Notes to the Accounts

1 Accounting policies

Accounting policies have been consistently applied except that UITF 38 'Accounting for ESOP trusts' and the revision of UITF 17 'Employee share schemes' have been adopted in these statements. The adoption of these standards represents a change in accounting policy and the comparative figures have been restated accordingly. The effect of these changes in accounting policy is disclosed in note 24.

a. Basis of accounting – The accounts are prepared under the historical cost convention and in accordance with the Companies Act and applicable accounting standards. A summary of the significant accounting policies is set out below.

b. Basis of consolidation – The consolidated accounts include the accounts of all subsidiaries made up to 31 December. Where companies have become or ceased to be subsidiaries or associates during the year, the Group results include results for the period during which they were subsidiaries or associates.

The results of the Group includes the Group's share of the results of joint ventures and associates, and the consolidated balance sheet includes the Group's interest in joint ventures and associates at the book value of attributable net assets and attributable goodwill.

c. Goodwill – From 1 January 1998 goodwill, being either the net excess of the cost of shares in subsidiaries, joint ventures and associates over the value attributable to their net assets on acquisition or the cost of other goodwill by purchase, is capitalised and amortised through the profit and loss account on a straight-line basis over its estimated useful life not exceeding 20 years. Estimated useful life is determined after taking into account such factors as the nature and age of the business and the stability of the industry in which the acquired business operates, as well as typical life spans of the acquired products to which the goodwill attaches. Goodwill is subject to an impairment review at the end of the first full year following an acquisition, and at any other time if events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill arising on acquisitions before 1 January 1998 has been deducted from reserves and is charged or credited to the profit and loss account on disposal or closure of the business to which it relates.

d. Sales – Sales represent the amount of goods and services, net of value added tax and other sales taxes, and excluding trade discounts and anticipated returns, provided to external customers and associates.

Revenue from the sale of books is recognised when title passes. Anticipated returns are based primarily on historical return rates.

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. 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 direct and indirect 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.

e. Pension costs – The regular pension cost of the Group's defined benefit pension schemes is charged to the profit and loss account in accordance with SSAP 24 'Accounting for pension costs' in order to apportion the cost of pensions over the service lives of employees in the schemes.

1 Accounting policies *continued*
Variations are apportioned over the expected service lives of current employees in the schemes. The pension cost of the Group's defined contribution schemes is the amount of contributions payable for the year.

f. Post-retirement benefits other than pensions – Post-retirement benefits other than pensions are accounted for on an accruals basis to recognise the obligation over the expected service lives of the employees concerned.

g. Tangible fixed assets – The cost of tangible fixed assets other than freehold land is depreciated over estimated economic lives in equal annual amounts. Generally, freeholds are depreciated at 1% to 5% per annum, leaseholds at 2% per annum, or over the period of the lease if shorter, and plant and equipment at various rates between 5% and 33% per annum.

h. Leases – Finance lease rentals are capitalised at the net present value of the total amount of rentals payable under the leasing agreement (excluding finance charges) and depreciated in accordance with policy g above. Finance charges are written off over the period of the lease in reducing amounts in relation to the written down carrying cost. Operating lease rentals are charged to the profit and loss account on a straight-line basis over the duration of each lease term.

i. Fixed asset investments – Fixed asset investments are stated at cost less provisions for diminution in value.

j. Share schemes – Shares held by employee share ownership trusts are shown at cost and recorded as a deduction in arriving at shareholders' funds. The costs of funding and administering the trusts are charged to the profit and loss account in the period to which they relate. The fair market value of the shares at the date of grant, less any consideration to be received from the employee, is charged to the profit and loss account over the period to which the employee's performance relates. Where awards are contingent upon future events (other than continued employment) an assessment of the likelihood of these conditions being achieved is made at the end of each reporting period and an appropriate adjustment to the charge is made.

k. Stocks – Stocks and work in progress are stated at the lower of cost and net realisable value.

l. Pre-publication costs – Pre-publication costs represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are carried forward in stock where the title to which they relate has a useful life in excess of one year. These costs are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected life cycle of the title, with a higher proportion of the amortisation taken in the earlier years.

m. Royalty advances – Advances of royalties to authors are included within debtors when the advance is paid less any provision required to bring the amount down to its net realisable value. The royalty advance is expensed at the contracted royalty rate as the related revenues are earned.

n. Newspaper development costs – Revenue investment in the development of newspaper titles consists of measures to increase the volume and geographical spread of circulation. These measures include additional and enhanced editorial content, extended distribution and remote printing. These extra costs arising are expensed as incurred.

o. Deferred taxation – Provision is made in full for deferred tax that arises from timing differences that have originated but not reversed by the balance sheet date on transactions or events that result in an obligation to pay more tax in the future. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be taxable profits from which the underlying timing differences can be deducted. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax assets and liabilities are not discounted.

p. Financial instruments – Interest and the premium or discount on the issue of financial instruments is taken to the profit and loss account so as to produce a constant rate of return over the period to the date of expected redemption.

The Group uses derivative financial instruments to manage its exposure to interest rate and foreign exchange risks. These include interest rate swaps, currency swaps and forward currency contracts.

1 Accounting policies *continued*

Amounts payable or receivable in respect of interest rate derivatives are accrued with net interest payable over the period of the contract. Where the derivative instrument is terminated early, the gain or loss is spread over the remaining maturity of the original instrument. Where the underlying exposure ceases to exist, any termination gain or loss is taken to the profit and loss account. Foreign currency borrowings and their related derivatives are carried in the balance sheet at the relevant exchange rates at the balance sheet date. Gains or losses in respect of the hedging of overseas subsidiaries are taken to reserves. Gains or losses arising from foreign exchange contracts are taken to the profit and loss account in line with the transactions which they are hedging. Premiums paid on contracts designed to manage currency exposure on specific acquisitions or disposals are charged to the profit and loss account.

The company participates in offset arrangements with certain banks whereby cash and overdraft amounts are offset against each other.

q. Foreign currencies – Profit and loss accounts in overseas currencies are translated into sterling at average rates. Balance sheets are translated into sterling at the rates ruling at 31 December. Exchange differences arising on consolidation are taken directly to reserves. Other exchange differences are taken to the profit and loss account where they relate to trading transactions and directly to reserves where they relate to investments.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.83 (2003: \$1.63) and the year end rate was \$1.92 (2003: \$1.79).

r. Liquid resources – Liquid resources comprise short-term deposits of less than one year and investments which are readily realisable and held on a short-term basis.

s. Retained profits of overseas subsidiaries and associates – No provision is made for any additional taxation, less double taxation relief, which would arise on the remittance of profits retained where there is no intention to remit such profits.

2a Analysis of sales

All figures in £ millions	2004	2003
Business sectors		
Pearson Education	2,356	2,451
FT Group	587	588
The Penguin Group	786	840
Continuing operations	3,729	3,879
Discontinued operations	190	169
	3,919	4,048
Geographical markets supplied		
United Kingdom	545	474
Continental Europe	300	294
North America	2,505	2,742
Asia Pacific	261	255
Rest of world	118	114
Continuing operations	3,729	3,879
Discontinued operations	190	169
	3,919	4,048

2a Analysis of sales *continued*

All figures in £ millions	2004 Total by source	2004 Inter-regional	2004 Total sales	2003 Total by source	2003 Inter-regional	2003 Total sales
Geographical source of sales						
United Kingdom	802	(57)	745	751	(60)	691
Continental Europe	174	(1)	173	166	–	166
North America	2,499	(2)	2,497	2,721	(2)	2,719
Asia Pacific	225	(2)	223	230	(1)	229
Rest of world	93	(2)	91	74	–	74
Continuing operations	3,793	(64)	3,729	3,942	(63)	3,879
Discontinued operations	190	–	190	169	–	169
	3,983	(64)	3,919	4,111	(63)	4,048

Note The table above analyses sales by the geographical region from which the products and services originate. Inter-regional sales are those made between Group companies in different regions.

Included within sales for 2004 is an amount of £10m attributable to acquisitions made during the year.

2b Analysis of total operating profit

All figures in £ millions	2004 Results from operations	2004 Goodwill amortisation	2004 Operating profit
Business sectors			
Pearson Education	293	(174)	119
FT Group	86	(20)	66
The Penguin Group	54	(21)	33
Continuing operations	433	(215)	218
Discontinued operations	22	(9)	13
	455	(224)	231
Geographical markets supplied			
United Kingdom	(26)	(30)	(56)
Continental Europe	21	(2)	19
North America	393	(177)	216
Asia Pacific	31	(5)	26
Rest of world	14	(1)	13
Continuing operations	433	(215)	218
Discontinued operations	22	(9)	13
	455	(224)	231

2b Analysis of total operating profit *continued*

All figures in £ millions			2003
	Results from operations	Goodwill amortisation	Operating profit
Business sectors			
Pearson Education	313	(207)	106
FT Group	58	(30)	28
The Penguin Group	91	(21)	70
Continuing operations	462	(258)	204
Discontinued operations	28	(6)	22
	490	(264)	226
Geographical markets supplied			
United Kingdom	(46)	(31)	(77)
Continental Europe	1	(4)	(3)
North America	466	(218)	248
Asia Pacific	33	(5)	28
Rest of world	8	–	8
Continuing operations	462	(258)	204
Discontinued operations	28	(6)	22
	490	(264)	226

Note Discontinued operations relate to the disposal of the Group's interest in Recoletos, see note 31. Included within operating profit for 2004 is an amount of £1m attributable to acquisitions made during the year.

2c Share of operating loss of joint ventures

All figures in £ millions			2004
	Results from operations	Goodwill amortisation	Operating profit/(loss)
Business sectors			
Pearson Education	–	–	–
FT Group	(8)	–	(8)
The Penguin Group	1	–	1
Continuing operations	(7)	–	(7)

All figures in £ millions			2003
	Results from operations	Goodwill amortisation	Operating profit/(loss)
Business sectors			
Pearson Education	–	–	–
FT Group	(11)	–	(11)
The Penguin Group	1	–	1
Continuing operations	(10)	–	(10)

2d Share of operating profit of associates

All figures in £ millions	Results from operations 2004	Goodwill amortisation 2004	Operating profit 2004
Business sectors			
Pearson Education	1	–	1
FT Group	14	–	14
The Penguin Group	–	–	–
Continuing operations	15	–	15
Discontinued operations	2	–	2
	17	–	17

All figures in £ millions	Results from operations 2003	Goodwill amortisation 2003	Operating profit 2003
Business sectors			
Pearson Education	1	–	1
FT Group	14	(7)	7
The Penguin Group	–	–	–
Continuing operations	15	(7)	8
Discontinued operations	2	–	2
	17	(7)	10

2e Analysis of capital employed

All figures in £ millions	2004	2003 restated
Business sectors		
Pearson Education	3,059	3,457
FT Group	198	256
The Penguin Group	593	591
Continuing operations	3,850	4,304
Discontinued operations	130	152
	3,980	4,456
Geographical location		
United Kingdom	410	425
Continental Europe	58	62
North America	3,245	3,676
Asia Pacific	114	120
Rest of world	23	21
Continuing operations	3,850	4,304
Discontinued operations	130	152
	3,980	4,456

2e Analysis of capital employed *continued*

All figures in £ millions	Note	2004	2003 restated
Reconciliation of capital employed to net assets			
Capital employed		3,980	4,456
Add: deferred taxation	21	165	145
Less: provisions for liabilities and charges	22	(123)	(152)
Less: net debt excluding finance leases	27	(1,206)	(1,361)
Net assets		2,816	3,088

3 Analysis of consolidated profit and loss account

All figures in £ millions	2004	2003
Cost of sales	(1,866)	(1,910)
Gross profit	2,053	2,138
Distribution costs	(243)	(239)
Administration and other expenses	(1,635)	(1,724)
Other operating income	46	51
Net operating expenses	(1,832)	(1,912)
Analysed as		
Net operating expenses – before other items	(1,608)	(1,655)
Net operating expenses – other items		
– Goodwill amortisation	(224)	(257)
Net operating expenses	(1,832)	(1,912)

Note Other items are all included in administration and other expenses. Included above are the following amounts in respect of discontinued operations: cost of sales £61m (2003: £53m), distribution costs £40m (2003: £33m) and administration and other expenses £66m (2003: £55m).

3 Analysis of consolidated profit and loss account *continued*

All figures in £ millions	2004	2003
Other operating income		
Income from other investments		
Unlisted	–	4
Other operating income (mainly royalties, rights and commission income)	46	47
	46	51
Profit before taxation is stated after charging		
Amortisation of pre-publication costs	168	158
Depreciation	102	111
Operating lease rentals		
– Plant and machinery	9	14
– Properties	97	113
– Other	13	9
Auditors' remuneration		
Statutory audit and audit-related regulatory reporting services	4	3
Non-audit services	2	2
Non-audit services were as follows		
Tax compliance services	1	1
Tax advisory services	1	1

Note Included in statutory audit fees are amounts relating to the parent company of £20,000 (2003: £20,000). Audit-related regulatory reporting fees relating to the parent company are £225,000 (2003: £200,000) and £600,000 (2003: £nil) relating to overseas subsidiaries. Non-audit fees in the UK in 2004 are £1m (2003: £341,000) and are in respect of tax advisory, tax compliance services and other advisory services. The remainder of the non-audit fees relate to overseas subsidiaries.

4a Profit/(loss) on sale of fixed assets and investments

All figures in £ millions	2004	2003
Net loss on sale of property	(4)	(1)
Net gain/(loss) on sale of investments	16	(1)
Continuing operations	12	(2)
Taxation	(2)	–

4b Profit/(loss) on sale of subsidiaries and associates

All figures in £ millions	2004	2003
Net loss on sale of subsidiaries and associates	(3)	(4)
Continuing operations	(3)	(4)
Discontinued operations	–	12
	(3)	8
Taxation	1	(3)

5 Net finance costs

All figures in £ millions	Note	2004	2003
Net interest payable			
– Group	6	(70)	(81)
– Associates		1	1
Total net finance costs		(69)	(80)

6 Net interest payable – Group

All figures in £ millions	2004	2003
Interest payable and similar charges		
Bank loans, overdrafts, bonds and commercial paper		
On borrowing repayable wholly within five years	(58)	(60)
On borrowing repayable wholly or partly after five years	(32)	(31)
Other borrowings		
On borrowing repayable wholly within five years	(1)	(2)
	(91)	(93)
Interest receivable and similar income		
On deposits, liquid funds and other	21	12
Net interest payable	(70)	(81)

7 Taxation

All figures in £ millions	2004	2003
Analysis of (charge)/benefit in the year		
Current taxation		
UK corporation tax for the year	10	(9)
Adjustments in respect of prior years	(2)	10
	8	1
Overseas tax for the year	(82)	(59)
Adjustments in respect of prior years	27	3
Associates	(3)	(5)
	(50)	(60)
Deferred taxation		
Origination and reversal of timing differences		
UK	(5)	(4)
Overseas	(30)	(54)
Adjustments in respect of prior years	23	43
	(12)	(15)
Taxation	(62)	(75)

The current tax charge for the year is different from the standard rate of corporation tax in the UK (30%). The differences are explained below:

All figures in £ millions	2004	2003
Profit before tax	171	152
Expected charge at UK corporation tax rate of 30% (2003: 30%)	(51)	(46)
Effect of overseas tax rates	7	8
Effect of tax losses	(9)	(5)
Timing differences	35	64
Non-deductible goodwill amortisation	(61)	(90)
Adjustments in respect of prior years and other items	29	9
Current tax charge for the year	(50)	(60)

All figures in percentages	2004	2003
Tax rate reconciliation		
UK tax rate	30.0	30.0
Effect of overseas tax rates	1.4	1.3
Other items	(1.1)	(0.1)
Tax rate reflected in adjusted earnings	30.3	31.2

Note The current tax charge on profit before tax will continue to be affected by the fact that there is only partial tax relief available on the goodwill amortisation charged in the accounts. The charge will also be affected by the utilisation of tax losses and by the impact of other timing differences, in both cases mainly in the United States. In both 2004 and 2003 the tax charge was materially affected by adjustments in respect to prior years; it is not practicable to forecast the possible effect of such items in future years as this will depend on progress in agreeing the Group's tax returns with the tax authorities. The total charge in future years will also be affected by any changes to corporation tax rates and/or any other relevant legislative changes in the jurisdictions in which the Group operates and by the mix of profits between the different jurisdictions.

8 Dividends on equity shares

	2004		2003	
	Pence per share	£m	Pence per share	£m
Interim paid	9.7	76	9.4	73
Final proposed	15.7	125	14.8	119
Dividends for the year	25.4	201	24.2	192

Note Dividends in respect of the company's shares held by employee share trusts (see note 24) have been waived.

9 Earnings per share

In order to show results from operations on a consistent basis, an adjusted earnings per share is presented which excludes certain items as set out below. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

		2004		2003	
	Note	£m	Earnings per share pence	£m	Earnings per share pence
Profit for the financial year		88	11.1	55	6.9
Adjustments					
– Non-operating items		(9)	(1.2)	(6)	(0.8)
– Goodwill amortisation	2b	224	28.1	264	33.3
Taxation on above items		(55)	(6.9)	(53)	(6.6)
Minority interest share of above items		(9)	(1.1)	(6)	(0.8)
Adjusted earnings		239	30.0	254	32.0
Diluted earnings		88	11.0	55	6.9
Weighted average number of shares (millions) – for basic earnings and adjusted earnings		795.6		794.4	
Effect of dilutive share options		1.1		0.9	
Weighted average number of shares (millions) – for diluted earnings		796.7		795.3	

10a Employee information

The details of the emoluments of the directors of Pearson plc are shown on pages 20 to 35.

All figures in £ millions	2004	2003
Staff costs		
Wages and salaries	1,023	1,027
Social security costs	105	99
Post-retirement costs	68	62
	1,196	1,188

	UK	US	Other	Total
Average number employed 2004				
Pearson Education	2,071	16,133	4,080	22,284
FT Group	1,709	1,352	2,594	5,655
The Penguin Group	1,067	2,026	992	4,085
Other	792	572	1	1,365
	5,639	20,083	7,667	33,389

	UK	US	Other	Total
Average number employed 2003				
Pearson Education	1,443	14,438	4,097	19,978
FT Group	1,885	1,397	2,362	5,644
The Penguin Group	1,223	2,115	980	4,318
Other	414	513	1	928
	4,965	18,463	7,440	30,868

10b Pensions

SSAP 24 accounting The Group operates a number of pension schemes throughout the world, the principal ones being in the UK and US. The major schemes are self-administered with the schemes' assets being held independently of the Group. Pension costs are assessed in accordance with the advice of independent qualified actuaries. The UK scheme is a hybrid scheme with both defined benefit and defined contribution sections but, predominantly, consisting of defined benefit liabilities. There are a number of defined contribution schemes, principally overseas. The cost of the schemes is as follows:

All figures in £ millions	2004	2003
UK Group scheme		
Regular pension cost		
– Defined benefit sections	10	10
– Defined contribution sections	8	7
Variation cost	9	6
	27	23
Other schemes		
Defined benefit schemes	6	7
Defined contribution schemes	29	27
	35	34
	62	57

Note From 1 January 2003 the UK Group scheme only offers defined contribution benefits to new joiners. The main US defined benefit scheme was closed to the majority of active members in 2001. The changes to these schemes will give rise to a reduction in defined benefit and an increase in defined contribution costs.

Included in the balance sheet, there is a pension provision of £19m (2003: £29m) as measured in accordance with SSAP 24 (see note 22).

A full actuarial valuation of the UK Group scheme was performed as at 1 January 2004 using the projected unit method of valuation. The market value of the assets of the scheme at 1 January 2004 was £1,091m. The major assumptions used to determine the SSAP 24 charge are as follows:

All figures in percentages	UK Group scheme
Inflation	2.75
Rate of increase in salaries	4.75
Rate of increase for pensions in payment and deferred pensions	2.0 – 4.5
Return on investments	7.1
Level of funding	95

The funding policy differs from the accounting policy to the extent that more conservative assumptions are used for funding purposes. In particular, the deficit measured on the funding assumptions was £137m (compared to £56m on the SSAP 24 assumptions). Please refer to page 56 for further details of the funding of the scheme.

The next full actuarial valuation of the UK Group scheme for funding purposes is due to be carried out as at 1 January 2006. The date of the most recent valuation of the US plan was 1 January 2004.

10b Pensions *continued*

FRS 17 disclosures The disclosures required under the transitional arrangements of FRS 17 for the Group's defined benefit schemes and the UK Group hybrid scheme are set out below. The disclosures for the UK Group hybrid scheme are in respect of both the defined benefit and defined contribution sections.

For the purpose of these disclosures, the latest full actuarial valuations of the UK Group scheme and other schemes have been updated by independent actuaries to 31 December 2004. The assumptions used are shown below. Weighted average assumptions have been shown for the other schemes.

	2004		2003		2002	
All figures in percentages	UK Group scheme	Other schemes	UK Group scheme	Other schemes	UK Group scheme	Other schemes
Inflation	2.80	3.00	2.75	3.00	2.25	3.00
Rate of increase in salaries	4.80	4.50	4.75	4.50	4.25	4.50
Rate of increase for pensions in payment and deferred pensions	2.80 – 4.00	–	2.75 – 4.00	–	2.25 – 4.00	–
Rate used to discount scheme liabilities	5.40	5.85	5.50	6.10	5.70	6.75

The assets of the UK Group scheme and the expected rate of return on these assets, and the assets of the other defined benefit schemes and the expected rate of return on these assets shown as a weighted average, are as follows:

	Long-term rate of return expected at 31 Dec 2004 %	Value at 31 Dec 2004 £m	Long-term rate of return expected at 31 Dec 2003 %	Value at 31 Dec 2003 £m	Long-term rate of return expected at 31 Dec 2002 %	Value at 31 Dec 2002 £m
UK Group scheme						
Equities	7.50	638	7.75	589	8.00	472
Bonds	4.75	276	5.00	262	4.75	284
Properties	6.25	113	6.50	107	6.50	112
Other	6.25	174	6.50	133	6.50	108
Total market value of assets		1,201		1,091		976
Present value of scheme liabilities		(1,495)		(1,316)		(1,189)
Deficit in the scheme		(294)		(225)		(213)
Related deferred tax asset		88		68		64
Net pension liability		(206)		(157)		(149)
Other schemes						
Equities	8.50	45	9.00	41	9.75	33
Bonds	5.50	26	6.00	25	6.00	23
Other	3.75	2	2.80	1	2.75	1
Total market value of assets		73		67		57
Present value of scheme liabilities		(102)		(104)		(96)
Deficit in the schemes		(29)		(37)		(39)
Related deferred tax asset		10		13		14
Net pension liability		(19)		(24)		(25)

Note The measurement of the deficit in the scheme for FRS 17 follows a different approach to SSAP 24. The FRS 17 measurement date is 31 December 2004. Although the rise in stock markets in 2004 increased the market value of the UK Group scheme assets, this is more than offset by the increase in the present value of the UK Group scheme liabilities. This increase has largely been caused by use of the 1 January 2004 formal funding valuation and the change in both economic and mortality assumptions used for FRS 17 purposes since 31 December 2003. This has resulted in an increased deficit in the UK Group scheme under FRS 17.

10b Pensions *continued*

All figures in £ millions	UK Group scheme	Defined benefit other	Sub-total	Defined contribution	2004 Total
Operating charge					
Current service cost	(24)	(1)	(25)	(29)	(54)
Past service cost	–	–	–	–	–
Total operating charge	(24)	(1)	(25)	(29)	(54)
Other finance income/(charge)					
Expected return on pension scheme assets	73	5	78	–	78
Interest on pension scheme liabilities	(70)	(6)	(76)	–	(76)
Net finance credit/(charge)	3	(1)	2	–	2
Net profit and loss impact	(21)	(2)	(23)	(29)	(52)
Statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	60	2	62		
Experience (losses)/gains arising on the scheme liabilities	(62)	1	(61)		
Changes in assumptions underlying the present value of the scheme liabilities	(76)	(4)	(80)		
Exchange differences	–	2	2		
Actuarial (loss)/gain	(78)	1	(77)		
Movement in deficit during the year					
Deficit in scheme at beginning of the year	(225)	(37)	(262)		
Current service cost	(24)	(1)	(25)		
Past service cost	–	–	–		
Contributions	30	9	39		
Other finance charge	3	(1)	2		
Actuarial (loss)/gain	(78)	1	(77)		
Deficit in scheme at end of the year	(294)	(29)	(323)		
Related deferred tax asset	88	10	98		
Net pension deficit	(206)	(19)	(225)		

Following the 1 January 2004 actuarial valuation for funding purposes, the Group has agreed to pay contributions of 14.8% of pensionable salaries, plus contributions in respect of the Money Purchase 2003 section introduced with effect from 1 January 2003, in respect of future service benefits. Further, the Group has agreed to pay contributions of £10m in respect of 2004, £15m in respect of 2005 and £21m in respect of each year from 2006 to 2013 to fund the past service deficit revealed by the funding valuation.

10b Pensions *continued*

All figures in £ millions	UK Group scheme	Defined benefit other	Sub-total	Defined contribution	2003 Total
Operating charge					
Current service cost	(20)	(1)	(21)	(27)	(48)
Past service cost	–	(1)	(1)	–	(1)
Total operating charge	(20)	(2)	(22)	(27)	(49)
Other finance income/(charge)					
Expected return on pension scheme assets	65	5	70	–	70
Interest on pension scheme liabilities	(66)	(7)	(73)	–	(73)
Net finance charge	(1)	(2)	(3)	–	(3)
Net profit and loss impact	(21)	(4)	(25)	(27)	(52)
Statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	80	8	88		
Experience losses arising on the scheme liabilities	(1)	(8)	(9)		
Changes in assumptions underlying the present value of the scheme liabilities	(95)	(6)	(101)		
Exchange differences	–	3	3		
Actuarial loss	(16)	(3)	(19)		
Movement in deficit during the year					
Deficit in scheme at beginning of the year	(213)	(39)	(252)		
Current service cost	(20)	(1)	(21)		
Past service cost	–	(1)	(1)		
Contributions	25	9	34		
Other finance charge	(1)	(2)	(3)		
Actuarial loss	(16)	(3)	(19)		
Deficit in scheme at end of the year	(225)	(37)	(262)		
Related deferred tax asset	68	13	81		
Net pension deficit	(157)	(24)	(181)		

The contribution rate for 2003 for the UK Group scheme was 17.1% of pensionable salaries, plus £1m in respect of the new Money Purchase section introduced with effect from 1 January 2003. In addition, a one-off contribution of £5m was paid into this scheme to improve the funding position.

10b Pensions *continued*

The experience gains and losses of both the UK Group scheme and other schemes are shown below:

	2004	2003	2002
History of experience gains and losses			
Difference between the actual and expected return on scheme assets	£62m	£88m	£(176)m
As a percentage of year end assets	5%	8%	(17)%
Experience gains and (losses) on scheme liabilities	£(61)m	£(9)m	£16m
As a percentage of year end liabilities	(4)%	(1)%	1%
Total amount recognised in statement of total recognised gains and losses	£(77)m	£(19)m	£(159)m
As a percentage of year end liabilities	(5)%	(1)%	(12)%

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserve at 31 December 2004 would be as follows:

All figures in £ millions	2004	2003
Net assets excluding pension liability (see note below)	2,835	3,117
FRS 17 pension liability	(225)	(181)
Net assets including FRS 17 pension liability	2,610	2,936
Profit and loss reserve excluding pension reserve (see note below)	(52)	252
FRS 17 pension reserve	(225)	(181)
Profit and loss reserve including FRS 17 pension reserves	(277)	71

Note The net assets and profit and loss reserve exclude the pension liability of £19m (2003: £29m) included within provisions (see note 22).

10c Other post-retirement benefits

UITF 6 accounting The Group provides certain healthcare and life assurance benefits principally for retired US employees and their dependents. These plans are unfunded. Retirees are eligible for participation in the plans if they meet certain age and service requirements. Plans that are available vary depending on the business division in which the retiree worked. Plan choices and retiree contributions are dependent on retirement date, business division, option chosen and length of service. The valuation and costs relating to other post-retirement benefits are assessed in accordance with the advice of independent qualified actuaries. The cost of the benefits and the major assumptions used, based on a valuation with a measurement date of 31 December 2003, are as follows:

All figures in £ millions	2004	2003
Other post-retirement benefits	6	5

All figures in percentages	
Inflation	3.0
Initial rate of increase in healthcare rates	12.0
Ultimate rate of increase in healthcare rates (2008)	5.0
Rate used to discount scheme liabilities	6.1

Included in the balance sheet, there is a post-retirement medical benefits provision of £51m (2003: £51m). In accordance with UITF 6, the cost of post-retirement benefits, and related provisions, are based on the equivalent US GAAP standard, FAS 106 (see note 22).

10c Other post-retirement benefits *continued*

FRS 17 disclosures The disclosures required under the transitional arrangements of FRS 17 are set out below. For the purpose of these disclosures the valuation of the schemes has been updated to 31 December 2004 using the assumptions listed below.

All figures in percentages	2004	2003	2002
Inflation	3.00	3.00	3.00
Initial rate of increase in healthcare rates	12.00	12.00	12.00
Ultimate rate of increase in healthcare rates (2009; 2008; 2007)	5.00	5.00	5.00
Rate used to discount scheme liabilities	5.85	6.10	6.75

The value of the unfunded liability is as follows:			
Present value of unfunded liabilities	(58)	(61)	(63)
Related deferred tax asset	20	21	22
Net post-retirement healthcare liability	(38)	(40)	(41)
Operating charge			
Current service cost	(1)	(1)	
Past service cost	–	–	
Total operating charge	(1)	(1)	
Other finance charge			
Interest on pension scheme liabilities	(3)	(4)	
Net finance charge	(3)	(4)	
Net profit and loss impact	(4)	(5)	
Statement of total recognised gains and losses			
Experience gains arising on the scheme liabilities	5	3	
Changes in assumptions underlying the present value of the scheme liabilities	(5)	(6)	
Exchange differences	4	6	
Actuarial gain	4	3	
Movement in deficit during the year			
Deficit in scheme at beginning of the year	(61)	(63)	
Current service cost	(1)	(1)	
Contributions	3	4	
Other finance charge	(3)	(4)	
Actuarial gain	4	3	
Deficit in scheme at end of the year	(58)	(61)	
Related deferred tax asset	20	21	
Net post-retirement deficit	(38)	(40)	

10c Other post-retirement benefits *continued*

The experience gains and losses for the schemes are shown below:

	2004	2003	2002
History of experience gains and losses			
Experience gains on scheme liabilities	£5m	£3m	£3m
As a percentage of year end liabilities	9%	5%	4%
Total amount recognised in statement of total recognised gains and losses	£4m	£3m	£1m
As a percentage of year end liabilities	7%	5%	2%

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserves at 31 December 2004 would be as follows:

All figures in £ millions	2004	2003
Net assets excluding post-retirement healthcare liability (see note below)	2,867	3,139
FRS 17 post-retirement healthcare liability	(38)	(40)
Net assets including FRS 17 post-retirement healthcare liability	2,829	3,099
Profit and loss reserve excluding post-retirement healthcare reserve (see note below)	(20)	274
FRS 17 post-retirement healthcare reserve	(38)	(40)
Profit and loss reserve including FRS 17 post-retirement healthcare reserve	(58)	234

Note The net assets and profit and loss reserve exclude the post-retirement healthcare liability of £51m (2003: £51m) included within provisions (see note 22).

11 Intangible fixed assets

All figures in £ millions	Goodwill
Cost	
At 31 December 2003	4,224
Exchange differences	(245)
Additions	33
Disposals	–
At 31 December 2004	4,012
Amortisation	
At 31 December 2003	(964)
Exchange differences	66
Provided in the year	(224)
Disposals	–
At 31 December 2004	(1,122)
Net carrying amount	
At 31 December 2003	3,260
At 31 December 2004	2,890

12 Tangible fixed assets

All figures in £ millions	Freehold and lease property	Plant and equipment	Assets in course of construction	Total
Cost				
At 31 December 2003	301	753	22	1,076
Exchange differences	(9)	(27)	–	(36)
Reclassifications	–	14	(14)	–
Owned by subsidiaries acquired	1	4	–	5
Owned by subsidiaries disposed	(4)	–	–	(4)
Additions	14	103	10	127
Disposals	(13)	(44)	–	(57)
At 31 December 2004	290	803	18	1,111
Depreciation				
At 31 December 2003	(102)	(506)	–	(608)
Exchange differences	4	19	–	23
Provided in the year	(16)	(86)	–	(102)
Owned by subsidiaries acquired	–	(4)	–	(4)
Owned by subsidiaries disposed	4	–	–	4
Disposals	6	43	–	49
At 31 December 2004	(104)	(534)	–	(638)
Net book value				
At 31 December 2003	199	247	22	468
At 31 December 2004	186	269	18	473

Freehold and leasehold property – Net book value includes freehold of £109m (2003: £120m) and short leases of £77m (2003: £79m).

Capital commitments – The Group had capital commitments for fixed assets, including finance leases, already under contract amounting to £6m at 31 December 2004 (2003: £1m).

Other notes – The net book value of Group tangible fixed assets includes £3m (2003: £5m) in respect of assets held under finance leases. Depreciation on these assets charged in 2004 was £2m (2003: £2m).

13 Joint ventures

All figures in £ millions	2004 Valuation	2004 Book value	2003 Valuation	2003 Book value
Unlisted joint ventures	7	7	6	6

Note The valuations of unlisted joint ventures are directors' valuations as at 31 December 2004. If realised at these values there would be an estimated liability for taxation of £nil (2003: £nil). The Group had no capital commitments to subscribe for further capital or loan stock.

All figures in £ millions	Share of equity	Reserves	Total net assets
Summary of movements			
At 31 December 2003	75	(69)	6
Exchange differences	1	–	1
Additions	10	(2)	8
Dividends (including tax credits) from joint ventures	–	(1)	(1)
Retained loss for the year	–	(7)	(7)
At 31 December 2004	86	(79)	7

All figures in £ millions	2004 Operating loss	2004 Total net assets	2003 Operating loss	2003 Total net assets
Business sectors				
FT Group	(8)	2	(11)	2
The Penguin Group	1	5	1	4
	(7)	7	(10)	6
Geographical markets supplied and location of net assets				
United Kingdom	1	4	1	4
Continental Europe	(8)	3	(11)	2
	(7)	7	(10)	6

All figures in £ millions	2004	2003
Reconciliation to retained loss		
Operating loss of joint ventures	(7)	(10)
Taxation	–	–
Retained loss for the year	(7)	(10)

14 Associates

All figures in £ millions	2004 Valuation	2004 Book value	2003 Valuation	2003 Book value
Listed associates	53	9	27	9
Unlisted associates	175	32	192	49
	228	41	219	58

Note Principal associates are listed in note 34. The valuations of unlisted associates are directors' valuations as at 31 December 2004. If realised at these values there would be an estimated liability for taxation of £nil (2003: £nil). The Group had no capital commitments to subscribe for further capital or loan stock.

All figures in £ millions	Share of equity	Reserves	Total net assets
Summary of movements			
At 31 December 2003	49	9	58
Exchange differences	(1)	1	–
Additions	1	–	1
Disposals	(24)	–	(24)
Retained profit for the year	–	6	6
At 31 December 2004	25	16	41

All figures in £ millions	2004 Operating profit	2004 Total net assets	2003 Operating profit	2003 Total net assets
Business sectors				
Pearson Education	1	5	1	4
FT Group	14	33	7	30
Continuing operations	15	38	8	34
Discontinued operations	2	3	2	24
	17	41	10	58
Geographical markets supplied and location of net assets/(liabilities)				
United Kingdom	9	19	10	20
Continental Europe	1	13	2	39
North America	4	(1)	(3)	(7)
Rest of world	1	7	1	6
Continuing operations	15	38	10	58
Discontinued operations	2	3	–	–
	17	41	10	58

14 Associates *continued*

All figures in £ millions	2004	2003
Reconciliation to retained profit		
Operating profit of associates (before goodwill amortisation)	17	17
Interest	1	1
Taxation	(3)	(5)
Dividends (including tax credits) from unlisted associates	(9)	(8)
Retained profit for the year	6	5

The aggregate of the Group's share in its associates is shown below:

All figures in £ millions	2004	2003
Sales	290	234
Fixed assets	22	24
Current assets	102	116
Liabilities due within one year	(75)	(70)
Liabilities due after one year or more	(8)	(12)
Net assets	41	58

15 Other fixed asset investments

All figures in £ millions	2004 Valuation	2004 Book value	2003 restated Valuation	2003 restated Book value
Unlisted other fixed asset investments	17	17	21	21

Note The valuations of unlisted investments are directors' valuations as at 31 December 2004. If realised at valuation there would be an estimated liability for taxation of £nil (2003: £nil). Other fixed asset investments have been restated for the adoption of UITF 38 (see note 24).

All figures in £ millions	Total
Cost	
At 31 December 2003 restated	59
Exchange differences	(2)
Additions	1
Disposals	(25)
At 31 December 2004	33
Provision	
At 31 December 2003 restated	(38)
Exchange differences	1
Provision written back in the year	4
Disposals	17
At 31 December 2004	(16)
Net book value	
At 31 December 2003 restated	21
At 31 December 2004	17

16 Stocks

All figures in £ millions	2004	2003
Raw materials	27	24
Work in progress	36	30
Finished goods	261	270
Pre-publication costs	352	359
	676	683

Note The replacement cost of stocks is not materially different from book value.

17 Debtors

All figures in £ millions	2004	2003
Amounts falling due within one year		
Trade debtors	785	822
Associates	1	1
Joint ventures	1	–
Royalty advances	116	110
Other debtors	53	61
Prepayments and accrued income	45	38
	1,001	1,032
Amounts falling due after more than one year		
Royalty advances	70	83
Other debtors	31	16
Prepayments and accrued income	1	1
	102	100
	1,103	1,132

18 Cash at bank and in hand

	2004		2003	
All figures in £ millions	Group	Company	Group	Company
Cash, bank current accounts and overnight deposits	371	–	309	–
Certificates of deposit and commercial paper	5	–	8	–
Term bank deposits	237	87	244	75
	613	87	561	75

19 Financial instruments

A full discussion on treasury policy is given in the Financial Review on pages 10 to 12. Short-term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures as set out in table e.

a. Maturity of borrowings and other financial liabilities

The maturity profile of the Group's borrowings and other financial liabilities is shown below:

	2004		2003	
All figures in £ millions	Group	Company	Group	Company
Maturity of borrowings				
Short-term				
Bank loans and overdrafts	107	139	119	262
9.5% Sterling Bonds 2004	–	–	108	–
4.625% Euro Bonds 2004	–	–	348	348
Total due within one year, or on demand	107	139	575	610
Medium and long-term				
Loans or instalments thereof repayable:				
From one to two years	130	–	85	–
From two to five years	733	541	582	443
After five years not by instalments	849	640	680	680
Total due after more than one year	1,712	1,181	1,347	1,123
Total borrowings	1,819	1,320	1,922	1,733

Note At 31 December 2004 £61m (2003: £85m) of debt, including commercial paper, currently classified from two to five years would be repayable within one year if refinancing contracts were not in place. The short-term bank loans and overdrafts of the Group are lower than those of the company because of bank offset arrangements.

	2004			2003		
All figures in £ millions	Finance leases	Other financial liabilities	Total	Finance leases	Other financial liabilities	Total
Maturity of other financial liabilities						
Amounts falling due:						
In one year or less or on demand	2	4	6	3	5	8
In more than one year but not more than two years	1	19	20	1	14	15
In more than two years but not more than five years	1	9	10	1	7	8
In more than five years	–	25	25	–	21	21
	4	57	61	5	47	52

19 Financial instruments *continued*
b. Borrowings by instrument

All figures in £ millions	2004 Group	2004 Company	2003 Group	2003 Company
Unsecured				
9.5% Sterling Bonds 2004	–	–	108	–
4.625% Euro Bonds 2004	–	–	348	348
7.375% US Dollar notes 2006	130	–	139	–
6.125% Euro Bonds 2007	390	390	343	343
10.5% Sterling Bonds 2008	100	100	100	100
4.7% US Dollar Bonds 2009	181	–	–	–
7% Global Dollar Bonds 2011	260	260	278	278
7% Sterling Bonds 2014	226	226	235	235
5.7% US Dollar Bonds 2014	207	–	–	–
4.625% US Dollar notes 2018	156	156	167	167
Bank loans and overdrafts and commercial paper	169	188	204	262
Total borrowings	1,819	1,320	1,922	1,733

c. Undrawn committed borrowing facilities

All figures in £ millions	2004	2003
Expiring within one year	–	–
Expiring between one and two years	–	950
Expiring in more than two years	641	–
	641	950

Note All of the above committed borrowing facilities incur commitment fees at market rates. In addition to the above facilities, there are a number of short-term overdrafts that are utilised in the normal course of the business.

d. Currency and interest rate risk profile

	2004				
				Fixed rate borrowings	
	Borrowings £m	Total variable rate £m	Total fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed – years
Currency and interest rate risk profile of borrowings					
US dollar	1,332	830	502	5.8	2.4
Sterling	201	91	110	8.9	6.4
Euro	284	160	124	5.6	1.5
Other currencies	2	2	–	–	–
	1,819	1,083	736		

19 Financial instruments *continued*
d. Currency and interest rate risk profile continued

				2003	
				Fixed rate borrowings	
	Borrowings £m	Total variable rate £m	Total fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed – years
Currency and interest rate risk profile of borrowings					
US dollar	1,427	864	563	5.9	3.2
Sterling	201	61	140	8.0	9.0
Euro	292	166	126	5.3	1.7
Other currencies	2	2	–	–	–
	1,922	1,093	829		

Note The figures shown in the tables above take into account interest rate, currency swaps and forward rate contracts entered into by the Group. Variable rate borrowings bear interest at rates based on relevant national LIBOR equivalents.

			2004
All figures in £ millions	Other financial liabilities	Total fixed rate	Total no interest paid
Currency and interest rate risk profile of other financial liabilities			
US dollar	40	10	30
Sterling	8	3	5
Euro	11	–	11
Other currencies	2	1	1
	61	14	47

Note The US dollar fixed rate liability is fixed for 7 years at a rate of 6.3%. The sterling fixed rate liability is fixed for 2 years at a rate of 6.9%. The other currencies fixed rate liability is fixed for 3 years at a rate of 5.0%.

			2003
All figures in £ millions	Other financial liabilities	Total fixed rate	Total no interest paid
Currency and interest rate risk profile of other financial liabilities			
US dollar	35	4	31
Sterling	5	1	4
Euro	12	–	12
	52	5	47

19 Financial instruments *continued*
d. Currency and interest rate risk profile continued

All figures in £ millions	US dollar	Sterling	Euro	Other currencies	Total
					2004
Currency and interest rate risk profile of financial assets					
Cash at bank and in hand	170	52	72	77	371
Short-term deposits	7	89	125	21	242
Other financial assets	33	12	3	1	49
	210	153	200	99	662
Fixed rate	5	3	–	1	9
Floating rate	189	140	195	95	619
No interest received	16	10	5	3	34
	210	153	200	99	662

Note The US dollar fixed rate asset is fixed for 11 years at a rate of 8.2%. The sterling fixed rate asset is fixed for 5 years at a rate of 7.0%. The other currencies fixed rate asset is fixed for 7 years at a rate of 2.0%.

All figures in £ millions	US dollar	Sterling	Euro	Other currencies	Total
					2003
Currency and interest rate risk profile of financial assets					
Cash at bank and in hand	150	54	40	65	309
Short-term deposits	112	20	104	16	252
Other financial assets	44	7	7	1	59
	306	81	151	82	620
Fixed rate	6	2	–	–	8
Floating rate	259	72	144	78	553
No interest received	41	7	7	4	59
	306	81	151	82	620

19 Financial instruments *continued*

e. Currency exposures The table below shows the extent to which Group companies have monetary assets and liabilities in currencies other than their local currency.

All figures in £ millions	2004 Net foreign monetary assets/(liabilities) US dollar	Sterling	Euro	Other currencies	Total
Functional currency of entity					
US dollar	–	1	–	5	6
Sterling	(6)	–	9	3	6
Euro	–	–	–	–	–
Other currencies	20	(1)	–	–	19
	14	–	9	8	31

All figures in £ millions	2003 Net foreign monetary assets/(liabilities) US dollar	Sterling	Euro	Other currencies	Total
Functional currency of entity					
US dollar	–	3	–	6	9
Sterling	20	–	7	6	33
Euro	–	–	–	5	5
Other currencies	5	(8)	5	–	2
	25	(5)	12	17	49

19 Financial instruments *continued*

f. Fair values of financial assets and financial liabilities

The table below shows the book value and the fair value of the Group's financial assets and financial liabilities:

All figures in £ millions	2004 Book value	2004 Fair value	2003 Book value	2003 Fair value
Primary financial instruments held or issued to finance the Group's operations				
Other financial assets	49	49	59	59
Other financial liabilities	(61)	(61)	(52)	(52)
Cash at bank and in hand	371	371	309	309
Short-term deposits	242	242	252	252
Short-term borrowings	(107)	(107)	(575)	(619)
Medium and long-term borrowings	(1,712)	(1,817)	(1,347)	(1,553)
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	–	23	–	(4)
Currency swaps	–	11	–	26

Note Other financial assets, other financial liabilities, cash at bank and in hand, short-term deposits and short-term borrowings: the fair value approximates to the carrying value due to the short maturity periods of these financial instruments. Medium and long-term borrowings: the fair value is based on market values or, where these are not available, on the quoted market prices of comparable debt issued by other companies. Interest rate swaps: the fair value of interest rate swaps is based on market values. At 31 December 2004 the notional principal value of these swaps was £2,824m (2003: £2,394m). Currency swaps: the fair value of these contracts is based on market values. At 31 December 2004 the Group had £368m (2003: £1,096m) of such contracts outstanding.

g. Hedges The Group's policy on hedges is explained on page 10. The table below shows the extent to which the Group has off-balance sheet (unrecognised) gains and losses in respect of financial instruments used as hedges at the beginning and end of the year. It also shows the amount of such gains and losses which have been included in the profit and loss account for the year and those gains and losses which are expected to be included in next year's or later profit and loss accounts.

All figures in £ millions	Unrecognised gains	Unrecognised losses	Unrecognised total net gains/(losses)
Gains and losses on hedges at 31 December 2003	82	(60)	22
Gains and losses arising in previous years that were recognised in 2004	(19)	–	(19)
Gains and losses arising before 31 December 2003 that were not recognised in 2004	63	(60)	3
Gains and losses arising in 2004 that were not recognised in 2004	10	21	31
Unrecognised gains and losses on hedges at 31 December 2004	73	(39)	34
Of which:			
Gains and losses expected to be recognised in 2005	1	(2)	(1)
Gains and losses expected to be recognised in 2006 or later	72	(37)	35

20 Other creditors

All figures in £ millions	2004	2003
Amounts falling due within one year		
Trade creditors	349	407
Taxation	91	55
Social security and other taxes	14	4
Other creditors	75	85
Accruals and deferred income	512	456
Obligations under finance leases	2	3
Dividends	125	119
	1,168	1,129
Amounts falling due after more than one year		
Other creditors	37	34
Accruals and deferred income	21	9
Obligations under finance leases	2	2
	60	45

21 Deferred taxation

All figures in £ millions	
Summary of movements	
At 31 December 2003	145
Exchange differences	(9)
Transfers	41
Net release in the year	(12)
At 31 December 2004	165

All figures in £ millions	2004	2003
Deferred taxation derives from		
Capital allowances	(31)	(21)
Tax losses carried forward	150	168
Taxation on unremitted overseas earnings	(2)	(4)
Other timing differences	48	2
	165	145
Deferred taxation not provided		
Relating to gains subject to roll-over relief	–	1

Note The Group has calculated deferred tax not provided on rolled over gains in 2004, taking into account the indexation allowance which would be deductible on a disposal of the asset into which the gain was rolled. The recovery of the deferred tax asset relating to tax losses carried forward is dependent on future taxable profits arising mainly in the US. The Group regularly reviews its projections of these future taxable profits to ensure that recoverability of the asset is still foreseeable.

22 Provisions for liabilities and charges

All figures in £ millions	Post-retirement	Deferred consideration	Integration	Reorganisations	Leases	Other	Total
At 31 December 2003	80	29	9	12	14	8	152
Exchange differences	(7)	(2)	(1)	(1)	(1)	–	(12)
Arising on acquisitions	1	(3)	–	–	–	–	(2)
Released	–	(2)	–	(1)	–	(1)	(4)
Provided	68	–	–	5	–	6	79
Utilised	(72)	(1)	(3)	(8)	(3)	(3)	(90)
At 31 December 2004	70	21	5	7	10	10	123

Note

a Post-retirement provisions are in respect of pensions, £19m (2003: £29m) and post-retirement medical benefits, £51m (2003: £51m).

b Integration. During the year, £3m of this balance has been utilised, primarily in relation to properties, severance and IT systems. The remaining provision should be utilised in the next two years.

c Reorganisations. £5m has been provided during the year and £8m utilised mainly in respect of redundancies.

d Lease commitments. These relate primarily to onerous lease contracts, acquired as part of the purchase of subsidiaries, which have various expiry dates up to 2010. The provision is based on current occupancy estimates.

23 Share capital

	Number of shares (000's)	£m
Ordinary shares of 25p each		
Authorised		
At 31 December 2004	1,182,000	296
Called up, allotted and fully paid		
At 31 December 2003	802,388	201
Issued under share option and employee share schemes	862	–
At 31 December 2004	803,250	201

Note The consideration received in respect of shares issued during the year was £4m (2003: £5m).

	When granted	Number of shares (000's)	Price (p)	Original subscription exercise period
Options outstanding at 31 December 2004				
Worldwide Save for Shares plans	1997	5	530	2004 – 05
	1998	46	687	2005 – 06
	1999	118	913 – 926	2004 – 07
	2000	52	1,277 – 1,481	2005 – 08
	2001	303	957 – 1,096	2004 – 09
	2002	474	696	2005 – 10
	2003	1,978	425 – 426	2006 – 11
	2004	878	495 – 518	2007 – 12
		3,854		

23 Share capital *continued*

	When granted	Number of shares (000's)	Price (p)	Original subscription exercise period
Discretionary share option plans	1995	116	487 – 545	1998 – 05
	1996	195	584 – 654	1999 – 06
	1997	943	677 – 758	2000 – 07
	1998	1,483	847 – 1,090	2001 – 08
	1999	2,950	1,081 – 1,922	2002 – 09
	2000	5,432	64 – 3,224	2000 – 10
	2001	11,206	822 – 1,421	2002 – 11
		22,325		

Note The subscription prices have been rounded up to the nearest whole penny. The figures include replacement options granted to employees of Dorling Kindersley and the Family Education Network following their acquisition. The discretionary share option plans include all options granted under the Pearson Executive Share Option Plans, the Pearson Reward Plan, the Pearson Special Share Option Plan and the Pearson Long Term Incentive Plan.

24 Reserves

All figures in £ millions	Share premium account	Profit and loss account
Summary of movements		
At 31 December 2003 restated	2,469	223
Exchange differences net of taxation	–	(176)
Premium on issue of equity shares	4	–
Loss retained for the year	–	(113)
Purchase of own shares	–	(10)
UITF 17 charge for the year	–	5
At 31 December 2004	2,473	(71)
Analysed as		
Joint ventures and associates		(63)
Group excluding joint ventures and associates		(8)

Note Cumulative goodwill relating to acquisitions made prior to 1998, which was deducted from reserves, amounts to £915m (2003: £961m). Included in exchange differences are exchange gains of £nil (2003: £74m) arising on borrowings denominated in, or swapped into, foreign currencies designated as hedges of net investments overseas.

Prior year adjustment

UITF Abstract 38 'Accounting for ESOP trusts' and the revision of UITF Abstract 17 'Employee share schemes' were issued on 15 December 2003 and these revisions have been applied for the first time in 2004. Under UITF 38 own shares held in treasury or through an ESOP trust are recorded at cost and shown as a deduction in arriving at shareholders' funds. Previously these shares were recorded at cost less provision for impairment and shown as a fixed asset investment with impairment charges being taken to the profit and loss account. Under the revised UITF 17, employee share scheme charges to the profit and loss account are now always calculated as the intrinsic value of the award and spread over the performance period. The intrinsic value is the difference between the fair value of shares at the date of grant and the amount paid by the employee to exercise the rights to those shares irrespective of the cost of shares purchased to fund the award.

24 Reserves *continued*

Prior year adjustment *continued*

The reclassification of own shares from fixed asset investments to equity has reduced net assets by £59m at 31 December 2003 (1 January 2003: £62m). The reversal of prior year impairments taken on the cost of shares held in trust (£37m) has been shown as a prior year adjustment in the statement of total recognised gains and losses. The amendment to UITF 17 in respect of the calculation of share scheme charges has had no material effect on the profit and loss account.

Included within own shares are shares held by the Pearson Employee Share Trust and Pearson plc Employee Share Ownership Trusts. Together they hold 6.9 million (2003: 7.5 million) Pearson plc ordinary shares which had a market value of £43m at 31 December 2004 (2003: £46m). These shares have been acquired by the trusts, using funds provided by Pearson plc, to meet obligations under various executive and employee option and restricted share plans. Under these plans the participants become entitled to shares after a specified number of years and subject to certain performance criteria being met. Pearson aims to hedge its liability under the plans by buying shares through the trusts to meet the anticipated future liability. Dividends on the shares held by the trusts have been waived. The amount of dividend waived on the ESOP shares was £2m (2003: £2m).

The Group operates a worldwide Save As You Earn scheme together with a similar scheme for US employees that allows the grant of share options at a discount to the market price of the option granted. The Group has made use of the exemption under UITF 17 not to recognise any compensation charge in respect of these options.

25 Acquisitions

All acquisitions have been consolidated applying acquisition accounting principles.

a. Acquisition of subsidiaries

All figures in £ millions	2004	2003
Tangible fixed assets	1	10
Stocks	2	–
Debtors	3	32
Creditors	(2)	(95)
Provisions	1	(4)
Deferred taxation	–	(15)
Net cash and short-term deposits acquired	–	34
	5	(38)
Equity minority interests	(7)	(8)
Net liabilities acquired at fair value	(2)	(46)
Fair value of consideration		
Cash	(33)	(87)
Deferred cash consideration	–	(24)
Costs provided for	(1)	–
Net prior year adjustments	3	–
Total consideration	(31)	(111)
Goodwill arising	33	157
Acquisition fair values		
Book value of net liabilities acquired	(3)	(32)
Fair value adjustments	1	(14)
Fair value to the Group	(2)	(46)

Note The fair value adjustments above relate to acquisitions made in both 2003 and 2004. They include adjustments to provisions and accruals and an adjustment to a pension scheme liability. The fair value adjustments relating to 2004 acquisitions are provisional and will be finalised in the 2005 financial statements.

b. Cash flow from acquisitions

All figures in £ millions	2004	2003
Cash – current year acquisitions	33	87
Deferred payments for prior year acquisitions and other items	2	7
Net cash outflow	35	94

26 Disposals

a. Disposal of subsidiaries

All figures in £ millions	2004	2003
Intangible fixed assets	–	(4)
Tangible fixed assets	–	(3)
Stocks	–	(2)
Debtors	(4)	(9)
Creditors	–	10
Net overdraft	1	1
Net assets disposed of	(3)	(7)
Proceeds received	2	1
Deferred consideration	–	2
Costs	(2)	(1)
Net prior year adjustments	–	1
Loss on sale	(3)	(4)

b. Cash flow from disposals

All figures in £ millions	2004	2003
Cash – current year disposals	2	1
Costs paid	(2)	(2)
Deferred receipts and payments from prior year disposals and other amounts	–	(3)
Net cash outflow	–	(4)

27 Notes to consolidated cash flow statement

All figures in £ millions	2004 Continuing	2004 Discontinued	2004 Total	2003 restated Continuing	2003 restated Discontinued	2003 restated Total
a. Reconciliation of operating profit to net cash inflow from operating activities						
Total operating profit	218	13	231	204	22	226
Share of operating profit of joint ventures and associates	(8)	(2)	(10)	2	(2)	–
Depreciation	95	7	102	104	7	111
Goodwill amortisation and impairment	215	9	224	251	6	257
Increase in stocks	(26)	(1)	(27)	(8)	–	(8)
Increase in debtors	(10)	(5)	(15)	(93)	(3)	(96)
Increase/(decrease) in creditors	47	3	50	(71)	3	(68)
Decrease in operating provisions	(15)	–	(15)	(20)	–	(20)
Other and non-cash items	(10)	–	(10)	(44)	1	(43)
Net cash inflow from operating activities	506	24	530	325	34	359
Dividends from joint ventures and associates	9	1	10	8	1	9
Purchase of tangible fixed assets	(118)	(7)	(125)	(94)	(11)	(105)
Capital element of finance leases	(2)	–	(2)	(3)	–	(3)
Sale of tangible fixed assets	4	–	4	8	–	8
Add back: cash received relating to acquired deferred income	–	–	–	42	–	42
Add back: non operating capital expenditure	1	–	1	2	–	2
Add back: integration costs	4	–	4	8	–	8
Operating cash flow	404	18	422	296	24	320
Operating tax paid	(43)	(12)	(55)	(11)	(23)	(34)
Operating finance charges	(88)	3	(85)	(79)	3	(76)
Operating free cash flow	273	9	282	206	4	210
Non operating tax received/(paid)	10	–	10	(10)	–	(10)
Integration costs	(4)	–	(4)	(8)	–	(8)
Total free cash flow	279	9	288	188	4	192
Dividends paid (including minorities)	(196)	(1)	(197)	(189)	(18)	(207)
Net movement of funds from operations	83	8	91	(1)	(14)	(15)
Acquisitions of businesses and investments	(45)	(1)	(46)	(108)	(3)	(111)
Disposals of businesses, investments and property	18	24	42	(4)	56	52
New equity	4	–	4	5	–	5
Purchase of own shares	(10)	–	(10)	(1)	–	(1)
Other non operating items	(1)	–	(1)	–	–	–
Net movement of funds	49	31	80	(109)	39	(70)
Exchange movements on net debt	78	(3)	75	104	13	117
Total movement in net debt	127	28	155	(5)	52	47

Note Operating cash flow, operating free cash flow and total free cash flow have been disclosed as they are part of Pearson's corporate and operating measures. Tax payments that can be clearly identified with disposals, integration and exchange differences taken to reserves are allocated as non operating tax payments. In 2003 cash received relating to acquired deferred income is an adjustment in Pearson's operating cash flow to match pre acquisition cash received with post acquisition revenue recognised following the acquisition of London Qualifications and more accurately reflect the substance of the transaction. A contra entry to this adjustment is included in 'Acquisitions of businesses and investments'.

27 Notes to consolidated cash flow statement *continued*

All figures in £ millions	Cash	Overdrafts	Sub-total	Short-term deposits	Debt due within one year	Debt due after one year	Finance leases	Total
b. Analysis of net debt								
At 31 December 2003	309	(23)	286	252	(552)	(1,347)	(5)	(1,366)
Exchange differences	(5)	2	(3)	(9)	37	50	–	75
Other non-cash items	–	–	–	–	–	–	(1)	(1)
Net cash flow	67	(37)	30	(1)	466	(415)	2	82
At 31 December 2004	371	(58)	313	242	(49)	(1,712)	(4)	(1,210)
At 31 December 2002	417	(77)	340	158	(172)	(1,734)	(7)	(1,415)
Exchange differences	6	31	37	9	(40)	111	–	117
Other non-cash items	–	–	–	–	(459)	458	(1)	(2)
Net cash flow	(114)	23	(91)	85	119	(182)	3	(66)
At 31 December 2003	309	(23)	286	252	(552)	(1,347)	(5)	(1,366)

Note Finance leases are included within other creditors in the balance sheet (see note 20).

All figures in £ millions	2004	2003
c. Reconciliation of net cash flow to movement in net debt		
Increase/(decrease) in cash in the year	30	(91)
(Increase)/decrease in net debt from management of liquid resources	(1)	85
Decrease/(increase) in net debt from other borrowings	51	(63)
Decrease in finance leases	2	3
Other non-cash items	(1)	(2)
Exchange differences	75	117
Movement in net debt in the year	156	49
Net debt at beginning of the year	(1,366)	(1,415)
Net debt at end of the year	(1,210)	(1,366)

28 Contingent liabilities

There are contingent Group and company 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.

29 Commitments under leases

At 31 December 2004 the Group had commitments under leases, other than finance leases, to make payments in 2005 as follows:

All figures in £ millions	Land and buildings	Other
For leases expiring		
In 2005	7	4
Between 2006 and 2009	22	15
Thereafter	67	–
	96	19

30 Related parties

Joint ventures and associates – Loans and equity advanced to joint ventures and associates during the year and at the balance sheet date are shown in notes 13 and 14. Amounts falling due from joint ventures and associates are set out in note 17. Dividends receivable from joint ventures and associates are set out in notes 13 and 14.

There were no other related party transactions in 2004.

31 Post balance sheet events

In December 2004, Pearson announced its intention to dispose of its 79% interest in Recoletos Grupo de Comunicaciòn, 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.

32 Company balance sheet as at 31 December 2004

All figures in £ millions	Note	2004	2003 restated
Fixed assets			
Investments: subsidiaries	33	7,134	6,343
		7,134	6,343
Current assets			
Debtors:			
Amounts due from subsidiaries – due within one year		674	1,394
Amounts due from subsidiaries – due after more than one year		288	944
Taxation		66	3
Other debtors		–	–
Cash at bank and in hand	18	87	75
		1,115	2,416
Creditors – amounts falling due within one year			
Short-term borrowing	19	(139)	(610)
Amounts due to subsidiaries		(1,815)	(2,860)
Other creditors		(2)	(1)
Accruals and deferred income		(11)	(16)
Dividends	8	(125)	(119)
		(2,092)	(3,606)
Net current liabilities		(977)	(1,190)
Total assets less current liabilities		6,157	5,153
Creditors – amounts falling due after more than one year			
Medium and long-term borrowing	19	(1,181)	(1,123)
Amounts due to subsidiaries		(440)	(234)
Provisions for liabilities and charges		(4)	(2)
		(1,625)	(1,359)
Net assets		4,532	3,794
Capital and reserves			
Called up share capital	23	201	201
Share premium account	33	2,473	2,469
Special reserve	33	397	397
Other reserves	33	26	17
Profit and loss account	33	1,435	710
Equity shareholders' funds		4,532	3,794

The 2003 comparatives have been restated for the adoption of UITF38 (see note 24).

The financial statements were approved by the board of directors on 27 February 2005 and signed on its behalf by

Dennis Stevenson, Chairman *Rona Fairhead, Chief Financial Officer*

33 Notes to the company balance sheet

All figures in £ millions

Investment in subsidiaries	
At 31 December 2003	6,343
Subscription for share capital in subsidiary	915
Provision for diminution in value	(100)
Revaluations	(24)
At 31 December 2004	7,134

Note Shares are stated at cost less provisions for diminution in value or directors' valuations.

All figures in £ millions	Share premium account	Special reserve	Other reserves	Profit and loss account	Total
Reserves					
Summary of movements					
At 31 December 2003	2,469	397	17	710	3,593
Exchange differences	–	–	–	(20)	(20)
Premium on issue of equity shares	4	–	–	–	4
Net amount received in respect of ESOP shares	–	–	9	–	9
Profit for the financial year	–	–	–	946	946
Dividends on equity shares	–	–	–	(201)	(201)
At 31 December 2004	2,473	397	26	1,435	4,331

Note The special reserve represents the cumulative effect of cancellation of the company's share premium account. As permitted by section 230(4) of the Companies Act 1985, only the Group's profit and loss account has been presented.

34 Principal subsidiaries and associates

	Country of incorporation or registration
Subsidiaries	
The principal operating subsidiaries are listed below. They operate mainly in the countries of incorporation or registration, the investments are in equity share capital and they are all 100% owned unless stated otherwise.	
Pearson Education	
Pearson Education Inc.	US
Pearson Education Ltd	England
NCS Pearson Inc.	US
FT Group	
The Financial Times Ltd	England
Financial Times Business Ltd	England
Interactive Data Corporation (61%)	US
Les Echos SA	France
Recoletos Grupo de Comunicación SA (79%) see note 31	Spain
The Penguin Group	
Penguin Group (USA) Inc.	US
The Penguin Publishing Co Ltd	England
Dorling Kindersley Holdings Ltd*	England

*Direct investment of Pearson plc.

	Country of incorporation or registration	Class of share	Beneficial interest %	Accounting year end
Associates				
FT Group				
The Economist Newspaper Ltd	England	Ord 5p	50	March
		'B' 5p	100	
		'A' 5p	Nil	
		Trust 5p	Nil	
FT-SE International Ltd	England	Ord £1	50	December