The directors are pleased to present their report to shareholders, together with the financial statements for the year ended 31 December 2004 on pages 36 to 39 and 41 to 83 respectively. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given on pages 1 to 12 of this governance and financial statements and on pages 16 to 25 of the annual review and summary financial statements. Sales and profits of the different sectors and geographical markets are given on pages 43 to 45.

Results and dividend
The profit for the financial year ended 31 December 2004 was £88m (2003: £55m). The loss retained for the year, after the payment of dividends, was £113m (2003: £137m) and has been transferred to reserves. A final dividend of 15.7p per share is recommended for the year ended 31 December 2004. This, together with the interim dividend already paid, makes a total for the year of 25.4p (2003: 24.2p). The final dividend will be paid on 6 May 2005 to shareholders on the register at the close of business on 8 April 2005, the record date.

Significant acquisitions and disposals
There were no significant transactions during the year to report.

Transactions with related parties
Details of transactions with related parties, which are reportable under FRS 8 ‘Related party transactions’, are given in note 30 to the accounts on page 80.

Capital expenditure
The analysis of capital expenditure and details of capital commitments are shown in note 12 to the accounts on page 60.

Post balance sheet events
In December 2004, Pearson announced its intention to dispose of its 79% interest in Recoletos Grupo de Comunicación, S.A. to Retos Cartera, a consortium of investors, as part of a tender offer for all of Recoletos. The transaction was approved by the Spanish regulatory authorities in February 2005 and will close in the early part of 2005. In January 2005 Pearson sold its 22% stake in MarketWatch to Dow Jones & Co for $101m.

Directors
The present members of the board, together with their biographical details, are shown on page 26 of the annual review and summary financial statements. Peter Jovanovich, formerly chief executive of Pearson Education, resigned as a director of the board with effect from 31 January 2005. Details of directors’ remuneration and interests in ordinary shares and options of the company are contained in the report on directors’ remuneration on pages 20 to 35. Five directors, Marjorie Scardino, Rona Fairhead, Patrick Cescau, Reuben Mark and Vernon Sankey will retire by rotation at the forthcoming annual general meeting (AGM) on 29 April 2005. All five, being eligible, will offer themselves for re-election. In addition, Susan Fuhrman, who joined the board as a non-executive director in July 2004, will retire from office in accordance with the company’s articles of association. She will offer herself for reappointment at the AGM. Details of directors’ service contracts can be found on page 24. No director was materially interested in any contract of significance to the company’s business.

Corporate governance
Introduction
As stated in the 2003 annual report the board implemented the new Combined Code (hereinafter referred to as the Code) in 2004 although we already conformed to most of the Code’s provisions. A detailed account of how we comply with its provisions can be found on our website at www.pearson.com/investor/corpgov.htm, or by telephoning our company secretarial department on +44 (0)20 7010 2257 or 2253.

Under the Code the only area where explanation is required, since the resignation of Peter Jovanovich who had a service contract that provided for two years’ severance pay, is the independence of two of the non-executive directors, Reuben Mark and Vernon Sankey, which is covered below. Except for this area the board believes that we are in compliance with the Code.

Composition of the board
The board consists of the chairman, Dennis Stevenson, four executive directors and six non-executive directors. Terry Burns was appointed in 2003 as the senior independent director.
Independence of directors Since Reuben Mark (17 years) and Vernon Sankey (12 years) have both been on the board for more than the allotted nine years under the Code, they can be counted as independent directors only if the board deems them to be so. This we do without hesitation. Neither wishes to stay unless considered independent, and we are quite clear that their leaving would not be in the shareholders’ interest. Reuben Mark, who as chairman and CEO of Colgate Palmolive over the last 20 years has been one of the most successful chief executives in the world, has been a committed director; he is robustly independent and continues to make a substantial constructively critical contribution to the Pearson board. Vernon Sankey who brings to bear not only substantial FTSE corporate experience, but also in recent years experience of smaller, more entrepreneurial business, is an outstanding chairman of the audit committee. Both intend to step down at the 2006 AGM. Their departure will be a considerable loss to the company and its shareholders since they are outstanding independent directors. They have both agreed to stand for re-election this year.

This leaves us in the position of having six independent directors, four executive directors and Dennis Stevenson, our chairman, who is part time and so is not formally considered ‘independent’.

Board meetings
The board meets six times a year and at other times as appropriate. The following table sets out the attendance of our directors at the board and committee meetings during 2004:

<table>
<thead>
<tr>
<th>Chairman</th>
<th>Audit committee meetings (maximum 5)</th>
<th>Treasury committee meetings (maximum 2)</th>
<th>Personnel committee meetings (maximum 5)</th>
<th>Nomination committee meetings (maximum 1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dennis Stevenson</td>
<td>6</td>
<td>2</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Executive directors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marjorie Scardino</td>
<td>6</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>David Bell</td>
<td>6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Peter Jovanovich</td>
<td>2* and part of 1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rona Fairhead</td>
<td>6</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>John Makinson</td>
<td>6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-executive directors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Terry Burns</td>
<td>6</td>
<td>5</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Patrick Cescau</td>
<td>6</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Susan Fuhrman</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reuben Mark</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Vernon Sankey</td>
<td>5 and part of 1</td>
<td>5</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Rana Talwar</td>
<td>5</td>
<td>1</td>
<td>4</td>
<td>1</td>
</tr>
</tbody>
</table>

*Peter Jovanovich missed three board meetings due to illness.
†Susan Fuhrman joined the board in July 2004 and attended all board meetings after that date.
The role and business of the board  The formal matters reserved for the board’s decision and approval are: the company’s strategy; acquisitions, disposals and capital expenditure projects above certain thresholds; all guarantees over £10m; treasury policies; the interim and final dividends and the financial statements; borrowing powers; appointments to the board; and the appointment and removal of the company secretary.

The board receives timely, regular and necessary management and other information to fulfil its duties. Directors can obtain independent professional advice at the company’s expense in performance of their duties as directors. All directors have access to the advice and the services of the company secretary.

In addition to these formal roles, we aim to give the non-executive directors access to the senior managers of the business via involvement at both formal and informal meetings. In this way we hope that the experience and expertise of the non-executive directors can be garnered to the benefit of the company. At the same time, the non-executive directors will develop an understanding of the abilities of the most senior managers that will help them judge the company’s prospects and plans for succession.

Board evaluation  The annual board evaluation took place at the end of 2004 and the results will be reviewed in early 2005 and reported back to the board. The chief executive’s performance was appraised by the chairman in 2004, reviewed with the non-executive directors and discussed with the chief executive in a meeting of all non-executive directors. During the year the executive directors were evaluated by the chief executive under the company’s standard appraisal mechanism; their performance, and that of the company’s major executives, is also reviewed by the chief executive with the chairman and non-executive directors as part of an annual succession planning meeting. The senior independent director reviewed the performance of the chairman.

The chairman’s commitments  In line with the requirement of the Code, we report that Dennis Stevenson’s commitments have not changed throughout the year. Under the Code he is allowed to remain as chairman of two FTSE 100 companies, and the board is pleased to say that in their view there is no conflict of interest or time whatsoever to the disadvantage of the company. As part of the 2004 board evaluation the non-executive directors undertook a thorough review of the chairman’s performance and considered this against the background of his other commitments. In their view, the chairman performed extremely well against all the measured criteria. He has consistently demonstrated full commitment to his responsibilities at Pearson and he has always made himself available when circumstances require additional time commitment.

Directors’ training  Directors receive an induction programme and a range of information about the company when they join the board which includes background information on Pearson and its directors and details of board procedures, directors’ responsibilities and various governance-related issues, including procedures for dealing in Pearson shares; and continuing updates on that programme through presentations about the company’s operations at the board meetings as well as ongoing information. The induction includes a series of meetings with members of the board, presentations from senior executives and a briefing on Pearson’s investor relations programme. We supplement the existing directors’ training programme by making available to the directors the opportunity for additional visits to operating company divisions and meetings with local management, as well as to facilitate access to externally run courses should a director wish to make use of them.

Executive directors’ service contracts  The board is supportive of 12 months being the longest period of notice in directors’ service contracts.

Dialogue with institutional shareholders  There is an extensive programme for executive directors and top managers to meet with institutional shareholders, and the non-executive directors meet informally with shareholders both before and after the AGM, and respond to shareholder queries and requests. The chairman makes himself available to meet any significant shareholder, as required. Makinson Cowell reports to the board each year the results of an extensive survey on major shareholders’ views and each month on changes in market positions and shareholders’ views.
Board committees
The board has established four committees. Chairmen and members of these committees are appointed by the board on the recommendation (where appropriate) of the nomination committee and in consultation with each requisite committee chairman.

i Audit committee Vernon Sankey (chairman), Terry Burns, Reuben Mark.

Patrick Cescau joined the committee on 1 January 2005.

All of the committee members are independent non-executive directors and have significant financial experience due to the senior positions they hold or held in other listed or publicly traded companies.

The committee has written terms of reference which clearly set out its authority and duties. These can be found on the company website at www.pearson.com/investor/corpgov.htm. With the issuance in 2003 of the new UK Combined Code, the New York Stock Exchange Corporate Governance Rules, and the Sarbanes-Oxley Act of 2002, a revised audit committee charter and terms of reference reflecting the new requirements was approved by the board and implemented with effect from 1 January 2004.

The committee provides the board with the means to appraise Pearson’s financial management and reporting, and to assess the integrity of the Group’s accounting procedures and financial controls. The Group’s internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee. The committee reports to the full board of Pearson. The committee also reviews the objectivity of the external auditors, including non-audit services supplied, and ensures that there is an appropriate audit relationship.

The committee met five times during the year with the chief financial officer, head of group control and other members of the senior management team, together with the external auditors, in attendance. The committee meets privately with the external auditors and the head of group control at least once a year or more regularly if required at its or their request.

ii Personnel committee Reuben Mark (chairman), Terry Burns, Rana Talwar.

The committee is comprised solely of independent non-executive directors and meets at least three times a year and on other occasions when circumstances require.

The committee has responsibility for determining the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the management committee, as well as recommending the chairman’s remuneration to the board for its decision. It also reviews the company’s management development, diversity and succession plans. The committee takes independent advice from consultants when required. No executive director takes part in any discussion or decision concerning their own remuneration. The committee reports to the full board and its report on directors’ remuneration, which has been considered and adopted by the board, is set out on pages 20 to 35.

iii Nomination committee Dennis Stevenson (chairman), Marjorie Scardino, Terry Burns, Patrick Cescau, Susan Fuhrman, Reuben Mark, Vernon Sankey, Rana Talwar.

The committee is comprised of the chairman, chief executive and all of the non-executive directors and meets as and when required. The committee primarily monitors the composition and balance of the board and its committees, and identifies and recommends to the board the appointment of new directors. Whilst the chairman of the board chairs this committee he is not permitted to chair meetings when the appointment of his successor is being considered or during discussion regarding his performance.

In accordance with the company’s articles of association, directors are subject to reappointment at the AGM immediately following the date of their appointment, and thereafter they must seek re-election no more than three years from the date they were last re-elected. The committee will recommend to the board the names of the directors who are to seek re-election at the AGM.
During the year Susan Fuhrman was appointed to the board as a non-executive director. When considering the appointment of new directors, the committee reviews the current balance of skills and experience on the board. A detailed specification is drawn up to include any specific knowledge or expertise that is considered necessary for the board. External search consultants are then used to identify suitable candidates who are shortlisted and then evaluated by the committee before it submits its recommendation to the board as a whole.

**iv Treasury committee** Dennis Stevenson (chairman), Rona Fairhead, Vernon Sankey, Rana Talwar.

The committee sets the policies for the company’s treasury department and reviews its procedures on a regular basis. The treasury committee schedules one meeting a year and arranges to meet at other times, if necessary.

**Internal control**

The directors are responsible for the Group’s system of internal control. They have reviewed its effectiveness, in accordance with the provisions of the Code, and consider that it is appropriately designed to manage the risk environment facing the Group and to provide reasonable, but not absolute, assurance against material misstatement or loss.

They confirm that there is an ongoing process allowing for the identification, evaluation and management of significant business risks. The board requires operating companies to undertake semi-annual reviews to identify new or potentially under-managed risks. The results of these reviews are reported to the board via the audit committee. This process has been in place throughout 2004 and up to the date of the approval of this annual report, and accords with the Turnbull guidance.

The main elements of the Group’s internal control system including risk identification are as follows:

**i Board** – The board of directors has overall responsibility for the Group’s system of internal control and exercises that control through an organisational structure with clearly defined levels of responsibility and authority as well as appropriate reporting procedures. To maintain effective control over strategic, financial, operational and compliance issues the board meets regularly and has a schedule of matters that is brought to it, or its duly authorised committees, for decision. This structure includes the audit committee, which with the chief financial officer, reviews the effectiveness of the internal financial and operating control environment of the Group. The audit committee meets regularly and considers reports from both the internal and external auditors.

**ii Operating company controls** – The identification and mitigation of major business risks is the responsibility of operating company management. Each operating company maintains controls and procedures appropriate to its own business environment while conforming to Group standards and guidelines, including procedures to identify and mitigate all types of risk. To this end operating companies undertake risk reviews, semi-annually, to identify new or potentially under-managed risks.

**iii Financial reporting** – There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the board of directors. Monthly financial information, including trading results, balance sheets, cash flow statements and indebtedness, are reported against the corresponding figures for the plan and prior years, with corrective action outlined by operating company executives as appropriate. Quarterly, Group senior management meet with operating company management to review their business and financial performance against plan and forecast. Major business risks relevant to each operating company are reviewed in these meetings.

**iv Treasury management** – The treasury department operates within policies approved by the board and its procedures are reviewed regularly by the treasury committee. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the chief financial officer and regular reports are prepared for the treasury committee.

**v Group control** – The Group control function is responsible for risk reviews and internal audit, which it exercises through teams located in the UK and US. The department reviews business risks, processes and procedures in all the main operating companies, agreeing with operating company management plans to mitigate those risks and improve internal controls and processes. It monitors operating companies’ progress in implementing its recommendations and
provides regular reports on its findings to executive management and, via the audit committee, to the board. Annually the department specifically reviews and reports on business risk to executive management and, via the audit committee, to the board.

As a requirement of our secondary US listing, we need to comply with section 404 of the Sarbanes Oxley Act. During 2004 we launched a project, led by Group control, to document and test our financial controls. We are on track to meet our deadlines.

**vi Insurance** – Insurance is provided through Pearson’s insurance subsidiary or externally, depending on the scale of the risk and the availability of cover in the external market, with the objective of achieving the most cost effective balance between insured and uninsured risks.

**Going concern**
Having reviewed the Group’s liquid resources and borrowing facilities, and the 2005 and 2006 cash flow forecasts contained in the Group budget for 2005, the directors believe that the Group has adequate resources to continue as a going concern for the foreseeable future. For this reason, the financial statements have, as usual, been prepared on that basis.

**Shareholder communication**
Pearson has an extensive programme of communication with all its shareholders – large and small, institutional and private. We also make a particular effort to communicate regularly with our employees, a large majority of whom are shareholders in the company. We post all company announcements on our website, www.pearson.com, as soon as they are released, and major shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes information about all of our businesses, links to their websites, and details of our corporate responsibility policies and activities.

In 2004, we continued our programme of educational seminars for our institutional shareholders focusing on individual parts of Pearson. The seminars are available to all shareholders via webcast on www.pearson.com.

Our AGM – which will be held on 29 April this year – includes opportunities to meet the company’s managers, presentations about Pearson’s businesses and the previous year’s results as well as general AGM business.

**People**
During 2004, Pearson employed over 33,000 people in 60 countries. Each business has detailed employment practices for recruitment, remuneration, employee relations, health and safety, and terms and conditions designed for the different sectors and countries in which it operates.

We are committed to equality of opportunity for all regardless of gender, race, age, physical ability, religion or sexual orientation. This applies equally to recruitment and to the promotion, development and training of people who are already part of Pearson. The company takes seriously its obligations to the disabled and seeks not to discriminate against current or prospective employees because of any disability. We are always willing to make reasonable adjustments to premises or employment arrangements if these substantially disadvantage a disabled employee or prospective employee. Every effort is made to find suitable alternative jobs and, as necessary, training for those who are unable to continue in their existing role due to disability.

Pearson is committed to clear and timely communication with its people concerning business performance. It works hard to maintain effective channels of communication and supports employee representation to help positive employee relations. Twice a year, the European Employee Forum meets to discuss issues of importance to staff in their businesses across Europe.

The directors believe that the best way for people to profit from the success of the company is for them to become shareholders. Pearson operates a worldwide profit sharing plan and a share acquisition plan in 60 countries. With more than half our people in the US, we have taken special care to make it easy for them to acquire shares in Pearson. The listing of our shares on the New York Stock Exchange allows us to operate a US Employee Stock Purchase Plan that makes share ownership in Pearson accessible to the majority of our employees.
Supplier payment policy
Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. It is company policy that suppliers are aware of such terms of payment and that payments to them are made in accordance with these, provided that the supplier is also complying with all relevant terms and conditions. Group trade creditors at 31 December 2004 were equivalent to 30 days of purchases during the year ended on that date. The company does not have any significant trade creditors and therefore is unable to disclose average supplier payment terms.

External giving
In 2004, Pearson's charitable giving totalled £2.5m (2003: £2.1m). In addition to cash donations, Pearson provides in-kind support such as books, publishing expertise, advertising space and staff time. We focus our charitable giving on projects related to education. We encourage our employees to support their personal charities by matching donations and payroll giving. More details can be found on our website at www.pearson.com/community/csr_report2004.

Share capital
Details of share issues are given in note 23 to the accounts on pages 73 and 74. At the AGM held on 30 April 2004, the company was authorised, subject to certain conditions, to acquire up to 80 million of its ordinary shares by market purchase. Although circumstances have not merited using this authority and there are no plans at present to do so, shareholders will be asked to renew this authority at the AGM on 29 April 2005.

At 27 February 2005, beneficial interests amounting to 3% or more of the issued ordinary share capital of the company notified to the company comprised:

<table>
<thead>
<tr>
<th></th>
<th>Number of shares</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Capital Group</td>
<td>120,639,432</td>
<td>15%</td>
</tr>
<tr>
<td>Companies Inc.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Franklin Resources, Inc.</td>
<td>80,405,466</td>
<td>10%</td>
</tr>
<tr>
<td>Legal &amp; General</td>
<td>24,046,759</td>
<td>3%</td>
</tr>
</tbody>
</table>

Annual general meeting – The notice convening the AGM to be held at 12 noon on Friday, 29 April 2005 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, is contained in a circular to shareholders to be dated 31 March 2005.

Registered auditors – In accordance with section 384 of the Companies Act 1985 (the Act) resolutions proposing the reappointment of PricewaterhouseCoopers LLP as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the directors.

Auditor independence – In line with best practice, the audit committee has introduced a policy that defines those non-audit services that the independent auditors, PricewaterhouseCoopers LLP, may or may not provide to Pearson. The policy requires the provision of these services to be approved in advance by the audit committee. The policy also establishes other procedures to ensure that the auditors' independence has not been compromised. A full statement of the fees for audit and non-audit services is provided in note 3 on page 48 to the accounts.

Statement of directors' responsibilities – Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group as at the end of the year and of the profit or loss of the Group for that period. The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time, the financial position of the company and the Group and to enable them to ensure that the financial statements comply with the Act. They are also responsible for safeguarding the assets of the Group, and hence for taking reasonable steps towards preventing and detecting fraud and other irregularities. In preparing the financial statements on pages 36 to 39 and 41 to 83 inclusive, the directors consider that appropriate accounting policies have been used and applied in a consistent manner, supported by reasonable and prudent judgements and estimates, and that all relevant accounting standards have been followed.

Approved by the board on 27 February 2005 and signed on its behalf by

Philip Hoffman, Secretary

Note On 27 February 2005 Pearson announced that Dennis Stevenson intends to retire later in the year.