only on liquidation to be classified as equity. Management have determined that this has no impact on the financial statements of the Group.

Amendments to IFRIC 9 'Reassessment of Embedded Derivatives' and IAS 39 'Financial Instruments: Recognition and Measurement', effective for annual reporting periods ending on or after 30 June 2009. The amendments clarify the position on embedded derivatives following the earlier amendments to IAS 39 regarding reclassification. The amendment to IFRIC 9 requires an entity to assess whether an embedded derivative must be separated from a host contract when the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. IAS 39 now states that if an embedded derivative cannot be reliably measured, the entire hybrid instrument must remain classified as at fair value through profit and loss. Management have determined this has no impact on the financial statements of the Group.

'Improvements to Financial Reporting Standards 2008', mostly effective for annual reporting periods beginning on or after 1 January 2009. This is the first standard published under the IASB's annual improvements process which is designed to deal with non-urgent minor amendments to standards. Of the 35 amendments issued, the adoption of the following amendment resulted in a change to accounting policy but did not have any significant impact on the Group's financial position or performance.

Amendments to IAS 38 'Intangible Assets' require expenditure on advertising and promotional activities to be recognised as an expense when the Group either has the right to access the goods or has received the service, rather than when the Group uses the goods or service.

Other amendments did not have any impact on the accounting policies or financial statements of the Group.

In the 2008 accounts the Group early adopted IFRS 8 'Operating Segments', effective for annual reporting periods beginning on or after 1 January 2009.

The standard requires a management approach to reporting segmental information and six reporting segments have been identified under IFRS 8 as detailed in note 2.

IFRIC 13 'Customer Loyalty Programmes', effective for annual reporting periods beginning on or after 1 July 2008. IFRIC 13 explains how entities that grant loyalty award credit to customers should account for their obligations to provide free or discounted goods or services to customers who redeem award credits. As no Group entities operate a customer loyalty programme management have assessed that IFRIC 13 is not relevant to the Group.

IFRIC 15 'Agreements for the Construction of Real Estate', effective for annual reporting periods beginning on or after 1 January 2009. IFRIC 15 addresses the accounting by entities that undertake the construction of real estate with guidance on determining whether an agreement for the construction of real estate falls within the scope of IAS 11 'Construction Contracts' or IAS 18 'Revenue'. As no Group entities undertake the construction of real estate management have assessed that IFRIC 15 is not relevant to the Group.

IFRIC 16 'Hedges of a Net Investment in Foreign Operations', effective for annual reporting periods beginning on or after 1 October 2008. IFRIC 16 provides guidance on net investment hedging including which foreign currency risks within the Group qualify for hedging and where the hedging investments can be held within the Group. Management have assessed that this has no impact on the Group's financial statements.

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

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 3 (Revised) 'Business Combinations' and amendments to IAS 27 'Consolidated and Separate Financial Statements', effective for annual reporting periods beginning on or after 1 July 2009. The amendments affect the accounting for business combinations, including the requirement to re-measure the fair value of previously held interests in step acquisitions with any gain or loss arising being recognised in the income statement, the requirement to expense acquisition costs and the requirement to recognise adjustments to contingent consideration in the income statement.

Amendments to IAS 39 'Financial Instruments: Recognition and Measurement', effective for annual reporting periods beginning on or after 1 July 2009. These amendments clarify that inflation may only be hedged where changes in inflation are a specified portion of cash flows of a financial instrument, and also clarify hedging with options.

Amendments to IAS 24 'Related Parties', effective for annual reporting periods beginning on or after 1 January 2011. The amendments simplify disclosure for government related entities and clarify the definition of a related party.

Amendments to IFRS 2 'Share-based Payment': Group cash-settled share-based payment transactions, effective for annual reporting periods beginning on or after 1 January 2010. This amendment clarifies the scope and accounting for group cash-settled share-based payment transactions.

Amendments to IAS 32 'Financial Instruments: Presentation' – Classification of Rights, effective for annual reporting periods beginning on or after 1 February 2010. The amendment clarifies that rights, options or warrants issued to a acquire a fixed number of an entity's own non-derivative equity instruments for a fixed amount in any currency are classified as equity instruments provided the offer is made pro-rata to all existing owners of the same class of the entity's own non-derivative equity instruments.

IFRS 9 'Financial Instruments', effective for annual reporting periods beginning on or after 1 January 2013. The new standard details the requirements for the classification and measurement of financial assets.

'Improvements to IFRSs – 2009' effective dates vary upon the amendment. This is the second set of amendments published under the IASB's annual improvements process and incorporates minor amendments to 12 standards and interpretations.

IFRIC 18 'Transfers of Assets from Customers' effective for transfers of assets from customers received on or after 1 July 2009. IFRIC 18 states that when an item of property, plant and equipment is received from a customer and it meets the definition of an asset from the perspective of the recipient, the recipient should recognise the asset at its fair value at the date of transfer and recognise the credit in accordance with IAS 18 'Revenue'.

IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments', effective for annual reporting periods beginning on or after 1 July 2010. IFRIC 19 clarifies accounting by entities issuing equity instruments to extinguish all or part of a financial liability.

Amendments to IFRIC 14 'Prepayments of a Minimum Funding Requirement,' effective for annual reporting periods beginning on or after 1 January 2011. This amendment remedies a consequence of IFRIC 14 where, in certain circumstances, an entity was not permitted to recognise prepayments of a minimum funding requirement as an asset.

Management are currently assessing the impact of these new standards, interpretations and amendments on the Group's financial statements.

In addition, management has assessed the relevance of the following interpretation with respect to the Group's operations:

1. Accounting policies continued

a. Basis of preparation continued
2. Standards, interpretations and amendments to published standards that are not yet effective – continued

IFRIC 17 'Distributions of Non-cash Assets to Owners', effective for annual reporting periods beginning on or after 1 July 2009. IFRIC 17 provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends, including recognition upon authorisation and measurement at fair value of assets distributed, with any difference between fair value and carrying value of these assets being recognised in the income statement when an entity settles the dividend payable. This does not apply to distributions of non-cash assets under common control. This interpretation will have no impact on the Group's financial statements as the Group does not currently distribute non-cash assets.

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:

Intangible assets:	Goodwill
Intangible assets:	Pre-publication assets
Royalty advances	
Taxation	
Employee benefits:	Pension obligations
Revenue recognition	

b. Consolidation
1. Business combinations The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

Where the settlement of consideration payable is deferred, or contingent on future events, the fair value of the deferred component is determined by discounting the amount payable or probable to be paid to its present value using an appropriate discount rate.

Identifiable assets and contingent assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. For material acquisitions, the fair value of the acquired intangible assets is determined by an external, independent valuer. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. See note 1e(1) for the accounting policy on goodwill.

2. Subsidiaries Subsidiaries are entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

3. Transactions with minority interests Transactions with minority interests are treated as transactions with shareholders. Any surplus or deficit arising from disposals to a minority interest is recorded in equity. For purchases from a minority 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 which are jointly controlled, with one or more other venturers, under a contractual arrangement. 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. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at cost.

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.

Notes to the consolidated financial statements continued

1. Accounting policies continued

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.

At the date of transition to IFRS the cumulative translation differences in respect of foreign operations have been deemed to be zero.

Any gains and losses on disposals of foreign operations will exclude translation differences that arose prior to the transition date.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.57 (2008: $1.85) and the year end rate was $1.61 (2008: $1.44).

d. Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost 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.

e. Intangible assets

1. Goodwill Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary, associate or joint venture at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

Goodwill is tested 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 to sell 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 cash-generating units for the purpose of impairment testing. The allocation is made to those 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.

1. Accounting policies continued

e. Intangible assets continued
1. Goodwill – continued

IFRS 3 'Business Combinations' has not been applied retrospectively to business combinations before the date of transition to IFRS. Subject to the transition adjustments to IFRS required by IFRS 1, the accounting for business combinations before the date of transition has been grandfathered.

2. 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 and relationships, trademarks and brands, publishing rights, content and technology. 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 a depreciation 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 life cycle 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 31).

The assessment of the recoverability of pre-publication assets and the determination of the amortisation profile 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.

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.

Notes to the consolidated financial statements continued

1. Accounting policies continued

i. Newspaper development costs

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

j. Cash and cash equivalents

Cash and cash equivalents in the cash flow statement include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are 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. Movements on these financial instruments are classified as cash flows from financing activities in the cash flow statement as these amounts are used to offset the borrowings of the Group.

k. Share capital

Ordinary shares are classified as equity.

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

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

l. Borrowings

Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. 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. Interest on borrowings is expensed in the income statement as incurred.

m. Derivative financial instruments

Derivatives are recognised at fair value and re-measured 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. The Group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of its bonds (fair value hedges) or hedges of net investments in foreign operations (net investment hedges).

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

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

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

n. Taxation

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

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

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

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

1. Accounting policies continued

n. Taxation continued

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

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

Deferred 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.

o. Employee benefits

1. Pension obligations 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.

The determination of the pension cost and defined benefit obligation of the Group's defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth, longevity and expected return on scheme assets.

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

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. The unwinding of the discount rate on the scheme liabilities and the expected return on scheme assets are 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 healthcare 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 material 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. The Group has applied IFRS 2 'Share-based Payment' retrospectively to all options granted but not fully vested at the date of transition to IFRS.

p. Provisions

Provisions are 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 when the payment of the deferred consideration is probable.

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 continued

1. Accounting policies continued

q. Revenue recognition

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

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

Circulation and advertising revenue is recognised when the newspaper or other publication is published. Subscription revenue is recognised on a straight-line basis over the life of the subscription.

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

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in 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. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

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

Income from recharges of freight and other activities which are incidental to the normal revenue generating activities is included in other income.

r. Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges 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.

s. Dividends

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

t. Non-current 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 intended to recover their carrying amount principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale. 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 1q).

2. Segment information

The Group is organised into six business segments:

North American Education Educational publishing, assessment and testing for the school and higher education market within the USA and Canada;

International Education Educational publishing, assessment and testing for the school and higher education market outside of North America;

Professional Business and technology publishing and testing and certification for professional bodies;

FT Publishing Publisher of the *Financial Times*, business magazines and specialist information;

Interactive Data Provider of financial and business information to financial institutions and retail investors;

Penguin Publisher with brand imprints such as Penguin, Putnam, Berkley, Viking and Dorling Kindersley.

For more detail on the services and products included in each business segment refer to the business review.

									2009
All figures in £ millions	Notes	North American Education	International Education	Professional	FT Publishing	Interactive Data	Penguin	Corporate	Group
Continuing operations									
Sales (external)		2,470	1,035	275	358	484	1,002	–	5,624
Sales (inter-segment)		–	–	7	–	–	24	–	31
Adjusted operating profit		403	141	43	39	148	84	–	858
Amortisation of acquired intangibles		(49)	(32)	(1)	(8)	(12)	(1)	–	(103)
Operating profit		354	109	42	31	136	83	–	755
Finance costs	6								(122)
Finance income	6								27
Profit before tax									660
Income tax	7								(198)
Profit for the year from continuing operations									462
Segment assets		4,382	1,635	377	420	471	1,173	924	9,382
Joint ventures	12	13	–	1	1	–	3	–	18
Associates	12	–	5	–	7	–	–	–	12
Total assets		4,395	1,640	378	428	471	1,176	924	9,412
Other segment items									
Share of results of joint ventures and associates	12	(2)	6	1	25	–	–	–	30
Capital expenditure	10, 11, 20	258	80	20	15	29	46	–	448
Depreciation	10	24	16	10	5	21	9	–	85
Amortisation	11, 20	274	89	13	20	16	42	–	454

Notes to the consolidated financial statements continued

2. Segment information continued

All figures in £ millions	Notes	North American Education	International Education	Professional	FT Publishing	Interactive Data	Penguin	Corporate	Group
									2008
Continuing operations									
Sales (external)		2,002	866	244	390	406	903	–	4,811
Sales (inter-segment)		–	–	4	–	–	22	–	26
Adjusted operating profit		303	135	36	74	121	93	–	762
Amortisation of acquired intangibles		(45)	(22)	(1)	(7)	(9)	(2)	–	(86)
Operating profit		258	113	35	67	112	91	–	676
Finance costs	6								(136)
Finance income	6								45
Profit before tax									585
Income tax	7								(172)
Profit for the year from continuing operations									413
Segment assets		4,952	1,358	423	482	524	1,211	923	9,873
Joint ventures	12	–	8	–	2	–	3	–	13
Associates	12	–	4	–	6	–	–	–	10
Total assets		4,952	1,370	423	490	524	1,214	923	9,896
Other segment items									
Share of results of joint ventures and associates	12	–	5	–	19	–	1	–	25
Capital expenditure	10, 11, 20	224	82	22	17	25	51	–	421
Depreciation	10	25	12	8	13	13	9	–	80
Amortisation	11, 20	219	69	12	12	12	36	–	360

In 2009, sales from the provision of goods were £3,947m (2008: £3,411m) and sales from the provision of services were £1,677m (2008: £1,400m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing, market pricing and other service businesses are classified as being from the provision of services.

2. Segment information continued

Corporate costs are allocated to business segments on an appropriate basis depending on the nature of the cost and therefore the segment result is equal to the Group operating profit. Inter-segment pricing is determined on an arm's-length basis. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, retirement benefit assets and deferred taxation 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 intangible assets, including pre-publication but excluding goodwill (see notes 10, 11 and 20).

Property, plant and equipment and intangible assets acquired through business combination were £153m (2008: £253m) (see note 29). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations. Discontinued operations in 2008 relate to the Data Management business (see note 3).

The Group operates in the following main geographic areas:

	Sales		Non-current assets	
All figures in £ millions	2009	2008	2009	2008
Continuing operations				
UK	748	754	941	701
Other European countries	474	463	242	224
USA	3,462	2,861	3,811	4,624
Canada	201	167	204	209
Asia Pacific	519	415	340	179
Other countries	220	151	121	14
Total continuing	5,624	4,811	5,659	5,951
Discontinued operations				
UK	–	–	–	–
Other European countries	–	–	–	–
USA	–	8	–	–
Canada	–	–	–	–
Asia Pacific	–	–	–	–
Other countries	–	–	–	–
Total discontinued	–	8	–	–
Total	5,624	4,819	5,659	5,951

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. Non-current assets are 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 other receivables.

Notes to the consolidated financial statements continued

3. Discontinued operations

There are no discontinued operations in 2009. Discontinued operations in 2008 relate to the Group's interest in the Data Management business (sold on 22 February 2008).

An analysis of the results and cash flows of the discontinued operation is as follows:

All figures in £ millions	2008 Data Management
Sales	8
Operating profit	–
Profit before tax	–
Attributable tax expense	–
Profit after tax	–
Loss on disposal of discontinued operations before tax	(53)
Attributable tax expense	(37)
Loss for the year from discontinued operations	(90)
Operating cash flows	–
Investing cash flows	–
Financing cash flows	–
Total cash flows	–

4. Operating expenses

All figures in £ millions	2009	2008
By function:		
Cost of goods sold	2,539	2,174
Operating expenses		
Distribution costs	274	235
Administrative and other expenses	2,206	1,853
Other income	(120)	(102)
Total operating expenses	2,360	1,986
Total	4,899	4,160

4. Operating expenses continued

All figures in £ millions	Notes	2009	2008
By nature:			
Utilisation of inventory	21	843	832
Depreciation of property, plant and equipment	10	85	80
Amortisation of intangible assets – Pre-publication	20	307	244
Amortisation of intangible assets – Other	11	147	116
Employee benefit expense	5	1,903	1,553
Operating lease rentals		171	168
Other property costs		87	116
Royalties expensed		497	415
Advertising, promotion and marketing		297	244
Information technology costs		96	76
Other costs		586	418
Other income		(120)	(102)
Total		4,899	4,160

During the year the Group obtained the following services from the Group's auditor:

All figures in £ millions	2009	2008
Fees payable to the company's auditor for the audit of parent company and consolidated financial statements	4	3
The audit of the company's subsidiaries pursuant to legislation	2	2
Tax services	2	2
Other services	1	1
Total	9	8

Reconciliation between audit and non-audit service fees is shown below:

All figures in £ millions	2009	2008
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	6	5
Non-audit fees	3	3
Total	9	8

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Tax services include services related to tax planning and various other tax advisory matters. Other services include due diligence on acquisitions.

Notes to the consolidated financial statements continued

5. Employee information

All figures in £ millions	Notes	2009	2008
Employee benefit expense			
Wages and salaries (including termination benefits and restructuring costs)		1,632	1,317
Social security costs		152	119
Share-based payment costs	26	37	33
Retirement benefits – defined contribution plans	25	62	41
Retirement benefits – defined benefit plans	25	18	37
Other post-retirement benefits	25	2	6
		1,903	1,553

The details of the emoluments of the directors of Pearson plc are shown in the report on directors' remuneration.

Average number employed	2009	2008
Employee numbers		
North American Education	15,606	15,412
International Education	8,899	5,718
Professional	2,662	2,641
FT Publishing	2,328	2,379
Interactive Data	2,459	2,413
Penguin	4,163	4,112
Other	1,047	909
Continuing operations	37,164	33,584
Discontinued operations	–	96
	37,164	33,680

6. Net finance costs

All figures in £ millions	Notes	2009	2008
Interest payable		(92)	(106)
Finance costs in respect of retirement benefits	25	(12)	–
Net foreign exchange losses		(7)	(11)
Other losses on financial instruments in a hedging relationship:			
– fair value hedges		(1)	(7)
Other losses on financial instruments not in a hedging relationship:			
– derivatives		(10)	(12)
Finance costs		(122)	(136)
Interest receivable		7	17
Finance income in respect of retirement benefits	25	–	8
Other gains on financial instruments in a hedging relationship:			
– fair value hedges		4	2
– net investment hedges		–	1
Other gains on financial instruments not in a hedging relationship:			
– amortisation of transitional adjustment on bonds		3	1
– derivatives		13	16
Finance income		27	45
Net finance costs		(95)	(91)
Analysed as:			
Net interest payable		(85)	(89)
Net foreign exchange losses reflected in adjusted earnings		–	(7)
Finance (costs)/income in respect of retirement benefits	25	(12)	8
Net finance costs reflected in adjusted earnings		(97)	(88)
Other net finance income/(costs)		2	(3)
Total net finance costs		(95)	(91)

The £3m net gain (2008: £5m net loss) on fair value hedges comprises a £96m gain (2008: £156m loss) on the underlying bonds offset by a £93m loss (2008: £151m gain) on the related derivative financial instruments.

7. Income tax

All figures in £ millions	Notes	2009	2008
Current tax			
Charge in respect of current year		(156)	(89)
Other adjustments in respect of prior years		9	10
Total current tax charge		(147)	(79)
Deferred tax			
In respect of temporary differences		(55)	(97)
Other adjustments in respect of prior years		4	4
Total deferred tax charge	13	(51)	(93)
Total tax charge		(198)	(172)

Notes to the consolidated financial statements continued

7. Income tax continued

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the UK tax rate as follows:

All figures in £ millions	2009	2008
Profit before tax	660	585
Tax calculated at UK rate (2009: 28%, 2008: 28.5%)	(185)	(167)
Effect of overseas tax rates	(40)	(23)
Joint venture and associate income reported net of tax	8	7
Net income/(expense) not subject to tax	5	(7)
Utilisation of previously unrecognised tax losses	2	4
Unutilised tax losses	(1)	–
Prior year adjustments	13	14
Total tax charge	(198)	(172)
UK	(43)	(53)
Overseas	(155)	(119)
Total tax charge	(198)	(172)
Tax rate reflected in earnings	30.0%	29.4%

The tax rate reflected in adjusted earnings is calculated as follows:

All figures in £ millions	2009	2008
Profit before tax	660	585
Adjustments:		
Amortisation of acquired intangibles	103	86
Other net finance (income)/costs	(2)	3
Adjusted profit before tax – continuing operations	761	674
Adjusted profit before tax – discontinued operations	–	–
Total adjusted profit before tax	761	674
Total tax charge	(198)	(172)
Adjustments:		
Tax benefit on other net gains and losses	–	(7)
Tax benefit on amortisation of acquired intangibles	(37)	(31)
Tax charge/(benefit) on other finance income	1	(1)
Tax amortisation benefit on goodwill and intangibles	40	33
Adjusted income tax charge – continuing operations	(194)	(178)
Adjusted income tax charge – discontinued operations	–	–
Total adjusted income tax charge	(194)	(178)
Tax rate reflected in adjusted earnings	25.5%	26.4%

The tax benefit/(charge) recognised in other comprehensive income is as follows:

All figures in £ millions	2009	2008
Pension contributions and actuarial gains and losses	79	10
Net investment hedges and other foreign exchange gains and losses	12	(1)
	91	9

A tax benefit of £6m (2008: tax charge £7m) 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.

All figures in £ millions	Notes	2009	2008
Profit for the year from continuing operations		462	413
Minority interest		(37)	(31)
Earnings from continuing operations		425	382
Loss for the year from discontinued operations	3	–	(90)
Earnings		425	292
Weighted average number of shares (millions)		799.3	797.0
Effect of dilutive share options (millions)		0.8	0.5
Weighted average number of shares (millions) for diluted earnings		800.1	797.5
Earnings per share from continuing and discontinued operations			
Basic		53.2p	36.6p
Diluted		53.1p	36.6p
Earnings per share from continuing operations			
Basic		53.2p	47.9p
Diluted		53.1p	47.9p
Earnings per share from discontinued operations			
Basic		–	(11.3p)

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 to other similarly titled measures reported by other companies.

The following items are excluded in the calculation of adjusted earnings:

Other net gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets that are included within continuing or discontinued operations but which distort the performance of the Group.

Amortisation of acquired intangibles is the amortisation of intangible assets acquired through business combinations. The amortisation charge is not considered to be fully reflective of the underlying performance of the Group.

Notes to the consolidated financial statements continued

8. Earnings per share continued

Other net finance income/costs are foreign exchange and other gains and losses that represent short-term fluctuations in market value and foreign exchange movements on transactions and balances that are no longer in a hedge relationship. These gains and losses are subject to significant volatility and may not be realised in due course as it is normally the intention to hold these 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.

Tax on the above items is excluded from adjusted earnings. The Group also adds the benefit of tax amortisation of goodwill and intangibles as this benefit more accurately aligns the adjusted tax charge with the expected medium-term rate of cash tax payments.

Minority interest for the above items is excluded from adjusted earnings.

The following tables reconcile statutory earnings to adjusted earnings.

						2009
All figures in £ millions	Statutory income statement	Other net gains and losses	Amortisation of acquired intangibles	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
Operating profit	755	–	103	–	–	858
Net finance costs	(95)	–	–	(2)	–	(97)
Profit before tax	660	–	103	(2)	–	761
Income tax	(198)	–	(37)	1	40	(194)
Profit for the year from continuing operations	462	–	66	(1)	40	567
Profit for the year from discontinued operations	–	–	–	–	–	–
Profit for the year	462	–	66	(1)	40	567
Minority interest	(37)	–	(5)	–	(2)	(44)
Earnings	425	–	61	(1)	38	523
Weighted average number of shares (millions)						799.3
Adjusted earnings per share						65.4p

8. Earnings per share continued

All figures in £ millions	Statutory income statement	Other net gains and losses	Amortisation of acquired intangibles	Other net finance income/costs	Tax amortisation benefit	Adjusted income statement
						2008
Operating profit	676	–	86	–	–	762
Net finance costs	(91)	–	–	3	–	(88)
Profit before tax	585	–	86	3	–	674
Income tax	(172)	(7)	(31)	(1)	33	(178)
Profit for the year from continuing operations	413	(7)	55	2	33	496
Loss for the year from discontinued operations	(90)	90	–	–	–	–
Profit for the year	323	83	55	2	33	496
Minority interest	(31)	–	(3)	–	(2)	(36)
Earnings	292	83	52	2	31	460
Weighted average number of shares (millions)						797.0
Adjusted earnings per share						57.7p

9. Dividends

All figures in £ millions	2009	2008
Final paid in respect of prior year 22.0p (2008: 20.5p)	176	163
Interim paid in respect of current year 12.2p (2008: 11.8p)	97	94
	273	257

The directors are proposing a final dividend in respect of the financial year ended 31 December 2009 of 23.3p per share which will absorb an estimated £187m of shareholders' funds. It will be paid on 7 May 2010 to shareholders who are on the register of members on 9 April 2010. These financial statements do not reflect this dividend.

Notes to the consolidated financial statements continued

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 2008	298	622	16	936
Exchange differences	54	138	6	198
Additions	6	67	6	79
Disposals	(7)	(38)	–	(45)
Acquisition through business combination	2	29	2	33
Reclassifications	2	21	(23)	–
At 31 December 2008	355	839	7	1,201
Exchange differences	(21)	(55)	(1)	(77)
Additions	14	46	7	67
Disposals	(2)	(41)	–	(43)
Acquisition through business combination	1	17	–	18
Reclassifications	1	5	(6)	–
At 31 December 2009	348	811	7	1,166

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2008	(126)	(455)	–	(581)
Exchange differences	(30)	(102)	–	(132)
Charge for the year	(19)	(61)	–	(80)
Disposals	6	36	–	42
Acquisition through business combination	(1)	(26)	–	(27)
At 31 December 2008	(170)	(608)	–	(778)
Exchange differences	11	42	–	53
Charge for the year	(17)	(68)	–	(85)
Disposals	2	39	–	41
Acquisition through business combination	–	(9)	–	(9)
At 31 December 2009	(174)	(604)	–	(778)
Carrying amounts				
At 1 January 2008	172	167	16	355
At 31 December 2008	185	231	7	423
At 31 December 2009	174	207	7	388

Depreciation expense of £12m (2008: £12m) has been included in the income statement in cost of goods sold, £7m (2008: £6m) in distribution expenses and £66m (2008: £61m) in administrative and other expenses. The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £15m (2008: £7m).

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2008	3,343	217	187	62	136	99	4,044
Exchange differences	1,082	71	77	24	31	62	1,347
Additions – internal development	–	29	–	–	–	–	29
Additions – purchased	–	16	–	–	–	–	16
Disposals	(8)	(27)	–	–	–	–	(35)
Acquisition through business combination	153	17	77	42	–	97	386
Disposal through business disposal	–	(1)	–	–	(2)	–	(3)
Transfer to Pre-publication	–	(12)	–	–	–	–	(12)
At 31 December 2008	4,570	310	341	128	165	258	5,772
Exchange differences	(420)	(25)	(32)	(9)	(5)	(22)	(513)
Additions – internal development	–	35	–	–	–	–	35
Additions – purchased	–	24	–	–	–	–	24
Disposals	(9)	(5)	–	–	–	–	(14)
Acquisition through business combination	205	–	38	24	55	25	347
At 31 December 2009	4,346	339	347	143	215	261	5,651

Notes to the consolidated financial statements continued

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2008	–	(142)	(28)	(4)	(32)	(24)	(230)
Exchange differences	–	(50)	(15)	(3)	(13)	(12)	(93)
Charge for the year	–	(30)	(24)	(10)	(25)	(27)	(116)
Disposals	–	27	–	–	–	–	27
Acquisition through business combination	–	(13)	–	–	–	–	(13)
Disposal through business disposal	–	1	–	–	1	–	2
Transfer to Pre-publication	–	4	–	–	–	–	4
At 31 December 2008	–	(203)	(67)	(17)	(69)	(63)	(419)
Exchange differences	–	19	6	1	6	8	40
Charge for the year	–	(44)	(35)	(11)	(22)	(35)	(147)
Disposals	–	4	–	–	–	–	4
At 31 December 2009	–	(224)	(96)	(27)	(85)	(90)	(522)
Carrying amounts							
At 1 January 2008	3,343	75	159	58	104	75	3,814
At 31 December 2008	4,570	107	274	111	96	195	5,353
At 31 December 2009	4,346	115	251	116	130	171	5,129

Goodwill

The goodwill carrying value of £4,346m 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. £3,127m of the carrying value relates to acquisitions completed between 1 January 1998 and 31 December 2002 and £1,219m relates to acquisitions completed after 1 January 2003 (the date of transition to IFRS).

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, with only the remaining difference between the purchase price and the fair value of net assets acquired being allocated to goodwill.

Other intangible assets

Other intangibles acquired include content, technology and software rights. Amortisation of £5m (2008: £5m) is included in the income statement in cost of goods sold and £142m (2008: £111m) in administrative and other expenses.

11. Intangible assets continued

Impairment tests for cash-generating units containing goodwill

Impairment tests have been carried out where appropriate as described below. The recoverable amount for each unit tested exceeds its carrying value.

Goodwill is allocated to 14 cash-generating units (CGUs) within the business segments as follows:

All figures in £ millions	2009	2008
US School Curriculum	812	937
US School Assessment and Information	652	722
US Higher Education	1,064	1,164
Canada	181	173
International Education Publishing	468	315
International Education Assessment and Testing	222	241
Professional Publishing	13	15
Professional Assessment and Testing	226	254
Pearson Education total	3,638	3,821
Financial Times	43	46
Mergermarket	125	130
Interactive Data	184	208
FT Group total	352	384
Penguin US	190	216
Penguin UK	103	95
Pearson Australia	63	54
Penguin total	356	365
Total goodwill	4,346	4,570

As highlighted in the 2008 business review, integration of the US School and Higher Education businesses began in 2008. This integration continued throughout 2009 and has now advanced to a point where, from 1 January 2010, these companies will be combined into one CGU for impairment review purposes.

The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. 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.

Key assumptions

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five-year period. The key assumptions used by management in the value in use calculations were:

Discount rate 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 pre-tax discount rates used are in the range of 10.9% to 11.8% for the Pearson Education businesses (2008: 10.2% to 11.7%), 12.7% to 18.1% for the FT Group businesses (2008: 10.8% to 20.5%) and 9.5% to 11.4% for the Penguin businesses (2008: 8.8% to 10.4%).

Perpetuity growth rates The cash flows subsequent to the approved budget period are based upon the long-term historic growth rates of the underlying territories in which the CGU operates and reflect the long-term growth prospects of the sectors in which the CGU operates. A perpetuity growth rate of 2.0% was used for all CGUs in 2009 (2008: 2.0%). The perpetuity growth rates are consistent with appropriate external sources for the relevant markets.

Notes to the consolidated financial statements continued

11. Intangible assets continued

Cash flow growth rates The cash flow growth rates are derived from management's latest forecast of sales taking into consideration past experience of operating margins achieved in the CGU. Historically, such forecasts have been reasonably accurate.

Sensitivities

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group's sensitivity analysis, a reasonably possible change in the discount rate or perpetuity growth rate could cause an impairment in the US School Curriculum CGU. Following a restructuring during 2009, the Penguin UK CGU is no longer considered sensitive to impairment.

The fair value of US School Curriculum is 6%, or approximately £59m, above its carrying value, but an increase of 0.4 percentage points in the discount rate or a reduction of 0.5 percentage points in the perpetuity growth rate would have caused the value in use to fall below the carrying value.

12. Investments in joint ventures and associates

Joint ventures

All figures in £ millions	2009	2008
At beginning of year	13	11
Exchange differences	–	(4)
Share of profit after tax	4	6
Dividends	(3)	(5)
Loan repayment	(3)	–
Additions and further investment	13	5
Transfer to subsidiary	(6)	–
At end of year	18	13

Investments in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost. Investments at 31 December 2009 include goodwill of £11m (2008: £nil).

The aggregate of the Group's share of its joint ventures' assets (including goodwill) and liabilities, none of which are individually significant, are as follows:

All figures in £ millions	2009	2008
Assets		
Non-current assets	15	6
Current assets	11	21
Liabilities		
Current liabilities	(8)	(14)
Net assets	18	13
Income	12	36
Expenses	(8)	(30)
Profit after income tax	4	6

12. Investments in joint ventures and associates continued

Associates

All figures in £ millions	2009	2008
At beginning of year	10	9
Exchange differences	4	(5)
Share of profit after tax	26	19
Dividends	(19)	(16)
Additions	1	–
(Reversal of distribution)/Distribution from associate in excess of carrying value	(7)	6
Actuarial losses on retirement benefit obligations	(3)	(3)
At end of year	12	10

Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. There is no acquisition goodwill relating to the Group's investments in associates.

The Group's interests in its principal associates, all of which are unlisted, are as follows:

2009 All figures in £ millions	Country of incorporation	% interest held	Assets	Liabilities	Revenues	Profit
The Economist Newspaper Ltd	England	50	116	(116)	161	22
Other			42	(30)	50	4
Total			158	(146)	211	26

2008 All figures in £ millions	Country of incorporation	% interest held	Assets	Liabilities	Revenues	Profit
The Economist Newspaper Ltd	England	50	86	(86)	149	16
Other			35	(25)	42	3
Total			121	(111)	191	19

The interests held in associates are equivalent to voting rights.

Notes to the consolidated financial statements continued

13. Deferred income tax

All figures in £ millions	2009	2008
Deferred income tax assets		
Deferred income tax assets to be recovered after more than 12 months	374	341
Deferred income tax assets to be recovered within 12 months	13	31
	387	372
Deferred income tax liabilities		
Deferred income tax liabilities to be settled after more than 12 months	(473)	(447)
Deferred income tax liabilities to be settled within 12 months	–	–
	(473)	(447)
Net deferred income tax	(86)	(75)

Deferred income tax assets to be recovered within 12 months relate to the utilisation of losses in the US.

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. The Group has unrecognised deferred income tax assets at 31 December 2009 in respect of UK losses of £20m (2008: £28m). None of these unrecognised deferred income tax assets have expiry dates associated with them.

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	2009	2008
At beginning of year		(75)	41
Exchange differences		10	(12)
Income statement charge	7	(51)	(93)
Acquisition through business combination	29	(45)	(4)
Tax benefit/(charge) to other comprehensive income or equity		75	(7)
At end of year		(86)	(75)

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	Goodwill and intangibles	Returns provisions	Retirement benefit obligations	Other	Total
Deferred income tax assets						
At 1 January 2008	87	20	79	10	132	328
Exchange differences	19	6	28	2	38	93
Acquisition through business combination	2	–	–	–	–	2
Income statement (charge)/benefit	(35)	(6)	(1)	(8)	5	(45)
Tax benefit/(charge) to other comprehensive income or equity	–	–	–	3	(9)	(6)
At 31 December 2008	73	20	106	7	166	372
Exchange differences	(5)	(2)	(10)	(1)	(17)	(35)
Acquisition through business combination	–	–	–	–	–	–
Income statement (charge)/benefit	(46)	(7)	(4)	(6)	42	(21)
Tax benefit to other comprehensive income or equity	–	–	–	68	3	71
At 31 December 2009	22	11	92	68	194	387

Other deferred income tax assets include temporary differences on share-based payments, inventory and other provisions.

All figures in £ millions	Goodwill and intangibles	Other	Total
Deferred income tax liabilities			
At 1 January 2008	(214)	(73)	(287)
Exchange differences	(73)	(32)	(105)
Acquisition through business combination	(5)	(1)	(6)
Income statement charge	(26)	(22)	(48)
Tax charge to other comprehensive income or equity	–	(1)	(1)
At 31 December 2008	(318)	(129)	(447)
Exchange differences	30	15	45
Acquisition through business combination	(41)	(4)	(45)
Income statement (charge)/benefit	10	(40)	(30)
Tax benefit to other comprehensive income or equity	–	4	4
At 31 December 2009	(319)	(154)	(473)

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

Notes to the consolidated financial statements continued

14. Classification of financial instruments

The accounting classification of each class of the Group's financial assets and financial liabilities, together with their fair values, is as follows:

		2009							
					Fair value	Amortised cost			
All figures in £ millions	Notes	Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Other liabilities	Loans and receivables	Other liabilities	Total carrying value	Total market value
Investments in unlisted securities	15	62	–	–	–	–	–	62	62
Cash and cash equivalents	17	–	–	–	–	750	–	750	750
Marketable securities		63	–	–	–	–	–	63	63
Derivative financial instruments	16	–	42	70	–	–	–	112	112
Trade receivables	22	–	–	–	–	989	–	989	989
Total financial assets		125	42	70	–	1,739	–	1,976	1,976
Derivative financial instruments	16	–	(9)	–	–	–	–	(9)	(9)
Trade payables	24	–	–	–	–	–	(461)	(461)	(461)
Other financial liabilities – put option over minority interest	24	–	–	–	(23)	–	–	(23)	(23)
Bank loans and overdrafts	18	–	–	–	–	–	(70)	(70)	(70)
Borrowings due within one year	18	–	–	–	–	–	(4)	(4)	(4)
Borrowings due after more than one year	18	–	–	–	–	–	(1,934)	(1,934)	(1,969)
Total financial liabilities		–	(9)	–	(23)	–	(2,469)	(2,501)	(2,536)

14. Classification of financial instruments continued

All figures in £ millions	Notes	Available for sale	Derivatives deemed held for trading	Derivatives in hedging relationships	Loans and receivables	Other liabilities	Total carrying value	Total market value
								2008
		Fair value			Amortised cost			
Investments in unlisted securities	15	63	–	–	–	–	63	63
Cash and cash equivalents	17	–	–	–	685	–	685	685
Marketable securities		54	–	–	–		54	54
Derivative financial instruments	16	–	23	161	–	–	184	184
Trade receivables	22	–	–	–	1,030	–	1,030	1,030
Total financial assets		117	23	161	1,715	–	2,016	2,016
Derivative financial instruments	16	–	(20)	–	–	–	(20)	(20)
Trade payables	24	–	–	–	–	(450)	(450)	(450)
Bank loans and overdrafts	18	–	–	–	–	(228)	(228)	(228)
Borrowings due within one year	18	–	–	–	–	(248)	(248)	(247)
Borrowings due after more than one year	18	–	–	–	–	(1,887)	(1,887)	(1,620)
Total financial liabilities		–	(20)	–	–	(2,813)	(2,833)	(2,565)

Certain of the Group's derivative financial instruments are deemed to be held for trading either as they do not meet the hedge accounting criteria specified in IAS 39 'Financial Instruments: Recognition and Measurement' or the Group has chosen not to seek hedge accounting for these instruments. None of these derivatives are held for speculative trading purposes. Transactions in derivative financial instruments are only undertaken to manage risks arising from underlying business activity, in accordance with the Group's treasury policy as described in note 19.

The Group 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 Group also designates certain of its borrowings and derivative financial instruments as hedges of its investments in foreign operations (net investment hedges). Movements in the fair value of these financial instruments (to the extent they are effective) are recognised in other comprehensive income.

None of the Group's financial assets or liabilities are designated at fair value through the income statement upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies. The Group's approach to managing risks in relation to financial instruments is described in note 19.

Notes to the consolidated financial statements continued

15. Other financial assets

All figures in £ millions	2009	2008
At beginning of year	63	52
Exchange differences	(6)	18
Acquisition of investments	10	1
Disposal of investments	(5)	(8)
At end of year	62	63

Other financial assets comprise non-current unlisted securities.

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:

	2009			2008		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,103	70	–	1,232	161	–
Interest rate derivatives – not in a hedge relationship	486	13	(7)	1,033	23	(20)
Cross currency rate derivatives – in a net investment hedge relationship	220	29	(2)	–	–	–
Total	1,809	112	(9)	2,265	184	(20)
Analysed as expiring:						
In less than one year	238	–	(7)	487	3	(5)
Later than one year and not later than five years	844	60	(2)	859	47	(15)
Later than five years	727	52	–	919	134	–
Total	1,809	112	(9)	2,265	184	(20)

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.

At the end of 2009, 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 £(127)m, sterling £252m and South African rand £(22)m (2008: US dollar £161m, sterling £3m and South African rand £nil).

The fixed interest rates on outstanding rate derivative contracts at the end of 2009 range from 3.65% to 9.28% (2008: 4.45% to 7.00%) and the floating rates are based on LIBOR in US dollar and sterling.

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.

16. Derivative financial instruments continued

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. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

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	2009	2008
Cash at bank and in hand	580	528
Short-term bank deposits	170	157
	750	685

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2009 the currency split of cash and cash equivalents was US dollar 35% (2008: 36%), sterling 22% (2008: 22%), euro 18% (2008: 20%) and other 25% (2008: 22%).

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	2009	2008
Cash and cash equivalents	750	685
Bank overdrafts	(70)	(96)
	680	589

Notes to the consolidated financial statements continued

18. Financial liabilities – Borrowings

The Group's current and non-current borrowings are as follows:

All figures in £ millions	2009	2008
Non-current		
Bank loans and overdrafts	–	132
7.0% Global Dollar Bonds 2011 (nominal amount $500m)	322	368
5.5% Global Dollar Bonds 2013 (nominal amount $350m)	226	258
5.7% US Dollar Bonds 2014 (nominal amount $400m)	274	322
7.0% Sterling Bonds 2014 (nominal amount £250m)	254	254
6.0% Sterling Bonds 2015 (nominal amount £300m)	297	–
6.25% Global Dollar Bonds 2018 (nominal amount $550m)	359	445
4.625% US Dollar notes 2018 (nominal amount $300m)	191	237
Finance lease liabilities	11	3
	1,934	2,019
Current		
Due within one year or on demand:		
Bank loans and overdrafts	70	96
4.7% US Dollar Bonds 2009 (nominal amount $350m)	–	244
Finance lease liabilities	4	4
	74	344
Total borrowings	2,008	2,363

Included in the non-current borrowings above is £12m of accrued interest (2008: £12m). Included in the current borrowings above is £nil of accrued interest (2008: £1m).

The maturity of the Group's non-current borrowing is as follows:

All figures in £ millions	2009	2008
Between one and two years	327	2
Between two and five years	760	759
Over five years	847	1,258
	1,934	2,019

18. Financial liabilities – Borrowings continued

The carrying amounts and market values of borrowings are as follows:

All figures in £ millions	Effective interest rate	2009 Carrying value	2009 Market value	2008 Carrying value	2008 Market value
Bank loans and overdrafts	n/a	70	70	228	228
4.7% US Dollar Bonds 2009	4.86%	–	–	244	243
7.0% Global Dollar Bonds 2011	7.16%	322	331	368	349
5.5% Global Dollar Bonds 2013	5.76%	226	232	258	227
5.7% US Dollar Bonds 2014	5.88%	274	266	322	262
7.0% Sterling Bonds 2014	7.20%	254	276	254	258
6.0% Sterling Bonds 2015	6.27%	297	317	–	–
6.25% Global Dollar Bonds 2018	6.46%	359	360	445	352
4.625% US Dollar notes 2018	4.69%	191	176	237	169
Finance lease liabilities	n/a	15	15	7	7
		2,008	2,043	2,363	2,095

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 Group's borrowings are denominated in the following currencies:

All figures in £ millions	2009	2008
US dollar	1,457	2,081
Sterling	551	277
Euro	–	5
	2,008	2,363

The Group has the following undrawn capacity on its committed borrowing facilities as at 31 December:

All figures in £ millions	2009	2008
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,084	1,085
	1,084	1,085

In addition to the above facilities, 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.

Notes to the consolidated financial statements continued

18. Financial liabilities – Borrowings continued

The maturity of the Group's finance lease obligations is as follows:

All figures in £ millions	2009	2008
Finance lease liabilities – minimum lease payments		
Not later than one year	4	4
Later than one year and not later than two years	5	2
Later than two years and not later than three years	3	1
Later than three years and not later than four years	3	–
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	15	7

The present value of finance lease liabilities is as follows:

All figures in £ millions	2009	2008
Not later than one year	4	4
Later than one year and not later than five years	11	3
Later than five years	–	–
	15	7

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 is set out below.

Treasury policy

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. The Group borrows principally in US dollars and sterling, at both floating and fixed rates of interest, using derivative financial instruments ('derivatives), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised below. All the treasury policies remained unchanged throughout 2009, apart from a revision to the Group's bank counterparty limits policy and a minor change applicable to the authorisation of treasury policy waivers.

The audit committee receives reports on the Group's treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.

19. Financial risk management continued

Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39 'Financial Instruments: Recognition and Measurement') to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2009 the fixed to floating hedging ratio, on the above basis, was approximately 71%. This above-policy level was a result of better than forecast cash collections in December 2009, resulting in lower than expected net debt. A simultaneous 1% change on 1 January in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £6m effect on profit before tax.

Use of interest rate derivatives

The policy described in the section above creates a group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has predominantly swapped its fixed rate bond issues to floating rate at their launch. This creates a second group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates. The Group's accounting objective in its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces sharply the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

Liquidity and refinancing risk management

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2009 the average maturity of gross borrowings was 5.1 years of which bonds represented 96% of these borrowings (up from 5.0 years and up from 90% respectively at the beginning of the year).

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of the Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2009 the committed facilities amounted to £1,084m and their weighted average maturity was 2.4 years.

Notes to the consolidated financial statements continued

19. Financial risk management continued

Analysis of Group debt, including the impact of derivatives

The following tables analyse the Group's sources of funding and the impact of derivatives on the Group's debt instruments.

The Group's net debt position is set out below:

All figures in £ millions	2009	2008
Cash and cash equivalents	750	685
Marketable securities	63	54
Derivative financial instruments	103	164
Bank loans, overdrafts and loan notes	(70)	(228)
Bonds	(1,923)	(2,128)
Finance lease liabilities	(15)	(7)
Net debt	(1,092)	(1,460)

The split of net debt between fixed and floating rate, stated after the impact of rate derivatives, is as follows:

All figures in £ millions	2009	2008
Fixed rate	772	781
Floating rate	320	679
Total	1,092	1,460

Gross borrowings, after the impact of cross-currency rate derivatives, analysed by currency are as follows:

All figures in £ millions	2009	2008
US dollar	1,656	2,081
Sterling	330	277
Other	22	5
Total	2,008	2,363

As at 31 December 2009 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows:

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	74	1,087	847	2,008
Effect of rate derivatives	1,289	(762)	(527)	–
Total	1,363	325	320	2,008

19. Financial risk management continued

The maturity of contracted cash flows on the Group's borrowings and all of its derivative financial instruments are as follows:

All figures in £ millions	USD	GBP	Other	Total
				2009
Not later than one year	42	21	2	65
Later than one year and not later than five years	878	313	30	1,221
Later than five years	739	106	–	845
Total	1,659	440	32	2,131
Analysed as:				
Revolving credit facilities and commercial paper	–	–	–	–
Bonds	1,692	745	–	2,437
Rate derivatives – inflows	(386)	(313)	–	(699)
Rate derivatives – outflows	353	8	32	393
Total	1,659	440	32	2,131

All figures in £ millions	USD	GBP	Other	Total
				2008
Not later than one year	311	17	–	328
Later than one year and not later than five years	884	65	–	949
Later than five years	954	266	–	1,220
Total	2,149	348	–	2,497
Analysed as:				
Revolving credit facilities and commercial paper	141	–	–	141
Bonds	2,237	355	–	2,592
Rate derivatives – inflows	(392)	(21)	–	(413)
Rate derivatives – outflows	163	14	–	177
Total	2,149	348	–	2,497

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 Group net settles these amounts wherever possible.

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.

Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover our 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.

Notes to the consolidated financial statements continued

19. Financial risk management continued

Foreign currency risk management

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings (after the impact of cross currency rate derivatives) with its forecast operating profit before depreciation and amortisation. This policy aims to dampen the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently is only the US dollar. The Group still borrows small amounts in other currencies, typically for seasonal working capital needs. Our policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. In addition, currencies that account for less than 15% of Group operating profit before depreciation and amortisation can be included in the above hedging process at the request of the chief financial officer.

Included within year end net debt, the net borrowings/(cash) in the hedging currencies above (taking into account the effect of cross currency swaps) were: US dollar £1,314m, sterling £168m and South African rand £9m.

Use of currency debt and currency derivatives

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

Financial instruments – fair value measurement

The following table provides an analysis of those financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3, based on the degree to which the fair value is observable:

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); and

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).

				2009
All figures in £ millions	Level 1	Level 2	Level 3	Total
Financial assets at fair value				
Derivative financial assets	–	112	–	112
Marketable securities	–	63	–	63
Available for sale financial assets				
Investments in unlisted securities	–	–	62	62
Financial liabilities at fair value				
Derivative financial liabilities	–	(9)	–	(9)
Other financial liabilities – put option over minority interest	–	–	(23)	(23)
Total	–	166	39	205

19. Financial risk management continued

The following table analyses the movements in level 3 fair value measurements:

All figures in £ millions	2009 Investments in unlisted securities	2009 Other financial liabilities
At beginning of year	63	–
Exchange differences	(6)	–
Additions	10	(23)
Disposals	(5)	–
At end of year	62	(23)

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. The fair value of other financial liabilities represents the present value of the estimated future liability.

Financial instruments – sensitivity analysis

As at 31 December 2009 the sensitivity 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	62	–	–	(2)	3
Cash and cash equivalents	750	–	–	(47)	58
Marketable securities	63	–	–	(5)	7
Derivative financial instruments	103	(59)	66	14	(17)
Bonds	(1,923)	54	(61)	118	(144)
Other borrowings	(85)	–	–	8	(9)
Put option over minority interest	(23)	–	–	3	(3)
Other net financial assets	528	–	–	(42)	52
Total financial instruments	(525)	(5)	5	47	(53)

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. The class 'Other net financial assets' comprises trade assets less trade liabilities.

The sensitivities of derivative instruments are calculated using established 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%. A large proportion of the movements shown above would impact equity rather than the income statement, depending on the location and functional currency of the entity in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

Notes to the consolidated financial statements continued

20. Intangible assets – Pre-publication

All figures in £ millions	2009	2008
Cost		
At beginning of year	1,800	1,264
Exchange differences	(160)	494
Additions	322	297
Disposals	(230)	(345)
Acquisition through business combination	(1)	78
Transfer from software	–	12
Transfer to inventories	(4)	–
At end of year	1,727	1,800
Amortisation		
At beginning of year	(1,105)	(814)
Exchange differences	102	(337)
Charge for the year	(307)	(244)
Disposals	230	345
Acquisition through business combination	3	(51)
Transfer from software	–	(4)
At end of year	(1,077)	(1,105)
Carrying amounts		
At end of year	650	695

Included in the above are pre-publication assets amounting to £398m (2008: £462m) which will be realised in more than 12 months.

Amortisation is included in the income statement in cost of goods sold.

21. Inventories

All figures in £ millions	2009	2008
Raw materials	32	31
Work in progress	23	29
Finished goods	390	441
	445	501

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 £843m (2008: £832m). In 2009 £75m (2008: £56m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

22. Trade and other receivables

All figures in £ millions	2009	2008
Current		
Trade receivables	989	1,030
Royalty advances	99	111
Prepayments and accrued income	75	62
Other receivables	121	135
Receivables from related parties	–	4
	1,284	1,342
Non-current		
Royalty advances	86	102
Prepayments and accrued income	24	3
Other receivables	2	47
	112	152

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	2009	2008
At beginning of year	(72)	(52)
Exchange differences	5	(18)
Income statement movements	(26)	(27)
Utilised	20	27
Acquisition through business combination	(3)	(2)
At end of year	(76)	(72)

Concentrations of credit risk with respect to trade receivables are limited due to the Group's large number of customers, who are internationally dispersed.

Notes to the consolidated financial statements continued

22. Trade and other receivables continued

The ageing of the Group's trade receivables is as follows:

All figures in £ millions	2009	2008
Within due date	1,096	1,110
Up to three months past due date	228	248
Three to six months past due date	51	60
Six to nine months past due date	20	21
Nine to 12 months past due date	4	15
More than 12 months past due date	20	20
Total trade receivables	1,419	1,474
Less: provision for bad and doubtful debts	(76)	(72)
Less: provision for sales returns	(354)	(372)
Net trade receivables	989	1,030

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historic payment profiles. Management believe all the remaining receivable balances are fully recoverable.

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Leases	Other	Total
At 1 January 2009	43	8	38	89
Exchange differences	(2)	–	(3)	(5)
Charged to income statement	3	3	2	8
Released to income statement	–	–	(3)	(3)
Acquisition through business combination – current year	27	–	–	27
Acquisition through business combination – prior year adjustments	(4)	–	–	(4)
Utilised	(29)	(2)	(13)	(44)
At 31 December 2009	38	9	21	68

All figures in £ millions	2009	2008
Analysis of provisions		
Non-current	50	33
Current	18	56
	68	89

Deferred consideration primarily relates to the acquisition of Fronter in 2009.

24. Trade and other liabilities

All figures in £ millions	2009	2008
Trade payables	461	450
Social security and other taxes	30	35
Accruals	504	501
Deferred income	487	444
Interest payable	10	10
Dividends payable to minority interest	–	5
Put option over minority interest	23	–
Other liabilities	205	205
	1,720	1,650
Less: non-current portion		
Accruals	23	42
Deferred income	116	87
Interest payable	–	1
Put option over minority interest	23	–
Other liabilities	91	91
	253	221
Current portion	1,467	1,429

The carrying value of the Group's payables approximates its fair value.

The deferred income balances comprise:

multi-year obligations to deliver workbooks to adoption customers in school businesses;
advance payments in assessment and testing businesses;
subscription income in school, newspaper and market pricing businesses;
advertising income relating to future publishing days in newspaper businesses; and
obligations to deliver digital content in future periods.

The put option over minority interest is the fair value of an option held by the minority interest in our Pearson South Africa business. The option enables the minority interest to sell their 15% share of Pearson South Africa to Pearson from 1 January 2012 at a price determined by the future performance of that business.

Notes to the consolidated financial statements continued

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. For the defined benefit plans, benefits are based on employees' length of service and final pensionable pay. Defined contribution benefits are based on the amount of contributions paid in respect of an individual member, the investment returns earned and the amount of pension this money will buy when a member retires.

The largest plan is the Pearson Group Pension Plan ('UK Group plan') with both defined benefit and defined contribution sections. From 1 November 2006, all sections of the UK Group plan were closed to new members with the exception of a defined contribution section that was opened in 2003. This section is available to all new employees of participating companies. The other major defined benefit plans are based in the US.

Other defined contribution plans are operated principally overseas with the largest plan being in the US. The specific features of these plans vary in accordance with the regulations of the country in which employees are located.

Pearson 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.

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.

			2009			2008
%	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.50	2.50	2.50	2.80	2.80	2.80
Rate used to discount plan liabilities	5.70	5.25	5.50	6.40	6.25	6.25
Expected return on assets	6.03	6.75	–	6.33	7.60	–
Expected rate of increase in salaries	5.00	4.00	–	4.30	4.50	–
Expected rate of increase for pensions in payment and deferred pensions	2.60 to 4.40	–	–	2.30 to 4.20	–	–
Initial rate of increase in healthcare rate	–	–	8.50	–	–	9.00
Ultimate rate of increase in healthcare rate	–	–	5.00	–	–	5.00

The UK discount rate is based on the annualised yield on the iBoxx over 15-year AA-rated corporate bond index, adjusted to reflect the duration of our liabilities. The US discount rate is set by reference to a US bond portfolio matching model. The expected return on assets is based on market expectations of long-term asset returns for the defined portfolio at the end of the year.

The expected rates of return on categories of plan assets are determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio.

The expected rate of increase in salaries has been set at 5.0% for 2009 with a short-term assumption of 3.0% for three years.

In 2008 the UK mortality assumptions were derived by adjusting standard mortality tables (PMFA 92 tables projected forward with medium cohort improvement factors). In 2009 the Group changed its mortality assumptions in the UK. 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 medium cohort improvement factors. In 2008 a 1% improvement floor on the medium cohort was applied. In 2009 this was changed to 1.5% for males and 1.25% for females, with tapering.

For the US plans, the assumptions used were based on standard US mortality tables. In 2008 a switch from GAM94 to RP2000 was made, to reflect the mortality assumption now more prevalent in the US.

25. Retirement benefit and other post-retirement obligations 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 and US Group plans is as follows:

	UK		US	
	2009	2008	2009	2008
Male	22.7	21.5	17.6	17.6
Female	23.5	21.8	20.2	20.2

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:

	UK		US	
	2009	2008	2009	2008
Male	25.3	23.3	17.6	17.6
Female	25.6	23.8	20.2	20.2

Financial statement information

The amounts recognised in the income statement are as follows:

						2009
All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	14	3	17	62	2	81
Past service cost	–	1	1	–	–	1
Total operating expense	14	4	18	62	2	82
Expected return on plan assets	(83)	(5)	(88)	–	–	(88)
Interest on plan liabilities	89	8	97	–	3	100
Net finance expense	6	3	9	–	3	12
Net income statement charge	20	7	27	62	5	94
Actual return on plan assets	136	8	144	–	–	144

						2008
All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	33	3	36	41	1	78
Past service cost	–	1	1	–	5	6
Total operating expense	33	4	37	41	6	84
Expected return on plan assets	(104)	(7)	(111)	–	–	(111)
Interest on plan liabilities	93	7	100	–	3	103
Net finance (income)/expense	(11)	–	(11)	–	3	(8)
Net income statement charge	22	4	26	41	9	76
Actual loss on plan assets	(130)	(27)	(157)	–	–	(157)

The total operating charge is included in administrative and other expenses. In 2008 the UK Group plan current service cost included £14m relating to defined contribution sections. In 2009 the defined contribution section of the UK Group plan is recorded within the defined contribution expense.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2009 UK Group plan	2009 Other funded plans	2009 Other unfunded plans	2009 Total	2008 UK Group plan	2008 Other funded plans	2008 Other unfunded plans	2008 Total
Fair value of plan assets	1,609	118	–	1,727	1,478	100	–	1,578
Present value of defined benefit obligation	(1,798)	(151)	(18)	(1,967)	(1,429)	(149)	(16)	(1,594)
Net pension (liability)/asset	(189)	(33)	(18)	(240)	49	(49)	(16)	(16)
Other post-retirement medical benefit obligation				(65)				(68)
Other pension accruals				(34)				(34)
Net retirement benefit obligations				(339)				(118)
Analysed as:								
Retirement benefit assets				–				49
Retirement benefit obligations				(339)				(167)

The following (losses)/gains have been recognised in other comprehensive income:

All figures in £ millions	2009	2008
Amounts recognised for defined benefit plans	(295)	(74)
Amounts recognised for post-retirement medical benefit plans	(4)	3
Total recognised in year	(299)	(71)
Cumulative amounts recognised	(246)	53

The fair value of plan assets comprises the following:

%	2009 UK Group plan	2009 Other funded plans	2009 Total	2008 UK Group plan	2008 Other funded plans	2008 Total
Equities	27.4	2.4	29.8	28.0	3.1	31.1
Bonds	47.2	2.1	49.3	40.8	2.2	43.0
Properties	9.4	0.0	9.4	7.4	0.1	7.5
Other	10.4	1.1	11.5	17.5	0.9	18.4

The plan assets do not include any of the Group's own financial instruments, or any property occupied by the Group.

25. Retirement benefit and other post-retirement obligations continued

Changes in the values of plan assets and liabilities of the retirement benefit plans are as follows:

All figures in £ millions	2009 UK Group plan	2009 Other plans	2009 Total	2008 UK Group plan	2008 Other plans	2008 Total
Fair value of plan assets						
Opening fair value of plan assets	1,478	100	1,578	1,744	109	1,853
Exchange differences	–	(6)	(6)	–	23	23
Expected return on plan assets	83	5	88	104	7	111
Actuarial gains and (losses)	53	3	56	(234)	(34)	(268)
Contributions by employer	64	26	90	54	3	57
Contributions by employee	3	–	3	9	–	9
Benefits paid	(72)	(10)	(82)	(72)	(8)	(80)
Other movements	–	–	–	(127)	–	(127)
Closing fair value of plan assets	1,609	118	1,727	1,478	100	1,578
Present value of defined benefit obligation						
Opening defined benefit obligation	(1,429)	(165)	(1,594)	(1,682)	(129)	(1,811)
Exchange differences	–	14	14	–	(38)	(38)
Current service cost	(14)	(3)	(17)	(33)	(3)	(36)
Past service cost	–	(1)	(1)	–	(1)	(1)
Interest cost	(89)	(8)	(97)	(93)	(7)	(100)
Actuarial gains and (losses)	(335)	(16)	(351)	189	5	194
Contributions by employee	(3)	–	(3)	(9)	–	(9)
Benefits paid	72	10	82	72	8	80
Other movements	–	–	–	127	–	127
Closing defined benefit obligation	(1,798)	(169)	(1,967)	(1,429)	(165)	(1,594)

During 2008 changes made to the administration of the plan assets enabled assets relating to the defined contribution sections of the UK Group plan to be identified separately from those of the defined benefit section, for accounting purposes. Defined contribution assets are no longer disclosed as part of the UK Group plan assets. The other movements in both the change in value of plan assets and liabilities in 2008 represent the separation out of these defined contribution assets.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Changes in the value of the US PRMB are as follows:

All figures in £ millions	2009	2008
Opening defined benefit obligation	(68)	(47)
Exchange differences	8	(19)
Current service cost	(2)	(1)
Past service cost	–	(5)
Interest cost	(3)	(3)
Actuarial gains and (losses)	(4)	3
Benefits paid	4	4
Closing defined benefit obligation	(65)	(68)

The history of the defined benefit plans is as follows:

All figures in £ millions	2009	2008	2007	2006	2005
Fair value of plan assets	1,727	1,578	1,853	1,633	1,500
Present value of defined benefit obligation	(1,967)	(1,594)	(1,811)	(1,810)	(1,803)
Net pension (liability)/asset	(240)	(16)	42	(177)	(303)
Experience adjustments on plan assets	56	(268)	29	74	140
Experience adjustments on plan liabilities	(351)	194	50	28	(119)

Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group. The trustees of the plan are required to act in the best interest of the plan's beneficiaries. The plan trustees and the company are currently finalising the latest triennial valuation for funding purposes as at 1 January 2009. At this point, the Group has contributed an additional £20m to the plan in 2009. In total the Group contributed £42m (2008: £21m) towards the funding shortfall and expects to contribute a similar amount in 2010. Regular contributions to the plan are estimated to be £23m for 2010.

The Group expects to contribute $83m in 2010 and $126m in 2011 to its US pension plans.

25. Retirement benefit and other post-retirement obligations continued

Sensitivities

The net retirement benefit obligations are calculated using a number of assumptions, the most significant being the discount rate used to calculate the defined benefit obligation. 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:

	2009	
All figures in £ millions	1% increase	1% decrease
Effect on:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(260.2)	325.4
(Decrease)/increase of aggregate of service cost and interest cost – UK Group plan	(4.5)	3.9
(Decrease)/increase in defined benefit obligation – US plan	(12.4)	14.7

The effect of members living one year more or one year less on the defined benefit obligation and the total pension expense is as follows:

	2009	
All figures in £ millions	1 year increase	1 year decrease
Effect on:		
Increase/(decrease) in defined benefit obligation – UK Group plan	50.7	(49.3)
Increase/(decrease) in defined benefit obligation – US plan	1.3	(1.7)

The effect of a one percentage point increase and decrease in the assumed medical cost trend rates is as follows:

	2009	
All figures in £ millions	1% increase	1% decrease
Effect on:		
Increase/(decrease) in post-retirement medical benefit obligation	3.1	(2.7)
Increase/(decrease) of aggregate of service cost and interest cost	0.2	(0.2)

Notes to the consolidated financial statements continued

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	2009	2008
Pearson plans	27	25
Interactive Data plans	10	8
Total share-based payment costs	37	33

The Group operates the following equity-settled employee option and share plans:

Worldwide Save for Shares Plan Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the 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 ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

Long-Term Incentive Plan This plan was introduced in 2001 and renewed in 2006 and consists of two parts: share options and/or restricted shares.

Options were last granted under this plan in 2001 based on a pre-grant earnings per share growth test and are not subject to further performance conditions on exercise. The options became exercisable in tranches and lapse if they remain unexercised at the tenth anniversary of the date of grant.

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 March 2008 and March 2009 vest dependent on relative shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2008 and 2009 vest depending on continuing service over a three-year period.

Annual Bonus Share Matching Plan This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis i.e. the maximum number of matching shares is equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares.

In addition to the above, share options remain outstanding under Executive Share Option, Reward and Special Share Option Plans. These are legacy plans which were replaced with the introduction of the Long-Term Incentive Plan in 2001.

26. Share-based payments continued

The number and weighted average exercise prices of share options granted under the Group's plans are as follows:

	2009		2008	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	14,379	13.14	16,781	13.15
Granted during the year	1,320	5.47	1,437	5.35
Exercised during the year	(656)	5.91	(683)	4.85
Forfeited during the year	(2,488)	13.02	(3,082)	11.56
Expired during the year	(68)	5.20	(74)	6.06
Outstanding at end of year	12,487	12.78	14,379	13.14
Options exercisable at end of year	9,264	15.28	11,527	14.97

Options were exercised regularly throughout the year. The weighted average share price during the year was £7.15 (2008: £6.44). 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:

	2009		2008	
Range of exercise prices £	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	172	1.07	453	1.23
5 – 10	5,523	2.37	5,113	2.84
10 – 15	4,225	1.36	5,481	1.97
15 – 20	270	0.75	908	0.84
20 – 25	344	0.19	350	1.19
>25	1,953	0.19	2,074	1.19
	12,487	1.57	14,379	2.05

In 2009 and 2008 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.

Notes to the consolidated financial statements continued

26. Share-based payments continued

The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

	2009 Weighted average	2008 Weighted average
Fair value	£1.69	£1.67
Weighted average share price	£7.13	£6.96
Weighted average exercise price	£5.47	£5.35
Expected volatility	27.32%	21.41%
Expected life	4.0 years	4.1 years
Risk free rate	2.45%	4.28%
Expected dividend yield	4.74%	4.54%
Forfeiture rate	3.5%	3.6%

The expected volatility is based on the historic volatility of the company's share price over the previous three to seven years depending on the vesting term of the options.

The following shares were granted under restricted share arrangements:

	2009		2008	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Long-Term Incentive Plan	4,519	5.77	4,152	5.78
Annual Bonus Share Matching Plan	271	6.70	253	6.73

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. Participants of the Long-Term Incentive Plan are entitled to dividends during the vesting period. The number of shares to vest has been adjusted, based on historical experience, to account for any potential forfeitures. Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Shares granted include the entitlement 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 were considered by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

Subsidiary share option plans

Interactive Data, a 61% subsidiary of the Group, operates the following share-based payment plans:

2001 Employee Stock Purchase Plan The 2001 Employee Stock Purchase Plan allows all eligible employees worldwide to purchase stock at a discounted price at specific times.

26. Share-based payments continued

2000 Long-Term Incentive Plan Under this plan, the Compensation Committee of the Board of Directors can grant share-based awards representing up to 20% of the total number of shares of common stock outstanding at the date of grant. The plan provides for the discretionary issuance of share-based awards to directors, officers and employees of Interactive Data, as well as persons who provide consulting or other services to Interactive Data. The exercise price for all options granted to date has been equal to the market price of the underlying shares at the date of grant. Options expire ten years from the date of grant and generally vest over a three to four-year period without any performance criteria attached.

In addition, grants of restricted stock can be made to certain executives and members of the Board of Directors of Interactive Data. The awarded shares are available for distribution, at no cost, at the end of a three-year vesting period. No performance criteria are attached to shares granted under this plan.

Interactive Data employees purchased 234,956 shares (2008: 183,318) under the 2001 Employee Stock Purchase Plan at an average share price of $19.47 (£12.06) (2008: $22.95; £15.96). The weighted average fair value at the date of grant was $5.82 (£3.60) (2008: $6.59; £4.58).

The number and weighted average exercise prices of share options granted under the 2000 Long-Term Incentive Plan are as follows:

	2009			2008		
	Number of share options 000s	Weighted average exercise price $	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price $	Weighted average exercise price £
Outstanding at beginning of year	10,264	19.38	13.48	9,827	18.21	9.15
Granted during the year	1,224	23.25	14.40	1,449	24.95	17.35
Exercised during the year	(1,493)	14.20	8.79	(895)	15.37	10.69
Forfeited during the year	(159)	24.44	15.13	(99)	22.05	15.34
Expired during the year	(64)	25.93	16.06	(18)	12.17	8.46
Outstanding at end of year	9,772	20.53	12.71	10,264	19.38	13.48
Options exercisable at end of year	6,839	18.92	11.72	6,865	16.89	11.75

The options outstanding at the end of the year have a weighted average remaining contractual life and exercise price as follows:

	2009		2008	
Range of exercise prices $	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 4.4	–	–	–	–
4.4 – 7.5	20	0.3	47	1.3
7.5 – 12	909	1.5	1,502	2.4
12 – 20	2,339	3.6	2,987	4.6
› 20	6,504	7.5	5,728	8.0
	9,772	6.0	10,264	6.2

Notes to the consolidated financial statements continued

26. Share-based payments continued

The fair value of the options granted under the 2000 Long-Term Incentive Plan and of the shares awarded under the 2001 Employee Stock Purchase Plan was estimated using a Black-Scholes option pricing model. The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

	Long-Term Incentive Plan		Employee Stock Purchase Plan	
	2009	2008	2009	2008
	Weighted average	Weighted average	Weighted average	Weighted average
Fair value	$4.92	$5.58	$5.82	$6.59
Weighted average share price	$23.25	$24.95	$19.47	$22.95
Weighted average exercise price	$23.25	$24.95	$19.47	$22.95
Expected volatility	29.70%	24.20%	48.40%	33.70%
Expected life	5.9 years	5.7 years	0.5 years	0.5 years
Risk free rate	2.4% to 2.6%	1.5% to 3.5%	0.3% to 0.4%	2.0% to 2.4%
Expected dividend yield	3.6%	2.2%	3.6%	2.1%
Forfeiture rate	0.0%	0.0%	0.0%	0.0%

The expected volatility is based on the historic volatility of Interactive Data's share price over the vesting term of the options.

During the year Interactive Data granted the following shares under restricted share arrangements:

	2009			2008		
	Number of shares 000s	Weighted average fair value $	Weighted average fair value £	Number of shares 000s	Weighted average fair value $	Weighted average fair value £
2000 Long-Term Incentive Plan	415	22.92	14.19	194	25.43	17.69

Shares awarded under the 2000 Long-Term Incentive Plan were valued based on the share price prevailing at the date of grant.

27. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2008	808,028	202	2,499
Issue of ordinary shares – share option schemes	1,248	–	6
At 31 December 2008	809,276	202	2,505
Issue of ordinary shares – share option schemes	1,523	1	7
At 31 December 2009	810,799	203	2,512

The ordinary shares have a par value of 25p per share (2008: 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.

27. Share capital and share premium continued

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings.

The Group reviews its capital structure on a regular basis and will balance its overall capital structure through payments of dividends, new share issues as well as the issue of new debt or the redemption of existing debt in line with the financial risk policies outlined in note 19.

28. Treasury shares

	Pearson plc		Interactive Data		Total
	Number of shares 000s	£m	Number of shares 000s	£m	£m
At 1 January 2008	11,761	141	7,229	75	216
Purchase of treasury shares	2,028	12	1,976	35	47
Release of treasury shares	(3,341)	(41)	–	–	(41)
At 31 December 2008	10,448	112	9,205	110	222
Purchase of treasury shares	2,200	13	1,280	20	33
Release of treasury shares	(2,983)	(29)	–	–	(29)
At 31 December 2009	9,665	96	10,485	130	226

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.2% (2008: 1.3%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

Interactive Data hold their own shares in respect of share buy-back programmes. These shares are held as treasury shares and have a par value of $0.01.

The nominal value of Pearson plc treasury shares amounts to £2.4m (2008: £2.6m). The nominal value of Interactive Data treasury shares amounts to £0.07m (2008: £0.06m).

At 31 December 2009 the market value of Pearson plc treasury shares was £86.1m (2008: £67.0m) and the market value of Interactive Data treasury shares was £164.3m (2008: £157.9m).

Notes to the consolidated financial statements continued

29. Business combinations

On 15 April 2009 the Group acquired Wall Street English (WSE), China's leading provider of premium English language training to adults. On 15 July 2009 the Group completed the purchase of an additional stake in Maskew Miller Longman (MML), its South African publishing business. Provisional values for the assets and liabilities arising from these and other acquisitions completed in the year together with adjustments to prior year acquisitions are as follows:

All figures in £ millions	Notes	Wall Street English Fair value 2009	MML Fair value 2009	Other Fair value 2009	Total Fair value 2009	Total Fair value 2008
Property, plant and equipment	10	6	1	2	9	6
Intangible assets	11	40	47	55	142	220
Intangible assets – Pre-publication	20	–	–	2	2	27
Inventories		1	12	1	14	7
Trade and other receivables		8	7	8	23	54
Cash and cash equivalents		3	9	17	29	16
Trade and other liabilities		(56)	(16)	(19)	(91)	(52)
Current income tax liabilities		–	(2)	(2)	(4)	(3)
Net deferred income tax liabilities	13	(9)	(12)	(24)	(45)	(4)
Provisions for other liabilities and charges		–	–	–	–	(26)
Retirement benefit obligations		–	–	(1)	(1)	–
Minority interest		–	(7)	(9)	(16)	(2)
Assets held for sale		–	–	–	–	3
Net assets/(liabilities) acquired at fair value		(7)	39	30	62	246
Goodwill	11	108	38	59	205	153
Increase in fair values of proportionate holding arising on stepped acquisition		–	(23)	–	(23)	–
Total		101	54	89	244	399
Satisfied by:						
Cash		(101)	(49)	(51)	(201)	(394)
Other consideration		–	(5)	–	(5)	–
Deferred consideration		–	–	(27)	(27)	–
Net prior year adjustments		–	–	(11)	(11)	(5)
Total consideration		(101)	(54)	(89)	(244)	(399)

All figures in £ millions	Wall Street English Fair value 2009	MML Fair value 2009	Other Fair value 2009	Total Fair value 2009	Total Fair value 2008
Carrying value of net (liabilities)/assets acquired	(22)	5	2	(15)	78
Fair value adjustments	15	34	28	77	168
Fair value	(7)	39	30	62	246

The goodwill arising on these acquisitions results from substantial cost and revenue synergies and from benefits that cannot be separately recognised, such as the assembled workforce.

29. Business combinations continued

Wall Street English

All figures in £ millions	Carrying value	Fair value adjustments	Fair value
Property, plant and equipment	6	–	6
Intangible assets	16	24	40
Inventories	1	–	1
Trade and other receivables	8	–	8
Cash and cash equivalents	3	–	3
Trade and other liabilities	(56)	–	(56)
Net deferred income tax liabilities	–	(9)	(9)
Net liabilities acquired	(22)	15	(7)
Goodwill			108
Total			101

MML

All figures in £ millions	Carrying value	Fair value adjustments	Fair value
Property, plant and equipment	1	–	1
Intangible assets	–	47	47
Inventories	12	–	12
Trade and other receivables	7	–	7
Cash and cash equivalents	9	–	9
Trade and other liabilities	(16)	–	(16)
Current income tax liabilities	(2)	–	(2)
Net deferred income tax liabilities	1	(13)	(12)
Minority interest	(7)	–	(7)
Net assets acquired	5	34	39
Goodwill			38
Increase in fair values of proportionate holding arising on stepped acquisition			(23)
Total			54

Net cash outflow on acquisition:

All figures in £ millions	2009	2008
Cash – Current year acquisitions	(201)	(394)
Cash – Acquisitions yet to complete	(4)	(12)
Deferred payments for prior year acquisitions and other items	(32)	(5)
Cash and cash equivalents acquired	29	16
Cash outflow on acquisition	(208)	(395)

Wall Street English contributed £29m of sales and £nil to the Group's profit before tax between the date of acquisition and the balance sheet date. MML contributed £22m of sales and £4m to the Group's profit before tax between the date of acquisition and the balance sheet date. Other businesses acquired contributed £37m to the Group's sales and £6m to the Group's profit before tax between the date of acquisition and the balance sheet date.

If the acquisitions had been completed on 1 January 2009, the Group estimates that sales for the period would have been £5,658m and profit before tax would have been £662m.

Notes to the consolidated financial statements continued

30. Disposals

All figures in £ millions	2009 Total	2008 Total
Disposal of subsidiaries		
Property, plant and equipment	–	(7)
Intangible assets	–	(1)
Intangible assets – Pre-publication	–	(2)
Inventories	–	(7)
Trade and other receivables	–	(8)
Trade and other liabilities	–	9
Minority interest	–	–
Attributable goodwill	–	(99)
Cumulative translation adjustment	–	(49)
Net assets disposed	–	(164)
Cash received	–	114
Deferred receipts	–	2
Costs	–	(5)
Loss on sale	–	(53)

	2009	2008
Cash flow from disposals		
Cash – Current year disposals	–	114
Cash – Transactions with minorities	14	12
Costs paid	–	(15)
Net cash inflow	14	111

Further details of the Data Management business disposal in 2008 are shown in note 3.

31. Cash generated from operations

All figures in £ millions	Notes	2009	2008
Net profit		462	323
Adjustments for:			
Income tax		198	209
Depreciation	10	85	80
Amortisation of purchased intangible assets	11	103	86
Amortisation of other intangible assets	11	44	30
Loss on sale of property, plant and equipment		2	1
Net finance costs	6	95	91
Share of results of joint ventures and associates	12	(30)	(25)
Loss on sale of discontinued operations	3	–	53
Net foreign exchange adjustment from transactions		(14)	105
Share-based payment costs	26	37	33
Pre-publication		(16)	(58)
Inventories		32	(12)
Trade and other receivables		(14)	(81)
Trade and other liabilities		103	82
Retirement benefit obligations		(72)	(14)
Provisions for other liabilities and charges		(3)	(9)
Net cash generated from operations		1,012	894
Dividends from joint ventures and associates		22	23
Purchase of property, plant and equipment		(62)	(75)
Purchase of intangible assets		(58)	(45)
Finance lease principal payments		(2)	(3)
Proceeds from sale of property, plant and equipment		1	2
Operating cash flow		913	796
Operating tax paid		(103)	(89)
Net operating finance costs paid		(87)	(76)
Total operating and free cash flow		723	631
Dividends paid (including to minorities)		(293)	(285)
Net movement of funds from operations		430	346
Acquisitions and disposals		(218)	(285)
Purchase of treasury shares		(33)	(47)
New equity		8	6
Other movements on financial instruments		3	8
Net movement of funds		190	28
Exchange movements on net debt		178	(515)
Total movement in net debt		368	(487)

Notes to the consolidated financial statements continued

31. Cash generated from operations continued

Net cash generated from operations is translated at an exchange rate approximating to 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.

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

All figures in £ millions	2009	2008
Net book amount	3	3
Loss on sale of property, plant and equipment	(2)	(1)
Proceeds from sale of property, plant and equipment	1	2

The principal other non-cash transactions are movements in finance lease obligations of £8m (2008: £2m).

32. 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 and associates. In addition there are contingent liabilities of the Group in respect of legal claims. None of these claims are expected to result in a material gain or loss to the Group.

33. Commitments

There were no commitments for capital expenditure contracted for at the balance sheet date 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. The lease expenditure charged to the income statement during the year is disclosed in note 4.

The future aggregate minimum lease payments in respect of operating leases are as follows:

All figures in £ millions	2009	2008
Not later than one year	153	149
Later than one year and not later than two years	144	138
Later than two years and not later than three years	129	129
Later than three years and not later than four years	114	118
Later than four years and not later than five years	99	108
Later than five years	848	970
	1,487	1,612

34. 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. Amounts falling due from joint ventures and associates are set out in note 22.

Key management personnel

Key management personnel are deemed to be the members of the board of directors of Pearson plc. It is this board which has responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the directors' remuneration report.

There were no other material related party transactions.

No guarantees have been provided to related parties.

35. Events after the balance sheet date

During January 2010, the Group announced that Interactive Data was undertaking a preliminary review of strategic alternatives for its business. At the date of this report, the outcome of the review is still uncertain.

On 3 February 2010 the FT Publishing business announced the acquisition of Medley Global Advisors LLC, a premier provider of macro policy intelligence to the world's top investment banks, hedge funds and asset managers for $15.5m.

Company statement of comprehensive income

Year ended 31 December 2009

All figures in £ millions	2009	2008
Profit for the year	233	526
Currency translation differences on fair value hedges	–	(6)
Total comprehensive income for the year	233	520

Company statement of changes in equity

Year ended 31 December 2009

	Equity attributable to equity holders of the company					
All figures in £millions	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2009	202	2,505	(63)	447	835	3,926
Total comprehensive income	–	–	–	–	233	233
Issue of ordinary shares under share option schemes	1	7	–	–	–	8
Purchase of treasury shares	–	–	(13)	–	–	(13)
Release of treasury shares	–	–	29	–	(29)	–
Dividends	–	–	–	–	(273)	(273)
At 31 December 2009	203	2,512	(47)	447	766	3,881

	Equity attributable to equity holders of the company					
All figures in £millions	Share capital	Share premium	Treasury shares	Special reserve	Retained earnings	Total
At 1 January 2008	202	2,499	(82)	447	603	3,669
Total comprehensive income	–	–	–	–	520	520
Issue of ordinary shares under share option schemes	–	6	–	–	–	6
Purchase of treasury shares	–	–	(12)	–	–	(12)
Release of treasury shares	–	–	41	–	(31)	10
Prior year contribution applied to release of shares	–	–	(10)	–	–	(10)
Dividends	–	–	–	–	(257)	(257)
At 31 December 2008	202	2,505	(63)	447	835	3,926

The special reserve represents the cumulative effect of cancellation of the company's share premium account.

Included within retained earnings is an amount of £131m (2008: £131m) relating to profit on intra-group disposals that is not distributable.

Company balance sheet
As at 31 December 2009

All figures in £ millions	Notes	2009	2008
Assets			
Non-current assets			
Investments in subsidiaries	2	8,547	6,912
Amounts due from subsidiaries		464	322
Financial assets – Derivative financial instruments	6	112	181
Other financial assets		–	6
		9,123	7,421
Current assets			
Amounts due from subsidiaries		2,151	2,953
Current income tax assets		21	30
Cash and cash equivalents (excluding overdrafts)	4	124	57
Financial assets – Derivative financial instruments	6	–	3
Total assets		11,419	10,464
Liabilities			
Non-current liabilities			
Financial liabilities – Borrowings	5	(767)	(991)
Financial liabilities – Derivative financial instruments	6	(2)	(15)
Amounts due to subsidiaries		(3,808)	(1,840)
		(4,577)	(2,846)
Current liabilities			
Current income tax liabilities		–	(2)
Financial liabilities – Borrowings	5	(419)	(352)
Financial liabilities – Derivative financial instruments	6	(7)	(5)
Amounts due to subsidiaries		(2,535)	(3,333)
Total liabilities		(7,538)	(6,538)
Net assets		3,881	3,926
Equity			
Share capital	7	203	202
Share premium	7	2,512	2,505
Treasury shares	8	(47)	(63)
Special reserve		447	447
Retained earnings		766	835
Total equity attributable to equity holders of the company		3,881	3,926

These financial statements have been approved for issue by the board of directors on 10 March 2010 and signed on its behalf by

Robin Freestone Chief financial officer

Company cash flow statement
Year ended 31 December 2009

All figures in £ millions	Notes	2009	2008
Cash flows from operating activities			
Net profit		233	526
Adjustments for:			
Income tax		(57)	(37)
Net finance costs		169	98
Other receivables		–	2
Amounts due from subsidiaries		115	193
Net cash generated from operations		460	782
Interest paid		(130)	(209)
Tax received		65	52
Net cash generated from operating activities		395	625
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired		(1)	–
Interest received		–	2
Net cash (used in)/generated from investing activities		(1)	2
Cash flows from financing activities			
Proceeds from issue of ordinary shares	7	8	6
Net purchase of treasury shares		(13)	(12)
Proceeds from borrowings		–	152
Repayment of borrowings		(131)	(584)
Dividends paid to company's shareholders		(273)	(257)
Net cash used in financing activities		(409)	(695)
Effects of exchange rate changes on cash and cash equivalents		15	(7)
Net decrease in cash and cash equivalents		–	(75)
Cash and cash equivalents at beginning of year		(295)	(220)
Cash and cash equivalents at end of year	4	(295)	(295)

Notes to the company financial statements

1. Accounting policies

a. Basis of preparation

The financial statements on pages 148 to 156 comprise the separate financial statements of Pearson plc. As permitted by section 408 of the Companies Act 2006, only the Group's income statement has been presented.

The company has no employees.

b. Group accounting policies

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the Group 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	2009	2008
At beginning of year	6,912	6,650
Subscription for share capital in subsidiaries	1,658	152
External disposal	(1)	–
Currency revaluations	(22)	110
At end of year	8,547	6,912

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 Group's financial statements. The company believes the value of its financial assets to be fully recoverable.

The company designates certain of its 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 a £36m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £40m 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 £110m, while a 10% decrease in the value of sterling would increase the carrying value by £137m. 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 continued

3. Financial risk management continued

The maturity of contracted cash flows on the company's borrowings and all of its derivative financial instruments are as follows:

All figures in £ millions	USD	GBP	Other	Total
				2009
Not later than one year	(5)	3	2	–
Later than one year and not later than five years	249	241	30	520
Later than five years	324	(212)	–	112
Total	568	32	32	632
Analysed as:				
Bonds	601	337	–	938
Rate derivatives – inflows	(386)	(313)	–	(699)
Rate derivatives – outflows	353	8	32	393
Total	568	32	32	632

All figures in £ millions	USD	GBP	Other	Total
				2008
Not later than one year	8	17	–	25
Later than one year and not later than five years	435	65	–	500
Later than five years	178	266	–	444
Total	621	348	–	969
Analysed as:				
Revolving credit facility and commercial paper	141	–	–	141
Bonds	709	355	–	1,064
Rate derivatives – inflows	(392)	(21)	–	(413)
Rate derivatives – outflows	163	14	–	177
Total	621	348	–	969

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.

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	2009	2008
Cash at bank and in hand	2	2
Short-term bank deposits	122	55
	124	57

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2009 the currency split of cash and cash equivalents was US dollar 26% (2008: nil), sterling 72% (2008: 95%) and euro 2% (2008: 5%).

Cash and cash equivalents have fair values that approximate to 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	2009	2008
Cash and cash equivalents	124	57
Bank overdrafts	(419)	(352)
	(295)	(295)

5. Financial liabilities – Borrowings

All figures in £ millions	2009	2008
Non-current		
Bank loans and overdrafts	–	132
7.0% Global Dollar Bonds 2011 (nominal amount $500m)	322	368
7.0% Sterling Bonds 2014 (nominal amount £250m)	254	254
4.625% US Dollar notes 2018 (nominal amount $300m)	191	237
	767	991
Current		
Due within one year or on demand:		
Bank loans and overdrafts	419	352
	419	352
Total borrowings	1,186	1,343

Included in the non-current borrowings above is £4m of accrued interest (2008: £5m).

Included in the current borrowings above is £nil of accrued interest (2008: £nil).

Notes to the company financial statements continued

5. Financial liabilities – Borrowings continued

The maturity of the company's non-current borrowings is as follows:

All figures in £ millions	2009	2008
Between one and two years	322	–
Between two and five years	254	500
Over five years	191	491
	767	991

As at 31 December 2009 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows:

All figures in £ millions	One year	One to five years	More than five years	Total
Re-pricing profile of borrowings	419	576	191	1,186
Amounts due to subsidiaries	5,159	517	527	6,203
Effect of rate derivatives	1,288	(762)	(526)	–
	6,866	331	192	7,389

The carrying amounts and market values of borrowings are as follows:

		2009		2008	
All figures in £ millions	Effective interest rate	Carrying amount	Market value	Carrying amount	Market value
Bank loans and overdrafts	n/a	419	419	484	484
7.0% Global Dollar Bonds 2011	7.16%	322	331	368	349
7.0% Sterling Bonds 2014	7.20%	254	276	254	258
4.625% US Dollar notes 2018	4.69%	191	176	237	169
		1,186	1,202	1,343	1,260

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	2009	2008
US dollar	523	1,089
Sterling	648	254
Euro	15	–
	1,186	1,343

6. Derivative financial instruments

The company's outstanding derivative financial instruments are as follows:

All figures in £ millions	2009			2008		
	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	360	17	–	398	44	–
Interest rate derivatives – not in a hedge relationship	1,229	66	(7)	1,867	140	(20)
Cross currency rate derivatives	220	29	(2)	–	–	–
Total	1,809	112	(9)	2,265	184	(20)
Analysed as expiring:						
In less than one year	238	–	(7)	487	3	(5)
Later than one year and not later than five years	844	60	(2)	859	47	(15)
Later than five years	727	52	–	919	134	–
Total	1,809	112	(9)	2,265	184	(20)

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. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2008	808,028	202	2,499
Issue of shares – share option schemes	1,248	–	6
At 31 December 2008	809,276	202	2,505
Issue of shares – share option schemes	1,523	1	7
At 31 December 2009	810,799	203	2,512

The ordinary shares have a par value of 25p per share (2008: 25p per share). All issued shares are fully paid. All shares have the same rights.

Notes to the company financial statements continued

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2008	11,761	82
Purchase of treasury shares	2,028	12
Release of treasury shares	(3,341)	(41)
Prior year contributions applied to release of shares	–	10
At 31 December 2008	10,448	63
Purchase of treasury shares	2,200	13
Release of treasury shares	(2,983)	(29)
At 31 December 2009	9,665	47

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 £2.4m (2008: £2.6m). At 31 December 2009 the market value of the company's treasury shares was £86.1m (2007: £67.0m).

9. Contingencies

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

10. Audit fees

Statutory audit fees relating to the company were £35,000 (2008: £35,000). Audit-related regulatory reporting fees relating to the company were £nil (2008: £nil).

11. Related party transactions

Subsidiaries

The company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the company balance sheet.

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries for the year of £232m (2008: £214m) and interest receivable from subsidiaries for the year of £147m (2008: £86m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £37m (2008: £33m). Dividends received from subsidiaries were £383m (2008: £620m).

Key management personnel

Key management personnel are deemed to be the members of the board of directors of the company. It is this board which has responsibility for planning, directing and controlling the activities of the company. Key management personnel compensation is disclosed in the directors' remuneration report of the Group.

There were no other material related party transactions.