PEARSON PLC
Form 20-F
April 04, 2018
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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON APRIL 4, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from to

or

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report

Commission file number 1-16055

PEARSON PLC

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

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(Address of principal executive offices)

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London, England WC2R 0RL

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Each Exchange on Which Registered
*Ordinary Shares, 25p par value	New York Stock Exchange
American Depositary Shares, each Representing One Ordinary Share, 25p per Ordinary Share	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the SEC.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock at the close of the period covered by the annual report:

Ordinary Shares, 25p par value	802,053,752

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated file and large accelerated filer , in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

If an emerging growth company that prepares its financial statements in accordance with US GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing

US GAAP	International financial Reporting Standards as Issued by the International Accounting Standards Board	Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow: Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

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INTRODUCTION

In this Annual Report on Form 20-F (the Annual Report) references to Pearson , the Company or the Group are references to Pearson plc, its predecessors and its consolidated subsidiaries, except as the context otherwise requires. Ordinary Shares refer to the ordinary share capital of Pearson of par value 25p each. ADSs refer to American Depositary Shares which are Ordinary Shares deposited pursuant to the Second Amended and Restated Deposit Agreement dated August 15, 2014, amended and restated as of August 8, 2000 among Pearson, The Bank of New York Mellon as depositary (the Depositary) and owners and holders of ADSs (the Deposit Agreement). ADSs are represented by American Depositary Receipts (ADRs) delivered by the Depositary under the terms of the Deposit Agreement.

The Group has prepared the financial information contained in this Annual Report in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and in conformity with International Financial Reporting Standards as adopted by the European Union (EU). Unless otherwise indicated, any reference in this Annual Report to consolidated financial statements is to the consolidated financial statements and the related notes, included elsewhere in this Annual Report.

The Group publishes its consolidated financial statements in sterling. The Group has included, however, references to other currencies. In this Annual Report:

references to sterling , pounds , pence or £ are to the lawful currency of the United Kingdom,

references to euro or are to the euro, the lawful currency of the participating Member States in the Third Stage of the European Economic and Monetary Union of the Treaty Establishing the European Commission, and

references to US dollars , dollars , cents or $ are to the lawful currency of the United States.

For convenience and except where specified otherwise, the Group has translated some sterling figures into US dollars at the rate of £1.00 = $1.35, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2017. The Group does not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On February 28, 2018 the noon buying rate for sterling was £1.00 = $1.38

The Group currently consists of its education business, plus a 25% interest in the consumer publishing business Penguin Random House. See Item 4. Information on the Company Overview of operating divisions . The Pearson plc Consolidated Financial Statements are included in this report on pages F-1 to F-80. The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-81 to F-151.

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FORWARD-LOOKING STATEMENTS

You should not rely unduly on forward-looking statements in this Annual Report. This Annual Report, including the sections entitled Item 3. Key Information Risk Factors , Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects , contains forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), that relate to future events or the Group s future financial performance. In some cases, you can identify forward-looking statements by terms such as may , will , should , expect , intend , plan , anticipate , believe , estimate potential , continue or the negative of these terms or other comparable terminology. Examples of these forward-looking statements include, but are not limited to, statements regarding the following:

- operations and prospects,
- growth strategy,
- funding needs and financing resources,
- expected financial position,
- market risk,
- currency risk,
- US federal and state spending patterns,
- debt levels, and
- general market and economic conditions.

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the Group s or its industry s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. In evaluating them, you should consider various factors, including the risks outlined under Item 3. Key Information Risk Factors , which may cause actual events or industry results to differ materially from those expressed or implied by any forward-looking statement. Although the Group believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievements.

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PART I

ITEM 1. ***IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS***
Not applicable.

ITEM 2. ***OFFER STATISTICS AND EXPECTED TIMETABLE***
Not applicable.

ITEM 3. ***KEY INFORMATION***
Selected consolidated financial data

The table below shows selected consolidated financial data under IFRS as issued by the IASB and in conformity with IFRS as adopted by the EU. The selected consolidated income statement data for the years ended December 31, 2017, 2016 and 2015 and the selected consolidated balance sheet data as at December 31, 2017 and 2016 have been derived from the Group s audited consolidated financial statements included in Item 18. Financial Statements in this Annual Report.

On July 1, 2013 Penquin Random House was formed through the combination of Penguin, owned by Pearson, and Random House, owned by Bertelsmann SE & Co. KGaA (Bertelsmann). From that date, Pearson no longer controlled the Penguin Group of companies and accounted for its 47% associate interest in Penguin Random House on an equity basis.

On February 4, 2014, the Group completed the sale of the Mergermarket group. The Mergermarket business was classified as held for sale on the Group s balance sheet at December 31, 2013. The results of the Mergermarket business have been included in discontinued operations for all the years through to 2014.

On November 30, 2015, the Group completed the sale of The Financial Times to Nikkei Inc. The results of The Financial Times have been included in discontinued operations for all years through to 2014 and for the 11 months to November 30, 2015.

On October 16, 2015, the Group completed the sale of its 50% stake in The Economist Group. The share of profit after tax from the associate interest in the Economist Group has been included in discontinued operations for all years through to 2014 and for the period until October 16, 2015.

On October 5, 2017 the Group completed the sale of a 22% share in Penguin Random House to Bertelsmann, retaining a 25% share. The Group also received recapitalization dividends in 2017, with an additional amount due in 2018. The Group accounts for its remaining 25% associate interest in Penguin Random House on an equity basis.

On May 5, 2017, the Group announced that it was undertaking a strategic review of its US K-12 courseware business. On February 23, 2018 the Group announced that it was in discussions with potential buyers regarding a disposal of the US K-12 courseware business. The US K-12 business was classified as held for sale on the Group s balance sheet as at December 31, 2017.

On August 16, 2017 the Group completed the sale of its test preparation business in China (GEDU) to Puxin Education.

On November 27, 2017 the Group announced that it had agreed to the sale of Wall Street English (WSE) to a consortium consisting of funds affiliated with Baring Private Equity Asia and CITIC Capital. Consequently WSE was classified as held for sale on the Group s balance sheet as at December 31, 2017. The disposal completed on March 15, 2018.

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The selected consolidated financial information should be read in conjunction with Item 5. Operating and Financial Review and Prospects and the Group s consolidated financial statements and the related notes appearing elsewhere in this Annual Report. The information provided below is not necessarily indicative of the results that may be expected from future operations.

For convenience, the Group has translated the 2017 amounts into US dollars at the rate of £1.00 = $1.35, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2017.

	Year Ended December 31					
	2017	2017	2016	2015	2014	2013
	$	£	£	£	£	£
	(In millions, except for per share amounts)					
Consolidated Income Statement data						
Sales	6,093	4,513	4,552	4,468	4,540	4,728
Operating profit/(loss)	609	451	(2,497)	(404)	348	431
Profit/(loss) after taxation from continuing operations	551	408	(2,335)	(352)	199	270
Profit/(loss) for the financial year	551	408	(2,335)	823	470	539
Consolidated Earnings data per share						
Basic earnings/(loss) per equity share(1)	67.4¢	49.9p	(286.8)p	101.2p	58.1p	66.6p
Diluted earnings/(loss) per equity share(2)	67.4¢	49.9p	(286.8)p	101.2p	58.0p	66.5p
Basic earnings/(loss) from continuing operations per equity share(1)	67.4¢	49.9p	(286.8)p	(43.3)p	24.7p	33.3p
Diluted earnings/(loss) from continuing operations per equity share(2)	67.4¢	49.9p	(286.8)p	(43.3)p	24.6p	33.3p
Dividends per ordinary share	22.9¢	17.0p	52.0p	52.0p	51.0p	48.0p
Consolidated Balance Sheet data at period end						
Total assets (non-current assets plus current assets)	10,648	7,888	10,066	11,635	11,397	10,931
Net assets	5,428	4,021	4,348	6,418	5,985	5,706
Long-term obligations(3)	(2,244)	(1,662)	(3,794)	(3,310)	(3,225)	(2,829)
Capital stock	270	200	205	205	205	205
Number of equity shares outstanding (millions of ordinary shares)	802	802	822	821	820	819

Notes:

(1) Basic earnings per equity share is based on profit for the financial period and the weighted average number of ordinary shares in issue during the period.

(2) Diluted earnings per equity share is based on diluted earnings for the financial period and the diluted weighted average number of ordinary shares in issue during the period. Diluted earnings comprise earnings adjusted for the tax benefit on the conversion of share options by employees and the weighted average number of ordinary shares adjusted for the dilutive effect of share options. There is no dilution in 2015 and 2016 due to there being a loss from continuing operations.

(3) Long-term obligations comprise any liabilities with a maturity of more than one year, including medium and long-term borrowings, derivative financial instruments, pension obligations and deferred income tax liabilities.

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Dividend information

The Group pays dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. The board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. The board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders approval at the annual general meeting. At the Group s annual general meeting on May 4, 2018 shareholders will be asked to approve a final dividend of 12.0p per ordinary share for the year ended December 31, 2017.

The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in The City of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2017 fiscal year will be paid on May 11, 2018 (subject to shareholder approval).

Fiscal year	Interim	Final	Total	Interim	Final	Total
	(Pence per ordinary share)			(Cents per ordinary share)		
2017	5.0	12.0	17.0	6.8	16.2*	23.0*
2016	18.0	34.0	52.0	23.6	43.8	67.4
2015	18.0	34.0	52.0	27.8	49.0	76.8
2014	17.0	34.0	51.0	27.6	51.5	79.1
2013	16.0	32.0	48.0	25.4	54.0	79.4

* As the 2017 final dividend had not been paid by the filing date, the dividend has been translated into cents using the noon buying rate for sterling as at December 31, 2017.

Future dividends will be dependent on the Group s future earnings, financial condition and cash flow, as well as other factors affecting the Group. The dividend was rebased in 2017 to reflect portfolio changes, increased product investment, and the outlook for 2017.

Exchange rate information

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in The City of New York on each day during a monthly period and on the last day of each month during an annual period. On December 31, 2017 the noon buying rate for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes for sterling was £1.00 = $1.35. On February 28, 2018 the noon buying rate for sterling was £1.00 = $1.38.

Month	High	Low
February 2018	$ 1.43	$ 1.35
January 2018	$ 1.42	$ 1.38
December 2017	$ 1.35	$ 1.33
November 2017	$ 1.35	$ 1.31
October 2017	$ 1.33	$ 1.31
September 2017	$ 1.36	$ 1.30

Year Ended December 31	Average rate
2017	$ 1.30
2016	$ 1.34
2015	$ 1.53
2014	$ 1.65
2013	$ 1.57

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Risk Factors

You should carefully consider the risk factors described below, as well as the other information included in the rest of this document. The Group s business, financial condition or results from operations could be materially adversely affected by any or all of these risks, or by other risks that it presently cannot identify.

The pace and scope of the Group s business transformation initiatives increase the execution risk that benefits may not be fully realized, costs of these changes may increase, or that its business as usual activities do not perform in line with expectations.

Business transformation and change initiatives in support of the Group s strategic goals to accelerate its digital transition and to simplify its business will continue throughout 2018. The pace and scope of change increases the risk that not all these changes will deliver within anticipated timeframes, or that the costs of these changes may increase. In addition, as a result of the increased pressure of transformational change, business as usual activities may not perform in line with plans or the level of customer service may not meet expectations. In parallel with the business transformation, as the Group responds to the digital revolution and shift from a product to a services business, it will continue to look at opportunities to develop business models and further refine organization structures. Resistance to change could restrict the organization from making the necessary changes to the business model.

Risk related to data quality and integrity may lead to noncompliance with legal and other requirements which could damage the Group s business.

Unavailability of timely, complete and accurate data limits informed decision-making and increases risk of non-compliance with legal, regulatory and reporting requirements. Business change and transformation success is dependent on migration of a significant number of datasets.

Global economy and cyclical market factors may adversely impact the Group s financial performance.

With the continued pressure and uncertainty in the worldwide economies, there remains a risk of a weakening in trading conditions, which could adversely impact future financial performance. The effect of continued deterioration or lack of recovery in the global economy will vary across different businesses and will depend on the depth, length and severity of any economic downturn. The education market can be affected by cyclical factors, which may lead to a reduction in demand for the Group s products and services.

Failure to successfully invest in and deliver the right products and services and respond to competitive threats could result in lower than expected revenues and profits.

A common trend facing all the Group s businesses is the digitization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration brings the need for change in product and content distribution, consumers perception of value and the publisher s position between consumers, retailers and authors.

This is a highly competitive market that is subject to rapid change. The Group faces competitive threats both from large media players and from smaller businesses, online and mobile portals and operators in the digital arena that provide alternative sources of content. New distribution channels, e.g. digital format, the internet, online retailers, growing delivery platforms (e.g., e-readers or tablets), pose both threats and opportunities to traditional publishing business models, potentially impacting both sales volumes and pricing.

Students are seeking cheaper sources of content, e.g. second hand and rental copies, online discounters, file sharing and use of pirated copies. This change in behavior puts downward pressure on textbook prices in major markets, and this could adversely impact the Group s results.

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If the Group does not adapt rapidly to these changes, it may lose business to faster and more agile competitors, who increasingly are non-traditional competitors, making their identification all the more difficult. The Group may be required to invest significant resources to further adapt to the changing competitive environment.

Changes in government policy and/or regulations have the potential to affect the Group s business model and/or decisions across all markets.

The Group s educational services and assessment businesses may be adversely affected by changes in government funding resulting from either trends that are beyond the Group s direct control, such as general economic conditions, changes in government educational funding, programs, policy decisions, legislation and/or changes in the procurement process, or the Group s failure to successfully deliver previous contracts.

The results and growth of the Group s US educational services and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. While the US tax reform bill that was signed into law by the President in December avoids the significant immediate impacts learners would have felt from earlier versions, concern remains about the potential impact that the cap on state and local tax (SALT) deductions, the tax on certain college endowments, and the disincentives for charitable contributions could have on education funding. State, local and municipal education funding pressures remain, competition from low price and disruptive new business models continues and open source is promoted as a way to keep costs down for customers. The current challenging environment could impact the Group s ability to collect on education-related debt.

State and local government leadership changes and resultant shifts in education policy can also affect the funding available for educational expenditure, which include the impact of educational reform. Similarly, changes in the government procurement process for textbooks, learning material and student tests, and vocational training programs can also affect the Group s markets. Political pressure on testing, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of the market in any given year. The full impact of the UK s pending departure from the EU is still unclear, however known potential risk areas include tax, data privacy and non-tariff exposure arising from cross-border transactions.

There are multiple competing demands for educational funds and there is no guarantee that new courseware or testing or training programs will be funded, or that the Group will win or retain this business.

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

The Group is subject to global and local anti-trust and competition law and although it is committed to conducting business in compliance with local and international laws, there is a risk that management, employees or representatives may act in a way that violates applicable anti-trust or competition laws. As a result, there is a risk of litigation and regulatory proceedings in the countries in which the Group operates. These legal proceedings could result in greater scrutiny of the Group s operations in other countries for anti-competitive behavior and, in the worst case, incur a substantial financial cost. This would also have an adverse impact on the Group s reputation.

If the Group does not adequately protect its intellectual property and proprietary rights, its competitive position and results may be adversely affected and its ability to grow limited.

The Group s products and services largely comprise intellectual property delivered through a variety of print and digital media, online software applications and platforms. The Group relies on trademark, patent, copyright and other intellectual property laws to establish and protect its proprietary rights in these products and services.

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The Group s intellectual property rights (IPR) in brands and content historically its core assets are generally well established in key markets. As technology has become an increasingly critical component of the Group s business strategy, it has also been steadily increasing investment in its patent program to expand its protection of high value inventions in the US. The Group s forward-looking IP strategy also includes plans to increase its global patent footprint in key markets outside the US. However, the Group also conducts business in other countries where its protection efforts have been limited or inconsistent and the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect future growth. Where the Group has registered or otherwise established its IPR, it cannot guarantee that such rights will provide competitive advantages due to: the challenges and costs of monitoring and enforcement in jurisdictions where competition may be intense; the limited and/or ineffective IPR protection and enforcement mechanisms available to it in many countries; the potential that its IPR may lapse, be invalidated, circumvented, challenged, or abandoned, or that it may otherwise lose the ability to assert its intellectual property rights against others. Moreover, despite trademark, brand and copyright protection, third parties may copy, infringe or otherwise profit from the Group s proprietary rights without its authorization. The loss or diminution in value of these proprietary rights or the Group s intellectual property could have a material adverse effect on the Group s business and financial performance.

A control breakdown or service failure in the Group s school assessment and qualification business could result in financial loss and reputational damage.

The Group s professional services and assessment businesses involves complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. The Group s financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed or face increased competitive pressures.

There are inherent risks associated with the Group s assessment and qualification businesses, both in the US and the UK. A service failure caused by a breakdown in testing and assessment processes could lead to a mis-grading of student tests and/or late delivery of test results to students and their schools. In either event the Group may be subject to legal claims, penalty charges under contracts, non-renewal of contracts and/or the suspension or withdrawal of its accreditation to conduct tests. A late delivery of qualification results could result in a potentially significant regulatory fine in addition to the contractual penalties. It is also possible that such events would result in adverse publicity, which may affect the Group s ability to retain existing contracts and/or obtain new customers.

The Group s investment in inherently riskier emerging markets may deliver returns that are lower than anticipated.

To take advantage of international growth opportunities and to reduce its reliance on the US and UK markets, the Group has invested in a number of emerging markets, some of which are inherently more risky than its traditional markets. Political, regulatory, economic and legal systems in emerging markets may be less predictable than in countries with more developed institutional structures. Political, regulatory, economic, currency, reputational and corporate governance and compliance risks (including fraud, bribery and corruption) as well as unmanaged expansion are all factors which could limit returns on investments made in these markets.

Failure to effectively manage risks associated with compliance to global and local anti-bribery and corruption (ABC) legislation could result in costly legal investigations and/or adversely impact the Group s reputation.

Although the Group is committed to conducting business in a legal and ethical manner in compliance with local and international statutory requirements and standards applicable to its business, there is a risk that the Group s management, employees or representatives may take actions that violate applicable laws and regulations prohibiting the making of improper payments for the purposes of obtaining or keeping business, including laws

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such as the US Foreign Corrupt Practices Act or the UK Bribery Act. Responding to investigations is costly and requires a significant amount of management s time and attention. In addition, investigations may adversely impact the Group s reputation, or lead to litigation and financial impacts.

Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations, could lead to goodwill and intangible asset impairments.

The Group periodically acquires and disposes of businesses to achieve its strategic objectives and will continue to consider both as means to pursue its strategic priorities, although it does not plan to make any significant acquisitions in the short term.

The Group operates in markets that are dependent on Information Technology (IT) systems and technological change. Failure to maintain and support customer facing services, systems, and platforms, including addressing quality issues and execution on time of new products and enhancements, could negatively impact the Group s revenues and reputation.

All the Group s businesses, to a greater or lesser extent, are dependent on information technology. It either provides software and/or internet services to its customers or uses complex IT systems and products to support its businesses activities, including customer-facing systems, back-office processing and infrastructure. The Group faces several technological risks associated with software product development and service delivery, information technology security (including virus and cyber-attacks), e-commerce, enterprise resource planning system implementation and upgrades. Although plans and procedures are in place to reduce such risks, from time to time the Group has experienced verifiable attacks on its systems by unauthorized parties. To date, such attacks have not resulted in any material damage, but the Group s businesses could be adversely affected if its systems and infrastructure experience a significant failure or interruption.

Failure to comply with data privacy regulations, or any unauthorized disclosure of personal information, could result in an incident or other issue potentially causing reputational damage to the Group s brands and financial loss.

Across the Group s businesses, it holds large volumes of personally identifiable information including that of employees, customers, students and citizens. Any perceived or actual unauthorized disclosure of personally identifiable information, whether through breach of the Group s network by an unauthorized party, employee theft, misuse or error or otherwise, could harm the Group s reputation, impair its ability to attract and retain its customers, or subject the Group to claims or litigation arising from damages suffered by individuals, and thereby harm its business and operational results. Failure to adequately protect personally identifiable information could potentially lead to penalties, significant remediation costs, reputational damage, cancellation of some existing contracts and difficulty in competing for future business. In addition, the Group could incur significant costs in complying with the relevant laws and regulations regarding the unauthorized disclosure of personal information. Changes to data privacy legislation must also be monitored and acted upon to ensure the Group remains in compliance across different markets.

Failure to prevent or detect a malicious attack on the Group s systems could result in a breach of confidentiality, integrity and/or availability of sensitive information.

Information security and cyber risk is continually evolving and comprises many complex external drivers: increasing customer demand to demonstrate a strong security posture, external compliance requirements, ongoing digital revolution, increasing use of the cloud and increasingly sophisticated attack strategies. Across its businesses, the Group holds large volumes of personally identifiable information including that of employees, customers, students and citizens, and other highly sensitive business critical data such as financial data, internal sensitive information, and intellectual property. Despite its implementation of security measures, individuals may try to gain unauthorized access to the Group s data in order to misappropriate such information for potentially

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fraudulent purposes. A significant breach can result in a devastating impact on the Group s reputation, customer loyalty, and student experience. Inability to prove due diligence can result in severe penalties and loss of business (existing and future).

The Group s reported earnings and cash flows may be adversely affected by changes in its pension costs and funding requirements.

The Group operates a number of pension plans throughout the world, the principal ones being in the UK and the US. The major plans are self-administered with the plans assets held independently of the Group. Regular valuations, conducted by independent qualified actuaries, are used to determine pension costs and funding requirements. As these assets are invested in the capital markets, which are often volatile, the plans may require additional funding from the Group, which could have an adverse impact on its results.

It is the Group s policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. The Group s earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in its defined benefit plans. The Group s greatest exposure relates to the UK defined benefit pension plan, which is valued every three years. Pension fund deficits may arise because of inadequate investment returns, increased member life expectancy, changes in actuarial assumptions and changes in pension regulations, including accounting rules and minimum funding requests. As of the end of 2017, the UK defined benefit plan continues to show a surplus on an IAS19 basis. The Group has committed to targeting a self-sufficient level of funding, resulting in the plan becoming largely independent of Pearson by the end of 2019. However the plan s ability to achieve and maintain this standard remains subject to market conditions, meaning that additional funding could still be required from the Group in the future.

Operational disruption to its business caused by third party providers, a major disaster and/or external threats could restrict the Group s ability to supply products and services to its customers.

Across all its businesses, the Group manages complex operational and logistical arrangements including distribution centers, data centers, and educational and office facilities, as well as relationships with third party print sites. It has also outsourced some support functions, including information technology, warehousing and logistics to third party providers. The failure of third parties to whom it has outsourced business functions could adversely affect its reputation or financial condition. Failure to recover from a major disaster, (e.g. fire, flood, etc.) at a key facility or the disruption of supply from a key third party vendor or partner (e.g. due to bankruptcy) could restrict the Group s ability to service its customers and meet the terms of its contractual relationships with both government agencies and commercial customers. Penalty clauses and/or the failure to retain these contracts at the end of the contract term could adversely impact future revenue growth.

A significant deterioration in the Group s profitability and/or cash flow caused by prolonged economic instability could reduce its liquidity and/or impair its financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate its banking covenants.

To the extent that worldwide economic conditions materially deteriorate, the Group s revenues, profitability and cash flows could be significantly reduced as customers would be unable to purchase products and services in the expected quantities and/or pay for them within normal agreed terms.

Disruption in capital markets or potential concerns about the Group s credit, such as downgrades or negative outlooks by the credit rating agencies, may mean that this capital may not be available on favorable terms or may not be available at all, although the reduced size of debt maturities mean that this risk is reduced.

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The Group generates a substantial proportion of its revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuations could adversely affect the Group s earnings and the strength of its balance sheet.

As with any international business, the Group s earnings can be materially affected by exchange rate movements. The main exposure is to movements in the US dollar to sterling exchange rate as approximately 60% of the Group s total revenue is generated in US dollars. The Group also has exposure to a range of other international currencies including emerging market currencies. Operating profit for 2017, translated at 2016 average rates, would have been £13m or 1% lower.

A lack of sufficient capital resources could adversely impact the Group s ability to operate.

If the global economy weakens further and/or the global financial markets collapse, the Group may not have access to or could lose its bank deposits or suffer a significant increase in customer bad debts. Lack of sufficient capital resources could significantly limit the Group s ability to take advantage of business and strategic opportunities. If replacement funds are not available, the Group may be required to delay, reduce the scope of, or eliminate material parts of its business strategy, including potential additional acquisitions or development of new products, services and technologies. The Group aims to mitigate this risk by enforcing limits and financing through strong counterparties.

Changes in tax law or perceptions on tax planning strategies may lead to higher effective tax rate or negative reputational impact.

Changes in corporate tax rates and/or other relevant tax laws in the UK, US or other jurisdictions could have a material impact on the Group s future reported tax rate and/or its future tax payments. The Group has been subject to audit by tax authorities. Although the Group believes its tax provision is reasonable, the final determination of its tax liability could be materially different from its historical income tax provisions, which could have a material effect on the Group s financial position, results of operations or cash flows.

The Group s tax strategy reflects its business strategy and the locations and financing needs of its operations. In common with many companies, the Group seeks to manage its tax affairs to protect value for its shareholders, in line with its broader fiduciary duties. The Group is committed to complying with all statutory obligations, to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy.

If the Group fails to attract, retain and develop appropriately skilled employees, it may limit its ability to achieve its strategic and operational goals and its business may be harmed.

The Group s success depends on the skill, experience and engagement of its employees. If it is unable to attract, retain and develop sufficiently experienced and capable staff, especially in technology, product development, sales and leadership, its business and financial results may suffer. When talented employees leave, the Group may have difficulty replacing those skills, and its business may suffer. There can be no assurance that the Group will be able to successfully retain and attract the skills that it needs.

Failure to adequately protect learners could result in significant harm to one or more.

Incidents may occur that could cause harm to learners. For example, where the Group has direct learner contact via online learning, or in its direct delivery businesses where it is operating, either itself or in partnership with schools, colleges, universities, testing and assessment centers. These incidents can cause harm to learners, which is something the Group takes extremely seriously, and could also have a negative financial, legal and reputational impact to the business.

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Failure to adequately protect the health, safety and well-being of the Group s employees, learners and other stakeholders could adversely impact the Group s reputation, profitability and future growth.

Although the Group has invested in global Health and Safety to safeguard the health, safety and wellbeing of its employees and other stakeholders, accidents or incidents could still occur due to unforeseen risks, causing injury or harm to individuals and impacting the Group s business operations. This has the potential to lead to criminal and civil litigation, business disruption leading to operational loss, reduction in profitability and impact on the Group s global reputation.

Failure to ensure security for the Group s staff, learners, assets and reputation, due to increasing numbers of and variety of local and global threats.

Pearson is a global business with locations in diverse, sometimes high-risk, locations worldwide. Although it has protective measures in place to secure its staff, learners and assets, the Group could still be impacted by external threats, such as flu pandemic, terrorist attacks, strikes, weather etc. The Group has seen an increase in these incidents in 2017 compared to 2016. Such occurrences could cause harm to individuals and/or disrupt business operations and have the potential to lead to operational loss, reduction in profitability and impact on the Group s global reputation.

Environmental, social and governance risks may also adversely impact the Group s business.

The Group considers environmental, social and governance risks (ESG) risks no differently to the way it manages any other business risk. These include ethical business behavior, compliance with UN Global Compact standards, environmental impact, people and editorial standards.

The Group s business depends on a strong brand, and any failure to maintain, protect and enhance its brand would hurt its ability to retain or expand its business.

Protecting the Pearson brand is critical to expanding the Group s business and will depend largely on its ability to maintain its customers trust in its solutions and in the quality and integrity of its products and services. If the Group does not successfully maintain a strong brand, its business could be harmed. Beyond protection, strengthening the Pearson brand will enable the Group to more effectively engage governments, administrators, teachers, learners and influencers.

ITEM 4. *INFORMATION ON THE COMPANY*

Pearson plc

Pearson plc, (Pearson or the Group) is an international education company with its principal operations in the education and consumer publishing markets. The Group delivers content, assessment and services, powered by technology, in order to drive personalized learning at scale. The Group creates and manages intellectual property, which it promotes and sells to its customers under well-known brand names. The Group delivers its content in a variety of forms and through a variety of channels, including books and online services. The Group offers services as well as content, from test creation, administration and processing to teacher development and school software. Though it operates in more than 70 countries around the world, today its largest markets are North America (65% of sales) and Europe (14% of sales).

Pearson was incorporated and registered in 1897 under the laws of England and Wales as a limited company and re-registered under the UK Companies Act as a public limited company in 1981. The Group conducts its operations primarily through its subsidiaries and other affiliates. Its principal executive offices are located at 80 Strand, London WC2R 0RL, United Kingdom (telephone: +44 20 7010 2000).

Overview

The Group consists of its worldwide education business plus a 25% interest in Penguin Random House.

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The Group is a leading provider of educational materials and learning technologies. It provides test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. It publishes across the curriculum and provides a range of education services including teacher development, educational software and system-wide solutions, and also owns and operates schools.

From January 1, 2014 the Group has been run as one global education company, organized around three geographical operating segments (North America, Core and Growth). Within each segment, the Group provides content, assessment and digital services to schools, colleges and universities, as well as professional and vocational education to learners.

The Group owns a 25% interest in Penguin Random House, which was formed on July 1, 2013, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House. Pearson originally owned a 47% stake in Penguin Random House, but sold 22% on October 5, 2017. The Group accounts for its remaining interest in Penguin Random House on an equity basis.

Recent developments

During January 2018, the Group executed market tenders to repurchase 250m of its 500m Euro 1.875% notes due May 2021 and 200m of its 500m Euro 1.375% notes due May 2025.

On February 16, 2018 the Group completed its £300m share buyback programme. In aggregate between October 18, 2017 and February 16, 2018, the Group repurchased 42,835,577 shares, including 21,839,676 repurchased since December 31, 2017 at a cost of £151m.

The Group s strategy

The Group s mission is to help people make progress in their lives through learning by being the trusted gateway to lifelong education. To deliver on this, the Group has three key strategic objectives:

- Grow market share through the digital transformation of the Group s courseware and assessment businesses;
- Invest to build the Group s businesses in structurally growing markets more quickly; and
- Simplify the company to be more efficient and deliver a much better experience for customers.

The Group will strive to leverage its core strengths in content and assessment, powered by services and technology, to deliver more effective teaching and personalised learning at scale. More detail on the three areas of focus is set out below.

Grow market share through digital transformation

The Group s digital transformation will help to satisfy changing learner consumption preferences and transition the assessment businesses to delivering fewer, smarter tests.

The single biggest opportunity to gain share through digital transformation is in US higher education courseware, which makes up 25% of revenues and 28% of product contribution. Profits have declined in this business over the last few years due to the business challenges, which will continue for the next couple of years. However the Group is making progress in shifting the business from an ownership to pay for use model, which is more viable and sustainable. The Group is achieving this by making the business significantly more digital, prioritising access to content over ownership and selling more product direct to consumers and institutions. The Group lowered the price of thousands of eBook rentals and launched a new print rental program. The Group is also focusing on an inclusive access model that provides both convenience and better value to students and is a direct-to-institution model which allows students to have materials for their course on day one.

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The Group is building a Global Learning Platform, which is a single, cloud-based platform that is highly scalable and more reliable than current platforms. It also facilitates faster innovation and supports a lifelong learning ecosystem for learners.

The Group knows that getting products to market more quickly and improving the agility of its businesses is vital. To that end, the Group is investing heavily in its businesses each year (over £700m each year) to drive innovation.

Invest in structural growth markets

This second strategic priority means the Group is investing and growing market share in its fastest growing businesses, such as:

- Professional Certifications and Licensure (Pearson VUE), which helps more than 450 credentialed owners around the world to develop, manage, deliver and grow their assessment programs.
- Virtual Schools (Connections Academy), which provide online education for around 78,000 K-12 students in the US.
- English Language Learning curriculum, instruction and assessment. This includes the Pearson Test of English, which offers a convenient way for people to demonstrate their English language proficiency as a gateway for other opportunities.
- Online Program Management, which helps colleges and universities take their programs online and improves access for learners who cannot attend a brick-and-mortar school.

Become a simpler and more efficient company

This third strategic priority involves phasing out dated systems and technologies, eliminating duplication and streamlining operations. The Group has removed more than £650m in costs since 2013, and has announced plans to eliminate a further £300m of costs by the end of 2019 by further simplifying technology, increasing the use of shared service centres and standardising processes. This will further reduce the Group s headcount by around 3000, improve the Group s operational efficiency and respond to the needs of the changing educational landscape.

While the Group is optimistic about the future and expects to make further progress in 2018, management continue to see challenging headwinds in US higher education courseware for the next few years. These challenges will be offset by growth in the Group s other businesses, the creation of further cost efficiencies and the strength of the Group s cash flow generation and balance sheet. Over time, these strategic actions, which increase the Group s scale, investment and expertise, will help people make progress in their lives through learning.

Operating divisions

Pearson is one of the leading providers of educational courseware, assessment and digital services. The Group provides test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. The Group publishes across the curriculum and provides a range of education services including teacher development, educational software and system-wide solutions.

The Group reports its performance in three segments: North America, Growth, and Core.

North America Segment

The North American business serves educators and students in the US and Canada from early education through elementary, middle and high schools and into higher education with a wide range of products and services: courseware including curriculum textbooks and other learning materials; assessments including test development and scoring; and services including the provision of online learning services. The Group has a leading position in each of these areas and a distinctive strategy of connecting those parts to support institutions and personalize learning. The largest market is North America, and across the US the business works with states, schools and colleges to help make education more effective, accessible and affordable for a diverse community of learners.

The North America school business offers early learning solutions that help educators and families teach fundamental math and literacy skills; elementary and secondary imprints publish leading school programs in reading, literature, math, science, and social studies; and digital instructional solutions for pre K-12, such as enVisionMATH and Miller-Levine Biology. The Connections Education business provides school management services and operates virtual and blended schools, serving around 78,000 students. On February 23, 2018 the Group announced that it was in discussions with potential buyers regarding a disposal of the US K-12 courseware business.

Testing plays an integral role in determining educator and student success and the business is the largest provider of educational assessment services in the US. It marks large-scale school examinations for the US federal government and more than 25 American states, scoring billions of machine-scorable test questions and evaluating more than 111 million essays, portfolios and open-ended test questions every year. Working with educators and education advocates, the business experts help to lead the development of Next-Generation Assessments that feature technology-enhanced items, performance-based assessments, and adaptive learning to foster problem-solvers and critical thinkers ready to compete in the global economy.

The business s solutions include learning assessments to help gauge how students learn, talent assessments to help growing companies develop their workforce, and clinical assessments to help psychologists and speech/language/ hearing/occupational and physical therapists diagnose and monitor patients.

The professional certification business, Pearson VUE (VUE), is a global leader in electronic testing for regulatory and certification boards, providing a full suite of services from test development to test delivery and data management. Pearson VUE offers exams through an extensive network of over 20,000 test centers across the globe, delivering the NCLEX exam for the National Council of State Boards of Nursing, the GMAT for the Graduate Management Admissions Council and numerous IT exams such as Cisco and CompTIA.

Pearson VUE also includes Certiport, the world-leader in IT performance-based exams delivered through a global network of academic test centers, and GED Testing Service, a joint venture with the American Council on Education to deliver a leading high school equivalency exam.

The North America Higher Education business offers learning services for students, colleges and universities in the US. It provides learning tools and technologies. Custom content and curriculum solutions offer educators the opportunity to tailor their programs based on the needs of students. The business also offers workforce education products and flexible workforce development solutions to fill the growing skills gap and increased demand for quality certification prep training.

Global digital user registrations of Mylab and related products are more than 13 million. The use of these digital homeworking platforms and integrated digital courseware provides a wealth of data and analytics to improve the performance of individual students. The business s advanced capabilities in data, analytics and adaptive learning, and its leading efficacy research, enable it to design a smart learning path for every student.

The demand for online learning is steadily rising and management see this area as one of the fastest growing parts of the market with demand expected to increase significantly over the next few years both in school and higher education.

In higher education, Pearson Online Services provides Online Program Management (OPM) services to institutions including Arizona State University, Rutgers University and Maryville University, partnering with them to provide fully online undergraduate and graduate degree courses.

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See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2017 compared to year ended December 31, 2016 Sales and operating profit by division North America for a discussion of developments during 2017 with respect to this segment.

Core Segment

The biggest Core markets are the UK, Australia, Italy, Germany, France and the Benelux countries. These are countries where the business works closely with educators and policy makers to improve learning through creating curriculum, designing assessments and developing digital learning systems. Additionally the business participates in many other markets, where it does not have scale itself, but collaborates with others who share its values and commitment to efficacy to maximize reach and impact.

In the UK school market, the business is the largest awarding organization offering academic and vocational qualifications that are globally recognized and benchmarked, with educational excellence rooted in names like Edexcel, BTEC and LCCI. Learners take the business s qualifications in many countries worldwide. Online marking technology marks over 94% of examination papers and the ResultsPlus service provides detailed analysis of every learner s examination results. Innovation is also being driven through digital products such as Bug Club and ActiveLearn, and through supporting skills for employability for progression in study, work and life.

The Higher Education business has seen good growth in OPM in both Australia and the UK, launching degree programs with Monash and Griffith Universities in Australia and Kings College London, University of Leeds and Manchester Metropolitan University in the UK.

In English, the Pearson Test of English is being used to support visa applications to the Australian Department of Immigration and Border Protection resulting in significant growth in volumes.

In the UK, the professional certification business, Pearson VUE, works with professional and government bodies including the Driving and Vehicle Standards Agency (DVSA), Chartered Institute of Management Accountants (CIMA) and the Construction Industry Training Board (CITB).

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2017 compared to year ended December 31, 2016 Sales and operating profit by division Core for a discussion of developments during 2017 with respect to this segment.

Growth Segment

The business aims to take educational products and services and apply them at scale in countries such as Brazil, South Africa, China, India and other fast-growing economies.

English language teaching and learning is one of the biggest opportunities in global education. The Group has refocused its activities in English in 2017, with agreements to dispose of its Chinese direct delivery businesses, Wall Street English and GEDU. The opportunity in English is now addressed in three main ways:

- Pearson ELT courseware (institutional English language courses including FOCUS, Poptropica English and Longman) is number two in the market. MyEnglish Lab and other English courseware registrations were over 860,000;

- Pearson Test of English (PTE), a computer-based test of English for study abroad and immigration; and the Brazilian adult English language school franchises including Wizard.

> In 2014, Pearson English released the Global Scale of English, the world s first common, global benchmark of English language learning. It measures English language progress on a numeric scale in a way that is consistent, granular and actionable for governments, corporates, academics, institutions and learners. The Scale has been created as the Open Standard for English that meets a global need.

The Brazilian business serves primary and secondary education with its sistemas or learning systems which include COC, Dom Bosco and NAME.

In South Africa, the business is the largest player in the school textbook market and runs a private university with 8,500 students enrolled in courses ranging from undergraduate degrees in IT and sociology, to business diplomas and Masters courses in psychology.

In February 2017, the Group announced the intention to explore potential partnerships for, or sale of, its English language learning business (WSE) and possible sale of its English test preparation business (GEDU). The Group completed the sale of GEDU to Puxin Education on August 16, 2017 and the sale of WSE to a consortium consisting of funds affiliated with Baring Private Equity Asia and CITIC Capital on March 15, 2018.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2017 compared to year ended December 31, 2016 Sales and operating profit by division Growth for a discussion of developments during 2017 with respect to this segment.

Penguin Random House

On July 1, 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% respectively. With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, the Group announced on February 24, 2017 that it had issued an exit notice regarding its 47% share in Penguin Random House to its JV partner Bertelsmann, with a view to selling its stake or recapitalizing the business and extracting a dividend. The Group completed the sale of 22% of Penguin Random House to Bertelsmann on October 5, 2017 and also received recapitalization dividends. The Group used the proceeds from this transaction to maintain a strong balance sheet; invest in its business; and return excess capital to shareholders, whilst retaining an investment grade credit rating.

Penguin Random House comprises the adult and children s fiction and nonfiction print and digital book publishing businesses of Penguin and Random House in the US, UK, Canada, Australia, New Zealand and India, Penguin s publishing activity in Asia and South Africa, as well as Dorling Kindersley worldwide, and Random House s companies in Spain, Mexico, Argentina, Uruguay, Columbia and Chile.

Penguin Random House employs more than 10,000 people globally across almost 250 editorially and creatively independent imprints and publishing houses that collectively publish more than 15,000 new titles annually. Its publishing list includes more than 70 Nobel Prize laureates and hundreds of the world s most widely read authors.

Penguin Random House sells directly to bookshops and through wholesalers. Retail bookshops normally maintain relationships with both publishers and wholesalers and use the channel that best serves the specific requirements of an order. It also sells through online retailers such as Amazon.com, as well as its own websites and direct to the customer via digital sales agents.

In 2017, the Group s share of Penguin Random House profit after tax was £71m.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2017 compared to year ended December 31, 2016 Sales and operating profit by division Penguin Random House for a discussion of developments during 2017 with respect to Penguin Random House.

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Operating cycles

The Group determines a normal operating cycle separately for each entity/cash generating unit with distinct economic characteristics. The normal operating cycle for each of the Group s education businesses is primarily based on the expected period over which the educational programs and titles will generate cash flows, and also takes account of the time it takes to produce the educational programs. The operating cycles for the courseware markets are typically longer than one year as described below.

Particularly for the North American businesses, there are well established cycles operating in the courseware market:

- The School courseware market is primarily driven by an adoption cycle in which major state education boards adopt programs and provide funding to schools for the purchase of these programs. There is an established and published adoption cycle with new adoptions taking place on average every 5 years for a particular subject. Once adopted, a program will typically sell over the course of the subsequent 5 years. The Company renews its pre-publication assets to meet the market adoption cycles. Therefore the operating cycle naturally follows the market cycle.

- The Higher Education courseware market has a similar pattern, with colleges and professors typically refreshing their courses and selecting revised programs on a regular basis, often in line with the release of new editions or new technology offerings. The Company renews its pre-publication assets to meet the typical demand for new editions of, or revisions to, educational programs. Analysis of historical data shows that the typical life cycle of Higher Education content is up to 5 years. Again the operating cycle mirrors the market cycle.

A development phase of typically 12 to 18 months for Higher Education and up to 24 months for School precedes the period during which the Company receives and delivers against orders for the products it has developed for the program.

The Core and Growth courseware markets operate in a similar way although often with less formal adoption processes.

The operating cycles in respect of the Group s professional content are more specialized in nature as they relate to educational or heavy reference products released into smaller markets (e.g. the financial training and IT sectors). Nevertheless, in these markets, there is still a regular cycle of product renewal, in line with demand which management monitor. Typically the life cycle is 5 years for Professional content. Elsewhere in the Group, operating cycles are typically less than one year.

Competition

The Group s businesses operate in highly competitive environments.

The Group competes with other publishers and creators of educational materials and services. These companies include publishers such as Cengage Learning, McGraw-Hill Education and Houghton Mifflin Harcourt.

In services, the Group competes with companies such as K-12 Inc in virtual schools and 2U Inc. in online program management, alongside smaller niche players that specialize in a particular academic discipline or focus on a learning technology.

In US assessment, the Group competes with other companies offering test development and administration including Educational Testing Service (ETS), American Institute for Research (AIR), Measured Progress Inc, and others. The Professional Certification business competes with Prometric globally and a number of other smaller players in local markets.

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In Core student assessment, the UK qualifications business competes with AQA and OCR in general qualifications and a number of smaller players in vocational qualifications.

In English language teaching (ELT) courseware, the Group competes with Oxford University Press, Macmillan and other publishers. In English language testing Pearson Test of English (PTE) competes with alternative tests including iELTS and TOEFL.

Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the student, organizations, school boards, educators and government officials making purchasing decisions.

Intellectual property

The Group s principal intellectual property assets consist of its:

- trademarks and other rights via its brands (including corporate and business unit brands, imprints, as well as product and service brands);
- copyrights for its textbook and related educational content and software code; and
- patents and trade secrets related to the innovative methods deployed in its key technologies.

The Group believes it has taken all reasonable legal steps to protect its key brands in its major markets and copyright in its content and has taken appropriate steps to develop a comprehensive patent program to ensure appropriate protection of emerging inventions that are critical to its new business strategies.

Raw materials

Paper remains the principal raw material used by the Group. The Group purchases most of its paper through its Global Sourcing department located in the United States. The Group has not experienced and does not anticipate difficulty in obtaining adequate supplies of paper for its operations, with sourcing available from numerous suppliers. While local prices fluctuate depending upon local market conditions, the Group has not experienced extensive volatility in fulfilling paper requirements. In the event of a sharp increase in paper prices, the Group has a number of alternatives to minimize the impact on its operating margins, including modifying the grades of paper used in production.

Government regulation

The manufacture of certain products in various markets is subject to governmental regulation relating to the discharge of materials into the environment. Operations are also subject to the risks and uncertainties attendant to doing business in numerous countries. Some of the countries in which the Group conducts these operations maintain controls on the repatriation of earnings and capital and restrict the means available for hedging potential currency fluctuation risks. The operations that are affected by these controls, however, are not material. Accordingly, these controls have not significantly affected the Group s international operations. Regulatory authorities may have enforcement powers that could have an impact. The Group believes, however, that in light of the nature of its business the risk of these sanctions does not represent a material threat.

Licenses, patents and contracts

The Group is not dependent upon any particular licenses, patents or new manufacturing processes that are material to its business or profitability. Likewise, it is not materially dependent upon any contracts with suppliers or customers, including contracts of an industrial, commercial or financial nature. Notwithstanding the foregoing, the Education business is dependent upon licensed rights since most textbooks and digital learning tools include

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content and/or software that is licensed to it by third parties (or assigned subject to royalty arrangements). In addition, some software products in various business lines, particularly those of its Clinical business, rely upon patents licensed from third parties.

Legal proceedings

The Group and its subsidiaries are from time to time the subject of legal proceedings incidental to the nature of its and their operations. These may include private litigation or arbitrations, governmental proceedings and investigations by regulatory bodies. The Group does not currently expect that the outcome of pending proceedings or investigations, either individually or in aggregate, will have a significant effect on its financial position or profitability nor have any such proceedings had such effect in the recent past. The Group is not aware of material proceedings in which any member of senior management or any of its affiliates is a party adverse to it or any of its subsidiaries or in respect of which any of those persons has a material interest adverse to it or any of its subsidiaries.

Organizational structure

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of its significant subsidiaries and associates as at December 31, 2017, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

Name	Country of incorporation/residence	Percentage interest/voting power
Pearson Education Inc.	United States (Delaware)	100%
Pearson Education Ltd.	England and Wales	100%
NCS Pearson Inc.	United States (Minnesota)	100%
Penguin Random House LLC.	United States (Delaware)	25%
Penguin Random House Ltd.	England and Wales	25%

During 2013, the Group disposed of its interest in the Penguin group of companies in exchange for a 47% interest in Penguin Random House. During 2017, the Group disposed of 22% of Penguin Random House, retaining a 25% interest.

During 2014, the Group disposed of its interest in the Mergermarket group of companies and its North America business disposed of its joint venture interests in Safari Books Online and CourseSmart.

In February 2014, the Group acquired Grupo Multi, Brazil s leading adult English language training company.

During 2015, the Group disposed of its interest in the FT Group including its 50% share of The Economist. The Financial Times sale was completed in November 2015 and the sale of the 50% share of The Economist Group was substantially completed in October 2015, with the remaining share sold in 2016. Also, in July 2015, the Group disposed of its interest in PowerSchool.

In May 2017, the Group announced that it was undertaking a strategic review of its US K-12 courseware business. In February 2018, the Group announced that it is in discussions with potential buyers regarding a disposal of the US K-12 courseware business.

In August 2017, the Group completed the sale of its test preparation in China (GEDU) to Puxin Education.

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In November 2017, the Group announced that it had agreed the sale of Wall Street English to a consortium consisting of funds affiliated with Baring Private Equity Asia and CITIC Capital. The disposal completed on March 15, 2018.

There were no material acquisitions in 2015, 2016 or 2017.

Property, plant and equipment

The Group s headquarters are located at leasehold premises in London, England. As at December 31, 2017 it owned or leased approximately 825 properties, including approximately 650 testing/teaching centers in over 55 countries worldwide, the majority of which are located in the United Kingdom, the United States and China. Approximately 80 properties, primarily testing/teaching centers in China, were disposed in March 2018 as part of the WSE disposal.

The properties owned and leased by the Group consist mainly of offices, distribution centers and computer testing/ teaching centers.

In some cases properties leased by the Group are then sublet to third parties. These properties are not included in the list below as they are not considered to be principal properties.

The vast majority of printing is carried out by third party suppliers. The Group operates a small digital print operation as part of its Pearson Assessment & Testing businesses which provides short-run and print-on-demand products, typically custom client applications.

The Group owns the following principal properties at December 31, 2017:

General use of property	Location	Area in square feet
Office	Iowa City, Iowa, USA	312,760
Warehouse/Office	Old Tappan, New Jersey, USA	212,041
Warehouse/Office	Cedar Rapids, Iowa, USA	205,000
Office	Southwark, London, UK	148,696
Office	Hadley, Massachusetts, USA	137,070
Printing	Owatonna, Minnesota, USA	128,000

The Group leased the following principal properties at December 31, 2017:

General use of property	Location	Area in square feet
Teaching Centre	Midrand, South Africa	351,754
Office	New York City, New York, USA	313,285
Office	Westminster, London, UK	282,923
Office	Boston, Massachusetts, USA	225,299
Office	Hoboken, New Jersey, USA	216,273
Office	Glenview, Illinois, USA	187,500
Office	Bloomington, Minnesota, USA	147,159
Warehouse/Office	Uttar Pradesh, India	145,041
Office	Chandler, Arizona, USA	135,460
Teaching Centre	Pretoria, South Africa	134,553
Warehouse/Office	Cedar Rapids, Iowa, USA	119,682
Office	Centennial, Colorado, USA	117,554
Office	San Antonio, Texas, USA	117,063
Warehouse	Naucalpan de Juarez, Mexico	113,638
Call Center/Office	Lawrence, Kansas, USA	105,000

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Capital Expenditures

See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources for description of the Company s capital expenditure.

ITEM 4A. ***UNRESOLVED STAFF COMMENTS***
The Company has not received, 180 days or more before the end of the 2017 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

ITEM 5. ***OPERATING AND FINANCIAL REVIEW AND PROSPECTS***
The following discussion and analysis is based on and should be read in conjunction with the consolidated financial statements, including the related notes, appearing elsewhere in this Annual Report. The financial statements have been prepared in accordance with IFRS as issued by the IASB and in conformity with IFRS as adopted by the EU.

Where this discussion refers to constant currency comparisons, these are estimated by re-calculating the current year results using the exchange rates prevailing for the prior period. The increase or reduction in the value calculated is the estimate of the impact of exchange rates. The Group believes this presentation provides a more useful period to period comparison as changes due solely to movements in exchange rates are eliminated.

General overview

Introduction

The Group s primary segments for management and reporting are geographical as follows: North America, comprising the courseware, assessment and services businesses in the US and Canada; Core, comprising the courseware, assessment and services businesses in more mature markets outside North America, including the UK, Australia and Italy; and Growth, comprising the courseware, assessment and services businesses in emerging markets, including Brazil, China, India and South Africa. In addition the Group separately reports on an equity basis the results from its 25% interest in Penguin Random House (PRH).

On August 16, 2017, the Group completed the sale of its test preparation business in China (GEDU) to Puxin Education, realizing a pre-tax profit on sale of £44m. On October 5, 2017, the Group also completed the sale of a 22% share in Penguin Random House to Bertelsmann, realizing a pre-tax profit on sale of £96m. Neither of these were significant enough to meet the definition of a discontinued business and their results to the date of disposal are included in continuing operations.

On November 27, 2017, the Group announced that it had agreed the sale of Wall Street English (WSE) to a consortium of funds affiliated with Baring Private Equity Asia and CITIC Capital. The sale of WSE was completed on March 15, 2018. On February 23, 2018, the Group announced that it had completed a strategic review of its US K-12 courseware business and was in discussion with potential buyers regarding a disposal of the business. Both of these businesses have been classified as held for sale on the balance sheet as at December 31, 2017.

On October 16, 2015, the Group substantially completed the sale of its 50% interest in the Economist to EXOR and The Economist Group and on November 30, 2015 the Group completed the sale of the Financial Times to Nikkei. The results of the Economist and the Financial Times are included in discontinued operations to the date of sale in 2015. Also, in July 2015, the Group disposed of its interest in PowerSchool to Vista Equity Partners for consideration of £222m realizing a pre-tax gain of £30m net of a £70m write down of related software assets. The PowerSchool business was not significant enough to meet the definition of a discontinued business and its results to the date of disposal are included in continuing operations.

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Sales from continuing operations decreased from £4,552m in 2016 to £4,513m in 2017, a decrease of £39m or 1%. This year on year decrease was reduced by currency movements, primarily the comparative strength of the US dollar relative to sterling during the year. In 2017 currency movements increased sales by £126m when compared to the equivalent figures at constant 2016 rates. When measured at 2016 constant exchange rates, the Group s sales declined by 4%. Part of the decrease is due to the absence of sales from businesses sold during the year and the Group estimates that after excluding the impact of disposals, sales declined by 2% at constant exchange rates. This decrease is primarily explained by declines in North America in higher education and school courseware, school assessment and in Learning Studio, a learning management system that is being retired.

In 2017, the Group reported an operating profit of £451m compared to an operating loss of £2,497m in 2016. The increase in profit of £2,948m mainly reflects a decrease in intangible charges. At the end of 2016, following trading in the final quarter of the year, the Group determined that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, the Group revised its strategic plans and estimates for future cash flows and, as a consequence, recognized an impairment to North American goodwill of £2,548m. Operating profit before these impairments increased by £400m from £51m in 2016 to £451m in 2017 mainly due to reduced restructuring costs and gains on the sale of businesses. After stripping out the effect of lower restructuring costs and gains on the sale of businesses, profits from trading declined by around £58m. This was primarily due to increased amortization charges, higher staff incentives and cost inflation, offset in part by the year on year benefit from restructuring savings.

In January 2016, the Group announced that it was embarking on a major restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. Total restructuring in 2016 amounted to £338m and included costs associated with headcount reductions, property rationalization and closure or exit from certain systems, platforms, products and supplier and customer relationships. A new restructuring program, the 2017-2019 restructuring program announced in May 2017, began in the second half of 2017 and is expected to drive further significant cost savings. The cost incurred on the 2017-2019 program in 2017 was £79m.

Operating profit in 2017 included a gain of £128m from the sale of businesses. The sale of the Group s test preparation business in China resulted in a pre-tax profit on sale of £44m, while the sale of a 22% share in PRH resulted in a pre-tax profit on sale of £96m. These were offset in part by net losses on other smaller disposals. The operating loss in 2016 included a £25m loss on the sale of businesses, primarily relating to the closure of the English language schools business in Germany and the sale of the Pearson English Business Solutions business.

Currency movements increased operating profit by £13m when compared to the equivalent figures translated at constant 2016 exchange rates.

The profit before taxation in 2017 of £421m compares to a loss before taxation of £2,557m in 2016. The increase in profit of £2,978m reflects the £2,948m increase in the reported operating profit identified above and a decrease in net finance costs of £30m, from £60m in 2016 to £30m in 2017. The Group s net interest payable increased from £59m in 2016 to £79m in 2017. The movement in net interest payable was due to higher US interest rates in 2017, additional charges relating to the early redemption of various bonds in 2017 and additional interest on tax provisions. Also included in net finance costs are net finance costs relating to employee benefit plans, foreign exchange and other gains and losses. In 2017 the total of these items was a profit of £49m compared to a loss of £1m in 2016. Income relating to employee benefit plans was £8m lower in 2017 than in 2016 reflecting the lower net surplus on pension balances at the beginning of 2017 compared to the beginning of 2016. Other gains and losses in 2017 and 2016 primarily relate to foreign exchange differences on un-hedged cash and cash equivalents, and other financial instruments.

Net cash generated from operations decreased to £462m in 2017 from £522m in 2016. This decrease is due to higher pension deficit payments, including £202m of payments made in 2017 relating to the PRH merger in

2013 and £25m relating to the sale of the FT Group in 2015. Pension deficit payments of £90m were made in connection with the FT Group in 2016. The increase in pension payments more than offset the benefits from tight working capital control and a reduction in cash spend relating to restructuring. Net interest paid at £69m in 2017 compares to £51m in 2016 and reflects the increased interest charge for the year. Tax paid in 2017 was £75m compared to £45m in 2016 with the increase largely being due to higher profits following lower restructuring charges taken in the year compared to 2016.

Net capital expenditure on property, plant and equipment after proceeds from sales was £82m in 2017 compared to £84m in 2016. Net capital expenditure on software intangibles reduced slightly from £157m in 2016 to £150m in 2017. The expenditure on both tangible and intangible capital includes the continuing investment in enabling function technology designed to lower administrative costs. There were no significant acquisitions in either 2017 or 2016 and the net cash outflow in respect of businesses and investments acquired was £14m in 2017 and £21m in 2016. The net cash inflow in respect of businesses and investments disposed was £430m in 2017 compared to £42m in 2016. In 2017 the cash received largely related to the PRH and GEDU disposals and in 2016 includes proceeds from the sale of the remaining stake in the Economist partially offset by costs paid in 2016 relating to the Financial Times sale in 2015. Dividends from joint ventures and associates increased from £131m in 2016 to £458m in 2017, primarily due to the £312m dividend received upon re-capitalization of the PRH business as part of the transaction which included the sale of the 22% of the Group s equity interest. Dividends paid of £318m in 2017 compares to £424m in 2016 reflecting the rebasing of the dividend in 2017 to reflect portfolio changes, increased investment and to align with profit expectations. Overall the Group s net borrowings decreased from £1,092m at the end of 2016 to £432m at the end of 2017. The reduction in net debt was due to the disposal proceeds and PRH re-capitalization dividends, offset in part by higher pension payments and cash returned to shareholders via the share buy-back program.

Outlook

In 2018, the Group expects to report adjusted operating profit of between £520m and £560m (including businesses held for sale.) Adjusted operating profit, which is the key financial measure used by management to evaluate the performance of the Group and allocate resources to business segments, excludes profits and losses on the sale of businesses, acquisition costs, amortization and impairment of acquired intangibles, the cost of major restructuring programs and the impact of US tax reform. Reconciliations of adjusted operating profit to statutory operating profit are included in note 2 within Item 18 Financial Statements. The base for 2018 adjusted operating profit guidance is 2017 adjusted operating profit of £510m, being £576m less the full year impacts of disposals made in 2017 (£44m) and less favorable exchange rates at December 31, 2017 (£22m). The Group expects to complete the disposal of WSE and its stake in Mexican joint-venture Utel in the first-half of 2018 and has announced that it has concluded the strategic review of its US K-12 courseware business and has classified the business as held for sale. WSE contributed £195m to 2017 sales and WSE and Utel contributed £5m to 2017 adjusted operating profit and £5m to statutory operating profit. US K-12 courseware is expected to contribute £385m to 2018 sales and around £11m to 2018 adjusted and statutory operating profit. The Group s 2018 guidance incorporates cost inflation of approximately £50m together with other operational factors and incentives of £30m. It expects incremental in-year benefits from the 2017-2019 restructuring program of £80m in 2018. Costs relating to major restructuring of approximately £90m will continue to be excluded from adjusted operating profit.

In North America, the Group expects US Higher Education courseware revenues to be flat to down by a mid-single digit percent as similar pressures seen in the last two years continue with lower college enrolments, increased use of open educational resources (OER) and attrition from growth in the secondary market driven by print rental, partially offset by growth in digital revenues, benefits from the Group s actions to promote access over ownership and a continued normalization of channel returns behavior. Evidence of a marginally slower rate of decline in US student enrolment together with slightly lower than expected attrition from OER in 2017, means that the Group is now planning for an underlying decline in demand of around 6% in US higher education courseware, slightly improved from its prior range of 6% to 7%. The Group expects stable testing revenues in North America student assessment as new contracts offset a continued contraction in revenue associated with the Partnership for Assessment of Readiness for College and Careers (PARCC) contract. Connections Education is expected to grow modestly as new partner school openings and good growth in enrolment is partially offset by in-sourcing of non-core services by some partners and contract exits. North American Online Program Management (OPM) is expected to see modest growth in revenue as investment in new programs begins to ramp up. Professional certification is expected to grow revenues in the mid-single digits benefiting from new contracts, including the nationwide contract with the Association of American Medical Colleges (AAMC).

In Core, the Group is expecting modest growth driven by its recent investments in student assessment and qualifications, which offer new products and services of considerably greater value, along with continued growth in Pearson Test of English (PTE) and OPM, with 10 new program launches in the UK, and growth in existing programs in Australia.

In Growth, The Group expects a modest increase in revenues, with growth in China in ELT products, PTE and in South Africa (due to improving enrolments in CTI), partially offset by declines in school courseware after a strong 2017. In Brazil, the Group expects revenue to increase modestly from growth in Wizard and school sistemas, partially offset by declines in government contracts. In India, PTE and MyPedia are expected to continue growing.

In Penguin Random House, the Group anticipates a broadly level publishing performance and an annual after-tax contribution of around £60m-£65m to ITS adjusted operating profit.

Sales information by segment

The following table shows sales information for each of the past three years by segment:

	Year Ended December 31		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
North America	2,929	2,981	2,940
Core	815	803	815
Growth	769	768	713
Total continuing operations	4,513	4,552	4,468
Discontinued operations			312
Total	4,513	4,552	4,780

Sales information by geographic market supplied

The following table shows sales information for each of the past three years by geographic region:

	Year Ended December 31		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Continuing operations			
European countries	646	648	667
North America	2,896	2,947	2,907
Asia Pacific	643	632	590
Other countries	328	325	304
Total continuing operations	4,513	4,552	4,468
Discontinued operations			
European countries			198
North America			74

Asia Pacific			35
Other countries			5
Total discontinued operations			312
Total	4,513	4,552	4,780

In the table above sales are allocated based on the country in which the customer is located.

Exchange rate fluctuations

The Group earns a significant proportion of its sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was £1:$1.30 in 2017, £1:$1.33 in 2016 and £1:$1.53 in 2015. Fluctuations in exchange rates can have a significant impact on the Group s reported sales and profits. In 2017, the Group generated 65% of its continuing sales in the US (2016: 65%; 2015: 63%). In 2017 the Group estimates that a five cent change in the average exchange rate between the US dollar and sterling would have had an impact on its reported earnings per share of approximately 2p and a five cent change in the closing exchange rate between the US dollar and sterling would have had an impact on shareholders funds of approximately £130m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for more information. The year-end US dollar rate for 2017 was £1:$1.35 compared to £1:$1.23 for 2016 and £1:$1.47 for 2015. The total impact on shareholders funds of foreign exchange translation was a loss of £313m in 2017 compared to a gain of £913m in 2016. These net movements are principally driven by movements in the US dollar as a significant portion of the Group s operations are in the US. However, in 2016, other currencies contributed to the foreign exchange gain as many of these other currencies also strengthened in comparison to sterling.

Critical accounting policies

The Group s consolidated financial statements, included in Item 18. Financial Statements , are prepared based on the accounting policies described in note 1 to the consolidated financial statements.

Certain of these accounting policies require the application of management judgment in selecting assumptions when making significant estimates about matters that are inherently uncertain. Management bases its estimates on historical experience and other assumptions that it believes are reasonable. These policies are described in note 1a (3) in Item 18. Financial Statements .

Results of operations

Year ended December 31, 2017 compared to year ended December 31, 2016

Consolidated results of operations

Sales

The Group s total sales decreased from £4,552m in 2016 to £4,513m in 2017, a decrease of £39m or 1%. The year on year movement was impacted by currency movements, primarily the comparative strength of the US dollar relative to sterling during the year. In 2017, currency movements increased sales by £126m when compared to the equivalent figures at constant 2016 rates. When measured at 2016 constant exchange rates, the Group s sales declined by 4%. Part of the decrease is due to the absence of sales from businesses sold during the year and the Group estimates that after excluding the impact of disposals, sales declined by 2% at constant exchange rates.

North America sales decreased by £52m or 2% from £2,981m in 2016 to £2,929m in 2017. The Group estimates that after excluding the impact of exchange and the contribution from businesses disposed in 2016 and 2017, North America sales declined by 4% in 2017 compared to 2016 due to declines in higher education and school courseware, school assessment and in Learning Studio, a learning management system that is being retired. North America continued to be the most significant source of the Group s sales and as a proportion of sales contributed 65% in both 2017 and 2016.

Core sales increased by £12m or 1% from £803m in 2016 to £815m in 2017. The Group estimates that after excluding the impact of exchange and the contribution from businesses disposed in 2016, Core sales were flat when comparing 2017 and 2016. Sales growth in OPM in the UK and Australia and growth in the Pearson Test of English were offset by declines in school, higher education, English courseware and student assessment and qualifications.

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Growth sales increased by £1m from £768m in 2016 to £769 in 2017. The Group estimates that after excluding the impact of exchange and the contribution from businesses disposed in 2017, Growth sales were flat when comparing 2017 and 2016. Increases in China, school courseware in South Africa and Pearson Test of English, were offset by declines in higher education services primarily due to lower enrolment at CTI, the university business in South Africa and business rationalization in India, and declines in Brazil.

Cost of goods sold and operating expenses

The following table summarizes the Group s cost of sales, net operating expenses and impairment of intangible assets:

	Year Ended December 31	
	2017	2016
	£m	£m
Cost of goods sold	2,066	2,093
Operating expenses		
Distribution costs	84	88
Selling, marketing and product development costs	896	908
Administrative and other expenses	1,207	1,240
Restructuring costs	79	329
Other income	(64)	(85)
Total net operating expenses	2,202	2,480
Other net (gains) and losses	(128)	25
Impairment of intangible assets		2,548
Total expenses	4,140	7,146

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and testing business and the cost of teaching and facilities in direct delivery businesses. The Group s cost of sales decreased by £27m, or 1%, from £2,093m in 2016, to £2,066m in 2017. The decrease largely reflects the decrease in sales but also includes some benefit from 2016 restructuring realized in 2017. Cost of sales was 45.8% of sales in 2017 compared to 46.0% in 2016.

Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs have decreased by £4m reflecting restructuring benefits and the continuing shift to digital and services products.

Selling, marketing and product development costs. The Group s selling, marketing and product development costs decreased by £12m or 1% from £908m in 2016 to £896m in 2017. As a percentage of sales, these costs were consistent at 19.9% in both 2016 and 2017.

Administrative and other expenses. The Group s administrative and other expenses decreased by £33m or 3% from £1,240m in 2016 to £1,207m in 2017. This decrease is largely due to the full impact of restructuring savings from the 2016 program flowing through in 2017, partly offset by continuing investment in technology.

Restructuring costs. In 2017, restructuring costs of £79m relate to the 2017-2019 restructuring program announced in May 2017 and include costs incurred in the second half of 2017 relating to this program. Total restructuring in 2016 amounted to £338m and included costs associated with headcount reductions, property rationalization and closure or exit from certain systems, platforms, products and supplier and customer relationships.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income, distribution commissions, investment income and gains on minor asset disposals together with the service fee income from Penguin Random House. Other operating income decreased to £64m in 2017 compared to £85m in 2016 mainly due to a decline in investment income following the disposal of investments and the absence of gains on asset disposals.

Other net gains and losses. Other net gains and losses in 2017 include the sale of the Group s test preparation business in China, which resulted in a pre-tax profit on sale of £44m, the sale of a 22% share in PRH, which resulted in a pre-tax profit on sale of £96m and net losses of £12m relating to other smaller disposals. Included in other gains and losses in 2016 are losses of £25m associated with the closure of the English language schools in Germany and the sale of the Pearson English Business Solutions business.

Impairment of intangible assets. At the end of 2016, following trading in the final quarter of the year, the Group determined that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, the Group revised its strategic plans and estimates for future cash flows and, as a consequence, recognized an impairment to North American goodwill of £2,548m. There were no impairments in 2017.

Share of results of joint ventures and associates

The contribution from the Group s joint ventures and associates decreased by £19m to £78m in 2017 from £97m in 2016. The decrease is mainly due to the sale of 22% of PRH resulting in a lower share of profits for the final quarter of the year, which is the peak selling season for consumer publishing businesses.

Operating profit/(loss)

In 2017, there was an operating profit of £451m compared to an operating loss on a continuing basis of £2,497m in 2016. The increase in profits primarily reflects the absence of impairment charges in 2017 (£2,548m in 2016), lower restructuring costs (£79m in 2017 compared to £338m in 2016) and gains from the sale of businesses (a gain of £128m in 2017 compared to a loss of £25m in 2016). After stripping out the absence of impairments, lower restructuring costs and gains on the sale of businesses, profits from trading declined by around £58m. This was primarily due to increased amortization charges, higher staff incentives and cost inflation, offset in part by the year on year benefit from restructuring savings.

Net finance costs

Net interest payable in 2017 was £79m, compared to £59m in 2016. The increase was primarily due to higher US interest rates in 2017, additional charges relating to the early redemption of various bonds during the year and some additional interest on tax provisions. In March and November 2017 respectively, the Group redeemed the $550m 6.25% Global dollar bonds and $300m 4.625% US dollar notes, both originally due in 2018. In addition, in August 2017, the Group redeemed $383m out of the $500m 3.75% US dollar notes due in 2022 and $406m out of the $500m 3.25% US dollar notes due in 2023. Although there is a charge in respect of the early redemptions, there are partial year savings as a result which have flowed through the income statement in the period since redemption, with the full annualized savings coming through in 2018.

Other net finance costs are finance income and costs on retirement benefits, foreign exchange, interest costs relating to acquisition consideration and other gains and losses on derivative financial instruments. The decrease in finance income in respect of employee benefit plans from £11m in 2016 to £3m in 2017 reflects the lower net surplus on pension balances at the beginning of 2017 compared to the beginning of 2016. Both the exchange gain in 2017 of £44m and the exchange loss in 2016 of £20m mainly relate to foreign exchange differences on unhedged cash and cash equivalents and other financial instruments.

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For a more detailed discussion of the Group s borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

Taxation

The total tax charge in 2017 of £13m represents 3.1% of pre-tax profit and compares to a benefit of £222m or 8.7% of pre-tax losses in 2016. The tax benefit in 2016 was mainly due to the release of deferred tax liabilities relating to tax deductible goodwill that was impaired. The low tax rate in 2017 is largely attributable to uncertain tax position releases due to the expiry of the relevant statutes of limitation. As a result of US tax reform, the reported tax charge includes a benefit from revaluation of deferred tax balances to the reduced federal rate of £5m and a repatriation tax charge of £6m. The Group continues to analyze the detail of the new legislation and this may result in revisions to these impacts. In addition to the impact on the reported tax charge, the Group s share of profit from associates was adversely impacted by £8m.

Discontinued operations

There were no discontinued operations in either 2016 or 2017.

Profit/(loss) for the year

The profit for the financial year in 2017 was £408m compared to a loss in 2016 of £2,335m. The loss in 2016 includes the impairment charge of £2,548m and higher restructuring charges, as noted above.

Earnings/(loss) per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 49.9p in 2017 compared to a loss per share of 286.8p in 2016 based on a weighted average number of shares in issue of 813.4m in 2017 and 814.8m in 2016. The increase in earnings per share was due to the increase in profit for 2017 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share was also 49.9p in 2017, with the dilutive effect of options being minimal. The diluted earnings per ordinary share in 2016 was the same as the basic earnings per ordinary share due to the loss for the year.

Exchange rate fluctuations

Currency movements increased sales by £126m and increased the operating profit by £13m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding the Group s management of exchange rate risks.

Sales and operating profit by segment

The following tables summarize the Group s sales and adjusted operating profit for each of the Group s business segments. Adjusted operating profit is included as it is the key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income or expenditure relating to acquisition and disposal transactions.

In the Group s adjusted operating profit it has excluded other net gains and losses, acquisition costs, amortization and impairment of acquired intangibles, the cost of major restructuring programs and the impact of

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US tax reform. The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. The Group does not believe these charges are relevant to an understanding of the underlying performance. Charges relating to acquired intangible assets are non-cash charges that reflect the historical expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within adjusted operating profit. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group. US tax reform in 2017 resulted in the revaluation of deferred tax balances. These revaluations have been excluded from adjusted earnings in 2017 due to their one-off nature.

A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

	Year Ended December 31, 2017						
£m	**North America**	**Core**	**Growth**	**PRH**	**Continuing**	**Discontinued**	**Total**
Sales	2,929	815	769		4,513		4,513
	65%	*18%*	*17%*		*100%*		
Total operating profit	242	27	28	154	451		451
Add back:							
Other net gains and losses	3		(35)	(96)	(128)		(128)
Acquisition costs							
Costs of major restructuring	60	11	8		79		79
Intangible charges	89	12	37	28	166		166
Impact of US tax reform				8	8		8
Adjusted operating profit: continuing operations	394	50	38	94	576		576
Adjusted operating profit: discontinued operations							
Total adjusted operating profit	394	50	38	94	576		576
	68%	*9%*	*7%*	*16%*	*100%*	*%*	*100%*

	Year Ended December 31, 2016						
£m	**North America**	**Core**	**Growth**	**PRH**	**Continuing**	**Discontinued**	**Total**
Sales	2,981	803	768		4,552		4,552
	65%	*18%*	*17%*		*100%*		
Total operating profit	(2,448)	(33)	(100)	84	(2,497)		(2,497)
Add back:							
Other net gains and losses	12	12	1		25		25
Acquisition costs							
Costs of major restructuring	172	62	95	9	338		338
Intangible charges	2,684	16	33	36	2,769		2,769
Adjusted operating profit: continuing operations	420	57	29	129	635		635
Adjusted operating profit: discontinued operations							
Total adjusted operating profit	420	57	29	129	635		635
	66%	*9%*	*5%*	*20%*	*100%*	*%*	*100%*

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North America

Sales in North America decreased by £52m or 2% from £2,981m in 2016 to £2,929m in 2017 and adjusted operating profit decreased by £26m, or 6%, from £420m in 2016 to £394m in 2017. The Group estimates that after excluding the impact of exchange and the contribution from businesses disposed in 2017 and 2016, North America sales declined by 4% in 2017 compared to 2016 primarily due to anticipated declines in higher education and school courseware, school assessment, and Learning Studio, a learning management system was retired.

There were no impairment charges in 2017. In 2016, the Group recognized an impairment to its US goodwill. At the end of 2016, following trading in the final quarter of the year, the Group determined that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, the Group revised its strategic plans and estimates for future cash flows and, as a consequence, recognized an impairment to North America goodwill of £2,548m. The 2017 North America results also include £60m in respect of the further major restructuring program announced during the year. 2016 results included £172m in respect of the previous major restructuring program and other losses on disposal mainly relating to the sale of the Pearson English Business Solutions business. Overall adjusted operating margins in the North America business declined in 2017 to 13.5% compared to 14.1% in 2016 due primarily to the impact of lower sales and other operating factors, partially offset by restructuring savings.

North America courseware

In school courseware, revenue declined 6% primarily due to sharp declines across Open Territory states in the second half of the year. This was partially offset by growth in adoption state revenues where strong performance in Texas Grades K-12 Spanish, Indiana Grades K-12 Science and South Carolina Grades 6-8 Science outweighed a lower adoption participation rate resulting from the decision not to compete for the California Grades K-8 English Language Arts (ELA) adoption with a core basal program. The new adoption participation rate fell to 61% in 2017 from 64% in 2016. The Group won an estimated 38% share of adoptions competed for (30% in 2016) and 29% of total new adoption expenditure of $365m (19% of $470m in 2016).

In higher education, total US college enrolments, as reported by the National Student Clearinghouse, fell 1.1%, with combined two-year public and four-year for-profit enrolments declining 2.5%. Enrolment weakness was particularly focused on part-time students where enrolment declined 3.3%, a bigger decline than in any of the last five years. Full-time enrolment grew 0.3%, the first expansion since late 2010. Net revenues at constant exchange rates in the higher education courseware business declined 3% during the year. It is estimated that around 2% of this decline was driven by lower enrolment; just over 1% from the adoption of Open Educational Resources (OER); around 5% from the secondary market, new initiatives and other factors, primarily the growth in print rental; offset by an around 3% benefit from institutional selling and the shift to digital and a 2% benefit in 2017 from lower returns by the channel.

In 2017, the Group s US higher education courseware market share, as reported by MPI, was in the upper half of the 40-41.5% range seen over the last five years. During 2017, the Group performed strongly in Statistics and Business Statistics, Biology and Accounting. Statistics benefited from the popularity of best in class learning application StatCrunch, Biology from the success of Campbell Biology 11e and MasteringBiology, and Accounting from the success of Miller-Nobles Horngren Accounting 11e and MyAccountingLab. This was offset by weakness in Information Technology, particularly in the for-profit sector, and continued softness in Developmental Mathematics.

Digital revenues grew 9% benefiting from continued growth in direct sales, favourable mix and selected price increases. Global digital registrations of MyLab and related products fell 1%. In North America, digital registrations fell 3% with good growth in Science, Business & Economics and Revel offset by lower overall enrolment and continued softness in Developmental Mathematics. Revel registrations grew more than 50%. Including stand-alone e-book registrations, total North American digital registrations were flat.

The actions announced in early 2017 to promote access over ownership were successfully implemented. The rental price of 2,000 eBook titles was reduced and resulted in eBook revenues increasing by more than 20% in response. The print rental program has had a successful start, with the addition of more than 90 further titles. In institutional courseware solutions, 210 institutions were signed up to the Group s Inclusive Access (Direct Digital Access, DDA) solutions, taking the total to over 500. During the year, over 1m course enrolments were delivered with inclusive access rising to around 5% of higher education revenue as more colleges and faculties see the benefit of this model.

North America assessment

In school assessment (State and National assessments), revenues at constant exchange rates declined by 9% due to previously announced contract losses. Colorado announced in June 2017 they will be leaving the Partnership for Assessment of Readiness for College and Careers (PARCC) consortium after the 2017/2018 school year. The Group won the subsequent bid to deliver ELA, Math, Science, and Social Studies for at least the next six years and also secured contract extensions in Virginia, Indiana, Arizona, Minnesota, Puerto Rico, Kentucky, New York City and North Carolina and for the National Assessment of Educational Progress.

The Group delivered 25.3m standardized online tests to K-12 students, up 7% from 2016. TestNav 8, the Group s next-generation online test platform, supported a peak load of 752,000 tests in a single day and provided 99.99% up time. AI scoring systems scored 35m responses to open-ended test items, around 30% of the total. Paper based standardized test volumes fell 7% to 20.4m.

In professional certification, revenues grew 2%. VUE global test volume rose 1% to over 15m. Revenues in North America were flat, with continued growth in certification for professional bodies, offset by modest declines in US teacher certification and the GED (General Educational Development, the high school equivalency test that is part of a joint venture with the American Council on Education), after strong performance last year, and by weakness in higher level IT certifications in the second half.

The Group signed over 50 new contracts in 2017 including a ten-year contract with the Association of American Medical Colleges (AAMC) to administer the MCAT, and contracts with ExxonMobil for five years and the Project Management Institute for four years. Its renewal rate on existing contracts continues to be over 95%. During the year, the Group renewed over 50 contracts including the American Board of Internal Medicine (ABIM) for nine years, Florida Teacher Licensure Assessments for five years, Pharmacy Technician Certification Board (PTCB) for five years, and The Institute of Internal Auditors for four years.

Clinical assessment sales increased 2% largely due to the effect of exchange and, at constant exchange rates, declined slightly on an absence of new major product introductions. Q-Interactive, the Group s digital solution for Clinical Assessment administration, saw continued strong growth in license sales with sub-test administrations up more than 33% over the same period last year.

North America services

Connections Education the virtual school business, served nearly 78,000 Full Time Equivalent students through full-time virtual and blended school programs, up 6% on last year. Two new full-time online, state-wide, partner schools opened for the 2017-2018 school year. Enrolment growth from new and existing schools was partially offset by the termination of a school partnership at the end of the 2016-2017 school year. Revenues grew modestly as enrolment growth was partially offset by increased in-sourcing, as some partners took non-core services in-house. Enrolment and revenue is expected to grow in 2018 as growth in existing school partnerships and the opening of new partner schools for the 2018-2019 school year offsets the termination of two further

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contracts and the in-sourcing of services by some customers. The 2017 Connections Academy Parent Satisfaction Survey showed strong results with 92% of families with students enrolled in full-time online partner schools stating they would recommend the schools to others and 95% agreeing that the curriculum is of high quality.

In Pearson Online Services, revenues declined primarily due to a decline in Learning Studio revenues as the product is being retired and the restructuring of smaller non-OPM contracts. Learning Studio declined by just over 50% to a revenue contribution of £11m in 2017. In OPM, revenues grew modestly as course enrolments increased strongly, up 8% to more than 341,000, boosted by good growth and program extensions at key partners including Arizona State University Online, Maryville University, Rutgers University and University of Alabama at Birmingham and from new partners, partially offset by contract exits.

The Group signed 45 multi-year programs in 2017 renewed 19 programs and launched 14 new programs at partners including Maryville University, Duquesne University and Ohio University. During the year it also agreed the termination of nine programs that were not mutually viable and did not renew a further six programs.

Brinker International, Inc. (NYSE: EAT), one of the world s leading casual dining restaurant companies and owner of Chili's® Grill & Bar and Maggiano s Little Italy®, with over 1,600 owned, operated and franchised restaurant locations, partnered with the Group to launch a comprehensive employer-education program Best You EDU that provides free educational opportunities to Brinker employees including foundational, GED and Associate Degree programs.

Core

Sales in Core markets increased by £12m, or 1%, from £803m in 2016 to £815m in 2017 while adjusted operating profit decreased by £7m, or 12%, from £57m in 2016 to £50m in 2017. At constant exchange and after excluding the contribution from disposals, Core sales were flat year on year and profits declined by 14%. Growth in OPM sales in the UK and Australia and growth in Pearson Test of English were offset by declines in school, higher education, English courseware and student assessment and qualifications.

The decline in adjusted operating profit was due to revenue mix, investment in new products and services and product line exits, partially offset by restructuring savings. The Group s statutory results in 2017 included restructuring costs of £11m. The statutory results in 2016 included restructuring costs of £62m and a loss on closure of Wall Street English Germany of £12m.

Core courseware

Courseware revenues declined 2%. In school, revenues declined in Australia, due to market contraction in the primary sector partly offset by slight growth in secondary, and declines in smaller markets in Europe and Africa. In higher education, revenues were down slightly due to declines in smaller markets, whilst in Australia and the UK an increase in direct to institution sales and a further shift to digital offset declines in traditional textbook sales. In English, there were declines in smaller markets.

Core assessments

In higher education and School assessment, revenues fell 4% primarily due to lower AS level, iGCSE and Apprenticeship volumes as a result of policy changes. BTEC revenues also declined modestly as revenues recognized in 2017 lagged the greater stability seen in registrations and billed revenue in the year. The Group successfully delivered the National Curriculum Test for 2017, marking 3.5m scripts, up slightly from 2016.

Clinical assessment grew 15% with revenues benefiting from strong growth in the new editions of the Wechsler Intelligence Scale for Children (WISC-V) and the Clinical Evaluation of Language Fundamentals (CELF-5).

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Pearson Test of English (PTE) saw continued strong growth in test volumes, which rose 84% from 2016, driven primarily by its use to support visa applications to the Australian Department of Immigration and Border Protection and good growth in New Zealand.

In Professional certification, revenues were flat as the impact of last year s renegotiated terms of the UK Driving Theory test for the DVSA was offset by growth from new and existing contracts.

Core services

In higher education services, revenues grew 17% and OPM revenues grew by 33%. In Australia, there was good growth due to the successful partnership with Monash University, and the continued success of the Graduate Diploma in Psychology. There are a total of around 9,300 course registrations across the seven programs in Australia (up from around 6,900 registrations in 2016). In the UK, five new programs were launched in addition to the two launched in 2016. UK course registrations grew to about 1,400, compared to about 370 in 2016.

English services grew, with strong growth in WSE Italy, due to the opening of new centers in 2015 and 2016, partially offset by declines in Japan.

Growth

Growth sales increased by £1m, to £769m in 2017 from £768m in 2016. Adjusted operating profit increased by £9m or 31% to £38m in 2017 from £29m in 2016. The Group estimates that, after excluding the impact of exchange rates and the incremental contribution from businesses disposed in 2017 and 2016, sales were flat year on year. Growth in China, school courseware in South Africa and Pearson Test of English was offset by declines in higher education services, primarily due to lower enrolment at CTI, business rationalization in India and declines in Brazil.

The adjusted operating profit increase reflected the benefits of prior year restructuring and the higher revenues in China, South Africa school courseware and PTE in India, partially offset by lower revenues in Brazil. The Group s statutory results included restructuring costs of £8m in 2017 and £95m in 2016.

On November 27, 2017, The Group announced that it had agreed the sale of Wall Street English to a consortium of funds affiliated with Baring Private Equity Asia and CITIC Capital. The sale was completed on March 15, 2018.

Growth courseware

Courseware revenues grew 7%, due to strong growth in school textbook sales in South Africa and English language courseware in China, partially offset by weakness in Brazil.

Growth assessments

Professional Certification grew strongly. Pearson Test of English saw over 30% growth in the volume of tests taken in India.

Growth services

In English services, growth in Wall Street English in China, due to new center openings, was more than offset by declines in Brazil due to macroeconomic pressures.

In school services, revenue fell, with student enrolment in the sistemas business in Brazil falling 14% primarily due to NAME, the public sistema, where the Group took the strategic decision to exit two thirds of its contracts with municipalities due to unattractive economic prospects, together with a reduction in student enrolments in the Dom Bosco private sistema due to challenging economic conditions. In India, Pearson MyPedia, an inside service sistema solution for schools, expanded to over 500 schools with approximately 157,000 learners.

In higher education services, revenues declined sharply due to a 14% fall in total student enrolment at CTI, the university business in South Africa, driven by the cumulative impact of economic factors in recent years, partially offset by improved new student enrolments in 2017, together with business exits in India.

Penguin Random House

The Group owns 25% of Penguin Random House, the first truly global consumer book publishing company. The Group owned 47% until October 5, 2017, when it completed the sale of 22% to Bertelsmann. The Group s share of Penguin Random House adjusted operating profits were £94m in 2017 compared to £129m in 2016, primarily due to the sale of part of the Group s share.

Penguin Random House performed in line with expectations with revenues up slightly year on year on rising audio sales, broadly stable print sales, and modest ongoing declines in demand for e-books, whilst the business benefitted from bestsellers by Dan Brown, R.J. Palacio, John Grisham, Jamie Oliver, and Dr. Seuss.

The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-81 to F-151.

Results of operations

Year ended December 31, 2016 compared to year ended December 31, 2015

Consolidated results of operations

Sales

The Group s total sales from continuing operations increased from £4,468m in 2015 to £4,552m in 2016, an increase of £84m or 2%. This year on year increase was the result of currency movements, primarily the strength of the US dollar relative to sterling during the year but also due to the strength of many of the other currencies that the Group is exposed to. In 2016, currency movements increased sales by £486m when compared to the equivalent figures at constant 2015 rates. When measured at 2015 constant exchange rates, the Group s sales declined by 9%. Part of the decrease was due to the absence of sales from businesses sold during the year and the Group estimates that after excluding the impact of disposals, sales declined by 8% at constant exchange rates.

North America sales increased by £41m or 1% from £2,940m to £2,981m, mainly due to the strengthening of the US dollar against sterling. The Group estimates that after excluding the impact of exchange and the contribution from businesses disposed in 2015 and 2016, North America sales declined by 10% in 2016 compared to 2015 due to a significant decline in US higher education courseware, together with anticipated declines in school assessment (due to previously announced contract losses) and in school courseware (due to a smaller adoption market and a lower participation rate). The declines were partially offset by growth in professional certification, virtual and blended schools and Online Program Management. North America continued to be the most significant source of the Group s sales and, as a proportion of sales contributed 65% in 2016 and 66% in 2015.

Core sales declined by £12m or 1% from £815m in 2015 to £803m in 2016. The Group estimates that after excluding the impact of exchange movements and the closure of Wall Street English Germany, the disposal of other sub-scale businesses and the transfer of some smaller businesses to the Growth segment, Core sales declined by 4%. The decline was primarily due to expected declines in vocational course registrations in UK schools and courseware. This was partially offset by strong growth in English assessments in Australia and OPM services in the UK and Australia.

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Growth sales increased by £55m or 8% from £713m in 2015 to £768 in 2016, almost all of the increase can be attributed to exchange movements, particularly the strength of key emerging market currencies compared to sterling. The Group estimates that after excluding the impact of exchange rates and the incremental contribution from businesses disposed in 2015 and 2016 and the transfer of smaller businesses from the Core segment, sales declined by 1%. In China, growth in adult English language learning and English courseware was partly offset by declines in English test preparation. In Brazil, revenues declined due to enrolment declines in the English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to the previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015.

Cost of goods sold and operating expenses

The following table summarizes the Group s cost of sales, net operating expenses and impairment of intangible assets:

	Year Ended December 31	
	2016	**2015**
	£m	**£m**
Cost of goods sold	2,093	1,981
Operating expenses		
Distribution costs	88	80
Selling, marketing and product development costs	908	895
Administrative and other expenses	1,240	1,195
Restructuring costs	329	35
Other income	(85)	(98)
Total net operating expenses	2,480	2,107
Other net gains and losses	25	(13)
Impairment of intangible assets	2,548	849
Total expenses	7,146	4,924

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and testing business and the cost of teaching and facilities in direct delivery businesses. The Group s cost of sales increased by £112m, or 6%, from £1,981m in 2015, to £2,093m in 2016. The increase reflects the increase in sales but also the mix of sales, as sales declines in higher margin products were offset by sales increases in lower margin products and services. Cost of sales was 46.0% of sales in 2016 compared to 44.3% in 2015.

Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs increased due to the effect of exchange movements. After taking out the impact of exchange movements, distribution costs decreased due to the continuing shift to digital and services products.

Selling, marketing and product development costs. The Group s selling, marketing and product development costs increased by £13m or 1% from £895m in 2015 to £908m in 2016. As a percentage of sales these costs were relatively consistent at 19.9% in 2016 and 20.0% in 2015, the slight decline reflecting benefits from restructuring.

Administrative and other expenses. The Group s administrative and other expenses increased by £45m or 4% from £1,195m in 2015 to £1,240m in 2016. The increase is largely due to exchange and increased investment in technology, which offset significant savings from restructuring in 2016.

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Restructuring costs. In January 2016, the Group announced that it was embarking on a major restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. The scope and costs of the 2016 program are significantly more than normal levels of restructuring. Total restructuring in 2016 for the Group s subsidiary companies amounted to £329m compared to £35m in 2015 and includes costs associated with headcount reductions, property rationalization and closure or exit from certain systems, platforms, products and supplier and customer relationships.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income, distribution commissions, investment income and gains on minor asset disposals together with the service fee income from Penguin Random House. Other operating income decreased to £85m in 2016 compared to £98m in 2015 mainly due to a reduction in Penguin Random House service fee income. This income decreased as Penguin Random House reduced its reliance on Pearson systems and processes and the fee of £16m in 2015 compares to a fee of £4m in 2016.

Other net gains and losses. Included in other gains and losses in 2016 of £25m are the losses associated with the closure of the Group s English language schools in Germany and the sale of the Pearson English Business Solutions business. Included in other net gains and losses in 2015 is the profit on sale of PowerSchool of £30m, net of £70m of write downs on related software assets and small losses on investments and costs relating to prior year disposals totaling £17m.

Impairment of intangible assets. At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, the Group revised its strategic plans and estimates of future cash flows and, as a consequence, made an impairment to North American goodwill of £2,548m. In 2015, following economic and market deterioration in its operations in emerging markets and ongoing cyclical and policy related pressures in its mature market operations, the Group impaired intangible assets in North America by £282m, in Core markets by £37m and in Growth markets by £530m.

Share of results of joint ventures and associates

The contribution from the Group s joint ventures and associates increased by £45m to £97m in 2016 from £52m in 2015. The increase was mainly due to Penguin Random House where there was an improved operating performance coupled with a reduced amortization charge. The intangibles amortization charge arises on intangibles recognized on the creation of Penguin Random House in 2013. The amortization profile recognizes more of the amortization in the early years with progressively less amortization in later years.

Operating loss

In 2016, there was an operating loss on a continuing basis of £2,497m compared to an operating loss on a continuing basis of £404m in 2015. The increase in loss is due to the impairment of intangible assets and the additional restructuring charges taken in 2016, as outlined above.

Net finance costs

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

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Other net finance costs comprise finance income and costs on retirement benefits, foreign exchange and other gains and losses. The increase in finance income in respect of employee benefit plans from £4m in 2015 to £11m in 2016 is a reflection of the more favorable funding position at the end of 2015. Both the exchange loss in 2016 of £12m and the exchange gain in 2015 of £13m mainly relate to foreign exchange differences on unhedged cash and cash equivalents and other financial instruments.

For a more detailed discussion of the Group s borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

Taxation

The total tax benefit in 2016 of £222m represents 8.7% of pre-tax losses and compares to a benefit of £81m or 18.7% of pre-tax losses in 2015. The increased benefit in 2016 is mainly due to the release of deferred tax liabilities relating to tax deductible goodwill that was impaired. The Group s overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 20% in 2016 and 20.25% in 2015).Although tax relief on the impairment of goodwill was significant in both 2015 and 2016, this tax relief only related to a portion of goodwill impaired and this has driven the overall tax rate below the effective statutory rates.

Discontinued operations

Profit from discontinued operations in 2015 of £1,175m includes the results to date of sale and the gain on sale of the Financial Times and the Economist. There were no discontinued operations in 2016.

Profit/(loss) for the year

The loss for the financial year in 2016 was £2,335m compared to a profit in 2015 of £823m. The loss in 2016 includes the impairment charge of £2,548m as noted above. The 2015 profit includes the gains on the sale of the Financial Times and Economist partly offset by significant impairment charges in the year.

Earnings/(loss) per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was a loss of 286.8p in 2016 compared to earnings of 101.2p in 2015 based on a weighted average number of shares in issue of 814.8m in 2016 and 813.3m in 2015. The decrease in earnings per share was due to the decrease in profit for 2016 described above and was not significantly affected by the movement in the weighted average number of shares.

A diluted earnings per ordinary share was not calculated in either 2015 or 2016 as a result of the losses from continuing operations.

Exchange rate fluctuations

Currency movements increased sales by £486m and increased the operating loss by £454m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding the Group s management of exchange rate risks.

Sales and operating profit by segment

The following tables summarizes the Group s sales and adjusted operating profit for each of its business segments. Adjusted operating profit is included as it is the key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income or expenditure relating to acquisition and disposal transactions.

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In its adjusted operating profit the Group has excluded other net gains and losses, acquisition costs, amortization and impairment of acquired intangibles and the cost of major restructuring. The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. The Group does not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within adjusted operating profit. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group. In 2016, the definition of adjusted operating profit was amended to exclude the cost of major restructuring activity. In January 2016, the Group announced that it was embarking on a restructuring program to simplify the business, reduce costs and position itself for growth in its major markets. The costs of the program in 2016 are significant enough to exclude from adjusted operating profit so as to better highlight the underlying performance.

A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

	Year Ended December 31, 2016						
£m	**North America**	**Core**	**Growth**	**PRH**	**Continuing**	**Discontinued**	**Total**
Sales	2,981	803	768		4,552		4,552
	65%	*18%*	*17%*		*100%*		
Total operating profit	(2,448)	(33)	(100)	84	(2,497)		(2,497)
Add back:							
Other net gains and losses	12	12	1		25		25
Acquisition costs							
Costs of major restructuring	172	62	95	9	338		338
Intangible charges	2,684	16	33	36	2,769		2,769
Adjusted operating profit: continuing operations	420	57	29	129	635		635
Adjusted operating profit: discontinued operations							
Total adjusted operating profit	420	57	29	129	635		635
	66%	*9%*	*5%*	*20%*	*100%*	*%*	*100%*

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£m	North America	Core	Growth	PRH	Continuing	Discontinued	Total
				Year Ended December 31, 2015			
Sales	2,940	815	713		4,468	312	4,780
	66%	*18%*	*16%*		*100%*		
Total operating profit	113	21	(586)	48	(404)	1,232	828
Add back:							
Other net gains and losses	(19)	5		1	(13)	(1,184)	(1,197)
Costs of major restructuring							
Acquisition costs							
Intangible charges	386	79	583	41	1,089	3	1,092
Adjusted operating profit: continuing operations	480	105	(3)	90	672		672
Adjusted operating profit: discontinued operations						51	51
Total adjusted operating profit	480	105	(3)	90	672	51	723
	66%	*15%*	*(0)%*	*12%*	*93%*	*7%*	*100%*

North America

North America sales increased by £41m or 1% from £2,940m to £2,981m and adjusted operating profit decreased by £60m, or 13%, from £480m in 2015 to £420m in 2016. The Group estimates that, after excluding the impact of exchange movements and the contribution from businesses disposed in 2015 and 2016, North America sales declined by 10% in 2016 compared to 2015. This decline was due to a significant decline in US higher education courseware, together with anticipated declines in school assessment (due to previously announced contract losses) and in school courseware (due to a smaller adoption market and a lower participation rate). These declines were partially offset by growth in professional certification, virtual and blended schools and Online Program Management.

In 2016, the Group recognized an impairment to its US goodwill. At the end of 2016, following trading in the final quarter of the year, the Group determined that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, the Group revised its strategic plans and estimates of future cash flows and, as a consequence, recognized an impairment to North America goodwill of £2,548m. In 2015, the Group recognized an impairment of £282m following ongoing cyclical and policy related pressures in its main US markets. Also in the results was the cost of the major restructuring program of £172m and other losses on disposal mainly relating to the sale of the Pearson English Business Solutions business. In 2015 the Group realized a gain on sale of PowerSchool of £30m, net of the write down of related software assets. In addition to the gain on PowerSchool there were also small losses on the sale and write down of smaller investments of £11m.

Overall adjusted operating margins in the North America business declined in 2016 to 14.1% compared to 16.3% in 2015 as cost savings from restructuring were more than offset by the margin impact of lower sales, particularly in higher education courseware.

North America courseware

In school courseware, revenue declined 10% with a smaller new adoption market and a lower participation rate, partially offset by good growth and market share gains in Open Territories resulting from new product launches. The Group s new adoption participation rate fell from over 90% in 2015 to 64% in 2016 due to its decision not to compete for the California Grades K-8 English Language Arts (ELA) adoption with a core basal

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program. It won an estimated 30% share of adoptions competed for (31% in 2015) and 19% of total new adoption expenditure of $470m (29% of $730m in 2015), driven by strong performance in Indiana Math and Social Studies and South Carolina Science and Social Studies. Sales in open territories grew strongly benefiting from the new MyPerspectives program in Grades 6 12 ELA, ReadyGen, Investigations 3.0, the extension of enVisionMATH to cover Grades 6 8 and growth in the digital reading intervention program, iLit.

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

During 2016, the Group performed strongly in Science and Business & Economics with key titles including: *Applying, Biochemistry: Concepts & Connections 1e*; Amerman, *Human Anatomy & Physiology 1e*; Marieb, *Human Anatomy & Physiology 10e*; Young, Freedman, *University Physics 14e* and Parkin, *Economics 12e*. Global digital registrations of MyLab and related products grew 2%. In North America, digital registrations grew 2% with good growth in Science, Business & Economics and Revel, partly offset by continued softness in Developmental Mathematics. Skill Builder Adaptive Practice, the in-house adaptive homework solution launched in over 60 titles in 2016. Faculty-generated studies indicate that the use of MyLab, Mastering and Revel programs, as part of a broader course redesign, can support improvements in student test scores and lower institutional cost. Findings from an efficacy study suggest that students in Developmental Mathematics courses who increased their number of homework and quiz attempts in MyMathLab-Developmental increased their odds of passing; and that users of MyLab Writing who complete seven topics or more increase their final exam scores by 14%. In another study at a mid-sized university in the Midwest, during the 2015 2016 academic year, students using My IT Lab were able to raise their exam scores by half a letter grade for every seven additional activities attempted. In institutional courseware solutions, the Group signed 148 large-scale, enterprise adoptions of direct digital access (DDA), where content is purchased via an upfront course fee and integrated with university IT systems. New signings in the year included University of Tennessee Knoxville and Kentucky State University.

North America assessment

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

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In professional certification, revenues grew 7% with VUE global test volumes up 3% to almost 15 million, boosted by continued growth in IT, professional, US teacher certification programs and strong growth in GED. The Group renewed its contracts with the Computing Technology Industry Association (CompTIA) for three years, the Florida Department of Business & Professional Regulation for five years, the American Register of Radiologic Technologists (ARRT) for seven years and a contract to administer insurance back office licensing services in North Carolina for five years.

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

North America services

Connections Education, the Group s virtual school business, served nearly 73,000 full-time equivalent students through full-time virtual and blended school programs, up 6% on last year. Connections revenues grew 8%. Five new full-time online, statewide, partner schools opened for the 2016 2017 school year in Arkansas, Washington, Colorado, Pennsylvania and New Mexico. The 2016 Connections Education Parent Satisfaction Survey showed strong results with 92% of families with students enrolled in full-time online partner schools stating that they would recommend the schools to others.

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

Core

Sales in Core markets decreased by £12m, or 1%, from £815m in 2015 to £803m in 2016 while adjusted operating profit decreased by £48m, or 46%, from £105m in 2015 to £57m in 2016. At constant exchange and after excluding the closure of Wall Street English Germany, the disposal of other sub-scale businesses and the transfer of some smaller businesses to the Growth segment, Core sales declined by 4% and profits by 51%. This decline was primarily due to expected declines in vocational course registrations in UK schools and courseware. This was partially offset by strong growth in English assessments in Australia and OPM services in the UK and Australia.

In its statutory results in 2016, the Group recognized restructuring costs of £62m and a loss on closure of Wall Street English Germany of £12m. In 2015, it recognized an impairment to its goodwill of £37m mainly related to the English language teaching businesses in Europe.

Core courseware

Courseware revenues declined 7%. School revenues declined in smaller markets in Europe and Africa, in Australia as the Group exited a number of sub-scale market segments and in the UK primary due to a smaller adoption cycle, partially offset by growth in secondary in the UK due to new product launches aligned with the Group s qualifications and the successful delivery of The Crunch food project in partnership with the Wellcome Trust. In higher education courseware, revenues declined in smaller markets, in Australia due to phasing and in the UK as the Group exited sub-scale market segments. In the UK, 2.1 million pupils are now using a Pearson

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digital service on ActiveLearn Primary, including Bug Club, up from 1.8 million a year ago. In a randomized control trial, where its impact was periodically assessed, Bug Club was shown to have made a highly statistically significant impact on pupils reading, vocabulary and spelling performance, with a greater positive impact in schools with a higher proportion of children receiving free school meals.

Core assessments

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

Clinical assessment grew 9% with Australian revenues benefiting from strong growth in the new edition of the WISC-V. At VUE, revenues declined 1% due to the initial impact of contract renewals. The Group was awarded contracts: to continue to administer the UK driving theory test for the UK DVSA for four years from September 2016; to continue to provide testing services to the Construction Industry Training Board for four years from April 2017; and to administer the UK Clinical Aptitude Test for five years from January 2017. In France, VUE was awarded a new licence by the Délégation à la Sécurité et à la Circulation Routières (DSCR) du Ministere de l Intérieur to be one of the providers administering the country s computer-based driving theory exam throughout France.

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

Core services

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

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

Growth

Growth sales increased by £55m, or 8%, to £768m in 2016 from £713m in 2015. Adjusted operating profit increased by £32m to a profit of £29m in 2016 from a loss of £3m in 2015. The Group estimates that after

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excluding the impact of exchange rate movements, the incremental contribution from businesses disposed in 2015 and 2016 and the transfer of smaller businesses from the Core segment, sales declined by 1%. In China, growth in adult English language learning and English courseware was partly offset by declines in English test preparation. In Brazil, revenues declined due to enrolment declines in the English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to the previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from June 30, 2015.

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

In its statutory results, the Group included restructuring costs of £95m in 2016. In 2015, reflecting the significant economic and market deterioration in the Group s operations in emerging markets, the Group wrote down the balance sheet value of its goodwill and intangibles for businesses in Growth markets by £530m. This represented impairments of £269m for Brazil, £181m for China, £58m for South Africa and £22m for other Growth markets.

In February 2017, the Group announced the intention to explore potential partnership for its English language learning business Wall Street English (WSE) and possible sale of its English test preparation business Global Education (GEDU).

Growth courseware

Courseware revenues grew 8%, due to strong growth in school textbook sales in South Africa and English language courseware in China, Argentina and Mexico partially offset by weakness in Brazil. The Group saw strong growth in registrations for MyEnglishLab boosted by new editions of key titles such as Speakout and Top Notch. Middle East school courseware declined as a result of macroeconomic pressure and lower purchases from key international school clients.

Growth services

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

In Brazil, student enrolment in the Group s sistemas business fell 9% due to attrition in NAME and Dom Bosco partially offset by new students at COC. Revenues grew slightly due to improved mix. Revenues in English language learning fell due to challenging economic conditions, partially offset by an increased footprint for the Group s leading brand in language learning, Wizard, where new school openings expanded the number of franchise schools by 7% to 2,392. At the Group s public sistema (NAME), an efficacy study suggested that, after controlling for all of the identified student and school level factors, grade 5 NAME students significantly outperformed comparison students by 28 points in mathematics equating to one level higher attainment in the state Prova Brasil assessment. In another study at the Group s largest private sistema (COC), students scored significantly higher than students in similar non-COC schools in Writing, natural sciences, humanities, language, and mathematics.

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

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

Penguin Random House

During both 2016 and 2015, the Group owned 47% of Penguin Random House the first truly global consumer book publishing company. The Group s share of Penguin Random House adjusted operating profits were £129m compared to £90m for 2015.

Penguin Random House delivered a strong profit performance in 2016 with continued net benefits from the merger integration. Revenues declined after a very strong performance in 2015, which was boosted by the success of multi-million sellers *Grey* and *The Girl on the Train*, due to the anticipated industry-wide decrease in ebook purchases following 2015 s industry-wide digital-terms changes.

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

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

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

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

With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, on February 24, 2017 the Group announced that it had issued an exit notice regarding its 47% stake in Penguin Random House to its JV partner Bertelsmann, with a view to selling its stake or recapitalizing the business and extracting a dividend. On October 5, 2017 the Group completed the sale of a 22% share in Penguin Random House to Bertelsmann, retaining a 25% share. The Group used the proceeds from this action to maintain a strong balance sheet; invest in its business; and return excess capital to shareholders whilst retaining an investment grade credit rating.

The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-81 to F-151.

Liquidity and capital resources

Cash flows and financing

Net cash generated from operations decreased by £60m (or 11%) to £462m in 2017 from £522m in 2016, primarily due to higher special pension contributions (£227m in 2017 compared to £90m in 2016) and exchange

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movements due to the strengthening of sterling against the US dollar, with some offset from lower spend on restructuring (£71m in 2017 v £167m in 2016). Net cash generated from operations increased by £4m (or 1%) to £522m in 2016 from £518m in 2015 reflecting lower cash incentive payments and tight working capital partially offset by restructuring spend and higher pension deficit payments.

Net interest paid increased by £18m (or 35%) to £69m in 2017 from £51m in 2016 reflecting higher US interest rates and premiums incurred on the early redemption of bonds and associated swaps, as the Group sought to increase the efficiency of its balance sheet. Net interest paid in 2016 was the same as 2015 at £51m and reflects the similar interest charge for the year after taking out the one-off release of accrued interest in 2015 following agreement of historical tax positions.

Capital expenditure on property, plant and equipment and software intangibles was £232m in 2017, £245m in 2016 and £247m in 2015. The expenditure in all years on both tangible and intangible capital is largely due to the continuing investment in enabling function technology, designed to lower administrative costs.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £11m in 2017, £15m in 2016 and £20m in 2015. There were no major acquisitions in either 2017, 2016 or 2015.

The sale of subsidiaries and associates produced a net cash inflow of £430m in 2017 compared to an outflow of £50m in 2016 and an inflow of £1,409m in 2015. The cash inflow in 2017 relates to the Group s sale of a 22% stake in Penguin Random House to Bertelsmann for £413m and the sale of its test preparation business in China for £54m, less the associated costs and cash disposed. There were no significant disposals of subsidiaries and associates in 2016, with the cash outflow relating primarily to the disposal of the FT Group in 2015. The cash inflow in 2015 relates to the proceeds on the sale of the *Financial Times* of £858m, the proceeds on the sale of The Economist Group of £377m and proceeds on the sale of PowerSchool £222m.

The cash outflow from financing of £1,759m in 2017 reflects the early redemption of various bonds (and their associated swaps) and the partial completion of a share buyback program, offset in part by a lower dividend. In March and November 2017 respectively, the Group redeemed $500m 6.25% Global dollar bonds and $300 4.625% US dollar notes, both originally due in 2018. In addition, in August 2017, the Group redeemed $383m out of the $500m 3.75% US dollar notes due in 2022 and $406m out of the 3.25% US dollar notes due in 2023. In July 2017, the Group announced its intention to buy back £300m worth of its own shares. As at the end of 2017, the Group had spent £149m under this share buy-back program. The cash outflow from financing of £697m in 2016 reflects a broadly flat dividend payment compared to 2015 and the repayment of a $350m US Dollar note. The cash outflow from financing of £364m in 2015 reflects a further 7% increase in the dividend, the repayment of a £300m Sterling bond, offset in part by the proceeds from the issue of a 500m Euro note.

Capital resources

The Group s borrowings fluctuate by season due to the effect of the school year on the working capital requirements in the educational materials business. Assuming no acquisitions or disposals, the Group s maximum level of net debt normally occurs in July, and its minimum level of net debt normally occurs in December. Based on a review of historical trends in working capital requirements and of forecast monthly balance sheets for the next 12 months, the Group believes that it has sufficient funds available for the Group s present requirements, with an appropriate level of headroom given its portfolio of businesses and current plans. The Group s ability to expand and grow its business in accordance with current plans and to meet long-term capital requirements beyond this 12-month period will depend on many factors, including the rate, if any, at which its cash flow changes and the availability of public and private debt and equity financing, including its ability to secure bank lines of credit. The Group cannot be certain that additional financing, if required, will be available on favorable terms, if at all.

At December 31, 2017, the Group s net debt was £432m compared to £1,092m at December 31, 2016 reflecting proceeds from disposals, offset in part by special pension contributions. Net debt is defined as all

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short-term, medium-term and long-term borrowing (including finance leases), less all cash, cash equivalents and liquid resources. Cash equivalents comprise short-term deposits with a maturity of up to 90 days, while liquid resources comprise short-term deposits with maturities of more than 90 days and other marketable instruments which are readily realizable and held on a short-term basis. Total Short-term, medium-term and long-term borrowing amounted to £1,085m at December 31, 2017, compared to £2,468m at December 31, 2016 reflecting the bonds repaid during the year.. At December 31, 2017, total cash and liquid resources were £645m, compared to £1,459m at December 31, 2016. This decrease reflects the utilization of cash to pay down long-term debt and create a more efficient balance sheet.

To ensure efficient use of the cash balances, in January 2018, the Group executed market tenders to repurchase 250m out of its 500m euro 1.875% notes due May 2021 and 200m out of its 500m euro 1.375% notes due May 2025.

Contractual obligations

The following table summarizes the maturity of the Group s borrowings, its obligations under non-cancelable leases, and pension funding obligations, exclusive of anticipated interest payments. Due to the variability of future interest payments, these have been excluded from the table below.

	At December 31, 2017				
	Total £m	**Less than one year £m**	**One to two years £m**	**Two to five years £m**	**After five years £m**
Gross borrowings:					
Bank loans, overdrafts and commercial paper	15	15			
Bonds	1,062			548	514
Finance lease obligations	8	4	3	1	
Operating lease obligations	1,201	156	139	307	599
UK Pension funding obligations	25	25			
Total	2,311	200	142	856	1,113

The UK pension funding obligation of £25m is subject to change upon completion of the latest actuarial valuation of the UK Group plan.

At December 31, 2017 the Group had capital commitments for fixed assets, including finance leases already under contract, of £nil (2016: £9m). There are contingent liabilities 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 in respect of legal and royalty claims. None of these claims or guarantees is expected to result in a material gain or loss.

In 2014, the Group negotiated a new $1,750m committed revolving credit facility with an initial maturity date of August 2019, extended to August 2020 in 2015. During 2016, the Group extended the maturity date of this facility to August 2021. The facility requires the Group to pay an annual commitment fee of 0.1575%, payable quarterly, on the unused amount of the facility.

Off-Balance sheet arrangements

The Group does not have any off-balance sheet arrangements, as defined by the SEC for the purposes of Form 20-F, that have or are reasonably likely to have a material current or future effect on the Group s financial position or results of operations.

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Borrowings

The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets.

The Group has in place a committed revolving credit facility of $1.75bn, which matures in August 2021. At December 31, 2017, the full $1.75bn was available under this facility. This credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

The Group must maintain the ratio of its profit before interest, tax and amortization to its net interest payable at no less than 3:1; and

The Group must maintain the ratio of its rolling 12 month average net debt to its EBITDA, explained below, at no more than 4:1.

EBITDA refers to earnings before interest, taxes, depreciation and amortization. The Group is currently in compliance with these covenants.

See note 18 of Item 18. Financial Statements for information on the Group s longer term loans from banks and capital markets.

Treasury policy

The Group s treasury policy is described in note 19 of Item 18. Financial Statements . For a more detailed discussion of the Group s borrowing and use of derivatives, see Item 11. Quantitative and Qualitative Disclosures about Market Risk .

Related parties

There were no significant or unusual related party transactions in 2017, 2016 or 2015. Refer to note 36 in Item 18. Financial Statements .

Accounting policies

For a description of the Group s principal accounting policies used refer to note 1 in Item 18. Financial Statements .

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ITEM 6. *DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES*

Directors and senior management

The Group is managed by a board of directors and a chief executive who reports to the board and manages through an executive committee. The Groups refer to the board of directors, the chairman of the board of directors and the executive committee as its senior management .

The following table sets forth information concerning directors, as of February 28, 2018.

Name	Age	Position
Sidney Taurel	69	Chairman
John Fallon	55	Chief Executive
Elizabeth Corley, CBE	61	Non-executive Director
Vivienne Cox, CBE	58	Senior Independent Director
Josh Lewis	55	Non-executive Director
Linda Lorimer	65	Non-executive Director
Michael Lynton	58	Non-executive Director
Harish Manwani	64	Non-executive Director
Tim Score	57	Non-executive Director
Lincoln Wallen	57	Non-executive Director
Coram Williams	44	Chief Financial Officer

Sidney Taurel

Appointed January 1, 2016. Member of the nomination & governance and remuneration committees.

Sidney has over 45 years of experience in business and finance, and is currently a board director and chairman of the compensation committee at IBM Corporation. Sidney is an advisory board member at pharmaceutical firm Almirall. He was chief executive officer of global pharmaceutical firm Eli Lilly and Company from 1998 until 2008, chairman from 1999 until 2008, and has been chairman emeritus since 2009. He was also a director at McGraw Hill Financial, Inc., a role which he held from 1996 until April 2016 and at ITT Industries from 1996 to 2001. Sidney has received three US presidential appointments to: the Homeland Security Advisory Council, the President s Export Council and the Advisory Committee for Trade Policy and Negotiations, and is an officer of the French Legion of Honour.

John Fallon

Appointed October 3, 2012.

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

Elizabeth Corley, CBE

Appointed May 1, 2014. Chairman of the remuneration committee and member of the audit and nomination & governance committees.

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Elizabeth was CEO of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016 and continues to act as a senior advisor to the firm as vice-chair. She was previously at Merrill Lynch Investment Managers and Coopers & Lybrand. In addition to Pearson, Elizabeth serves on two other company boards as a non-executive director BAE Systems plc and Morgan Stanley. She has various financial services industry roles including as a member of the FICC Markets Standards Board, the ESMA stakeholder group and TheCityUK Advisory Council. Additionally she is a member of the Committee of 200 and a trustee of the British Museum. Elizabeth currently chairs a group advising the UK government on social impact investing. She is also a crime fiction author.

Vivienne Cox, CBE

Appointed on January 1, 2012. Chairman of the nomination & governance committee and member of the audit and reputation & responsibility committees.

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years in global roles including executive vice president and chief executive of BP s gas, power and renewables business and its alternative energy unit. She is non-executive director of Stena International and chairman of the supervisory board of Vallourec, a leader in the seamless steel pipe markets. She is also non-executive director at pharmaceutical company GlaxoSmithKline plc and an advisory board member of the African Leadership Institute.

Josh Lewis

Appointed on March 1, 2011. Member of the remuneration and nomination & governance committees.

Josh s experience spans finance, education and the development of digital enterprises. He is the founder of Salmon River Capital LLC, a New York-based private equity/venture capital firm focused on technology-enabled businesses in education, financial services and other sectors. Over a 25-year career in active, principal investing, he has been involved in a broad range of successful companies, including several pioneering enterprises in the education sector. In addition, he has long been active in the non-profit education sector, with associations including New Leaders, New Classrooms, and the Bill & Melinda Gates Foundation. He is also a non-executive director of several enterprises in the fin-tech/data, education and other sectors.

Linda Lorimer

Appointed July 1, 2013. Chairman of the reputation & responsibility committee and member of the audit committee.

Linda spent almost 40 years serving higher education. She retired from Yale in spring 2016 after 34 years at the university where she served in an array of senior positions including vice president for Global & Strategic Initiatives. She oversaw the development of Yale s burgeoning online education division and the expansion of Yale international programs and centers. During her tenure, she was responsible for many administrative services, ranging from Yale s public communications and alumni relations to sustainability, human resources and the university press. Previously, Linda was president of Randolph-Macon Woman s College and chair of the board of the Association of American Colleges and Universities. She also served on the boards of several public companies, including as presiding director of the McGraw-Hill companies. She is a member of the Trilateral Commission and the Council on Foreign Relations.

Michael Lynton

Appointed on February 1, 2018.

Michael served as CEO of Sony Entertainment from 2012 until 2017, overseeing Sony s global entertainment businesses. He also served as Chairman and CEO of Sony Pictures Entertainment from 2004. Prior

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to this, he held senior roles within Time Warner and AOL, and earlier served as Chairman and CEO of Penguin Group where he extended the Penguin brand to music and the internet. Michael is chairman of Snap, Inc., and currently serves on the boards of Pandora Media Inc., IEX and Ares Management, L.P. He is also a member on the Council on Foreign Relations, the Harvard Board of Overseers and serves on the boards of the Los Angeles County Museum of Art, the Tate, and the Rand Corporation. Michael holds a B.A. in History and Literature from Harvard College, where he also received his M.B.A.

Harish Manwani

Appointed October 1, 2013. Member of the nomination & governance and reputation & responsibility committees.

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

Tim Score

Appointed January 1, 2015. Chairman of the audit committee and member of the nomination & governance and remuneration committees.

Tim has extensive experience of the technology sector in both developed and emerging markets, having served as chief financial officer of ARM Holdings plc, the world s leading semiconductor IP company, for 13 years. He is an experienced non-executive director and currently sits on the boards of The British Land Company plc and HM Treasury, in addition to being on the board of trustees of the Royal National Theatre and chairman of the group audit committee of the Football Association. He served on the board of National Express Group plc from 2005 to 2014, including time as interim chairman and six years as the senior independent director. Earlier in his career Tim held senior finance roles with Rebus Group, William Baird, LucasVarity plc and BTR plc.

Lincoln Wallen

Appointed January 1, 2016. Member of the audit and reputation & responsibility committees.

Lincoln has extensive experience in the technology and media industries, having been CEO of DWA Nova, a software-as-a-service company spun out of DreamWorks Animation Studios in Los Angeles, a position he held until 2017. He worked at DreamWorks Animation for nine years in a variety of leadership roles including chief technology officer and head of animation technology. He was formerly CTO at Electronic Arts Mobile, leading EA s entry into the mobile gaming business internationally. He is currently a visiting associate in Computing and Mathematical Sciences at the California Institute of Technology (Caltech). Lincoln is also a non-executive director of the Smith Institute for Industrial Mathematics and Systems Engineering. Lincoln s early career involved 20 years of professional IT and mathematics research, including as a reader in Computer Science at Oxford.

Coram Williams

Appointed August 1, 2015.

Coram joined Pearson in 2003 and has held a number of senior positions including finance and operations director for Pearson s English Language Teaching business in Europe, Middle East & Africa, interim president of Pearson Education Italia and head of financial planning and analysis for Pearson. In 2008, Coram became CFO

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of The Penguin Group and was latterly appointed CFO of Penguin Random House in 2013, where he oversaw the integration of the two businesses. Coram trained at Arthur Andersen, and subsequently worked in both the auditing and consulting practices of the firm. He is a non-executive director and chairman of the audit committee for the Guardian Media Group.

The following table sets forth information concerning the executive committee, as at February 28, 2018

Name	Position
Tim Bozik	President, Global Product
Rod Bristow	President, Core Markets
Kevin Capitani	President, North America
Jonathan Chocqueel-Mangan	Chief Strategy Officer
Giovanni Giovannelli	President, Growth Markets
Albert Hitchcock	Chief Technology and Operations Officer
Kate James	Chief Corporate Affairs and Global Marketing Officer
Bjarne Tellmann	General Counsel and Chief Legal Officer
Anna Vikström Persson	Chief Human Resources Officer
Bob Whelan	President, Pearson Assessments

Tim Bozik

Tim is President, Global Product at Pearson and has extensive experience in product development and higher education. He joined Pearson in 1983 as a sales representative and has since held several leadership roles in product and general management, including recent posts as President of US higher education and global higher education. His work has included a focus on digital products and services, smart design, personalized learning, improving outcomes and bringing education and employment closer together.

Rod Bristow

Rod Bristow is President, UK & Core Markets for Pearson. Core Markets include those 100+ countries with, in general, developed economies and education systems. In 2010, Rod became President for Pearson UK and was appointed to lead all other Core Markets for Pearson in January 2014. Rod has worked in education, publishing and assessment for 30 years in universities, schools, colleges, professional training and learning technologies in the UK and internationally. He is a Trustee for the Education and Employers Taskforce, a Fellow of the Royal Society for Arts, Governor for Sir Charles Kao University Technical College and past President of the Publishers Association. He is also Chair of the judging panel for the National Teaching Awards. Rod is a graduate of University College London.

Kevin Capitani

Kevin is President of North America at Pearson. Kevin s background is in developing collaborative teams and fostering growth in customer-focused businesses. He has worked, managed and led in global, highly matrixed, technology organizations. Prior to Pearson, Kevin was general manager and chief operating officer for the enterprise software company, SAP. Throughout his career he has worked with Fortune 500 companies across multiple geographies and industries.

Jonathan Chocqueel-Mangan

Jonathan Chocqueel-Mangan is Chief Strategy Officer at Pearson. He was formerly chief strategy and transformation officer at Kantar Consumer Insights. Jonathan has professional qualifications in Consulting and Coaching for Change, from the Said Business School (Oxford University) and a Doctor of Business Administration (DBA) in organizational Behavior, from the School of Management at the University of Surrey.

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Giovanni Giovannelli

Gio is President, Growth Markets having joined Pearson as Managing Director of Pearson Brazil. Gio was previously CEO of Grupo Multi, Brazil s leading English language learning business, which was acquired by Pearson in December, 2013. Prior to Multi, he held CEO positions in Brazil across a number of sectors, including energy, mining and HR services. Gio is a board member of Natura (cosmetics and beauty products), listed in the Sao Paulo Stock Exchange BOVESPA. Gio earned his undergraduate degree in Italy s Bocconi University, holds a Ph.D. in Economics from the American University in Washington DC and is an OPM graduate of Harvard Business School.

Albert Hitchcock

Albert Hitchcock is Chief Technology and Operations Officer for Pearson, where he joined the Executive team in March 2014. Albert is responsible for the Technology & Operations organization within Pearson. In this role Albert leads digital product development, enterprise technology and operations encompassing supply chain, procurement, customer service and real estate. He previously held the position of Group Chief Information Officer at Vodafone and prior to this was Global CIO at Nortel. Albert is a Fellow of the Institute of Engineering and Technology and a Chartered Engineer.

Kate James

Kate joined Pearson in January 2014. A member of the Pearson Executive, as Chief Corporate Affairs and Global Marketing Officer she oversees communications, marketing and the Pearson brand, government and regulatory relations, investor relations and the company s social impact work. Prior to joining Pearson, Kate was Chief Communications Officer for the Bill & Melinda Gates Foundation, leveraging the Foundation s voice in support of the organization s global and domestic initiatives. Before that, she held senior leadership roles in the financial services industry including heading communications globally at Citibank and leading the advocacy and sustainability practice at Standard Chartered Bank.

Bjarne Tellmann

Bjarne is General Counsel and Chief Legal Officer of Pearson. He previously worked across Europe, Asia and the United States in various capacities with The Coca-Cola Company, most recently as Associate General Counsel. He has also held various legal positions at Kimberly-Clark and the law firms of Sullivan & Cromwell LLP and White & Case LLP. He holds a J.D. with honors from the University of Chicago, a M.Sc. (Econ.) from The London School of Economics, and has completed Harvard Law School s Leadership in Corporate Counsel program.

Anna Vikström Persson

Anna Vikström Persson joined Pearson in February 2018 as Chief Human Resources Officer. She has over 20 years of international HR experience, having led human resources teams for major global companies across a variety of business sectors, including telecommunications, manufacturing and engineering. Most recently, Anna served as executive vice president and head of group human resources for the global engineering company Sandvik, and similarly for SSAB, a global steel company. Prior to this, Anna was VP, HR & Organization for global telecom company Ericsson. She has a certificate in German and a Masters in Law, as well as professional HR qualifications from both London Business School and Michigan Business School.

Bob Whelan

Bob is President, Pearson Assessment and has significant expertise in assessment and growing businesses. As President and Chief Executive Officer of Pearson VUE since January 2000, Bob led Pearson s growth as a global leader in computer-based assessments. He now leads Pearson s combined assessments businesses including K-12 and clinical assessment as well as Pearson VUE. Bob received his BA from the University of Alabama in finance and economics.

Compensation of senior management

It is the role of the remuneration committee (the committee) to approve the remuneration and benefits packages of the executive directors and other members of the Pearson Executive.

The principal duties of the committee are to:

a) Determine and regularly review the remuneration policies for the executive directors, the presidents and other members of the Pearson executive management (who report directly to the CEO), and overview the approach for the senior leadership group. These policies include base salary, annual and long-term incentives, pension arrangements, any other benefits and termination of employment.

b) Regularly review the implementation and operation of the remuneration policy for executive management and approve the individual remuneration and benefits packages of the executive directors.

c) Approve the design of, and determine targets for, any performance-related pay plans operated by the group for Pearson executive management and approve the total payments to be made under such plans.

d) Review the design of the company s long-term incentive and other share plans operated by the group and where relevant recommend such plans for approval by the board and shareholders.

e) Advise and decide on general and specific arrangements in connection with the termination of employment of executive directors.

f) Review and approve corporate goals and objectives relevant to executive directors remuneration and evaluate the executive directors performance in light of those goals and objectives.

g) Delegated responsibility for determining the remuneration and benefits package of the chairman of the board.

h) Ensure the company maintains an appropriate level of engagement with its shareholders and shareholder representative bodies in relation to the remuneration policy and its implementation.

i) Appoint and set the terms of engagement for any remuneration consultants who advise the committee and monitor the cost of such advice.

Remuneration policy

The directors remuneration policy described below was approved by shareholders at the Annual General Meeting held on May 5, 2017. The intention of the committee is that the policy will remain in place for three years from the date of its approval.

The committee s starting point continues to be that total remuneration should reward both short and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional performance.

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives. Base salary helps to recruit, reward and retain people and reflects competitive market level, role, skills, experience and individual contribution. Allowances and benefits help to recruit and retain people and reflect the local competitive market. Retirement benefits help to recruit and retain people and recognize their long-term commitment to the company. Annual incentives motivate the achievement of annual strategic goals and personal objectives, provide focus on key financial metrics and reward individual contribution to the success of the company. Long-term incentives help to recruit, reward and retain people, drive long-term earnings, share

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price growth and value creation, align interests of executives and shareholders, encourage long-term shareholding and commitment to the company and link management s long-term reward and wealth to corporate performance in a flexible way.

For Executive Director benchmarking purposes, the committee reviews remuneration by reference to different comparator groups. It looks at survey data from FTSE 100 companies of similar size and scope, excluding financial services companies.

Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual and long-term incentives. The committee will continue to review the mix of fixed and performance- linked remuneration on an annual basis, consistent with its overall philosophy.

Base salary

Base salaries are set to provide the appropriate rate of remuneration for the job, taking into account relevant recruitment markets, business sectors and geographic regions. Base salaries may be set in sterling or the local currency of the country in which the director is based.

Base salaries are normally reviewed annually for the following year taking into account: general economic and market conditions; the level of increases made across the company as a whole; particular circumstances such as changes in role, responsibilities or organization; the remuneration and level of increases for executives in similar positions in comparable companies; and individual performance.

Base salaries are paid in cash via the regular employee payroll (monthly in the UK and every two weeks in the US) and are subject to all necessary withholdings.

No malus or claw back provisions apply to base salary.

Base salary increases for executive directors will not ordinarily exceed 10% per annum and will take account of the base salary increases elsewhere within the company.

The committee will retain the discretion to deliver base salary increases up to 25% over the normal maximum limit in specific individual situations including internal promotions and material changes to the business or the role. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favor among those consulted.

Allowances and benefits

Allowances and benefits comprise cash allowances and non-cash benefits and inter alia include: travel-related benefits (comprising company car, car allowance and private use of a driver); health-related benefits (comprising health care, health assessment and gym subsidy); and risk benefits (comprising additional life cover and long-term disability insurance that are not covered by the company s retirement plans). Allowances may also include, where appropriate, location and market premium and housing allowance although no continuing director is in receipt of such allowances.

Allowances and benefits received in 2017 are set out in the annual remuneration report.

Directors are also covered by the company s directors and officers liability insurance and an indemnity in respect of certain third-party liabilities.

Other benefits may be offered on the same terms as to other employees. Allowances and benefits do not form part of pensionable earnings.

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No malus or claw back provisions apply to allowances and benefits.

The provision and level of cash allowances and non-cash benefits are competitive and appropriate in the context of the local market.

The total value of cash allowances and non-cash benefits for executive directors will not ordinarily exceed 15% of base salary in any year, other than in the case of increases in the cost of benefits that are outside Pearson s control and changes in benefit providers. The committee will retain the further discretion to deliver a total value of benefits up to 25% above the normal limit in specific individual situations including changes in individual circumstances such as health status and changes in the role such as relocation. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favor among those consulted.

Executive directors are also eligible to participate in savings-related share acquisition programs which are not subject to any performance conditions, on the same terms as other employees.

Retirement benefits

New employees in the UK are eligible to join the Money Purchase 2003 section of the Pearson Group Pension Plan.

Under the Money Purchase 2003 section of the Pearson Group Pension Plan, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the company and the employee makes contributions into a pension fund. Account balances are used to provide benefits at retirement. Pensions for a member s spouse, dependent children and/or nominated financial dependents are payable on death.

In the UK, company contributions for eligible employees to the Money Purchase 2003 section of the Pearson Group Pension Plan amount up to 16% of pensionable salary (double the amount of the employee contribution, which is limited according to certain age bands).

Depending on when they joined the company, directors may participate in the Final Pay section of the Pearson Group Pension Plan, which is closed to new members.

Under the Final Pay section of the Pearson Group Pension Plan, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the employee makes a contribution of 5% of pensionable salary and the pension fund builds up based on final pensionable salary and pensionable service. The accrued pension is reduced on retirement prior to age 60. Pensions for a member s spouse, dependent children and/or nominated financial dependents are payable on death.

Executive directors may be entitled to additional pension benefits to take account of the cap on the amount of benefits that can be provided from the all-employee pension arrangements in the UK.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at April 6, 2006, was abolished by the Finance Act 2004. However, the Pearson Group Pension Plan has retained its own cap , which will increase annually in line with the UK Government s Index of Retail Prices (All Items). The cap was £154,200 as at April 6, 2017 and will rise to £160,800 as at April 6, 2018.

UK executive directors who are, or become, affected by the lifetime allowance or new hires who opt out of membership of the Plan may be provided with a cash supplement of normally up to 26% of salary as an alternative to further accrual of pension benefits. With effect from 2018, the maximum cash allowance for any future Executive Director external appointments will be reduced from 26% to 16% of salary.

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No malus or claw back provisions apply to retirement benefits.

If any executive director is from, or works, outside the UK, the committee retains a discretion to put in place retirement benefit arrangements for that director in line with local market practice including defined benefit pension arrangements operated by Pearson locally. The maximum value of such arrangement will reflect local market practice at the relevant time.

The committee will also honor all pre-existing retirement benefit obligations, commitments or other entitlements that were entered into by a member of the Pearson Group before that person became a director.

The pension entitlements of each director are as follows:

John Fallon	Member of the Pearson Group Pension Plan with an accrual rate of 1/30th of pensionable salary per annum, restricted to the plan earnings cap (£154,200 per annum in 2017/2018). Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS. There are no enhanced early retirement benefits.
Coram Williams	Member of the Pearson Group Pension Plan with an accrual rate of 1/60th of pensionable salary per annum, restricted to the plan earnings cap (£154,200 per annum in 2017/2018), with continuous service with a service gap. There are no enhanced early retirement benefits.

Annual incentives

Annual incentive does not form part of pensionable earnings.

Measures and performance targets are set by the committee at the start of the year with payment made after year-end following the committee s assessment of performance relative to targets.

The plan is designed to incentivize and reward underlying performance. Actual results are adjusted to remove the effect of foreign exchange and portfolio changes (acquisitions and disposals) and other relevant factors that the committee considers do not reflect the underlying performance of the business in the performance year.

Annual incentive plans are discretionary. The committee reserves the right to adjust payments up or down before they are made if it believes exceptional factors warrant doing so. The committee may in exceptional circumstances make a special award where it is satisfied that the normal operation of the annual incentive does not provide an appropriate incentive or reward to participants.

The committee also reserves the right as a form of malus to adjust payments before they are made if special circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.

The committee also reserves, in the same special circumstances, a right to reclaim or claw back payments or awards that have already been made.

Annual incentives will not exceed 200% of base salary.

For the chief executive officer, the individual maximum incentive opportunity is 180% of base salary and 170% for the chief financial officer (which are the same opportunities as applied under the previous policy).

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The committee has the discretion to select the performance measures, targets and relative weightings from year to year to ensure continuing alignment with strategy and to ensure targets are sufficiently stretching.

The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the annual incentive pays out in full.

The funding of annual incentives will normally be related to the performance against financial and strategic imperatives performance targets. Working within its existing policy, to simplify the annual incentive plan (AIP) structure for 2018, and reflecting shareholder feedback, the committee has reduced the number of performance measures from five to four. It has replaced the two profit based measures previously included (Operating Profit and EPS) with a single Operating Profit measure, which will determine 40% of the outcome of the plan. This provides a greater focus on the metric used by management on a day-to-day basis to manage the business, whilst reducing the prominence of EPS in the overall remuneration framework. The committee has also made minor adjustments to the weightings of the other performance measures (cash flow 20%, revenue 20% and strategic measures 20%). The committee believes this creates an AIP that is appropriately balanced between key metrics and objectives for 2018. Each performance measure will operate independently. There will be no changes to the maximum annual incentive opportunities for 2018.

Strategic measures will be measured, using third party data or externally audited internal data (where third party data is not available or applicable). Performance metrics linked to strategic imperatives can be selected annually to support the Group s transformation strategy.

A pay-out will only be made if a minimum level of performance has been achieved under the financial metrics, as determined by the committee each year.

Annual incentive pay-outs will also take into account individual performance against personal objectives. Personal objectives are agreed with the chief executive (or, in the case of the chief executive, the chairman) and may be functional, operational, strategic and non-financial and include inter alia objectives relating to environmental, social and governance issues.

Details of performance measures, weightings and targets will be disclosed in the annual remuneration report for the relevant financial year if and to the extent that the committee deems them to be no longer commercially sensitive.

The performance period is one year.

Long-term incentives

Awards of restricted shares are made on an annual basis.

Awards of restricted shares for executive directors vest on a sliding scale based on performance against stretching corporate performance targets measured at the end of the three-year performance period.

Performance will continue to be tested over three years and 75% of the vested shares will be released at that point. However, there is a mandatory restriction on participants ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further two years. Furthermore, participants rights to the release of the 25% of the vested shares will be subject to continued employment over the same period.

Where shares vest, participants also receive additional shares representing the gross value of dividends that would have been paid on these shares during the performance period and reinvested.

The plan permits awards of restricted shares to be made that are not subject to performance conditions to satisfy reward and retention objectives.

However, other than in the circumstances described in the recruitment section of this policy below, it is the company s policy not to award restricted shares to executive directors without performance conditions.

The long-term incentive plan also provides for the grant of stock options. Whilst it is not the committee s intention to grant stock options in 2018 or the foreseeable future, the committee believes that it should retain the flexibility of granting stock options in addition to, or instead of, restricted stock awards in the right circumstances. Any decision by the committee to grant stock options in the future would take account of best practice prevailing at the time. The committee would consult with shareholders before granting stock options to executive directors.

The Group s reported financial results for the relevant periods are used to measure performance.

The committee reserves the right to adjust pay-outs up or down before they are released taking into account exceptional factors that distort underlying business performance or if it believes exceptional factors warrant doing so. In making such adjustments, the committee is guided by the principle of aligning shareholder and management interests.

The committee also reserves the right as a form of malus to adjust pay-outs before they are released if exceptional circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.

The committee also reserves, in the same special circumstances, a right to reclaim or claw back payouts or awards that have already been released.

The committee sets the level of individual awards by taking into account: the face value of individual awards at the time of grant, assuming that performance targets are met in full; market practice for comparable companies and market assessments of total remuneration from its independent advisers; individual roles and responsibilities; and company and individual performance.

Restricted share awards to executive directors may normally be made up to a maximum face value of 400% of base salary. Awards in excess of 400% of base salary (and up to 25% over the normal maximum limit) may be made in exceptional circumstances, for example, for retention purposes or to reflect particular business situations. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favor among those consulted. In 2017, the committee reduced actual LTIP awards granted to executive directors by approximately 30% from prior levels, whilst retaining stretching performance targets. It has also reduced the proportion of these awards that will vest for threshold performance from 25% to 18% of the award. The committee will adopt the same approach for the 2018 awards by maintaining the 2017 award levels. Therefore, the 2018 awards will be made with the same face value as a % of salary as those in 2017 275% of salary for the CEO and 245% of salary for the CFO.

The committee will determine the performance measures, weightings and targets governing an award of restricted shares prior to grant to ensure continuing alignment with strategy and to ensure that targets are sufficiently stretching.

The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the award pays out in full. The proportion of the award that vests at threshold level of performance under each performance condition is 25% for relative TSR and 15% for financial measures.

Responding to shareholder feedback, the committee is rebalancing the performance measures for 2018 awards. One third of any award will vest based on each of Earnings Per Share (EPS), gross Return On Invested

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Capital (ROIC) and relative Total Shareholder Return (TSR) measured over three years. Awards will also be subject to a further two year holding period. The eventual value of the awards will depend on the Group s share price performance and dividends paid to shareholders over a five year period. The targets have been set as follows:

EPS Vesting schedule (% max)	EPS for FY20	ROIC Vesting schedule (% max)	ROIC for FY20	Relative TSR Vesting schedule (% max)	Ranked position vs FTSE 100
15%	65p	15%	5%	25%	Median
65%	68p	65%	6%		
100%	80p	100%	8%	100%	Upper quartile

As with restricted shares, the committee will determine the performance conditions that apply to any awards of stock options prior to grant. The intention would be that these conditions would be the same as apply to restricted shares.

Total shareholder return (TSR) is the return to shareholders from any growth in Pearson s share price and reinvested dividends over the performance period. For long-term incentive awards made in 2018 and onwards, TSR will be measured relative to the constituents of the FTSE 100 over a three-year period. Companies that drop out of the index are normally excluded i.e. only companies in the index for the entire period are counted. Share price is averaged over three months at the start and end of the performance period. Dividends are treated as reinvested on the ex-dividend date, in line with the Datastream methodology. The vesting of shares based on relative TSR is subject to the committee satisfying itself that the recorded TSR is a genuine reflection of the underlying financial performance of the business.

Gross Return on invested capital (ROIC) is adjusted operating profit less cash tax expressed as a percentage of gross invested capital (net operating assets plus gross goodwill).

Adjusted earnings per share (EPS) is calculated by dividing the adjusted earnings attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding any ordinary shares purchased by the company and held in trust.

The performance period is three years.

Shareholding policy

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership and to align further the interests of executives and shareholders. With effect from 2014, target holding is 300% of salary for the chief executive and 200% of salary for the other executive directors. Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children plus any shares vested but held pending release under a share plan. Executive directors have five years from the date of appointment to reach the guideline. With effect from 2014, these guidelines were extended to include all members of the Pearson executive management at 100% of salary.

Once met, the guideline is not re-tested, other than when shares are sold.

The shareholding guidelines do not apply to the chairman and non-executive directors. However, a minimum of 25% of the basic non-executive directors fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

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Service agreements

In accordance with long established policy, all executive directors have service agreements under which, other than by termination in accordance with the terms of these agreements, employment continues indefinitely.

There are no special provisions for notice or compensation in the event of a change of control of Pearson.

It is the company s policy that the company may terminate the chairman s and executive directors service agreements by giving no more than 12 months notice. As an alternative, for executive directors the company may, at its discretion, pay in lieu of that notice. Payment-in-lieu of notice may be made in equal monthly instalments from the date of termination to the end of any unexpired notice period. Payment-in-lieu of notice in instalments may also be subject to mitigation and reduced taking into account earnings from alternative employment.

For executive directors, pay in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. For the chairman, pay in lieu of notice comprises 100% of the annual fees at the date of termination. In limited circumstances, in addition to making a full payment in lieu of notice, the company may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective handover and/or allow time for a successor to be appointed.

The Group may, depending on the circumstances of the termination, determine that it will not pay the director in lieu of notice and may instead terminate a director s contract in breach and make a damages payment, taking into account as appropriate the director s ability to mitigate his or her loss. The Group may also pay an amount considered reasonable by the remuneration committee in respect of fees for legal and tax advice and outplacement support for the departing director.

On cessation of employment, save as otherwise provided for under the rules of Pearson s discretionary share plans, executive directors entitlements to any unvested awards lapse automatically. In the case of injury, disability, ill-health or redundancy (as determined by the committee), where a participant s employing company ceases to be part of Pearson, or any other reason if the committee so decides in its absolute discretion: awards that are subject to performance conditions will stay in force as if the participant had not ceased employment and shall vest on the original vesting date; awards that are not subject to a performance condition will be released as soon as practicable following cessation of employment; the number of shares that are released shall be prorated for the period of the participant s service in the restricted period (although the committee may in its absolute discretion waive or vary the prorating).

In determining whether and how to exercise its discretion under Pearson s discretionary share plans, the committee will have regard to all relevant circumstances distinguishing between different types of leaver, the circumstances at the time the award was originally made, the director s performance and the circumstances in which the director left employment.

On cessation of employment, executive directors, having been notified of participation in an annual incentive plan for the relevant financial year, may, at the committee s discretion, retain entitlement to a pro rata annual incentive for their period of service in the financial year prior to their leaving date. Such payout will normally be calculated in good faith on the same terms and paid at the same time as for continuing executive directors.

Eligibility for allowances and benefits including retirement benefits normally ceases on retirement or on the termination of employment for any other reason.

The rules of Pearson s discretionary share plans make provision for the treatment of awards in respect of corporate activity, including a change of control of Pearson. The committee would act in accordance with the terms of the awards in these circumstances, which includes terms as to the assessment of performance conditions and time apportionment.

Details of each individual s service agreement are outlined in the table below. Employment agreements for other employees are determined according to local labor law and market practice.

Executive directors non-executive directorships

The Group s policy is that executive directors may, by agreement with the board, serve as non-executives of other companies and retain any fees payable for their services.

Coram Williams is engaged as a non-executive director of Guardian Media Group plc. He received fees of £37,750 during 2017 in respect of this role. His current remuneration is at the rate of £39,000 per annum since April 1, 2017 when he became chair of the audit committee. In accordance with the Group s policy, Coram is permitted to retain these fees.

Chairman s and non-executive directors remuneration

The chairman is paid a single fee for all of his responsibilities.

The chairman s fee is set at a level that is competitive with those of chairmen in similar positions in comparable companies. The chairman is not entitled to any annual or long-term incentive, retirement or other employee benefits.

The non-executive directors are paid a basic fee. The committee chairmen and members of the main board committees and the senior independent director are paid an additional fee to reflect their extra responsibilities.

Following a review of the structure of the fees paid to non-executive directors, the board has determined that it would be appropriate to introduce additional fees for membership and chairmanship of the nomination and governance committee. Having taken independent advice from Deloitte, the fee that has been set by the board reflects the median level within the FTSE 100.

The chairman and the non-executive directors are covered by the company s normal arrangements for directors and officers liability insurance and an indemnity in respect of certain third-party liabilities.

The company reimburses the chairman s and non-executive directors travel and other business expenses and any tax incurred thereon, if applicable.

A minimum of 25% of the chairman s and non-executive directors basic fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships. Shares are acquired quarterly at the prevailing market price with the individual after-tax fee payments.

Fees for non-executive directors are determined by the full board having regard to market practice and within the restrictions contained in the company s Articles of Association. The chairman and non-executive directors receive no other pay or benefits (other than reimbursement for expenses incurred in connection with their directorship of the company) and do not participate in the company s equity-based incentive plans.

Non-executive directors serve Pearson under letters of appointment which are renewed annually and do not have service contracts. For non-executive directors, there is no notice period or entitlement to compensation on the termination of their directorships.

The chairman s fees were reviewed in 2017 and have not been increased since his appointment. Fees for the non-executive directors were last increased with effect from May 1, 2014. Following a review of fees paid to

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non-executive directors, the board has determined that most fees will remain unchanged, other than a small increase to apply to membership and chairmanship of the reputation and responsibility committee. A fee has also been introduced for the newly formed nomination & governance committee. These changes took effect from the AGM on 5 May 2017.

The structure of non-executive directors fees is as follows:

	With effect from May 5, 2017
Non-executive director	£ 70,000
Chairmanship of audit committee	£ 27,500
Chairmanship of remuneration committee	£ 22,000
Chairmanship of nomination and governance committee	£ 15,000
Chairmanship of reputation and responsibility committee	£ 13,000
Membership of audit committee	£ 15,000
Membership of remuneration committee	£ 10,000
Membership of nomination and governance committee	£ 8,000
Membership of reputation and responsibility committee	£ 6,000
Senior independent director	£ 22,000

Notes:

(1) The fee paid to the chairman remains unchanged at £500,000.
(2) A minimum of 25% of the basic fee is paid in Pearson shares that the chairman and non-executive directors have committed to retain for the period of their directorships.
(3) Non-executive directors serve Pearson under letters of appointment and do not have service contracts. There is no entitlement to compensation on the termination of their directorships.

Remuneration of senior management

The remuneration received by the chairman and executive directors in respect of the financial year ending December 31, 2017 was as follows:

	Base Salary/ Fees £000	Allowances & Benefits(1) £000	Annual Incentives £000	Long-term Incentives £000	Retirement Benefits £000	Total £000
Chairman						
Sidney Taurel	500	12				512
Executive directors						
John Fallon	780	45	624		309	1,758
Coram Williams	515	39	412		52	1,018
Senior management as a group	**1,795**	**96**	**1,036**		**361**	**3,288**

Notes:

(1) Benefits include company car, car allowance, private use of a driver, healthcare, additional life cover, long-term disability insurance and subsistence expenses.

Share options for senior management

There are no share options outstanding for senior management.

Share ownership of senior management

The table below shows the number of ordinary shares and conditional shares held by directors and their connected persons as at December 31, 2017. Additional information with respect to share options held by, and

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bonus awards for, these persons is set out above in Remuneration of Senior Management and Share Options of Senior Management . The total number of ordinary shares held by senior management as of December 31, 2017 was 487,669.

As at 31 December 2017	Ordinary Shares(1)	Conditional Shares(2)
Sidney Taurel	78,677	
John Fallon	326,784	749,000
Coram Williams	15,010	437,000
Elizabeth Corley	8,066	
Vivienne Cox	5,263	
Josh Lewis	11,033	
Linda Lorimer	6,977	
Harish Manwani	14,151	
Tim Score	17,285	
Lincoln Wallen	4,423	
Michael Lynton		

Notes:

(1) Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals under the long-term incentive plan and any legacy share plans they might have participated in.

(2) Conditional shares means unvested shares which remain subject to performance conditions and continuing employment for a pre-defined period.

(2) The register of directors interests (which is open to inspection during normal office hours) contains full details of directors shareholdings and options to subscribe for shares. The market price on December 31, 2017 was 736p per share and the range during the year was 566.5p to 818.5p.

(3) Ordinary shares do not include any shares vested but held pending release under a restricted share plan.

The total remuneration of the executive committee is set out in the table below:

All figures in £ millions	2017
Short-term employee benefits	12
Retirement benefits	1
Share-based payment costs	2
Total	**15**

Employee share ownership plans

In 1998, the Group introduced a worldwide save for shares plan. Under this plan, employees around the world have the option to save a portion of their monthly salary over periods of three or five years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the commencement of the employee s participation in the plan.

In 2014, shareholders approved the renewal and extension of the life of the UK plan by a further ten years, until 2024 and the renewal of the directors authority to continue to operate equivalent arrangements for non-UK employees. As part of this renewal, the savings limit for the UK HMRC-approved part of the plan (which forms the basis of the plan in the rest of the world outside the US) was increased from £250 to £500 per month.

In the United States, this plan operates as a stock purchase plan under Section 423 of the US Internal Revenue Code of 1986. This plan was introduced in 2000 following Pearson s listing on the New York Stock

Exchange. Under it, participants save a portion of their monthly salary over six month periods, at the end of which they have the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period. The maximum employee contribution under the plan is $1,000 per month.

Board practices

As at February 28, 2018, the Group s board comprises the chairman, two executive directors and eight non-executive directors. The articles of association provide that at every annual general meeting, one-third of the board of directors, or the number nearest to one-third, shall retire from office. The directors to retire each year are the directors who have been longest in office since their last election or appointment. A retiring director is eligible for re-election. If at any annual general meeting, the place of a retiring director is not filled, the retiring director, if willing, is deemed to have been re-elected, unless at or prior to such meeting it is expressly resolved not to fill the vacated office, or unless a resolution for the re-election of that director has been put to the meeting and lost. The articles of association also provide that every director be subject to re-appointment by shareholders at the next annual general meeting following their appointment.

However in accordance with the UK Corporate Governance Code, the board has resolved that all directors should offer themselves for re-election on an annual basis at the company s annual general meeting. Accordingly, with the exception of Harish Manwani, who will retire from the Board at the 2018 annual general meeting, all of the directors will offer themselves for re-election, (or election in the case of Michael Lynton, who was appointed on February 1, 2018), at the forthcoming annual general meeting on May 4, 2018.

Pearson is listed on the New York Stock Exchange (NYSE). As a listed non-US issuer, the Group is required to comply with some of the NYSE s corporate governance rules, and otherwise must disclose on its website any significant ways in which its corporate governance practices differ from those followed by US companies under the NYSE listing standards. At this time, the Group believes that it is in compliance in all material respects with all the NYSE rules except that the Remuneration Committee and the Nomination & Governance Committee are not composed entirely of independent directors as the Chairman, who is not considered independent under NYSE rules, is a member of each committee in addition to independent directors.

The board of directors has established the following formal committees, all of which report to the board. Each committee has its own written terms of reference setting out its authority and duties. These can be found on the Group s website (https://www.pearson.com/governance).

Audit committee

This committee appraises the Group s financial management and reporting and assesses the integrity of its accounting procedures and financial control. Tim Score chairs this committee and its other members are Elizabeth Corley, Vivienne Cox, Linda Lorimer and Lincoln Wallen. Tim Score is also the designated audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission. 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.

Remuneration committee

This committee meets regularly to determine the remuneration and benefits of the executive directors and oversees remuneration arrangements for the Pearson Executive. The committee also recommends the chairman s remuneration to the board of directors for its decision. Elizabeth Corley chairs this committee and its other members are Josh Lewis, Tim Score and Sidney Taurel.

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Nomination & governance committee

This committee reviews corporate governance matters including UK Corporate Governance Code compliance and board evaluation, considers the appointment of new directors, board experience and diversity, and reviews board induction and succession plans. The committee is chaired by Vivienne Cox and its other members are Elizabeth Corley, Josh Lewis, Harish Manwani, Tim Score and Sidney Taurel.

Reputation & responsibility committee

This committee considers the Group s impact on society and the communities in which the Group operates, including to ensure strategies are in place to manage and improve the Group s reputation. Linda Lorimer chairs this committee and its other members are Vivienne Cox, Harish Manwani and Lincoln Wallen.

Employees

The average number of persons employed by the Group in continuing operations during each of the three fiscal years ended 2017 were as follows:

30,339 in fiscal 2017,

32,719 in fiscal 2016, and

37,265 in fiscal 2015.

Through its subsidiaries, the Group has entered into collective bargaining agreements with employees in various locations. The Group s management has no reason to believe that it would not be able to renegotiate any such agreements on satisfactory terms. The Group encourages employees to contribute actively to the business in the context of their particular job roles and believes that the relations with its employees are generally good.

The table set forth below shows for 2017, 2016 and 2015 the average number of persons employed in each of the Group s segments.

Average number employed	2017	2016	2015
North America	16,295	16,841	19,951
Core	5,291	5,664	5,936
Growth	8,268	9,868	11,114
Other	485	364	264
Continuing operations	**30,339**	**32,719**	**37,265**

The average number employed in discontinued operations was nil in 2017, nil in 2016, and 2,282 in 2015.

ITEM 7. ***MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS***

As at February 28, 2018, the company had been notified under the Financial Conduct Authority s Disclosure and Transparency Rules of the following significant voting rights in its shares:

Name of shareholder	Number of ordinary shares held	% of outstanding ordinary shares represented by number of shares held
Schroders plc	108,921,950	13.91
Silchester International Investors LLP	88,951,732	11.14
Lindsell Train Limited	41,393,237	5.035
Ameriprise Financial Inc and its group	41,236,375	5.019

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On February 28, 2018, record holders with registered addresses in the United States held 24,322,555 ADRs, which represented 3.1% of the Group s outstanding ordinary shares. Some of these ADRs are held by nominees and so these numbers may not accurately represent the number of shares beneficially owned in the United States.

Loans and equity advanced to joint ventures and associates during the year and as at December 31, 2017 are shown in note 12 in Item 18. Financial Statements. Dividends receivable from joint ventures and associates are set out in note 12 in Item 18. Financial Statements . There were no other related party transactions in 2017.

ITEM 8. ***FINANCIAL INFORMATION***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-151 hereof.

Other than those events described in note 37 in Item 18. Financial Statements of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to the Group s financial condition or results of operations since December 31, 2017. The Group s borrowings fluctuate by season due to the effect of the school year on the working capital requirements of the educational book business. Assuming no acquisitions or disposals, the maximum level of net debt normally occurs in July, and the minimum level of net debt normally occurs in December.

The Group s policy with respect to dividend distributions is described in response to Item 3. Key Information above.

See Item 4. Information on the Company Legal Proceedings for information with respect to legal proceedings to which the Group may be subject from time to time.

ITEM 9. ***THE OFFER AND LISTING***

The principal trading market for the Group s ordinary shares is the London Stock Exchange. Its ordinary shares also trade in the United States in the form of ADSs evidenced by ADRs under a sponsored ADR facility with The Bank of New York Mellon, as depositary. The Group established this facility in March 1995 and most recently amended it in August 2014 in connection with its New York Stock Exchange listing. Each ADS represents one ordinary share.

The ADSs trade on the New York Stock Exchange under the symbol PSO .

The following table sets forth the highest and lowest middle market quotations, which represent the average of closing bid and asked prices, for the ordinary shares, as derived from the Daily Official List of the London Stock Exchange and the average daily trading volume on the London Stock Exchange:

- on an annual basis for the five most recent fiscal years,
- on a quarterly basis for the most recent quarter and two most recent fiscal years, and
- on a monthly basis for the six most recent months.

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Reference period	Ordinary shares High	Low	Average daily trading volume
	(In pence)		(Ordinary shares)
Five most recent fiscal years			
2017	818.5	566.5	4,146,100
2016	975	657.5	3,515,000
2015	1,508	695	2,928,500
2014	1,341	998	2,499,900
Most recent quarter and two most recent fiscal years			
2017 Fourth quarter	750	607	4,128,900
Third quarter.	691.5	566.5	3,256,100
Second quarter	739.5	616	4,008,000
First quarter	818.5	573	4,549,000
2016 Fourth quarter	832.5	726	3,898,200
Third quarter	975	726	3,652,000
Second quarter	967	784.5	2.931,300
First quarter	913	657.5	3,575,100
Most recent six months			
February 2018	732.4	653	5,423,100
January 2018	738.2	679.2	5,062,600
December 2017	750	713.5	3,927,600
November 2017	709.5	693	3,976,300
October 2017	719.5	607	4,455,300
September 2017	612	566.5	3,187,700

ITEM 10. *ADDITIONAL INFORMATION*

Articles of association

The Group summarizes below the material provisions of its articles of association, as amended, which have been filed as an exhibit to its annual report on Form 20-F for the year ended December 31, 2017. The summary below is qualified entirely by reference to the Articles of Association. The Group has multiple business objectives and purposes and is authorized to do such things as the board may consider fit to further its interests or incidental or conducive to the attainment of its objectives and purposes.

Directors powers

The Group s business shall be managed by the board of directors and the board may exercise all such of its powers as are not required by law or by the Articles of Association or by any directions given by the Company by special resolution, to be exercised in a general meeting.

Interested directors

For the purposes of section 175 of the Companies Act 2006, the board may authorize any matter proposed to it which would, if not so authorized, involve a breach of duty by a Director under that section, including, without limitation, any matter which relates to a situation in which a Director has, or can have, an interest which conflicts, or possibly may conflict, with the interests of the Company. Any such authorization will be effective only if:

(a) any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and

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(b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

The board may (whether at the time of the giving of the authorization or subsequently) make any such authorization subject to any limits or conditions it expressly imposes but such authorization is otherwise given to the fullest extent permitted. The board may vary or terminate any such authorization at any time.

Provided that he has disclosed to the board the nature and extent of his interest, a Director notwithstanding his office:

(a) may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise (directly or indirectly) interested;

(b) may act by himself or his firm in a professional capacity for the Company (otherwise than as auditor) and he or his firm shall be entitled to remuneration for professional services as if he were not a Director;

(c) may be a director or other officer of, or employed by, or a party to a transaction or arrangement with, or otherwise interested in, any body corporate in which the Company is otherwise (directly or indirectly) interested.

A Director shall not, by reason of his office, be accountable to the Company for any remuneration or other benefit which he derives from any office or employment or from any transaction or arrangement or from any interest in any body corporate:

(a) the acceptance, entry into or existence of which has been approved by the board (subject, in any such case, to any limits or conditions to which such approval was subject); or

(b) which he is permitted to hold or enter into by virtue of paragraph (a), (b) or (c) above;

nor shall the receipt of any such remuneration or other benefit constitute a breach of his duty under section 176 of the Act.

A Director shall be under no duty to the Company with respect to any information which he obtains or has obtained otherwise than as a Director of the Company and in respect of which he owes a duty of confidentiality to another person. However, to the extent that his relationship with that other person gives rise to a conflict of interest or possible conflict of interest, the preceding sentence only applies if the existence of such relationship has been approved by the board. In such circumstances, the Director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he fails:

(a) to disclose any such information to the board or to any Director or other officer or employee of the Company; and/or

(b) to use or apply any such information in performing his duties as a Director of the Company.

Where the existence of a Director s relationship with another person has been approved by the board and his relationship with that person gives rise to a conflict of interest or possible conflict of interest, the Director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he:

(a) absents himself from meetings of the board at which any matter relating to the conflict of interest or possible conflict of interest will or may be discussed or from the discussion of any such matter at a meeting or otherwise; and/or

(b) makes arrangements not to receive documents and information relating to any matter which gives rise to the conflict of interest or possible conflict of interest sent or supplied by the Company and/or for such documents and information to be received and read by a professional adviser, for so long as he reasonably believes such conflict of interest or possible conflict of interest subsists.

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Except as stated below, a Director shall not vote in respect of any contract or arrangement or any other proposal whatsoever in which he has an interest which is, to his knowledge, a material interest, otherwise than by virtue of his interests in shares or debentures or other securities of or otherwise in or through the Company. A Director shall not be counted in the quorum at a meeting of the Board in relation to any resolution on which he is debarred from voting.

Notwithstanding the foregoing, a Director will be entitled to vote, and be counted in the quorum, on any resolution concerning any of the following matters:

- the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of or for the benefit of the Company or any of its subsidiaries;

- the giving of any guarantee, security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which he himself has assumed responsibility in whole or in part and whether alone or jointly with others under a guarantee or indemnity or by the giving of security;

- any proposal relating to the Company or any of its subsidiary undertakings where it is offering securities in which offer a Director is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which a Director is to participate;

- any proposal relating to another company in which he and any persons connected with him do not to his knowledge hold an interest in shares (as that term is used in sections 820 to 825 of the Companies Act 2006) representing one per cent or more of either any class of the equity share capital, or the voting rights, in such company;

- any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; and

- any proposal concerning insurance that the Company proposes to maintain or purchase for the benefit of directors or for the benefit of persons, including Directors.

Where proposals are under consideration concerning the appointment of two or more Directors to offices or employment with us or any company in which the Group is interested, these proposals may be divided and considered separately and each of these directors, if not prohibited from voting under the provisions of the eighth paragraph before this one, will be entitled to vote and be counted in the quorum with respect to each resolution except that concerning his or her own appointment.

Borrowing powers

The board of Directors may exercise all powers to borrow money and to mortgage or charge the Group s undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as collateral security for any of its or any third party s debts, liabilities or obligations. The board of directors must restrict the borrowings in order to secure that the aggregate amount of undischarged monies borrowed by the Group (and any of its subsidiaries), but excluding any intra-group debts, shall not at any time (without the previous sanction of the Company in the form of an ordinary resolution) exceed a sum equal to twice the aggregate of the adjusted capital and reserves.

Other provisions relating to directors

Under the articles of association, directors are paid out of the Group s funds for their services as it may from time to time determine by ordinary resolution and, in the case of non-executive directors, up to an aggregate of £750,000 or such other amounts as resolved by the shareholders at a general meeting. Any Director who is not an Executive Director and who performs special services which in the opinion of the Board are outside the scope of

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the ordinary duties of a Director, may be paid such extra remuneration by way of additional fee, salary, commission or otherwise as the Board may determine in accordance with the Group s remuneration policy. Under the articles of association, Directors currently are not required to hold any share qualification. However, the remuneration policy mandates a shareholding guideline for executive directors which they are expected to build towards over a specified period.

Annual general meetings

Pursuant to the Companies Act 2006, the Company must hold an annual general meeting (AGM) (within six months beginning with the day following its accounting reference date) at a place and time determined by the board. The following matters are usually considered at an annual general meeting:

- approving final dividends;
- consideration of the accounts and balance sheet;
- ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;
- the appointment or election of directors Notwithstanding the provisions of the Articles, the board has resolved that all directors should offer themselves for re-election annually, in accordance with the UK Corporate Governance Code;
- appointment or reappointment of, and determination of the remuneration of, the auditors; and
- the renewal, limitation, extension, variation or grant of any authority to the board in relation to the allotment of securities.

The board may call a general meeting whenever it thinks fit. If at any time there are not within the United Kingdom sufficient directors capable of acting to form a quorum, any director or any two members may convene a general meeting in the same manner as nearly as possible as that in which meetings may be convened by the board.

No business shall be dealt with at any general meeting unless a quorum is present when the meeting proceeds to business. Three members present in person and entitled to vote shall be a quorum for all purposes. A corporation being a member shall be deemed to be personally present if represented by its duly authorized representative.

If a quorum for a meeting convened at the request of shareholders is not present within fifteen minutes of the appointed time, the meeting will be dissolved. In any other case, the general meeting will be adjourned to the same day in the next week, at the same time and place, or to a time and place that the chairman fixes. If at that rescheduled meeting a quorum is not present within fifteen minutes from the time appointed for holding the meeting, the shareholders present in person or by proxy will be a quorum. The chairman or, in his absence, the deputy chairman or any other director nominated by the board, will preside as chairman at every general meeting. If no director is present at the general meeting or no director consents to act as chairman, the shareholders present shall elect one of their number to be chairman of the meeting.

Share Certificates

Every person whose name is entered as a member in the Company s Register of Members shall be entitled to one certificate in respect of each class of shares held (the law regarding this does not apply to stock exchange nominees). Subject to the terms of issue of the shares, certificates are issued following allotment or receipt of the form of transfer bearing the appropriate stamp duty by the Group s registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom, telephone number +44 121-415-7062.

Share capital

Any share may be issued with such preferred, deferred or other special rights or other restrictions as may be determined by way of a shareholders vote in general meeting. Subject to the Companies Act 2006, any shares may be issued which are to be redeemed or are liable to be redeemed at the option of the Company or the shareholders.

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There are no provisions in the Articles of Association which discriminate against any existing or prospective shareholder as a result of such shareholder owning a substantial number of shares.

Subject to the terms of the shares which have been issued, the directors may from time to time make calls upon the shareholders in respect of any moneys unpaid on their shares, provided that (subject to the terms of the shares so issued) no call on any share shall be payable at less than fourteen clear days from the last call. The directors may, if they see fit, receive from any shareholder willing to advance the same, all and any part of the moneys uncalled and unpaid upon any shares held by him.

Changes in capital

The Group may, from time to time by ordinary resolution subject to the Companies Act 2006:

- consolidate and divide all or any of its share capital into shares of a larger nominal amount than its existing shares; or
- sub-divide all of or any of its existing shares into shares of smaller nominal amounts.

The Group may, from time to time increase its share capital by allotting new shares in accordance with the prescribed threshold authorized by shareholders at the last annual general meeting and subject to the consents and procedures required by the Companies Act 2006, may by special resolution reduce its share capital.

Voting rights

Every holder of ordinary shares present in person or by proxy at a meeting of shareholders has one vote on a vote taken by a show of hands. On a poll, every holder of ordinary shares who is present in person or by proxy has one vote for every ordinary share of which he or she is the holder. Voting at any meeting of shareholders is usually on a poll rather than by show of hands. Voting on a poll is more transparent and equitable because it includes the votes of all shareholders, including those cast by proxies, rather than just the votes of those shareholders who attend the meeting. A poll may be also demanded by:

- the chairman of the meeting;
- at least three shareholders present in person or by proxy and entitled to vote;
- any shareholder or shareholders present in person or by proxy representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting; or
- any shareholder or shareholders present in person or by proxy holding shares conferring a right to vote at the meeting being shares on which the aggregate sum paid up is equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

Dividends

Holders of ordinary shares are entitled to receive dividends out of Group profits that are available by law for distribution, as the Group may declare by ordinary resolution, subject to the terms of issue thereof. However, no dividends may be declared in excess of an amount recommended by the board of directors. The board may pay interim dividends on the shares of any class as it deems fit. It may invest or otherwise use all dividends left unclaimed for six months after having been declared for its benefit, until claimed. All dividends unclaimed for a period of twelve years after having been declared will be forfeited and revert to the Group.

The directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid, in whole or in part, instead of cash in respect of such dividend.

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The directors may deduct from any dividend payable to any shareholder all sums of money (if any) presently payable by that shareholder to the Group on account of calls or otherwise in relation to its shares.

Liquidation rights

In the event of the Group s liquidation, after payment of all liabilities, its remaining assets would be used to repay the holders of ordinary shares the amount they paid for their ordinary shares. Any balance would be divided among the holders of ordinary shares in proportion to the nominal amount of the ordinary shares held by them.

Other provisions of the articles of association

Whenever the Group s capital is divided into different classes of shares, the special rights attached to any class may, unless otherwise provided by the terms of the issue of the shares of that class, be varied or abrogated, either with the written consent of the holders of three-fourths of the issued shares of the class or with the sanction of a special resolution passed at a separate meeting of these holders. In the event that a shareholder or other person appearing to the board of directors to be interested in ordinary shares fails to comply with a notice requiring him or her to provide information with respect to their interest in voting shares pursuant to section 793 of the Companies Act 2006, the board may serve that shareholder with a notice of default. After service of a default notice, that shareholder shall not be entitled to attend or vote at any general meeting or at a separate meeting of holders of a class of shares or on a poll until he or she has complied in full with the Group s information request.

If the shares described in the default notice represent at least one-fourth of 1% in nominal value of the issued ordinary shares, then the default notice may additionally direct that in respect of those shares:

- the Group will not pay dividends (or issue shares in lieu of dividends); and

- the Group will not register transfers of shares unless the shareholder is not himself in default as regards supplying the information requested and the transfer, when presented for registration, is in such form as the board of directors may require to the effect that after due and careful inquiry, the shareholder is satisfied that no person in default is interested in any of the ordinary shares which are being transferred or the transfer is an approved transfer, as defined in the Group s articles of association.

No provision of the articles of association expressly governs the ordinary share ownership threshold above which shareholder ownership must be disclosed. Under the Disclosure and Transparency Rules of the Financial Conduct Authority, any person who acquires, either alone or, in specified circumstances, with others an interest in the Group s voting share capital equal to or in excess of 3% comes under an obligation to disclose prescribed particulars to the Group in respect of those ordinary shares. A disclosure obligation also arises where a person s notifiable interests fall below 3%, or where, at or above 3%, the percentage of the Group s voting share capital in which a person has a notifiable interest increases or decreases by 1% or more.

Limitations affecting holders of ordinary shares or ADSs

Under English law and articles of association, persons who are neither UK residents nor UK nationals may freely hold, vote and transfer ordinary shares in the same manner as UK residents or nationals.

With respect to the items discussed above, applicable UK law is not materially different from applicable US law.

Material contracts

The Group has not entered into any contracts outside the ordinary course of business during the two-year period immediately preceding the date of this annual report. The Trust Deed entered into in 2015 with respect to

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500.0 million aggregate principal amount of 1.375% guaranteed notes due 2025, issued by a subsidiary and guaranteed by Pearson, is filed as Exhibit 2.6 of this report.

Executive employment contracts

The Group has entered into agreements with each of its executive directors pursuant to which such executive director is employed by the Group. These agreements describe the duties of such executive director and the compensation to be paid by us. See Item 6. Directors, Senior Management and Employees Compensation of Senior Management .

It is the Group s policy that it may terminate the executive directors service agreements by giving no more than 12 months notice. As an alternative, the Group may at its discretion pay in lieu of that notice. Payment-in-lieu of notice may be made in equal monthly installments from the date of termination to the end of any unexpired notice period. In the case of the CEO, payment-in-lieu of notice in installments may also be subject to mitigation and reduced taking into account earnings from alternative employment. For executive directors, pay in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. In limited circumstances, in addition to making a full payment in lieu of notice, the Group may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective hand-over and/or allow time for a successor to be appointed. The Group may, depending on the circumstances of the termination, determine that it will not pay the director in lieu of notice and may instead terminate a director s contract in breach and make a damages payment, taking into account as appropriate the director s ability to mitigate his or her loss.

Exchange controls

There are no UK government laws, decrees, regulations or other legislation which restrict or which may affect the import or export of capital, including the availability of cash and cash equivalents for use by us or the remittance of dividends, interest or other payments to nonresident holders of the Group s securities, except as otherwise described under Tax Considerations below.

Tax considerations

The following is a discussion of the material US federal income tax considerations and UK tax considerations arising from the acquisition, ownership and disposition of ordinary shares and ADSs by a US holder. A US holder is:

- an individual citizen or resident of the US, or
- a corporation created or organized in or under the laws of the US or any of its political subdivisions, or
- an estate or trust the income of which is subject to US federal income taxation regardless of its source.

This discussion deals only with ordinary shares and ADSs that are held as capital assets by a US holder, and does not address tax considerations applicable to US holders that may be subject to special tax rules, such as:

- dealers or traders in securities or currencies,
- financial institutions or other US holders that treat income in respect of the ordinary shares or ADSs as financial services income,
- insurance companies,

tax-exempt entities,

persons acquiring shares or ADSs in connection with employment,

US holders that hold the ordinary shares or ADSs as a part of a straddle or conversion transaction or other arrangement involving more than one position,

- US holders that own, or are deemed for US tax purposes to own, 10% or more of the total combined voting power of all classes of the Group s voting stock,

- US holders that have a principal place of business or tax home outside the United States, or

- US holders whose functional currency is not the US dollar.

For US federal income tax purposes, holders of ADSs will be treated as the owners of the ordinary shares represented by those ADSs. In practice, HM Revenue & Customs (HMRC) will also regard holders of ADSs as the beneficial owners of the ordinary shares represented by those ADSs, although case law has cast some doubt on this. The discussion below assumes that HMRC s position is followed.

In addition, the following discussion assumes that The Bank of New York Mellon will perform its obligations as depositary in accordance with the terms of the depositary agreement and any related agreements.

Because US and UK tax consequences may differ from one holder to the next, the discussion set out below does not purport to describe all of the tax considerations that may be relevant to you and your particular situation. Accordingly, you are advised to consult your own tax advisor as to the US federal, state and local, UK and other, including foreign, tax consequences of investing in the ordinary shares or ADSs. Except where otherwise indicated, the statements of US and UK tax law set out below are based on the laws, interpretations and tax authority practice in force or applicable as of February 28, 2018, including without limitation the legislation commonly referred to as the US Tax Cuts and Jobs Act signed into law on December 22, 2017 and are subject to any changes occurring after that date, possibly with retroactive effect.

UK income taxation of distributions

The UK does not impose dividend withholding tax on dividends paid by the Company.

A US holder that is not resident in the UK for UK tax purposes and does not carry on a trade, profession or vocation in the UK through a branch or agency (or in the case of a company a permanent establishment) to which the ordinary shares or ADSs are attributable will not generally be liable to pay UK tax on dividends paid by the Company.

US income taxation of distributions

Distributions that the Group makes with respect to the ordinary shares or ADSs, other than distributions in liquidation and distributions in redemption of stock that are treated as exchanges, will be taxed to US holders as ordinary dividend income to the extent that the distributions do not exceed the Group s current and accumulated earnings and profits. The amount of any distribution will equal the amount of the cash distribution. Distributions, if any, in excess of the Group s current and accumulated earnings and profits will constitute a non-taxable return of capital to a US holder and will be applied against and reduce the US holder s tax basis in its ordinary shares or ADSs. To the extent that these distributions exceed the tax basis of the US holder in its ordinary shares or ADSs, the excess generally will be treated as capital gain.

Dividends that the Group pays will not be eligible for the dividends received deduction generally allowed to US corporations under Section 243 of the Code.

In the case of distributions in pounds sterling, the amount of the distributions generally will equal the US dollar value of the pounds sterling distributed, determined by reference to the spot currency exchange rate on the date of receipt of the distribution by the US holder in the case of shares or by The Bank of New York Mellon in the case of ADSs, regardless of whether the US holder reports income on a cash basis or an accrual basis. The US holder will realize separate foreign currency gain or loss only to the extent that this gain or loss arises on the actual disposition of pounds sterling received. For US holders claiming tax credits on a cash basis, taxes withheld

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from the distribution are translated into US dollars at the spot rate on the date of the distribution; for US holders claiming tax credits on an accrual basis, taxes withheld from the distribution are translated into US dollars at the average rate for the taxable year.

A distribution by the Company to non-corporate shareholders will be taxed as net capital gain at a maximum rate of 20%, provided certain holding periods are met, to the extent such distribution is treated as a dividend under US federal income tax principles. In addition, a 3.8% Medicare tax will generally be imposed on the net investment income, which generally would include distributions treated as dividends under US federal income tax principles, of non-corporate taxpayers whose adjusted gross income exceeds a threshold amount.

UK taxation of capital gains

A US holder that is not resident in the UK for UK tax purposes and who does not carry on a trade, profession or vocation in the UK through a branch or agency (or in the case of a company a permanent establishment) to which the ordinary shares or ADSs are attributable will not generally be liable for UK taxation on capital gains or eligible for relief for allowable losses, realized on the sale or other disposal of the ordinary shares or ADSs.

A US holder who is an individual who has been resident for tax purposes in the UK but who ceases to be so resident or becomes regarded as resident outside the UK for the purposes of any double tax treaty (Treaty Non-resident) and continues to not be resident in the UK, or continues to be Treaty Non-resident, for a period of five years or less (or, for departures before 6 April 2013, ceases to be resident or ordinarily resident or becomes Treaty Non-resident for a period of less than five tax years) and who disposes of his ordinary shares or ADSs during that period may also be liable on his return to the UK to UK tax on capital gains, subject to any available exemption or relief, even though he is not resident in the UK, or is Treaty Non-resident, at the time of the disposal.

US income taxation of capital gains

Upon a sale or exchange of ordinary shares or ADSs to a person other than Pearson, a US holder will recognize gain or loss in an amount equal to the difference between the amount realized on the sale or exchange and the US holder s adjusted tax basis in the ordinary shares or ADSs. Any gain or loss recognized will be capital gain or loss and will be long-term capital gain or loss if the US holder has held the ordinary shares or ADSs for more than one year. Long-term capital gain of a non-corporate US holder is generally taxed at a maximum rate of 20%. In addition, a 3.8% Medicare tax will generally be imposed on the net investment income, which generally would include capital gains, of non-corporate taxpayers whose adjusted gross income exceeds a threshold amount.

Gain or loss realized by a US holder on the sale or exchange of ordinary shares or ADSs generally will be treated as US-source gain or loss for US foreign tax credit purposes.

Estate and gift tax

The current Estate and Gift Tax Convention, or the Convention, between the US and the UK generally relieves from UK Inheritance Tax (the equivalent of US Estate and Gift Tax) the transfer of ordinary shares or of ADSs where the transferor is domiciled in the US for the purposes of the Convention. This relief will not apply if the ordinary shares or ADSs are part of the business property of an individual s permanent establishment in the UK or pertain to the fixed base in the UK of a person providing independent personal services. If no relief is given under the Convention, inheritance tax may be charged on death and also on the amount by which the value of an individual s estate is reduced as a result of any transfer made by way of gift or other gratuitous or undervalue transfer, in general within seven years of death, and in certain other circumstances. In the unusual case where ordinary shares or ADSs are subject to both UK Inheritance Tax and US Estate or Gift Tax, the Convention generally provides for tax paid in the UK to be credited against tax payable in the US or for tax paid in the US to be credited against tax payable in the UK based on priority rules set forth in the Convention.

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Stamp duty

No stamp duty or stamp duty reserve tax (SDRT) will generally be payable in the UK on the purchase or transfer of an ADS, provided that the ADS, and any separate instrument or written agreement of transfer, remain at all times outside the UK and that the instrument or written agreement of transfer is not executed in the UK. Subject to the following paragraph, UK legislation does however provide for SDRT or (in the case of transfers) stamp duty to be chargeable at the rate of 1.5% of the amount or value of the consideration or, in some circumstances, the value of the ordinary shares (rounded up to the next multiple of £5 in the case of stamp duty), where ordinary shares are issued or transferred to a person whose business is or includes issuing depositary receipts, or to a nominee or agent for such a person, or issued or transferred to a person whose business is or includes the provision of clearance services or to a nominee or agent for such a person.

Following litigation, HM Revenue & Customs (HMRC) has accepted that it will no longer seek to apply the 1.5% SDRT charge when new shares are issued to a clearance service or depositary receipt system on the basis that the charge is not compatible with EU law. The UK Government have announced their intention to continue with this approach following the UK s departure from the EU. HMRC s view is that the 1.5% SDRT or stamp duty charge will continue to apply to transfers of shares into a clearance service or depositary receipt system, unless they are an integral part of an issue of share capital. However, further litigation indicates that certain other transfers are also not chargeable under EU Law. **Accordingly, specific professional advice should be sought before paying the 1.5% SDRT or stamp duty charge in any circumstances.**

A transfer for value of the underlying ordinary shares will generally be subject to either stamp duty or SDRT, normally at the rate of 0.5% of the amount or value of the consideration (rounded up to the next multiple of £5 in the case of stamp duty). A transfer of ordinary shares from a nominee to its beneficial owner, including the transfer of underlying ordinary shares from the Depositary to an ADS holder, under which no beneficial interest passes will not be subject to stamp duty or SDRT.

Close company status

The Group believes that the close company provisions of the UK Corporation Tax Act 2010 do not apply to it.

Documents on display

Copies of the Group s Memorandum and Articles of Association and filed as exhibits to this Annual Report and certain other documents referred to in this Annual Report are available for inspection at its registered office at 80 Strand, London WC2R 0RL (c/o the Company Secretary), during usual business hours upon reasonable prior request.

ITEM 11. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Introduction

Pearson s treasury function has primary responsibility for managing certain financial risks to which the Group is exposed. The Group s treasury policies are approved by the board of Directors annually and the audit committee receives regular reports on the Group s treasury activities, policies and procedures. Pearson s treasury function is not run as a profit center and does not enter into any transactions for speculative purposes. The treasury function is permitted to use derivatives for risk management purposes which may include interest rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts, of which interest rate swaps and forward foreign exchange swaps are the most commonly used.

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Capital risk

The Group s objectives when managing capital are:

- to safeguard the Group s ability to continue as a going concern and retain financial flexibility by maintaining a strong balance sheet;
- to provide returns for shareholders;
- to maintain a solid investment grade credit rating.

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

Interest and foreign exchange rate management

The Group s principal currency exposure is to the US dollar which represents more than 60% of the Group s sales. The Group s long-term bond debt is primarily held in US dollars to provide a natural hedge of this exposure. Pearson has balanced fixed float interest rate mix which is managed within Treasury policy limits.

It is achieved in two ways:

1. Issuing fixed rate US dollar bonds;

2. Issuing fixed rate euro bonds which are swapped to US dollar using interest rate and cross currency swaps.

A floating rate exposure is created in the first instance. Pearson has subsequently layered on several overlay floating to fixed hedges with a tenor matching the maturity of the 2021 and 2025 bond. This is in line with the Group s interest rate hedging policy, which requires a proportion of the Group s gross debt to be fixed. At December 31, 2017, the group had contracts to fix $579m of debt for the next 12 months (2016: $800m).

Overseas profits are converted to sterling to satisfy sterling expenses such as dividends at the prevailing spot rate at the time of the transaction. To the extent the Group has sufficient sterling, US dollars may be held as dollar cash to provide a natural offset to the Group s debt or to satisfy future US dollar cash outflows.

The group does not have significant cross border foreign exchange transactional exposures.

Liquidity and re-financing risk management

The Group regularly reviews the level of cash and debt facilities required to fund its activities. This involves preparing a prudent cash flow forecast for the next three to five years, determining the level of debt facilities required to fund the business, planning for repayments of debt at its maturity and identifying an appropriate amount of headroom to provide a reserve against unexpected outflows.

At December 31, 2017, the Group had cash of £0.6 billion and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75 billion (£1.3 billion). At December 31, 2016 the Group had cash of £1.5 billion and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75 billion (£1.4 billion). The $1.75 billion facility contains interest cover and leverage covenants which the Group has complied with for the year ended December 31, 2017.

Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover the Group s total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

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ITEM 12. ***DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES AMERICAN DEPOSITARY SHARES***

Fees paid by ADR holders

The Group s ordinary shares trade in the United States under a sponsored ADR facility with The Bank of New York Mellon as depositary.

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal, or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

The following table summarizes various fees currently charged by The Bank of New York Mellon:

Person depositing or withdrawing shares must pay to the depositary:	For:
$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property
	Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
$.05 (or less) per ADS	Any cash distribution to ADS registered holders
A fee equivalent to the fee that would be payable if securities distributed had been shares and the shares had been deposited for issuance of ADSs	Distribution of securities by the depositary to ADS registered holders of deposited securities
$.05 (or less) per ADS per calendar year	Depositary services
Registration of transfer fees	Transfer and registration of shares on the share register to or from the name of the depositary or its agent when shares are deposited or withdrawn
Expenses of the depositary	Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)
	Converting foreign currency to US dollars
Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary
Any charges incurred by the depositary or its agents for servicing the deposited securities	As necessary

Fees incurred in past annual period and fees to be paid in the future

The Company received $355,554 as reimbursement from the depositary with respect to 2017 for standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing the proxy voting materials, and tabulation for the non-registered holders, any applicable performance indicators relating to the ADR facility, and legal fees).

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The depositary has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS program. The depositary also agrees to pay the standard out-of-pocket maintenance costs for the registered ADR holders , which consists of the expenses of postage and envelopes for mailing proxy voting materials , printing and distributing dividend cheques, electronic filing of US Federal tax information, mailing required tax forms, stationery, postage, facsimile and telephone calls. It has also agreed to reimburse the Company annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depositary will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depositary collects from investors.

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PART II

ITEM 13. *DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES*

None.

ITEM 14. *MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS*

None.

ITEM 15. *CONTROLS AND PROCEDURES*

Disclosure controls and procedures

An evaluation of the effectiveness the Group s disclosure controls and procedures as of December 31, 2017 was carried out by management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures (as defined in Rules 13a- 15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as at December 31, 2017 at a reasonable assurance level. A controls system, no matter how well designed and operated, cannot provide absolute assurance to achieve its objectives.

Management s annual report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process designed by, or under the supervision of, the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, and effected by the Company board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management has assessed the effectiveness of internal control over financial reporting as of December 31, 2017 based on the framework in *Internal Control Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management has concluded that the Company s internal control over financial reporting was effective as a December 31, 2017 based on criteria in *Internal Control Integrated Framework* (2013) issued by the COSO.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the effectiveness of the Company s internal control over financial reporting as of December 31, 2017, as stated in their report which appears on page F-2.

Change in internal control over financial reporting

There have been no changes to internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting. During the period covered by this Annual Report on Form 20-F, the Company has embarked on a program of work to deliver a single Pearson-wide solution to integrate data, systems and processes across human resources, finance, procurement and supply chain. This program went live in the UK in 2016 with a resulting change in some aspects of the control environment.

ITEM 16A.*AUDIT COMMITTEE FINANCIAL EXPERT*

The members of the Board of Directors of Pearson plc have determined that Tim Score is an audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission.

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ITEM 16B. ***CODE OF ETHICS***

Pearson has adopted a code of ethics (the Pearson code of conduct) which applies to all employees including the chief executive officer and chief financial officer and other senior financial management. This code of ethics is available on the Group s website (www.pearson.com/code-of-conduct.html). The information on this website is not incorporated by reference into this report.

ITEM 16C. ***PRINCIPAL ACCOUNTANT FEES AND SERVICES***

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

The audit committee approves all audit and non-audit services provided by PwC.

Services provided by PwC above these limits and all other allowable non-audit services, such as due diligence, irrespective of value, must be approved by the audit committee. Where appropriate, services will be tendered prior to awarding this work to the auditor.

The following table sets forth remuneration paid to PwC for 2017 and 2016:

Auditors Remuneration	**2017 £m**	**2016 £m**
Audit fees	6	7
Tax fees		
All other fees	2	2

Audit fees include £35,000 (2016: £35,000) of audit fees relating to the audit of the parent company.

Fees for the audit of the effectiveness of the Group s internal control over financial reporting are allocated to audit fees paid.

Tax services include services related to tax compliance and advisory services.

ITEM 16D. ***EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES***

Not applicable.

ITEM 16E. ***PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASES***

Period	**Total number of shares purchased**	**Average price paid per share**	**Total number of units purchased as part of publicly announced plans or programs**	**Approximate maximum value of shares that may yet be purchased under the plans or programs**
July 1, 2015 July 31, 2015	1,974,362	£11.81	n/a	n/a
August 1, 2016 August 31, 2016	3,000,000	£8.92	n/a	n/a
October 1, 2017 October 31, 2017	4,846,809	£7.03	4,846,809	£ 266m
November 1, 2017 November 30, 2017	11,210,922	£6.99	11,210,922	£ 187m

December 1, 2017	December 31, 2017	4,938,170	£7.23	4,938,170	£	151m
January 1, 2018	January 31, 2018	9,895,690	£7.03	9,895,690		£81m
February 1, 2018	February 28, 2018	11,943,986	£6.77	11,943,986		£nil

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Purchases of shares in 2015 and 2016 were made to satisfy obligations under Pearson employee share award programs. All purchases were made in open-market transactions.

In October 2017, The Group announced a £300m share buyback program. In 2017, the Group s brokers purchased 21m shares at a total value of £153m of which £149m had been cancelled at December 31, 2017. Cash payments of £149m had been made in respect of the purchases with the outstanding £4m settlement made at the beginning of January 2018. This £4m together with the remaining value of the buyback program of £147m was recorded as a liability at December 31, 2017. A further 22m shares were purchased under the program in 2018. The shares bought back were cancelled and the nominal value of these shares was transferred to a capital redemption reserve. The nominal value of shares cancelled at December 31, 2017 was £5m.

ITEM 16F. ***CHANGE IN REGISTRANT S CERTIFYING AUDITOR***

Not applicable.

ITEM 16G. ***CORPORATE GOVERNANCE***

Pearson is listed on the New York Stock Exchange (NYSE). As a listed non-US issuer, the Group is required to comply with some of the NYSE s corporate governance rules, and otherwise must disclose on its website any significant ways in which its corporate governance practices differ from those followed by US companies under the NYSE listing standards. At this time, the Company believes that it is in compliance in all material respects with all the NYSE rules except that the Remuneration Committee and the Nomination & Governance Committee are not composed entirely of independent directors as the Chairman, who is not considered independent under NYSE rules, is a member of each committee in addition to independent directors.

ITEM 16H. ***MINE SAFETY DISCLOSURE***

Not applicable.

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PART III

ITEM 17. ***FINANCIAL STATEMENTS***

Not applicable.

ITEM 18. ***FINANCIAL STATEMENTS***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-151 hereof.

ITEM 19. ***EXHIBITS***

1.1	Articles of Association of Pearson plc. ¥
2.1	Indenture dated June 23, 2003 between Pearson plc and The Bank of New York, as trustee *
2.2	Indenture dated May 6, 2008 among Pearson Dollar Finance Two plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York, as trustee, Paying Agent and Calculation Agent.
2.3	Indenture dated May 8, 2012 between Pearson Funding Four plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. f
2.4	Indenture dated May 8, 2013 between Pearson Funding Five plc, as the Issuer, Pearson plc, Guarantor, and The Bank of New York Mellon, as trustee, Paying Agent and Calculation Agent. q
2.5	Trust Deed dated May 19, 2014 between Pearson Funding Five plc, as the Issuer, Pearson plc, Guarantor, and The Law Debenture Trust Corporation P.L.C, as trustee. ¥
2.6	Trust Deed dated May 6, 2015 between Pearson Funding Five plc, as the Issuer, Pearson plc, Guarantor, and The Law Debenture Trust Corporation P.L.C, as trustee. l
8.1	List of Significant Subsidiaries.
12.1	Certification of Chief Executive Officer.
12.2	Certification of Chief Financial Officer.
13.1	Certification of Chief Executive Officer.
13.2	Certification of Chief Financial Officer.
15	Consent of PricewaterhouseCoopers LLP.
15.1	Consent of PricewaterhouseCoopers GmbH.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

* Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2003 and filed May 7, 2004.
Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2009 and filed March 31, 2010.
f Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2012 and filed March 22, 2013.
q Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2013 and filed March 27, 2014.
¥ Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2014 and filed March 26, 2015.
l Incorporated by reference from the Form 20-F of Pearson plc for the year ended December 31, 2015 and filed March 23, 2016.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Pearson plc

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Pearson plc and its subsidiaries as of December 31, 2017 and 2016, and the related consolidated income statements, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated cash flow statements for each of the three years in the period ended December 31, 2017 including the related notes (collectively referred to as the consolidated financial statements). We also have audited the Company s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with International Financial Reporting Standards as adopted by the European Union. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control Integrated Framework* (2013) issued by the COSO.

Basis for Opinions

The Company s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Annual Report on Internal Control Over Financial Reporting appearing under item 15. of this Form 20-F . Our responsibility is to express opinions on the Company s consolidated financial statements and on the Company s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/PricewaterhouseCoopers LLP

London

United Kingdom

April 4, 2018

We have served as the Company s auditor since 1996.

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Pearson plc Consolidated Financial Statements

Consolidated income statement

Year ended 31 December 2017

All figures in £ millions	Notes	**2017**	2016	2015
Continuing operations				
Sales	2	**4,513**	4,552	4,468
Cost of goods sold	4	**(2,066)**	(2,093)	(1,981)
Gross profit		**2,447**	2,459	2,487
Operating expenses	4	**(2,202)**	(2,480)	(2,107)
Other net gains and losses	4	**128**	(25)	13
Impairment of intangible assets	11		(2,548)	(849)
Share of results of joint ventures and associates	12	**78**	97	52
Operating profit/(loss)	2	**451**	(2,497)	(404)
Finance costs	6	**(110)**	(97)	(100)
Finance income	6	**80**	37	71
Profit/(loss) before tax		**421**	(2,557)	(433)
Income tax	7	**(13)**	222	81
Profit/(loss) for the year from continuing operations		**408**	(2,335)	(352)
Profit for the year from discontinued operations				1,175
Profit/(loss) for the year		**408**	(2,335)	823
Attributable to:				
Equity holders of the company		**406**	(2,337)	823
Non-controlling interest		**2**	2	
Earnings per share/(loss) from continuing and discontinued operations attributable to equity holders of the company during the year (expressed in pence per share)				
basic	8	**49.9p**	(286.8)p	101.2p
diluted	8	**49.9p**	(286.8)p	101.2p
Earnings per share/(loss) from continuing operations attributable to equity holders of the company during the year (expressed in pence per share)				
basic	8	**49.9p**	(286.8)p	(43.3)p
diluted	8	**49.9p**	(286.8)p	(43.3)p

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Pearson plc Consolidated Financial Statements

Consolidated statement of comprehensive income

Year ended 31 December 2017

All figures in £ millions	Notes	**2017**	2016	2015
Profit/(loss) for the year		**408**	(2,335)	823
Items that may be reclassified to the income statement				
Net exchange differences on translation of foreign operations Group		**(158)**	910	(85)
Net exchange differences on translation of foreign operations associates		**(104)**	3	16
Currency translation adjustment disposed		**(51)**		(10)
Attributable tax	7	**9**	(5)	5
Fair value gain on other financial assets		**13**		
Attributable tax	7	**(4)**		
Items that are not reclassified to the income statement				
Remeasurement of retirement benefit obligations Group	25	**175**	(268)	110
Remeasurement of retirement benefit obligations associates		**7**	(8)	8
Attributable tax	7	**(42)**	58	(24)
Other comprehensive (expense)/income for the year	29	**(155)**	690	20
Total comprehensive income/(expense) for the year		**253**	(1,645)	843
Attributable to:				
Equity holders of the company		**251**	(1,648)	845
Non-controlling interest		**2**	3	(2)

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Pearson plc Consolidated Financial Statements

Consolidated balance sheet

As at 31 December 2017

All figures in £ millions	Notes	**2017**	2016
Assets			
Non-current assets			
Property, plant and equipment	10	**281**	343
Intangible assets	11	**2,964**	3,442
Investments in joint ventures and associates	12	**398**	1,247
Deferred income tax assets	13	**95**	451
Financial assets derivative financial instruments	16	**140**	171
Retirement benefit assets	25	**545**	158
Other financial assets	15	**77**	65
Trade and other receivables	22	**103**	104
		4,603	5,981
Current assets			
Intangible assets pre-publication	20	**741**	1,024
Inventories	21	**148**	235
Trade and other receivables	22	**1,110**	1,357
Financial assets marketable securities	14	**8**	10
Cash and cash equivalents (excluding overdrafts)	17	**518**	1,459
		2,525	4,085
Assets classified as held for sale	32	**760**	
Total assets		**7,888**	10,066
Liabilities			
Non-current liabilities			
Financial liabilities borrowings	18	**(1,066)**	(2,424)
Financial liabilities derivative financial instruments	16	**(140)**	(264)
Deferred income tax liabilities	13	**(164)**	(466)
Retirement benefit obligations	25	**(104)**	(139)
Provisions for other liabilities and charges	23	**(55)**	(79)
Other liabilities	24	**(133)**	(422)
		(1,662)	(3,794)
Current liabilities			
Trade and other liabilities	24	**(1,342)**	(1,629)
Financial liabilities borrowings	18	**(19)**	(44)
Current income tax liabilities		**(231)**	(224)
Provisions for other liabilities and charges	23	**(25)**	(27)
		(1,617)	(1,924)
Liabilities classified as held for sale	32	**(588)**	

Total liabilities	**(3,867)**	(5,718)
Net assets	**4,021**	4,348

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All figures in £ millions	Notes	2017	2016
Equity			
Share capital	27	**200**	205
Share premium	27	**2,602**	2,597
Treasury shares	28	**(61)**	(79)
Capital redemption reserve		**5**	
Fair value reserve		**13**	
Translation reserve		**592**	905
Retained earnings		**662**	716
Total equity attributable to equity holders of the company		**4,013**	4,344
Non-controlling interest		**8**	4
Total equity		**4,021**	4,348

These financial statements have been approved for issue by the Board of Directors on 14 March 2018 and signed on its behalf by

Coram Williams

Chief Financial Officer

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Pearson plc Consolidated Financial Statements

Consolidated statement of changes in equity

Year ended 31 December 2017

All figures in £ millions	**Equity attributable to equity holders of the company**									
	Share capital	**Share premium**	**Treasury shares**	**Capital redemption reserve**	**Fair value reserve**	**Translation reserve**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
At 1 January 2017	**205**	**2,597**	**(79)**			**905**	**716**	**4,344**	**4**	**4,348**
Profit for the year							**406**	**406**	**2**	**408**
Other comprehensive income/(expense)					**13**	**(313)**	**145**	**(155)**		**(155)**
Total comprehensive income/(expense)					**13**	**(313)**	**551**	**251**	**2**	**253**
Equity-settled transactions							**33**	**33**		**33**
Issue of ordinary shares under share option schemes		**5**						**5**		**5**
Buyback of equity	**(5)**			**5**			**(300)**	**(300)**		**(300)**
Purchase of treasury shares										
Release of treasury shares			**18**				**(18)**			
Changes in non-controlling interest							**(2)**	**(2)**	**2**	
Dividends							**(318)**	**(318)**		**(318)**
At 31 December 2017	**200**	**2,602**	**(61)**	**5**	**13**	**592**	**662**	**4,013**	**8**	**4,021**

All figures in £ millions	Equity attributable to equity holders of the company									
	Share capital	Share premium	Treasury shares	Capital redemption reserve	Fair value reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
At 1 January 2016	205	2,590	(72)			(7)	3,698	6,414	4	6,418
Loss for the year							(2,337)	(2,337)	2	(2,335)
Other comprehensive income/(expense)						912	(223)	689	1	690
Total comprehensive income/(expense)						912	(2,560)	(1,648)	3	(1,645)
Equity-settled transactions							22	22		22
Issue of ordinary shares under share option schemes		7						7		7
Buyback of equity										
Purchase of treasury shares			(27)					(27)		(27)
Release of treasury shares			20				(20)			
Changes in non-controlling interest									(3)	(3)
Dividends							(424)	(424)		(424)
At 31 December 2016	205	2,597	(79)			905	716	4,344	4	4,348

The capital redemption reserve reflects the nominal value of shares cancelled in the Group s share buyback programme. The fair value reserve arises on revaluation of other financial assets. The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments.

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All figures in £ millions	Share capital	Share premium	Treasury shares	Capital redemption reserve	Fair value reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
	Equity attributable to equity holders of the company									
At 1 January 2015	205	2,579	(75)			70	3,200	5,979	6	5,985
Profit for the year							823	823		823
Other comprehensive income						(77)	99	22	(2)	20
Total comprehensive income						(77)	922	845	(2)	843
Equity-settled transactions							26	26		26
Tax on equity-settled transactions							(1)	(1)		(1)
Issue of ordinary shares under share option schemes		11						11		11
Purchase of treasury shares			(23)					(23)		(23)
Release of treasury shares			26				(26)			
Changes in non-controlling interest										
Dividends							(423)	(423)		(423)
At 31 December 2015	205	2,590	(72)			(7)	3,698	6,414	4	6,418

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Pearson plc Consolidated Financial Statements

Consolidated cash flow statement

Year ended 31 December 2017

All figures in £ millions	Notes	2017	2016	2015
Cash flows from operating activities				
Net cash generated from operations	33	**462**	522	518
Interest paid		**(89)**	(67)	(75)
Tax paid		**(75)**	(45)	(232)
Net cash generated from operating activities		**298**	410	211
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	30	**(11)**	(15)	(9)
Acquisition of joint ventures and associates				(11)
Purchase of investments		**(3)**	(6)	(7)
Purchase of property, plant and equipment		**(82)**	(88)	(86)
Purchase of intangible assets		**(150)**	(157)	(161)
Disposal of subsidiaries, net of cash disposed	31	**19**	(54)	1,030
Proceeds from sale of associates	31	**411**	4	379
Proceeds from sale of investments			92	13
Proceeds from sale of property, plant and equipment	33		4	2
Proceeds from sale of intangible assets				1
Proceeds from sale of liquid resources		**20**	42	17
Loans (advanced)/repaid by related parties		**(13)**	14	7
Investment in liquid resources		**(18)**	(24)	(29)
Interest received		**20**	16	24
Dividends received from joint ventures and associates		**458**	131	162
Net cash generated from/(used in) investing activities		**651**	(41)	1,332
Cash flows from financing activities				
Proceeds from issue of ordinary shares	27	**5**	7	11
Buyback of equity	27	**(149)**		
Purchase of treasury shares	28		(27)	(23)
Proceeds from borrowings		**2**	4	372
Repayment of borrowings		**(1,294)**	(249)	(300)
Finance lease principal payments		**(5)**	(6)	(1)
Transactions with non-controlling interest			(2)	
Dividends paid to company s shareholders	9	**(318)**	(424)	(423)
Net cash used in financing activities		**(1,759)**	(697)	(364)
Effects of exchange rate changes on cash and cash equivalents		**16**	81	(19)
Net decrease in cash and cash equivalents		**(794)**	(247)	1,160
Cash and cash equivalents at beginning of year		**1,424**	1,671	511
Cash and cash equivalents at end of year	17	**630**	1,424	1,671

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements

General information

Pearson plc (the company), its subsidiaries and associates (together the Group) are international businesses covering educational courseware, assessments and services, and consumer publishing through its associate interest in Penguin Random House.

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

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

These consolidated financial statements were approved for issue by the Board of Directors on 14 March 2018.

1. Accounting policies

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

a. Basis of preparation

These consolidated financial statements have been prepared on the going concern basis and in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) interpretations as issued by the IASB and in conformity with IFRS as adopted by the EU.

These consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value through profit or loss.

1. Interpretations and amendments to published standards effective 2017 The following amendments and interpretations were adopted in 2017:

Amendments to IFRS 12 Disclosure of Interests in Other Entities Annual Improvements 2014-2016 cycle

Amendments to IAS 7 Statement of Cash Flows Disclosure Initiative

Amendments to IAS 12 Income Taxes Recognition of Deferred Tax Assets for Unrealised Losses

The adoption of these new pronouncements from 1 January 2017 does not have a material impact on the consolidated financial statements. Additional disclosure has been given where relevant.

2. Standards, interpretations and amendments to published standards that are not yet effective New accounting standards and interpretations have been published that are not mandatory for the year ended 31 December 2017. The Group has elected not to early-adopt these new standards and interpretations. The Group s assessment of the impact of these new standards is set out below.

IFRS 9 Financial Instruments , effective for annual reporting periods beginning on or after 1 January 2018. The standard, which replaces IAS 39 Financial Instruments: Recognition and Measurement , addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new hedge accounting rules and a new impairment model for financial assets. The Group will adopt IFRS 9 as at 1 January

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

2018 and apply the new rules retrospectively, with the practical expedients permitted in the standard. Comparatives for 2017 will not be restated. The Group has assessed the impact of adopting IFRS 9 and is expecting the following impact:

Classification and measurement: The Group has reviewed its financial assets and liabilities and does not expect any changes in classification or measurement as a result of adopting IFRS 9. Trade receivables will continue to be measured at amortised cost as they are held to collect contractual cash flows which represent solely payments of principal and interest, in accordance with the business model. There will be no impact on classification and measurement of financial liabilities as the new requirements only affect the accounting for financial liabilities which are designated at fair value through the profit and loss account, and the Group does not have any such liabilities. Derivative assets and liabilities will continue to be recognised at fair value with movements recognised in finance income or costs, unless the hedging strategy determines otherwise. The Group s equity financial investments will continue to be recognised at fair value and the Group has elected the option to recognise all movements in fair value in other comprehensive income (FVOCI). Gains or losses realised on the subsequent sale of these financial assets will no longer be recycled through the profit and loss account, but instead reclassified from the FVOCI reserve to retained earnings. During 2017, £nil of such gains/losses were recycled to the profit and loss account in relation to the disposal of available-for-sale assets.

Impairment: IFRS 9 introduces a new impairment model which requires the recognition of impairment provisions based on expected credit losses rather than only incurred credit losses, as is the case under IAS 39. The Group expects this new impairment model will lead to a small increase in its provision for losses against trade debtors, representing anticipated losses (evidenced by both historical recovery rates and forward-looking indicators) where there has been no triggering event to suggest any impairment incurred to date. The Group expects its provision for losses against trade debtors as at 1 January 2018 to increase by an amount approximating 1% of gross trade debtors as a result of adopting the expected credit loss model for impairments. The Group does not anticipate the expected credit loss model having a material impact on profit before tax for 2018 unless market conditions or other factors change the outlook for credit losses.

Hedge accounting: IFRS 9 introduces a new, simpler hedge accounting model with a principles-based approach designed to align the accounting result with the economic hedging strategy. The group currently uses fair value hedge relationships to hedge interest rate risk and currency risk on its bond borrowings and also uses net investment hedging relationships to hedge currency re-translation risk on its overseas assets. The Group has confirmed that its current hedge relationships will continue to qualify as hedges upon the adoption of IFRS 9. The Group does not currently undertake any cash flow hedging, but is reviewing its strategy with regard to currency risk. Should the Group decide to expand its hedging strategy in this area, changes in fair value relating to forward points or currency basis may, subject to hedge designation, be deferred in a cost of hedging reserve and recognised against the related hedge transaction when it occurs.

IFRS 9 also requires additional disclosure which will be incorporated in the 2018 annual report.

IFRS 15 Revenue from Contracts with Customers , effective for annual reporting periods beginning on or after 1 January 2018. The standard, which replaces IAS 18 covering contracts for goods and services, and IAS 11 covering construction contracts, addresses the recognition of revenue. The new standard is based on the principle that revenue is recognised to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services. The Group will adopt the new standard as at 1 January 2018 and apply the modified retrospective approach.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

Comparatives for 2017 will not be restated and the cumulative impact of adoption will be recognised in retained earnings as at 1 January 2018.

The Group has reviewed the impact of adopting IFRS 15 across its various geographies and lines of business, with reference to underlying contractual terms and business practices, and has identified four areas of impact, as follows:

Unexercised customer rights (or breakage): The Group sells rights to future performance to customers which may go unexercised. While the customer has paid for future performance, usage is at the customer s discretion and those rights may expire prior to usage, or never be used. The Group maintains historical customer data to understand usage patterns over time (i.e. redemption rates). Where the Group expects to have no future obligation (based on these redemption rates), revenue has historically been recognised immediately for this portion of the sale. Under IFRS 15, where the Group currently recognises this breakage element on subscriptions, revenue instead will be recognised evenly over the period of use. Where breakage relates to sales of tests or vouchers, revenue will be recognised when the underlying tests are delivered. This revised treatment in respect of breakage primarily affects the school and higher education businesses in North America and will result in higher deferred revenue upon adoption on 1 January 2018.

Online Program Management (OPM) marketing: Historically the OPM (Embanet) business recognised revenue for the pre-semester costs of marketing and recruitment as a separate performance obligation from course delivery during the semester (i.e. revenue was recognised in line with the marketing costs incurred). Under IFRS 15, revenue will be recognised on a straight-line basis over the semester with no revenue recognised up front for pre-semester recruitment and marketing costs based on management s judgement under the new standard s requirements assessing the start of the Group s contract and determining the Group s performance obligations. This revised treatment of pre-semester costs only affects the OPM business in North America and will result in a lower trade receivable balance upon adoption on

1 January 2018.

Administration fees: This relates to non-refundable upfront administration fees charged to customers which do not relate to the transfer of a promised good or service to the customer. Rather these fees are charged to cover internal costs, such as registration fees for testing candidate exams. Historically administration fees have been recognised in revenue up front when charged. Under IFRS 15, such fees must be deferred and recognised over the period over which services are provided as they do not relate to a specific performance obligation. This revised treatment primarily affects the UK Assessments business and will result in higher deferred revenue upon adoption on 1 January 2018.

Commissions: This relates to incremental costs of obtaining customer contracts, such as sales incentive plans or sales commissions specifically linked to obtaining new contracts. Historically such commissions have been charged to the profit and loss account as incurred. Under IFRS 15, sales commissions in respect of customer transactions with an accounting period of greater than one year will be capitalised and amortised over that accounting period, using practical expedients permissible under the new standard. This revised treatment affects the US Assessments business and will result in a higher contract asset upon adoption on 1 January 2018.

IFRS 15 also requires increased disclosure, in particular analysis of disaggregated revenues, contract balances and transaction price allocated to remaining performance obligations. This disclosure will be incorporated in the 2018 annual report.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

Had the Group been applying IFRS 15 during 2017, both sales and profit before tax would have been around £2m higher, with the balance sheet impact at the beginning and end of the year being similar.

The impact on sales and profit before tax for 2018 is not expected to be materially different to 2017, assuming a like-for-like business portfolio. The cumulative pre-tax impact of adopting IFRS 15 on 1 January 2018 is expected to reduce retained earnings by around £143m, with deferred revenue increasing by £106m, trade receivables reducing by £38m and contract assets increasing by £1m.

IFRS 16 Leases , effective for annual reporting periods beginning on or after 1 January 2019. Early adoption is permitted. The new standard replaces IAS 17 Leases and related interpretations and details the requirements for the classification, measurement and recognition of lease arrangements. Adoption of the new standard is likely to have a material impact on the Group. Management continues to assess this impact but cannot reasonably estimate this impact due to judgements which are required to be made for each lease and the adoption methods available. The actual impact of applying IFRS 16 will depend on the composition of the Group s lease portfolio at the adoption date and the extent to which the Group chooses to use practical expedients and recognition exemptions. The Group plans to apply IFRS 16 on 1 January 2019, and anticipates using the modified retrospective approach. Under this approach, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings on 1 January 2019, with no restatement of comparative information.

Although the Group has not completed its detailed assessment, the following changes to lessee accounting are likely to have a material impact:

Currently no lease assets are included on the Group s consolidated balance sheet for operating leases. Under IFRS 16 right-of-use assets will be recorded on the balance sheet for assets that are leased by the Group

Currently no lease liabilities are included on the Group s consolidated balance sheet for future operating lease payments; these are disclosed as commitments. Under IFRS 16 liabilities will be recorded for future lease payments. As at 31 December 2017, the Group s future aggregate minimum lease payments under non-cancellable operating leases amounted to £1,203m, on an undiscounted basis (see note 35)

Currently operating lease rentals, net of any incentives received, are expensed to the income statement on a straight-line basis over the period of the lease. Under IFRS 16 the lease expense will represent the depreciation of the right-of-use asset together with interest charged on lease liabilities

Currently operating lease cash flows are included within operating cash flows in the Group s consolidated cash flow statement. Under IFRS 16 these cash flows will be recorded as cash flows from financing activities being the repayment of lease liabilities and related interest

Lessor accounting under IFRS 16 is similar to IAS 17 accounting and is not expected to have a material impact on the Group.

In June 2015, the IASB issued an exposure draft ED/2015/5 Remeasurement on a Plan Amendment, Curtailment or Settlement/Availability of a Refund from a Defined benefit Plan (Proposed Amendments to IAS 19 and IFRIC 14) . The proposed amendments to IFRIC 14, which may have restricted the Group s ability to recognise a pension asset in respect of pension surpluses in its UK defined benefit plan, have now been withdrawn.

A number of other new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2017, and have not been applied in preparing these financial statements. None of these is expected to have a material impact on the consolidated financial statements.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

3. Critical accounting assumptions and judgements The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting assumptions. It also requires management to exercise its judgement in the process of applying the Group s accounting policies. The areas requiring a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are discussed in the relevant accounting policies under the following headings and in the notes to the accounts where appropriate:

Consolidation: Business combinations classification of investments (see note 1b(1))

Intangible assets: Goodwill (see note 1e(1))

Intangible assets: Pre-publication assets (see note 1e(5)) Taxation (see note 1m)

Revenue recognition including provisions for returns (see note 1p)

Employee benefits: Pensions (see note 1n(1))

Consolidation: Business combinations determination of fair values (where relevant) (see note 1b(1))

b. Consolidation

1. Business combinations The acquisition method of accounting is used to account for business combinations.

The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred in the operating expenses line of the income statement. Identifiable assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The determination of fair values often requires significant judgements and the use of estimates, and, for material acquisitions, the fair value of the acquired intangible assets is determined by an independent valuer. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill (see note 30).

See note 1e(1) for the accounting policy on goodwill. If this is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest s proportionate share of the acquiree s net assets.

IFRS 3 Business Combinations has not been applied retrospectively to business combinations before the date of transition to IFRS.

Management exercises judgement in determining the classification of its investments in its businesses, in line with the following:

2. Subsidiaries Subsidiaries are entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

b. Consolidation continued

3. Transactions with non-controlling interests Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions, that is, as transactions with the owners in their capacity as owners. Any surplus or deficit arising from disposals to a non-controlling interest is recorded in equity. For purchases from a non-controlling interest, the difference between consideration paid and the relevant share acquired of the carrying value of the subsidiary is recorded in equity.

4. Joint ventures and associates Joint ventures are entities in which the Group holds an interest on a long-term basis and has rights to the net assets through contractually agreed sharing of control. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Ownership percentage is likely to be the key indicator of investment classification; however, other factors, such as Board representation, may also affect the accounting classification. Judgement is required to assess all of the qualitative and quantitative factors which may indicate that the Group does, or does not, have significant influence over an investment. Penguin Random House is the Group s only material associate see note 12 for further details on the judgements involved in its accounting classification. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at the fair value of consideration transferred.

The Group s share of its joint ventures and associates post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves.

The Group s share of its joint ventures and associates results is recognised as a component of operating profit as these operations form part of the core publishing business of the Group and are an integral part of existing wholly-owned businesses. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group s share of losses in a joint venture or associate equals or exceeds its interest in the joint venture or associate, the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the joint venture or associate.

5. Contribution of a subsidiary to an associate or joint venture The gain or loss resulting from the contribution or sale of a subsidiary to an associate or a joint venture is recognised in full. Where such transactions do not involve cash consideration, significant judgements and estimates are used in determining the fair values of the consideration received.

c. Foreign currency translation

1. Functional and presentation currency Items included in the financial statements of each of the Group s entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling, which is the company s functional and presentation currency.

2. Transactions and balances Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying net investment hedges.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

c. Foreign currency translation continued

3. Group companies The results and financial position of all Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

i) Assets and liabilities are translated at the closing rate at the date of the balance sheet

ii) Income and expenses are translated at average exchange rates

iii) All resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders equity. The Group treats specific inter-company loan balances, which are not intended to be repaid in the foreseeable future, as part of its net investment. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.30 (2016: $1.33) and the year-end rate was $1.35 (2016: $1.23).

d. Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for intended use. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives as follows:

Buildings (freehold):	20-50 years
Buildings (leasehold):	over the period of the lease
Plant and equipment:	3-10 years

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

The carrying value of an asset is written down to its recoverable amount if the carrying value of the asset is greater than its estimated recoverable amount.

e. Intangible assets

1. Goodwill For the acquisition of subsidiaries made on or after 1 January 2010, goodwill represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired. For the acquisition of subsidiaries made from the date of transition to IFRS to 31 December 2009, goodwill represents the excess of the cost of an acquisition over the fair value of the Group s share of the net identifiable assets acquired. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisition of associates and joint ventures represents the excess of the cost of an acquisition over the fair value of the Group s share of the net identifiable assets acquired. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. An impairment loss is recognised to the extent that the carrying value of goodwill exceeds the recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and value in use. These calculations require the use of estimates in respect of forecast cash flows and discount rates and significant management judgement in respect of CGU and cost allocation. A description of the key assumptions and sensitivities is included in note 11. Goodwill is allocated to aggregated cash-generating units for the purpose of impairment testing. The allocation is made to those aggregated cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

2. Acquired software Software separately acquired for internal use is capitalised at cost. Software acquired in material business combinations is capitalised at its fair value as determined by an independent valuer. Acquired software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

3. Internally developed software Internal and external costs incurred during the preliminary stage of developing computer software for internal use are expensed as incurred. Internal and external costs incurred to develop computer software for internal use during the application development stage are capitalised if the Group expects economic benefits from the development. Capitalisation in the application development stage begins once the Group can reliably measure the expenditure attributable to the software development and has demonstrated its intention to complete and use the software. Internally developed software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

4. Acquired intangible assets Acquired intangible assets include customer lists, contracts and relationships, trademarks and brands, publishing rights, content, technology and software rights. These assets are capitalised on acquisition at cost and included in intangible assets. Intangible assets acquired in material business combinations are capitalised at their fair value as determined by an independent valuer. Intangible assets are amortised over their estimated useful lives of between two and 20 years, using an amortisation method that reflects the pattern of their consumption.

5. Pre-publication assets Pre-publication assets represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating lifecycle of the title, with a higher proportion of the amortisation taken in the earlier years.

The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 33).

The assessment of the recoverability of pre-publication assets involve a significant degree of judgement based on historical trends and management estimation of future potential sales. An incorrect amortisation profile could result in excess amounts being carried forward as intangible assets that would otherwise have been written off to the income statement in an earlier period.

Reviews are performed regularly to estimate recoverability of pre-publication assets. The carrying amount of pre-publication assets is set out in note 20.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

f. Other financial assets

Other financial assets, designated as available for sale investments, are non-derivative financial assets measured at estimated fair value. Changes in the fair value are recorded in equity in the fair value reserve. On the subsequent disposal of the asset, the net fair value gains or losses are taken to the income statement.

g. Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale. Provisions are made for slow-moving and obsolete stock.

h. Royalty advances

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realisable value of author contracts is overstated, this will have an adverse effect on operating profits as these excess amounts will be written off.

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors.

The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non-current assets.

i. Cash and cash equivalents

Cash and cash equivalents in the cash flow statement include cash in hand, deposits held on call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are included in borrowings in current liabilities in the balance sheet.

Short-term deposits and marketable securities with maturities of greater than three months do not qualify as cash and cash equivalents and are reported as financial assets. Movements on these financial assets are classified as cash flows from financing activities in the cash flow statement where these amounts are used to offset the borrowings of the Group or as cash flows from investing activities where these amounts are held to generate an investment return.

j. Share capital

Ordinary shares are classified as equity.

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

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

j. Share capital continued

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

Ordinary shares purchased under a buyback programme are cancelled and the nominal value of the shares is transferred to a capital redemption reserve.

k. Borrowings

Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. Accrued interest is included as part of borrowings. Where a debt instrument is in a fair value hedging relationship, an adjustment is made to its carrying value in the income statement to reflect the hedged risk.

l. Derivative financial instruments

Derivatives are recognised at fair value and remeasured at each balance sheet date. The fair value of derivatives is determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

Changes in the fair value of derivatives are recognised immediately in finance income or costs. However, derivatives relating to borrowings and certain foreign exchange contracts are designated as part of a hedging transaction. The accounting treatment is summarised as follows:

Typical reason for designation	Reporting of gains and losses on effective portion of the hedge	Reporting of gains and losses on disposal
Net investment hedge		
The derivative creates a foreign currency liability which is used to hedge changes in the value of a subsidiary which transacts in that currency.	Recognised in other comprehensive income.	On disposal, the accumulated value of gains and losses reported in other comprehensive income is transferred to the income statement.
Fair value hedges		
The derivative transforms the interest profile on debt from fixed rate to floating rate. Changes in the value of the debt as a result of changes in interest rates are offset by equal and opposite changes in the value of the derivative. When the Group s debt is swapped to floating rates, the contracts used are designated as fair value	Gains and losses on the derivative are reported in finance income or finance costs. However, an equal and opposite change is made to the carrying value of the debt (a fair value adjustment) with the benefit/cost reported in finance income or finance costs. The net result should be a zero charge on a perfectly effective	If the debt and derivative are disposed of, the value of the derivative and the debt (including the fair value adjustment) are reset to zero. Any resultant gain or loss is recognised in finance income or finance costs.

hedges.	hedge.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

l. Derivative financial instruments continued

Typical reason for designation	Reporting of gains and losses on effective portion of the hedge	Reporting of gains and losses on disposal
Non-hedge accounted contracts		
These are not designated as hedging instruments. Typically these are short- term contracts to convert debt back to fixed rates or foreign exchange contracts where a natural offset exists.	No hedge accounting applies.	

m. Taxation

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

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

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

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

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

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises tax provisions when it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are based on management s best judgement of the application of tax legislation and best estimates of future settlement amounts (see note 7). Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, significant judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income together with any future tax planning strategies (see note 13).

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

n. Employee benefits

1. Pensions The retirement benefit asset and obligation recognised in the balance sheet represents the net of the present value of the defined benefit obligation and the fair value of plan assets at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high-quality corporate bonds which have terms to maturity approximating the terms of the related liability.

When the calculation results in a potential asset, the recognition of that asset is limited to the asset ceiling that is the present value of any economic benefits available in the form of refunds from the plan or a reduction in future contributions. Management uses judgement to determine the level of refunds available from the plan in recognising an asset.

The determination of the pension cost and defined benefit obligation of the Group s defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth and longevity (see note 25).

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. Net interest is calculated by applying the discount rate to the net defined benefit obligation and is presented as finance costs or finance income.

Obligations for contributions to defined contribution pension plans are recognised as an operating expense in the income statement as incurred.

2. Other post-retirement obligations The expected costs of post-retirement medical and life assurance benefits are accrued over the period of employment, using a similar accounting methodology as for defined benefit pension obligations. The liabilities and costs relating to significant other post-retirement obligations are assessed annually by independent qualified actuaries.

3. Share-based payments The fair value of options or shares granted under the Group s share and option plans is recognised as an employee expense after taking into account the Group s best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised.

o. Provisions

Provisions are recognised if the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are discounted to present value where the effect is material.

The Group recognises a provision for deferred consideration. Where this is contingent on future performance or a future event, judgement is exercised in establishing the fair value.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

o. Provisions continued

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. The provision is based on the present value of future payments for surplus leased properties under non-cancellable operating leases, net of estimated sub-leasing income.

p. Revenue recognition

The Group s revenue streams are courseware, assessments and services. Courseware includes curriculum materials provided in book form and/or via access to digital content. Assessments includes test development, processing and scoring services provided to governments, educational institutions, corporations and professional bodies. Services includes the operation of schools, colleges and universities, including sistemas in Brazil and English language teaching centres around the world as well as the provision of online learning services in partnership with universities and other academic institutions.

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

Revenue from the sale of books is recognised when title passes. A provision for anticipated returns is made based primarily on historical return rates, customer buying patterns and retailer behaviours including stock levels (see note 22). If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period.

Revenue from the sale of off-the-shelf software is recognised on delivery or on installation of the software where that is a condition of the contract. In certain circumstances, where installation is complex, revenue is recognised when the customer has completed their acceptance procedures. Where software is provided under a term licence, revenue is recognised on a straight-line basis over the period of the licence.

Revenue from the provision of services to academic institutions, such as programme development, student acquisition, education technology and student support services, is recognised as performance occurs. Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks and uncertainties inherent to long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Percentage of completion is calculated on a cost basis using the proportion of the total estimated costs incurred to date. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated.

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials or online access with textbooks and multiple deliverables within testing or service contracts, revenue is recognised for each element as if it were an individual contractual arrangement. This requires judgement regarding the identification of the individual elements as well as the estimation of its relative fair value.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

p. Revenue recognition continued

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

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

q. Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in financial liabilities borrowings. The interest element of the finance cost is charged to the income statement over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases by the lessee. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

r. Dividends

Final dividends are recorded in the Group s financial statements in the period in which they are approved by the company s shareholders. Interim dividends are recorded when paid.

s. Discontinued operations

A discontinued operation is a component of the Group s business that represents a separate major line of business or geographical area of operations that has been disposed of or meets the criteria to be classified as held for sale.

Discontinued operations are presented in the income statement as a separate line and are shown net of tax.

t. Assets and liabilities held for sale

Assets and liabilities are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is highly probable that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale. Amounts relating to non-current assets and liabilities held for sale are classified as discontinued operations in the income statement where appropriate.

u. Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1p).

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information

The primary segments for management and reporting are geographies as outlined below. In addition, the Group separately discloses its share of the results from the Penguin Random House associate.

The chief operating decision-maker is the Pearson executive.

North America Courseware, Assessments and Services businesses in the US and Canada.

Core Courseware, Assessments and Services businesses in more mature markets including UK, Australia and Italy.

Growth Courseware, Assessments and Services businesses in emerging markets including Brazil, China, India and South Africa.

For more detail on the services and products included in each business segment refer to Item 4.

All figures in £ millions	Notes	North America	Core	Growth	2017 Penguin Random House	Corporate	Discontinued operations	Group
Continuing operations								
Sales		**2,929**	**815**	**769**				**4,513**
Adjusted operating profit		**394**	**50**	**38**	**94**			**576**
Cost of major restructuring		**(60)**	**(11)**	**(8)**				**(79)**
Intangible charges		**(89)**	**(12)**	**(37)**	**(28)**			**(166)**
Other net gains and losses		**(3)**		**35**	**96**			**128**
Impact of US tax reform					**(8)**			**(8)**
Operating profit		**242**	**27**	**28**	**154**			**451**
Finance costs	6							**(110)**
Finance income	6							**80**
Profit before tax								**421**
Income tax	7							**(13)**
Profit for the year from continuing operations								**408**
Segment assets		**4,116**	**1,914**	**667**		**793**		**7,490**
Joint ventures	12			**3**				**3**
Associates	12	**4**	**3**		**388**			**395**
Total assets		**4,120**	**1,917**	**670**	**388**	**793**		**7,888**
Other segment items								
Share of results of joint ventures and associates	12	**5**	**1**	**1**	**71**			**78**
Capital expenditure	10, 11	**162**	**35**	**43**				**240**

Pre-publication investment	20	**218**	**84**	**59**	**361**
Depreciation	10	**56**	**13**	**21**	**90**
Amortisation	11, 20	**348**	**103**	**110**	**561**
Impairment	11				

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

All figures in £ millions	Notes	North America	Core	Growth	2016 Penguin Random House	Corporate	Discontinued operations	Group
Continuing operations								
Sales		2,981	803	768				4,552
Adjusted operating profit		420	57	29	129			635
Cost of major restructuring		(172)	(62)	(95)	(9)			(338)
Intangible charges		(2,684)	(16)	(33)	(36)			(2,769)
Other net gains and losses		(12)	(12)	(1)				(25)
Operating (loss)/profit		(2,448)	(33)	(100)	84			(2,497)
Finance costs	6							(97)
Finance income	6							37
Loss before tax								(2,557)
Income tax	7							222
Loss for the year from continuing operations								(2,335)
Segment assets		4,859	1,461	859		1,640		8,819
Joint ventures	12			2				2
Associates	12	1	4		1,240			1,245
Total assets		4,860	1,465	861	1,240	1,640		10,066
Other segment items								
Share of results of joint ventures and associates	12	(1)	1	(1)	98			97
Capital expenditure	10, 11	153	42	51				246
Pre-publication investment	20	235	92	68				395
Depreciation	10	56	12	27				95
Amortisation	11, 20	394	109	116				619
Impairment	11	2,548						2,548

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

					2015			
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
Continuing operations								
Sales		2,940	815	713				4,468
Adjusted operating profit/(loss)		480	105	(3)	90			672
Intangible charges		(386)	(79)	(583)	(41)			(1,089)
Cost of major restructuring								
Acquisition costs								
Other net gains and losses		19	(5)		(1)			13
Operating (loss)/profit		113	21	(586)	48			(404)
Finance costs	6							(100)
Finance income	6							71
Loss before tax								(433)
Income tax	7							81
Loss for the year from continuing operations								(352)
Segment assets		6,399	1,573	719		1,841		10,532
Joint ventures	12	1		3				4
Associates	12		6		1,093			1,099
Total assets		6,400	1,579	722	1,093	1,841		11,635
Other segment items								
Share of results of joint ventures and associates	12	(9)		(3)	64		16	68
Capital expenditure	10, 11	136	42	50			15	243
Pre-publication investment	20	218	63	66				347
Depreciation	10	42	9	18			6	75
Amortisation	11, 20	338	95	109			15	557
Impairment	11	282	37	530				849

There were no material inter-segment sales in either 2017, 2016 or 2015.

Adjusted operating profit is shown in the above tables as it is the key financial measure used by management to evaluate the performance of the Group and allocate resources to business segments. The measure also enables investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income and expenditure relating to acquisition and disposal transactions and major restructuring programmes.

Cost of major restructuring: In January 2016, the Group announced that it was embarking on a restructuring programme to simplify the business, reduce costs and position the Group for growth in its major markets. The costs of this programme of £338m in 2016 were significant enough to exclude from the adjusted operating profit measure so as to better highlight the underlying performance. These costs included costs associated with headcount reductions, property rationalisation and closure or exit from certain systems, platforms, products and supplier and customer relationships. A new programme of restructuring, announced in May 2017, to run between 2017 and 2019, began in the second half of 2017 and is expected to drive further significant cost savings. Costs incurred to date relating to this new programme were £79m at the end of 2017 and related to cost efficiencies in

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

higher education and enabling functions together with further rationalisation of the property portfolio. The costs of this new programme have also been excluded from adjusted operating profit (see note 3).

Intangible charges: These represent charges in respect of goodwill, including impairment, and intangible assets acquired through business combinations and the direct costs of acquiring those businesses. These charges are excluded as they reflect past acquisition activity and do not necessarily reflect the current year performance of the Group. In 2016, intangible charges included an impairment of goodwill in the Group s North America business of £2,548m (see note 11). In 2015, intangible charges included an impairment of goodwill and intangibles in our North America business of £282m, our Core business of £37m and our Growth business of £530m. There was no impairment in 2017.

Other net gains and losses: These represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets and are excluded from adjusted operating profit as they distort the performance of the Group as reported on a statutory basis. Other net gains of £128m in 2017 largely relate to the sale of the test preparation business in China which resulted in a profit on sale of £44m and the part sale of the Group s share in Penguin Random House which resulted in a profit of £96m (see note 31). In 2016, the net losses in the Core segment mainly relate to the closure of the Group s English language schools in Germany and in the North America segment relate to the sale of the Pearson English Business Solutions business. Other net gain and losses in 2015 relate to the profit on disposal of PowerSchool in North America, net of small losses on other investments.

Impact of US tax reform In 2017, as a result of US tax reform, the Group s share of profit from associates was adversely impacted by £8m. This amount has been excluded from adjusted operating profit as it is considered to be a transition adjustment that is not expected to recur in the near future.

Corporate costs are allocated to business segments on an appropriate basis depending on the nature of the cost and therefore the total segment result is equal to the Group operating profit.

Segment assets, excluding corporate assets, consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combination were £nil (2016: £10m) (see note 30).

The following tables analyse the Group s revenue streams. Courseware includes curriculum materials provided in book form and/or via access to digital content. Assessments includes test development, processing and scoring services provided to governments, educational institutions, corporations and professional bodies. Services includes the operation of schools, colleges and universities, including sistemas in Brazil and English language teaching centres around the world as well as the provision of online learning services in partnership with universities and other academic institutions.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

	2017			
All figures in £ millions	**North America**	**Core**	**Growth**	**Group**
Sales:				
Courseware				
School Courseware	**394**	**171**	**139**	**704**
Higher Education Courseware	**1,146**	**93**	**63**	**1,302**
English Courseware	**20**	**60**	**102**	**182**
	1,560	**324**	**304**	**2,188**
Assessments				
School and Higher Education Assessments	**355**	**256**	**23**	**634**
Clinical Assessments	**146**	**46**		**192**
Professional and English Certification	**341**	**138**	**60**	**539**
	842	**440**	**83**	**1,365**
Services				
School Services	**274**	**5**	**54**	**333**
Higher Education Services	**253**	**34**	**32**	**319**
English Services		**12**	**296**	**308**
	527	**51**	**382**	**960**
Total	**2,929**	**815**	**769**	**4,513**

	2016			
All figures in £ millions	North America	Core	Growth	Group
Sales:				
Courseware				
School Courseware	418	173	127	718
Higher Education Courseware	1,147	92	60	1,299
English Courseware	21	65	97	183
	1,586	330	284	2,200
Assessments				
School and Higher Education Assessments	378	268	21	667
Clinical Assessments	143	40		183
Professional and English Certification	333	112	49	494
	854	420	70	1,344
Services				

School Services	259	6	54	319
Higher Education Services	269	29	46	344
English Services	13	18	314	345
	541	53	414	1,008
Total	2,981	803	768	4,552

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Notes to the consolidated financial statements continued

2. Segment information continued

	2015			
All figures in £ millions	North America	Core	Growth	Group
Courseware				
School Courseware	406	178	112	696
Higher Education Courseware	1,207	94	57	1,358
English Courseware	22	65	84	171
	1,635	337	253	2,225
Assessments				
School and Higher Education Assessments	420	296	20	736
Clinical Assessments	126	32		158
Professional and English Certification	269	95	37	401
	815	423	57	1,295
Services				
School Services	209	1	47	257
Higher Education Services	223	26	70	319
English Services	18	28	286	332
School Systems	40			40
	490	55	403	948
Total	2,940	815	713	4,468

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

The Group operates in the following main geographic areas:

All figures in £ millions	Sales 2017	Sales 2016	Sales 2015	Non-current assets 2017	Non-current assets 2016
Continuing operations					
UK	**384**	393	421	**796**	946
Other European countries	**262**	255	246	**128**	134
US	**2,770**	2,829	2,800	**2,247**	3,351
Canada	**126**	118	107	**240**	268
Asia Pacific	**643**	632	590	**151**	205
Other countries	**328**	325	304	**184**	232
Total continuing	**4,513**	4,552	4,468	**3,746**	5,136
Discontinued operations					
UK			134		
Other European countries			64		
US			72		
Canada			2		
Asia Pacific			35		
Other countries			5		
Total discontinued			312		
Total	**4,513**	4,552	4,780	**3,746**	5,136

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. The geographical split of non-current assets is based on the subsidiary s country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

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Notes to the consolidated financial statements continued

2. Segment information continued

There are no discontinued operations in either 2017 or 2016. All discontinued operations in 2015 relate to the FT Group. An analysis of the results and cash flows of discontinued operations is as follows:

	2017	2016	2015	
All figures in £ millions	**Total**	Total	FT Group	Total
Sales			312	312
Operating profit			48	48
Finance income/(costs)				
Profit before tax			48	48
Income tax			(8)	(8)
Profit after tax			40	40
Profit on disposal of Penguin				
Attributable tax benefit				
Profit on disposal of The Economist			473	473
Profit on disposal of Financial Times			711	711
Attributable tax expense			(49)	(49)
Mergermarket transaction costs				
Profit on disposal of Mergermarket				
Attributable tax expense				
Profit for the year from discontinued operations			1,175	1,175
Operating cash flows			31	31
Investing cash flows			3	3
Financing cash flows				
Total cash flows			34	34

3. Restructuring costs

An analysis of restructuring costs is as follows:

All figures in £ millions	**2017**	**2016**	**2015**
By nature:			
Product costs	**15**	32	
Employee costs	**11**	139	18
Depreciation and amortisation	**13**	29	
Property and facilities	**24**	43	5
Technology and communications	**2**	7	

Professional and outsourced services	**12**	31	5
General and administrative costs	**2**	48	7
Total restructuring operating expenses	**79**	329	35
Share of associate restructuring		9	12
Total	**79**	338	47

In January 2016, the Group announced that it was embarking on a restructuring programme to simplify the business, reduce costs and position the Group for growth in its major markets. The costs of this programme in

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Notes to the consolidated financial statements continued

3. Restructuring costs continued

2016 were significant enough to exclude from the adjusted operating profit measure so as to better highlight the underlying performance (see note 8). A new programme of restructuring, the 2017-2019 restructuring programme announced in May 2017, began in the second half of 2017 and is expected to drive further significant cost savings. The costs of this new programme have also been excluded from adjusted operating profit. The restructuring in 2015 was not part of a major restructuring programme.

4. Operating expenses

All figures in £ millions	Notes	**2017**	2016	2015
By function:				
Cost of goods sold		**2,066**	2,093	1,981
Operating expenses				
Distribution costs		**84**	88	80
Selling, marketing and product development costs		**896**	908	895
Administrative and other expenses		**1,207**	1,240	1,195
Restructuring costs	3	**79**	329	35
Other income		**(64)**	(85)	(98)
Total net operating expenses		**2,202**	2,480	2,107
Other net gains and losses		**(128)**	25	(13)
Impairment of intangible assets	11		2,548	849
Total		**4,140**	7,146	4,924

Included in other income is service fee income from Penguin Random House of £3m (2016: £4m, 2015: £16m). Included in administrative and other expenses are research and efficacy costs of £14m (2016: £23m, 2015: £33m). In addition to the restructuring costs shown above, there were restructuring costs in Penguin Random House of £nil (2016: £9m, 2015: £12m).

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Notes to the consolidated financial statements continued

4. Operating expenses continued

All figures in £ millions	Notes	2017	2016	2015
By nature:				
Royalties expensed		**246**	264	249
Other product costs		**564**	616	566
Employee benefit expense	5	**1,805**	1,888	1,742
Contract labour		**152**	206	182
Employee-related expense		**127**	122	127
Promotional costs		**229**	217	163
Depreciation of property, plant and equipment	10	**90**	95	69
Amortisation of intangible assets pre-publication	20	**338**	350	281
Amortisation of intangible assets software	11	**85**	84	61
Amortisation of intangible assets other	11	**138**	185	199
Impairment of intangible assets	11		2,548	849
Property and facilities		**202**	243	219
Technology and communications		**218**	188	153
Professional and outsourced services		**322**	378	262
Other general and administrative costs		**140**	140	132
Costs capitalised to intangible assets		**(324)**	(318)	(219)
Other net gains and losses		**(128)**	25	(13)
Other income		**(64)**	(85)	(98)
Total		**4,140**	7,146	4,924

During the year the Group obtained the following services from the Group s auditors:

All figures in £ millions	2017	2016	2015
The audit of parent company and consolidated financial statements	**4**	5	4
The audit of the company s subsidiaries	**2**	2	2
Total audit fees	**6**	7	6
Other assurance services	**1**	1	2
Other non-audit services	**1**	1	1
Total other services	**2**	2	3
Tax compliance services			1
Total tax services			1
Total non-audit services	**2**	2	4
Total	**8**	9	10

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

All figures in £ millions	2017	2016	2015
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	**6**	7	6
Non-audit fees	**2**	2	4
Total	**8**	9	10

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

4. Operating expenses continued

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

Included in non-audit fees are amounts related to carve-out audits for disposals of £1m (2016: £1m, 2015: £1m).

5. Employee information

All figures in £ millions	Notes	2017	2016	2015
Employee benefit expense				
Wages and salaries (including termination costs)		**1,567**	1,661	1,507
Social security costs		**130**	124	124
Share-based payment costs	26	**33**	22	26
Retirement benefits defined contribution plans	25	**57**	67	66
Retirement benefits defined benefit plans	25	**19**	16	19
Other post-retirement medical benefits	25	**(1)**	(2)	
Total		**1,805**	1,888	1,742

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

Average number employed	2017	2016	2015
Employee numbers			
North America	**16,295**	16,841	19,951
Core	**5,291**	5,664	5,936
Growth	**8,268**	9,868	11,114
Other	**485**	346	264
Total	**30,339**	32,719	37,265

The employee benefit expense relating to discontinued operations was £nil (2016: £nil, 2015: £132m) and the average number employed was nil (2016: nil, 2015: 2,282).

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Notes to the consolidated financial statements continued

6. Net finance costs

All figures in £ millions	Notes	2017	2016	2015
Interest payable		**(99)**	(74)	(61)
Net foreign exchange losses			(21)	(36)
Finance costs associated with transactions		**(6)**		
Derivatives not in a hedge relationship		**(5)**	(2)	(3)
Finance costs		**(110)**	(97)	(100)
Interest receivable		**20**	15	15
Net finance income in respect of retirement benefits	25	**3**	11	4
Net foreign exchange gains		**44**	1	43
Derivatives not in a hedge relationship		**12**	10	9
Derivatives in a hedge relationship		**1**		
Finance income		**80**	37	71
Net finance costs		**(30)**	(60)	(29)

Included in interest receivable is £1m (2016: £1m, 2015: £1m) of interest receivable from related parties. There was a net movement of £1m on fair value hedges in 2017 (2016: £nil, 2015: £nil), comprising a gain of £37m (2016: loss of £4m, 2015: gain of £22m) on the underlying bonds, offset by a loss of £36m (2016: gain of £4m, 2015: loss of £22m) on the related derivative financial instruments.

7. Income tax

All figures in £ millions	Notes	2017	2016	2015
Current tax				
Charge in respect of current year		**(121)**	(66)	(155)
Adjustments in respect of prior years		**(2)**	27	42
Total current tax charge		**(123)**	(39)	(113)
Deferred tax				
In respect of temporary differences		**96**	277	185
Other adjustments in respect of prior years		**14**	(16)	9
Total deferred tax credit	13	**110**	261	194
Total tax (charge)/credit		**(13)**	222	81

The adjustments in respect of prior years in both 2017 and 2016 primarily arise from revising the previous year s reported tax provision to reflect the tax returns subsequently filed. This results in a change between deferred and current tax as well as an absolute benefit to the total tax charge.

The tax on the Group s profit/(loss) before tax differs from the theoretical amount that would arise using the UK tax rate as follows. Information for 2016 has been re-presented to give additional disclosure.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

7. Income tax continued

All figures in £ millions	2017	2016	2015
Profit/(loss) before tax	**421**	(2,557)	(433)
Tax calculated at UK rate (2017: 19.25%, 2016: 20%, 2015: 20.25%)	**(81)**	511	88
Effect of overseas tax rates	**15**	424	52
Joint venture and associate income reported net of tax	**15**	19	10
Intangible impairment not subject to tax		(722)	(60)
Intra-group financing benefit	**26**	34	18
Movement in provisions for tax uncertainties	**49**	(37)	30
Impact of US tax reform	**(1)**		
Net expense not subject to tax	**(39)**	(8)	(10)
Gains and losses on sale of businesses not subject to tax	**8**	15	(32)
Utilisation of previously unrecognised tax losses and credits	**(1)**		
Unrecognised tax losses	**(16)**	(25)	(22)
Adjustments in respect of prior years	**12**	11	7
Total tax (charge)/credit	**(13)**	222	81
UK	**(36)**	46	(25)
Overseas	**23**	176	106
Total tax (charge)/credit	**(13)**	222	81
Tax rate reflected in earnings	**3.1%**	8.7%	18.7%

The impact of US tax reform includes a benefit from revaluation of deferred tax balances to the reduced federal rate of £5m and a repatriation tax charge of £6m. The Group continues to analyse the detail of new legislation and this may result in revisions to these impacts.

Factors which may affect future tax charges include changes in tax legislation, transfer pricing regulations, the level and mix of profitability in different countries, and settlements with tax authorities.

The movement in provisions for tax uncertainties primarily reflects releases due to the expiry of relevant statutes of limitation. The current tax liability of £231m (2016: £224m) includes £280m (2016: £322m) of provisions for tax uncertainties principally in respect of a number of issues in the US, the UK and China. The issues provided for include the allocation between territories of proceeds of historic business disposals, and the potential disallowance of intra-group recharges and interest expense. The Group is currently under audit in a number of countries, and the timing of any resolution of these audits is uncertain. Of the balance of £280m, £38m relates to 2013 and earlier and is mostly under audit. In most countries tax years up to and including 2013 are now statute barred from examination by tax authorities. Of the remaining balance, £70m relates to 2014, £86m to 2015, £57m to 2016 and £29m to 2017. If relevant enquiry windows pass with no audit, management believes it is reasonably possible that provision levels will reduce by an estimated £60m within the next 12 months.

In 2016 the Group impaired US goodwill (see note 11). The majority of this impairment charge is not deductible for tax purposes.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

7. Income tax continued

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

All figures in £ millions	2017	2016	2015
Net exchange differences on translation of foreign operations	**9**	(5)	5
Fair value gain on other financial assets	**(4)**		
Remeasurement of retirement benefit obligations	**(42)**	58	(24)
	(37)	53	(19)

A tax charge of £nil (2016: tax charge £nil, 2015: tax charge £1m) relating to share-based payments has been recognised directly in equity.

8. Earnings per share

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares.

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares.

All figures in £ millions	Notes	2017	2016	2015
Earnings/(loss) for the year from continuing operations		**408**	(2,335)	(352)
Non-controlling interest		**(2)**	(2)	
Earnings/(loss) from continuing operations		**406**	(2,337)	(352)
Profit for the year from discontinued operations	2			1,175
Earnings/(loss) attributable to equity holders of the company		**406**	(2,337)	823
Weighted average number of shares (millions)		**813.4**	814.8	813.3
Effect of dilutive share options (millions)		**0.3**		
Weighted average number of shares (millions) for diluted earnings		**813.7**	814.8	813.3
Earnings/(loss) per share from continuing and discontinued operations				
Basic		**49.9p**	(286.8)p	101.2p
Diluted		**49.9p**	(286.8)p	101.2p

Earnings/(loss) per share from continuing operations			
Basic	**49.9p**	(286.8)p	(43.3)p
Diluted	**49.9p**	(286.8)p	(43.3)p
Earnings per share from discontinued operations			
Basic			144.5p
Diluted			144.5p

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Notes to the consolidated financial statements continued

9. Dividends

All figures in £ millions	2017	2016	2015
Final paid in respect of prior year 34.0p (2016: 34.0p, 2015: 34.0p)	**277**	277	277
Interim paid in respect of current year 5.0p (2016: 18.0p, 2015: 18.0p)	**41**	147	146
	318	424	423

The Directors are proposing a final dividend in respect of the financial year ended 31 December 2017 of 12.0p per share which will absorb an estimated £93m of shareholders funds. It will be paid on 11 May 2018 to shareholders who are on the register of members on 6 April 2018. These financial statements do not reflect this dividend.

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2016	359	508	22	889
Exchange differences	44	83	2	129
Additions	26	59	4	89
Disposals	(26)	(100)		(126)
Disposal through business disposal	(1)	(2)		(3)
Reclassifications	(4)	12	(8)	
At 31 December 2016	398	560	20	978
Exchange differences	**(20)**	**(29)**	**(2)**	**(51)**
Additions	**26**	**40**	**24**	**90**
Disposals	**(13)**	**(34)**		**(47)**
Disposal through business disposal	**(11)**	**(5)**		**(16)**
Reclassifications	**5**	**8**	**(13)**	
Transfer to intangible assets		**(11)**		**(11)**
Transfer to assets classified as held for sale	**(55)**	**(2)**		**(57)**
At 31 December 2017	**330**	**527**	**29**	**886**

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Notes to the consolidated financial statements continued

10. Property, plant and equipment continued

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2016	(192)	(377)		(569)
Exchange differences	(26)	(62)		(88)
Charge for the year	(34)	(61)		(95)
Disposals	22	95		117
Reclassifications	1	(1)		
At 31 December 2016	(229)	(406)		(635)
Exchange differences	**12**	**23**		**35**
Charge for the year	**(35)**	**(55)**		**(90)**
Disposals	**9**	**26**		**35**
Disposal through business disposal	**6**	**3**		**9**
Transfer to assets classified as held for sale	**40**	**1**		**41**
At 31 December 2017	**(197)**	**(408)**		**(605)**
Carrying amounts				
At 1 January 2016	167	131	22	320
At 31 December 2016	169	154	20	343
At 31 December 2017	**133**	**119**	**29**	**281**

Depreciation expense of £23m (2016: £21m) has been included in the income statement in cost of goods sold and £67m (2016: £74m) in operating expenses.

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £9m (2016: £10m).

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2016	4,134	619	860	281	180	509	6,583
Exchange differences	752	85	157	65	31	135	1,225
Impairment	(2,548)						(2,548)
Additions internal development		132					132
Additions purchased		25					25
Disposals		(49)	(37)				(86)
Acquisition through business combination	3			7		3	13
Disposal through business disposal			(6)			(47)	(53)
Transfer to intangible assets pre-publication		(14)					(14)
At 31 December 2016	2,341	798	974	353	211	600	5,277
Exchange differences	**(148)**	**(46)**	**(74)**	**(26)**	**(6)**	**(50)**	**(350)**
Impairment							
Additions internal development		**133**					**133**
Additions purchased		**17**					**17**
Disposals		**(23)**					**(23)**
Disposal through business disposal		**(4)**	**(9)**	**(19)**		**(27)**	**(59)**
Transfer from property, plant and equipment		**11**					**11**
Transfer to assets classified as held for sale	**(163)**	**(4)**	**(2)**	**(27)**	**(21)**	**(34)**	**(251)**
At 31 December 2017	**2,030**	**882**	**889**	**281**	**184**	**489**	**4,755**

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2016		(357)	(430)	(155)	(163)	(314)	(1,419)
Exchange differences		(60)	(83)	(32)	(27)	(75)	(277)
Charge for the year		(84)	(85)	(22)	(8)	(70)	(269)
Disposals		38	37				75
Disposal through business disposal			6			47	53
Transfer to intangible assets pre-publication		2					2
At 31 December 2016		(461)	(555)	(209)	(198)	(412)	(1,835)
Exchange differences		**30**	**43**	**13**	**4**	**36**	**126**
Charge for the year		**(85)**	**(77)**	**(18)**	**(3)**	**(40)**	**(223)**
Disposals		**21**					**21**
Disposal through business disposal		**2**	**8**	**18**		**22**	**50**
Transfer to assets classified as held for sale			**1**	**16**	**19**	**34**	**70**
At 31 December 2017		**(493)**	**(580)**	**(180)**	**(178)**	**(360)**	**(1,791)**
Carrying amounts							
At 1 January 2016	4,134	262	430	126	17	195	5,164
At 31 December 2016	2,341	337	419	144	13	188	3,442
At 31 December 2017	**2,030**	**389**	**309**	**101**	**6**	**129**	**2,964**

Goodwill

The goodwill carrying value of £2,030m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002, no value was ascribed to intangibles other than goodwill which was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated, then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003, value has been ascribed to other intangible assets which are amortised.

Other intangible assets

Other intangibles acquired include content, technology and software rights.

Intangible assets are valued separately for each acquisition and the primary method of valuation used is the discounted cash flow method. The majority of acquired intangibles are amortised using an amortisation profile based on the projected cash flows underlying the acquisition date valuation of the intangible asset, which generally results in a larger proportion of amortisation being recognised in the early years of the asset s life. The Group keeps the expected pattern of consumption under review.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

11. Intangible assets continued

Other intangible assets continued

Amortisation of £17m (2016: £17m) is included in the income statement in cost of goods sold and £206m (2016: £252m) in operating expenses.

The range of useful economic lives for each major class of intangible asset (excluding goodwill and software) is shown below:

Class of intangible asset	2017 Useful economic life
Acquired customer lists, contracts and relationships	**3 20 years**
Acquired trademarks and brands	**2 20 years**
Acquired publishing rights	**5 20 years**
Other intangibles acquired	**2 20 years**

The expected amortisation profile of acquired intangible assets is shown below:

All figures in £ millions	2017 One to five years	Six to ten years	More than ten years	Total
Class of intangible asset				
Acquired customer lists, contracts and relationships	**215**	**75**	**19**	**309**
Acquired trademarks and brands	**56**	**31**	**14**	**101**
Acquired publishing rights	**5**	**1**		**6**
Other intangibles acquired	**97**	**32**		**129**

Impairment tests for cash-generating units (CGUs) containing goodwill

Impairment tests have been carried out where appropriate as described below. Goodwill was allocated to CGUs, or an aggregation of CGUs, where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs. The recoverable amount for each unit exceeds its carrying value therefore there is no impairment in 2017. The carrying value of the goodwill in each of the CGUs is summarised below:

All figures in £ millions	2017	2016
North America	**1,013**	1,295
Core	**641**	633
Growth (includes Brazil, China, India and South Africa)		
Pearson VUE	**376**	413
Total	**2,030**	2,341

The recoverable amount of each aggregated CGU is based on fair value less costs of disposal. Goodwill is tested at least annually for impairment. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

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Notes to the consolidated financial statements continued

11. Intangible assets continued

Key assumptions

For the purpose of estimating the fair value less costs of disposal of the CGUs, management has used an income approach based on present value techniques. The calculations use cash flow projections based on financial budgets approved by management covering a five-year period, management s best estimate about future developments and market assumptions. The fair value less costs of disposal measurement is categorised as Level 3 on the fair value hierarchy. The key assumptions used by management in the fair value less costs of disposal calculations were:

Discount rates The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average post-tax discount rates range from 8.4% to 14.3%. Discount rates are lower for those businesses which operate in more mature markets with low inflation and higher for those operating in emerging markets with higher inflation.

Perpetuity growth rates A perpetuity growth rate of 2.0% was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historical growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 3.0% and 6.9% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historical growth rates in these markets.

The key assumptions used by management in setting the financial budgets for the initial five-year period were as follows:

Forecast sales growth rates Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key assumptions include growth in Online Program Management, Online Blended Learning and Professional Certification, stabilisation in UK Qualifications and US Assessments, and ongoing pressures in the US higher education courseware market. The five-year sales forecasts use average nominal growth rates between 3% and 6% for mature markets and between 5% and 14% for emerging markets with high inflation.

Operating profits Operating profits are forecast based on historical experience of operating margins, adjusted for the impact of changes to product costs and cost-saving initiatives, including the impact of the implementation of our cost efficiency programme.

Cash conversion Cash conversion is the ratio of operating cash flow to operating profit. Management forecasts cash conversion rates based on historical experience.

Sensitivities

The Group s impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates.

The carrying value of goodwill in the Growth market CGUs was written down to £nil in 2015.

A 0.1% increase in discount rates would cause the fair value less costs of disposal of the North America CGU to reduce by £50m, the Core GGU by £17m and the VUE CGU by £21m.

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Notes to the consolidated financial statements continued

11. Intangible assets continued

Sensitivities continued

A 0.1% reduction in perpetuity growth rates would cause the fair value less costs of disposal of the North America CGU to reduce by £39m, the Core CGU by £14m and the VUE CGU by £17m.

The Core CGU is highly sensitive to any reductions in short-term cash flows, whether driven by lower sales growth, lower operating profits or lower cash conversion. A 5% reduction in total annual operating profits, spread evenly across all CGUs, would give rise to an impairment of £66m in the Core CGU. An increase in discount rates or a reduction in perpetuity growth rates would also give rise to an impairment in the Core CGU. The North America CGU is no longer considered to be highly sensitive to changes in impairment assumptions, with increased headroom when compared to 2016.

2016 impairment tests

At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the US higher education courseware business market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, strategic plans and estimates for future cash flows were revised and we determined during the goodwill impairment review that the fair value less costs of disposal of the North America CGU no longer supported the carrying value of this goodwill and as a consequence impaired goodwill by £2,548m.

12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2017	2016
Associates	**395**	1,245
Joint ventures	**3**	2
Total	**398**	1,247

The amounts recognised in the income statement are as follows:

All figures in £ millions	2017	2016
Associates	**77**	98
Joint ventures	**1**	(1)
Total	**78**	97

Investment in associates

The Group has the following material associates:

	Principal place of business	Ownership interest	Nature of relationship	Measurement method
Penguin Random House Ltd	UK/Global	25%	See below	Equity
Penguin Random House LLC	US	25%	See below	Equity

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Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

On 1 July 2013, Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. On 5 October 2017, Pearson sold a 22% stake in Penguin Random House to Bertelsmann, retaining a 25% share (see note 31 for more information on disposal of associates). Pearson owns its 25% interest in Penguin Random House via 25% interests in each of the two entities listed in the table above. Despite the separate legal structures of the two Penguin Random House entities, Pearson regards Penguin Random House as one combined global business. Consequently, Pearson discloses Penguin Random House as one single operating segment and presents disclosures related to its interests in Penguin Random House on a combined basis.

The shareholder agreement includes protective rights for Pearson as the minority shareholder, including rights to dividends. Management considers ownership percentage, Board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over Penguin Random House and Bertelsmann has the power to direct the relevant activities and therefore control. Following the transaction in 2017 the assessment of significant influence has not changed. Penguin Random House does not have a quoted market price.

The summarised financial information of the material associate is detailed below:

All figures in £ millions	**2017 Penguin Random House**	2016 Penguin Random House
Assets		
Non-current assets	**1,048**	1,267
Current assets	**1,758**	1,587
Liabilities		
Non-current liabilities	**(859)**	(394)
Current liabilities	**(1,579)**	(1,074)
Net assets	**368**	1,386
Sales	**2,693**	2,620
Profit for the year	**171**	209
Other comprehensive expense	**(60)**	(14)
Total comprehensive income	**111**	195
Dividends received from associate in relation to profits	**146**	131
Re-capitalisation dividends received from associate	**312**	

The information above reflects the amounts presented in the financial statements of the associate, adjusted for fair value and similar adjustments. The tax on Penguin Random House LLC is settled by the partners. For the purposes of clear and consistent presentation, the tax has been shown in the associate line items in the consolidated income statement and consolidated balance sheet, recording the Group s share of profit after tax consistently for the Penguin Random House associates.

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Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

A reconciliation of the summarised financial information to the carrying value of the material associate is shown below:

All figures in £ millions	2017 Penguin Random House	2016 Penguin Random House
Opening net assets	**1,386**	1,206
Exchange differences	**(18)**	179
Profit for the year	**171**	209
Other comprehensive expense	**(60)**	(14)
Dividends, net of tax paid	**(1,167)**	(194)
Tax adjustments in relation to disposals	**56**	
Closing net assets	**368**	1,386
Share of net assets	**92**	651
Goodwill	**296**	589
Carrying value of associate	**388**	1,240

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2017	2016
Profit for the year	**7**	
Total comprehensive income	**7**	

Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2017 was £46m (2016: £33m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2017 was repaid in its entirety in January 2018.

The Group also has a current asset receivable of £19m (2016: £21m) from Penguin Random House and a current liability payable of £3m (2016: £nil) arising from the provision of services. Included in other income (note 4) is £3m (2016: £4m) of service fees. In addition, the Group will receive a further re-capitalisation dividend of £49m in April 2018, which was triggered by the Group s decision to sell a 22% stake in Penguin Random House in 2017.

Investment in joint ventures

Information on joint ventures, all of which are individually immaterial, is detailed below:

All figures in £ millions	2017	2016
Profit/(loss) for the year	**1**	(1)
Total comprehensive income/(expense)	**1**	(1)

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13. Deferred income tax

All figures in £ millions	**2017**	2016
Deferred income tax assets	**95**	451
Deferred income tax liabilities	**(164)**	(466)
Net deferred income tax	**(69)**	(15)

Substantially all of the deferred income tax assets are expected to be recovered after more than one year.

Deferred income tax assets and liabilities shall be offset when there is a legally enforceable right to offset current income tax assets with current income tax liabilities and where the deferred income taxes relate to the same fiscal authority. At 31 December 2017, the Group has unrecognised deferred income tax assets of £32m (2016: £32m) in respect of UK losses, £18m (2016: £18m) in respect of US losses and approximately £86m (2016: £95m) in respect of losses in other territories. The UK losses are capital losses. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years. Other deferred tax assets of £12m (2016: £9m) have not been recognised.

Deferred tax assets of £75m (2016: £95m) have been recognised in countries that reported a loss in either the current or preceding year. The majority arises in Brazil in respect of tax deductible goodwill. It is considered more likely than not that there will be sufficient future taxable profits to realise these assets.

The recognition of the deferred income tax assets is supported by management s forecasts of the future profitability of the relevant countries.

The movement in deferred income tax assets and liabilities during the year is as follows:

All figures in £ millions	Trading losses	Returns provisions	Retirement benefit obligations	Deferred revenue	Goodwill and intangibles	Other	Total
Deferred income tax assets/(liabilities)							
At 1 January 2016	19	43	(9)	55	(348)	(44)	(284)
Exchange differences	3	7	10	15	(84)	27	(22)
Income statement (charge)/benefit		(15)	(4)	50	144	86	261
Disposal through business disposal				(3)	(7)		(10)
Tax benefit in other comprehensive income			40				40
At 31 December 2016	22	35	37	117	(295)	69	(15)
Exchange differences	**(2)**	**(3)**	**(4)**	**(8)**	**19**	**(8)**	**(6)**
Income statement (charge)/benefit	**(11)**	**6**	**7**	**(9)**	**118**	**(1)**	**110**
Disposal through business disposal						**(3)**	**(3)**
Tax charge in other comprehensive income			**(84)**			**(5)**	**(89)**
Transfer to assets/(liabilities) classified as held for sale		**(4)**		**(73)**	**3**	**8**	**(66)**
At 31 December 2017	**9**	**34**	**(44)**	**27**	**(155)**	**60**	**(69)**

Other deferred income tax items include temporary differences in respect of share-based payments, provisions, depreciation and royalty advances.

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14. Classification of financial instruments

The accounting classification of each class of the Group s financial assets and their carrying values, is as follows:

All figures in £ millions	Notes	2017 Fair value Available for sale	2017 Fair value Derivatives held for trading	2017 Fair value Derivatives in hedge relationship	2017 Amortised cost Loans and receivables	2017 Total carrying value	2016 Fair value Available for sale	2016 Fair value Derivatives held for trading	2016 Fair value Derivatives in hedge relationship	2016 Amortised cost Loans and receivables	2016 Total carrying value
Investments in unlisted securities	15	**77**				**77**	65				65
Cash and cash equivalents	17				**518**	**518**				1,459	1,459
Cash and cash equivalents within assets classified as held for sale	32				**127**	**127**					
Marketable securities		**8**				**8**	10				10
Derivative financial instruments	16		**3**	**137**		**140**		3	168		171
Trade receivables	22				**760**	**760**				982	982
Trade receivables within assets classified as held for sale					**22**	**22**					
Total financial assets		**85**	**3**	**137**	**1,427**	**1,652**	75	3	168	2,441	2,687

The carrying value of the Group s financial assets is equal to, or approximately equal to, the market value.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

14. Classification of financial instruments continued

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

		2017					2016				
		Fair value		**Amortised cost**			Fair value		Amortised cost		
All figures in £ millions	**Notes**	**Derivatives held for trading**	**Derivatives in hedge relationship**	**Other liabilities**	**Total carrying value**	**Total market value**	Derivatives held for trading	Derivatives in hedge relationship	Other liabilities	Total carrying value	Total market value
Derivative financial liabilities	16		**(140)**		**(140)**	**(140)**	(7)	(257)		(264)	(264)
Trade payables	24			**(265)**	**(265)**	**(265)**			(333)	(333)	(333)
Trade payables within liabilities classified as held for sale				**(20)**	**(20)**	**(20)**					
Liability to purchase own shares	24			**(151)**	**(151)**	**(151)**					
Bank loans and overdrafts	18			**(15)**	**(15)**	**(15)**			(39)	(39)	(39)
Other borrowings due within one year	18			**(4)**	**(4)**	**(4)**			(5)	(5)	(5)
Borrowings due after more than one year	18			**(1,066)**	**(1,066)**	**(1,070)**			(2,424)	(2,424)	(2,385)
Total financial liabilities			**(140)**	**(1,521)**	**(1,661)**	**(1,665)**	(7)	(257)	(2,801)	(3,065)	(3,026)

Fair value measurement

As shown above, the Group s derivative assets and liabilities, unlisted securities and marketable securities are held at fair value. Financial instruments that are measured subsequently to initial recognition at fair value are grouped into levels 1 to 3, based on the degree to which the fair value is observable, as follows:

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Group s derivative assets valued at £140m (2016: £171m) and derivative liabilities valued at £140m (2016: £264m) are classified as level 2. The Group s marketable securities valued at £8m (2016: £10m) are classified as level 2. The Group s investments in unlisted securities are valued at £77m (2016: £65m) and are classified as level 3.

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Notes to the consolidated financial statements continued

14. Classification of financial instruments continued

Fair value measurement continued

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

All figures in £ millions	2017 Investments in unlisted securities	2016 Investments in unlisted securities
At beginning of year	**65**	143
Exchange differences	**(4)**	8
Acquisition of investments	**3**	6
Fair value movements	**13**	
Disposal of investments		(92)
At end of year	**77**	65

The fair value of the investments in unlisted securities is determined by reference to the financial performance of the underlying asset, recent funding rounds and amounts realised on the sale of similar assets.

15. Other financial assets

All figures in £ millions	2017	2016
At beginning of year	**65**	143
Exchange differences	**(4)**	8
Acquisition of investments	**3**	6
Fair value movements	**13**	
Disposal of investments		(92)
At end of year	**77**	65

Other financial assets comprise unlisted securities of £77m (2016: £65m).

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16. Derivative financial instruments

The Group s approach to the management of financial risks is set out in note 19. The Group s outstanding derivative financial instruments are as follows:

All figures in £ millions	2017 Gross notional amounts	2017 Assets	2017 Liabilities	2016 Gross notional amounts	2016 Assets	2016 Liabilities
Interest rate derivatives in a fair value hedge relationship	**799**	**23**		2,157	68	(4)
Interest rate derivatives not in a hedge relationship	**429**	**3**		1,187	3	(7)
Cross-currency rate derivatives in a hedge relationship	**1,522**	**114**	**(140)**	1,622	100	(253)
Total	**2,750**	**140**	**(140)**	4,966	171	(264)
Analysed as expiring:						
In less than one year				162		
Later than one year and not later than five years	**1,638**	**65**	**(95)**	2,776	86	(157)
Later than five years	**1,112**	**75**	**(45)**	2,028	85	(107)
Total	**2,750**	**140**	**(140)**	4,966	171	(264)

The Group has issued both euro and US dollar fixed rate debt. The fixed rate euro debt is converted to either a fixed or floating rate US dollar exposure using interest rate and cross-currency swaps. The Group s remaining fixed rate US dollar debt is held as fixed rate instruments.

The Group receives interest under its euro debt related swap contracts to match the interest on the bonds (ranging from a receipt of 1.375% on its euro 2025 notes to 1.875% on its euro 2021 notes) and, in turn, pays US dollar interest at rates ranging between US Libor + 0.84% to US Libor + 1.35%.

Interest rate swaps are then used to fix an element of the interest charge, in line with the Group s interest rate hedging policy, which requires a proportion of the Group s gross debt to be fixed in line with the Group s hedging policy. During 2017, the Group executed a number of floating interest rate swaps to match the maturity of the 2021 and 2025 euro bonds mitigating the exposure to interest rate increases. The all-in rates (including the Libor spread) that the Group pays are between 2.78% and 3.58%. At 31 December 2017, the Group had contracts to fix $579m of debt over the next 12 months and $331m of outstanding fixed rate bonds bringing the total fixed rate debt to $910m.

At the end of 2017, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross currency rate derivatives, was US dollar £(869)m, sterling £12m and euro £857m (2016: US dollar £(1,051)m, sterling £19m and euro £939m).

The Group s portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

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Notes to the consolidated financial statements continued

16. Derivative financial instruments continued

Derivative financial assets and liabilities subject to offsetting arrangements are as follows:

		2017			2016	
All figures in £ millions	**Gross derivative assets**	**Gross derivative liabilities**	**Net derivative assets/ liabilities**	Gross derivative assets	Gross derivative liabilities	Net derivative assets/ liabilities
Counterparties in an asset position	**103**	**(78)**	**25**	30	(11)	19
Counterparties in a liability position	**37**	**(62)**	**(25)**	141	(253)	(112)
Total as presented in the balance sheet	**140**	**(140)**		171	(264)	(93)

All of the Group s derivative financial instruments are subject to enforceable netting arrangements with individual counterparties, allowing net settlement in the event of default of either party. Offset arrangements in respect of cash balances are described in note 17.

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty.

In accordance with IAS 39 Financial Instruments: Recognition and Measurement , the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	**2017**	2016
Cash at bank and in hand	**361**	570
Short-term bank deposits	**157**	889
	518	1,459
Cash at bank and in hand within assets classified as held for sale	**127**	
	645	1,459

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

At the end of 2017, the currency split of cash and cash equivalents was US dollar 36% (2016: 34%), sterling 8% (2016: 40%), euro 7% (2016: 3%), renminbi 20% (2016: 10%) and other 29% (2016: 13%). At the end of 2017, a significant proportion of the renminbi cash relates to assets held for sale.

Cash and cash equivalents have fair values that approximate to their carrying value due to their short-term nature. Cash and cash equivalents include the following for the purpose of the cash flow statement:

All figures in £ millions	2017	2016
Cash and cash equivalents	**518**	1,459
Cash and cash equivalents within assets classified as held for sale	**127**	
Bank overdrafts	**(15)**	(35)
	630	1,424

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17. Cash and cash equivalents (excluding overdrafts) continued

The Group has certain cash pooling arrangements in US dollars, sterling, euro and Canadian dollars where both the company and the bank have a legal right of offset. At 31 December 2017, the offsetting amounts are presented gross in the balance sheet. Offset arrangements in respect of derivatives are shown in note 16.

18. Financial liabilities borrowings

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

All figures in £ millions	2017	2016
Non-current		
6.25% Global dollar bonds 2018 (nominal amount $550m)		469
4.625% US dollar notes 2018 (nominal amount $300m)		254
1.875% euro notes 2021 (nominal amount 500m)	**463**	453
3.75% US dollar notes 2022 (nominal amount $117m; 2016: nominal amount $500m)	**85**	407
3.25% US dollar notes 2023 (nominal amount $94m; 2016: nominal amount $500m)	**69**	402
1.375% euro notes 2025 (nominal amount 500m)	**445**	435
Finance lease liabilities	**4**	4
	1,066	2,424
Current		
Due within one year or on-demand:		
Bank loans and overdrafts	**15**	39
Finance lease liabilities	**4**	5
	19	44
Total borrowings	**1,085**	2,468

Included in the non-current borrowings above is £10m of accrued interest (2016: £18m). Included in the current borrowings above is £nil of accrued interest (2016: £nil).

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

All figures in £ millions	2017	2016
Between one and two years	**3**	726
Between two and five years	**549**	454
Over five years	**514**	1,244
	1,066	2,424

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18. Financial liabilities borrowings continued

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

All figures in £ millions	Effective interest rate	2017 Carrying value	Market value	Effective interest rate	2016 Carrying value	Market value
Bank loans and overdrafts	**n/a**	**15**	**15**	n/a	39	39
6.25% Global dollar bonds 2018	**n/a**			6.46%	469	468
4.625% US dollar notes 2018	**n/a**			4.69%	254	250
1.875% euro notes 2021	**2.04%**	**463**	**467**	2.04%	453	454
3.75% US dollar notes 2022	**3.94%**	**85**	**87**	3.94%	407	396
3.25% US dollar notes 2023	**3.36%**	**69**	**67**	3.36%	402	381
1.375% euro notes 2025	**1.44%**	**445**	**445**	1.44%	435	432
Finance lease liabilities	**n/a**	**8**	**8**	n/a	9	9
		1,085	**1,089**		2,468	2,429

The market values stated above are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group s borrowings before the effect of derivatives (see notes 16 and 19 for further information on the impact of derivatives) are denominated in the following currencies:

All figures in £ millions	2017	2016
US dollar	**172**	1,559
Sterling	**1**	13
Euro	**911**	892
Other	**1**	4
	1,085	2,468

The Group has $1.75bn (£1.3bn) of undrawn capacity on its committed borrowing facilities as at 31 December 2017 (2016: $1.75bn (£1.4bn) undrawn). In addition, there are a number of short-term facilities that are utilised in the normal course of business.

All of the Group s borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

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Notes to the consolidated financial statements continued

18. Financial liabilities borrowings continued

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

All figures in £ millions	2017	2016
Finance lease liabilities minimum lease payments		
Not later than one year	**4**	5
Later than one year and not later than two years	**3**	3
Later than two years and not later than three years	**1**	1
Later than three years and not later than four years		
Later than four years and not later than five years		
Later than five years		
Future finance charges on finance leases		
Present value of finance lease liabilities	**8**	9

The present value of the Group s finance lease obligations is as follows:

All figures in £ millions	2017	2016
Not later than one year	**4**	5
Later than one year and not later than five years	**4**	4
Later than five years		
	8	9

The carrying amounts of the Group s lease obligations approximate their fair value.

19. Financial risk management

The Group s approach to the management of financial risks together with sensitivity analyses of its financial instruments is set out below.

Treasury policy

Pearson s treasury function has primary responsibility for managing certain financial risks to which the Group is exposed. The Group s treasury policies are approved by the Board of Directors annually and the Audit Committee receives regular reports on the Group s treasury activities, policies and procedures. The Group s treasury function is not run as a profit centre and does not enter into any transactions for speculative purposes.

The treasury function is permitted to use derivatives for risk management purposes which may include interest rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts, of which interest rate swaps and forward foreign exchange swaps are the most commonly used.

Capital risk

The Group s primary objective when managing capital is to safeguard its ability to continue as a going concern and retain financial flexibility by maintaining a strong balance sheet. The Group aims to maintain net debt at a level less than 1.5 times EBITDA, which is consistent with a solid investment grade rating (assuming no material deterioration in trading performance) and provides comfortable headroom against covenants. This should permit the business to invest in organic growth. Shareholder returns are made through a sustainable and progressive dividend policy. Any surplus cash is returned to shareholders via share buybacks or special dividends.

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Notes to the consolidated financial statements continued

19. Financial risk management continued

Capital risk continued

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

Net debt

The Group s net debt position is set out below:

All figures in £ millions	2017	2016
Cash and cash equivalents	**645**	1,459
Marketable securities	**8**	10
Derivative financial instruments		(93)
Bank loans and overdrafts	**(15)**	(39)
Bonds	**(1,062)**	(2,420)
Finance lease liabilities	**(8)**	(9)
Net debt	**(432)**	(1,092)

Interest and foreign exchange rate management

The Group s principal currency exposure is to the US dollar which represents more than 60% of the Group s sales.

The Group s long-term debt is primarily held in US dollars to provide a natural hedge of this exposure, which is achieved through issued US dollar debt or by converting euro debt to US dollars using cross-currency swaps.

As at 31 December 2017, £674m of the Group s debt is held at fixed rates (2016: £650m), with £411m held at floating rates (2016: £1,818m), partially offset by US dollar cash balances which attract floating rate interest. As at 31 December 2017, a 1% movement in US dollar interest rates for one year would result in a £2m movement in the interest charge (2016: £13m).

Overseas profits are converted to sterling to satisfy sterling cash outflows such as dividends at the prevailing spot rate at the time of the transaction. To the extent the Group has sufficient sterling, US dollars may be held as dollar cash to provide a natural offset to the Group s debt or to satisfy future US dollar cash outflows.

The Group does not have significant cross border foreign exchange transactional exposures.

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19. Financial risk management continued

Interest and foreign exchange rate management continued

As at 31 December 2017, the sensitivity of the carrying value of the Group s financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in unlisted securities	77			(6)	7
Cash and cash equivalents	645			(54)	66
Marketable securities	8				
Derivative financial instruments		(26)	26	1	(1)
Bonds	(1,062)	45	(48)	97	(118)
Other borrowings	(23)			2	(2)
Liability to purchase own shares	(151)				
Other net financial assets	497			(41)	50
Total financial instruments	(9)	19	(22)	(1)	2

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. Other net financial assets comprises trade receivables less trade payables. A significant proportion of the movements shown above would impact equity rather than the income statement due to the location and functional currency of the entities in which they arise and the availability of net investment hedging.

The Group s income statement is reported at average rates for the year while the balance sheet is translated at the year-end closing rate. Differences between these rates can distort ratio calculations such as debt to EBITDA and interest cover. Adjusted operating profit translated at year-end closing rates would be £22m lower than the reported figure of £576m at £554m (2016: £55m higher if translated at the year-end 2016 rate instead of the 2016 average rate at £690m compared with a reported figure of £635m). EBITDA translated at year-end closing rates would be £25m lower than the reported figure of £738m at £713m (2016: £63m higher if translated at the year-end 2016 rate instead of the 2016 average rate, at £848m, compared with a reported figure of £785m).

Liquidity and re-financing risk management

The Group regularly reviews the level of cash and debt facilities required to fund its activities. This involves preparing a prudent cash flow forecast for the next three to five years, determining the level of debt facilities required to fund the business, planning for shareholder returns and repayments of maturing debt, and identifying an appropriate amount of headroom to provide a reserve against unexpected outflows.

At 31 December 2017, the Group had cash of £0.6bn and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75bn (£1.3bn). At 31 December 2016, the Group had cash of £1.5bn and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75bn (£1.4bn).

The $1.75bn facility contains interest cover and leverage covenants which the Group has complied with for the year ended 31 December 2017.

At the end of 2017, the currency split of the Group s trade payables was US dollar £137m, sterling £58m and other currencies £90m (2016: US dollar £164m, sterling £67m and other currencies £102m) . Trade payables are all due within one year (2016: all due within one year).

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19. Financial risk management continued

Liquidity and re-financing risk management continued

The following table analyses the Group s bonds and derivative assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows (including interest) and as such may differ from the amounts disclosed on the balance sheet.

	Analysed by maturity				Analysed by currency			
All figures in £ millions	**Less than one year**	**Later than one year but less than five years**	**Five years or more**	**Total**	**USD**	**GBP**	**Other**	**Total**
At 31 December 2017								
Bonds	**20**	**601**	**533**	**1,154**	**184**		**970**	**1,154**
Rate derivatives inflows	**(38)**	**(975)**	**(684)**	**(1,697)**	**(53)**	**(751)**	**(893)**	**(1,697)**
Rate derivatives outflows	**48**	**1,060**	**667**	**1,775**	**1,003**	**751**	**21**	**1,775**
Total	**30**	**686**	**516**	**1,232**	**1,134**		**98**	**1,232**
At 31 December 2016								
Bonds	82	1,308	1,292	2,682	1,732		950	2,682
Rate derivatives inflows	(103)	(1,086)	(867)	(2,056)	(239)	(838)	(979)	(2,056)
Rate derivatives outflows	82	1,202	891	2,175	1,308	838	29	2,175
Total	61	1,424	1,316	2,801	2,801			2,801

Financial counterparty risk management

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover the Group s total aggregate exposure to a single financial institution. The limits applicable to published credit rating bands are approved by the Chief Financial Officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

Cash deposits and derivative transactions are made with approved counterparties up to pre-agreed limits. To manage counterparty risk associated with cash and cash equivalents, the Group uses a mixture of money market funds as well as bank deposits. As at 31 December 2017, 58% of cash and cash equivalents was held with investment grade bank counterparties, 38% with AAA money market funds and 4% held with non-investment grade bank counterparties. As at 31 December 2017, the Group had a net exposure of £24m with investment grade counterparties for derivative transactions.

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20. Intangible assets pre-publication

All figures in £ millions	2017	2016
Cost		
At beginning of year	**2,417**	2,201
Exchange differences	**(168)**	380
Additions	**362**	395
Disposal through business disposal	**(1)**	(8)
Disposals	**(248)**	(565)
Transfer from intangible assets		14
Transfer to assets classified as held for sale	**(508)**	
At end of year	**1,854**	2,417
Amortisation		
At beginning of year	**(1,393)**	(1,360)
Exchange differences	**109**	(250)
Charge for the year	**(338)**	(350)
Disposal through business disposal		4
Disposals	**248**	565
Transfer from intangible assets		(2)
Transfer to assets classified as held for sale	**261**	
At end of year	**(1,113)**	(1,393)
Carrying amounts		
At end of year	**741**	1,024

Included in the above are pre-publication assets amounting to £504m (2016: £694m) which will be realised in more than one year.

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

21. Inventories

All figures in £ millions	2017	2016
Raw materials	**4**	5
Work in progress	**2**	6
Finished goods	**142**	224
	148	235

The cost of inventories recognised as an expense and included in the income statement in cost of goods sold amounted to £324m (2016: £340m). In 2017, £38m (2016: £48m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

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22. Trade and other receivables

All figures in £ millions	**2017**	2016
Current		
Trade receivables	**739**	961
Royalty advances	**8**	22
Prepayments	**82**	124
Accrued income	**1**	15
Other receivables	**280**	235
	1,110	1,357
Non-current		
Trade receivables	**21**	21
Royalty advances	**20**	10
Prepayments	**15**	13
Accrued income	**10**	31
Other receivables	**37**	29
	103	104

The carrying value of the Group s trade and other receivables approximates its fair value. Trade receivables are stated net of provisions for bad and doubtful debts and anticipated future sales returns. The movements in the provision for bad and doubtful debts are as follows:

All figures in £ millions	**2017**	2016
At beginning of year	**(112)**	(64)
Exchange differences	**7**	(17)
Income statement movements	**(38)**	(53)
Utilised	**21**	22
Disposal through business disposal	**1**	
Transfer to assets classified as held for sale	**5**	
At end of year	**(116)**	(112)

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

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

All figures in £ millions	**2017**	2016
Within due date	**661**	812
Up to three months past due date	**187**	232

Three to six months past due date	**48**	55
Six to nine months past due date	**18**	21
Nine to 12 months past due date	**13**	14
More than 12 months past due date	**3**	7
Total trade receivables	**930**	1,141
Less: provision for sales returns	**(170)**	(159)
Net trade receivables	**760**	982

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22. Trade and other receivables continued

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

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Property	Disposals and closures	Legal and other	Total
At 1 January 2017	56	4	10	36	106
Exchange differences	**(5)**			**(2)**	**(7)**
Charged to income statement				**4**	**4**
Released to income statement				**(7)**	**(7)**
Utilised	**(6)**		**(2)**	**(8)**	**(16)**
Disposal through business disposal		**(1)**	**3**	**(2)**	
At 31 December 2017	**45**	**3**	**11**	**21**	**80**

Analysis of provisions:

All figures in £ millions	Deferred consideration	Property	2017 Disposals and closures	Legal and other	Total
Current	**5**	**1**	**11**	**8**	**25**
Non-current	**40**	**2**		**13**	**55**
	45	**3**	**11**	**21**	**80**
			2016		
Current	6	1	8	12	27
Non-current	50	3	2	24	79
	56	4	10	36	106

Deferred consideration primarily relates to the formation of a venture in a North America business in 2011. The provision will be utilised over a number of years as payments are based on a royalty rate. Disposals and closures include liabilities related to the disposal of Penguin with the provisions utilised as the disposals and closures are completed. Legal and other includes legal claims, contract disputes and potential contract losses with the provisions utilised as the cases are settled. Restructuring provisions were not material in either 2017 or 2016.

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24. Trade and other liabilities

All figures in £ millions	2017	2016
Trade payables	**265**	333
Social security and other taxes	**21**	25
Accruals	**447**	507
Deferred income	**322**	883
Interest payable	**45**	31
Liability to purchase own shares	**151**	
Other liabilities	**224**	272
	1,475	2,051
Less: non-current portion		
Accruals	**26**	17
Deferred income	**35**	319
Other liabilities	**72**	86
	133	422
Current portion	**1,342**	1,629

The carrying value of the Group s trade and other liabilities approximates its fair value.

The deferred income balance comprises advance payments in assessment, testing and training businesses; subscription income in school and college businesses; and obligations to deliver digital content in future periods.

The liability to purchase own shares relates to a liability arising under a buyback agreement for the purchase of the company s own shares (see note 27).

25. Retirement benefit and other post-retirement obligations

Background

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world.

The largest plan is the Pearson Group Pension Plan (UK Group plan) in the UK, which is sectionalised to provide both defined benefit and defined contribution pension benefits. The defined benefit section was closed to new members from 1 November 2006. The defined contribution section, opened in 2003, is open to new and existing employees. Finally, there is a separate section within the UK Group plan set up for auto-enrolment. The defined benefit section of the UK Group plan is a final salary pension plan which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends on the length of service and final pensionable pay. The UK Group plan is funded with benefit payments from trustee-administered funds. The UK Group plan is administered in accordance with the Trust Deed and Rules in the interests of its beneficiaries by Pearson Group Pension Trustee Limited.

At 31 December 2017, the UK Group plan had approximately 24,000 members, analysed in the following table:

All figures in %	Active	Deferred	Pensioners	Total
Defined benefit	**1**	**26**	**35**	**62**
Defined contribution	**8**	**30**		**38**
Total	**9**	**56**	**35**	**100**

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Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

Background continued

The other major defined benefit plans are based in the US. These are also final salary pension plans which provide benefits to members in the form of a guaranteed pension payable for life, with the level of benefits dependent on length of service and final pensionable pay. The majority of the US plans are funded.

The Group also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

The defined benefit schemes expose the Group to actuarial risks, such as life expectancy, inflation risks, and investment risk including asset volatility and changes in bond yields. The Group is not exposed to any unusual, entity-specific or plan-specific risks.

The defined contribution section of the UK Group plan operates a Reference Scheme Test (RST) pension underpin for its members. Where a member s fund value is insufficient to purchase the RST pension upon retirement, the UK Group plan is liable for the shortfall to cover the member s RST pension. During the year, the UK Group plan revised its approach to securing the RST underpin by converting a member s fund value into a pension in the UK Group plan rather than purchasing an annuity with an insurer. A liability of £32m (2016: £181m) in respect of the underpin is included in the UK Group plan s defined benefit obligation, calculated as the present value of projected payments less the fund value. The UK Group plan s conversion factors are lower than the respective insurer annuity values and this has driven a reduction in the underpin liability, resulting in an actuarial gain through other comprehensive income and an increase in the surplus at 31 December 2017. From 1 January 2018, members who have sufficient funds to purchase an RST pension will be able to convert their fund value into a pension in the UK Group plan as an alternative to purchasing an annuity with an insurer. The Group does not recognise the assets and liabilities for members of the defined contribution section of the UK Group plan whose fund values are expected to be sufficient to purchase an RST pension without assistance from the UK Group plan. The defined contribution section of the UK Group plan had gross assets of £442m at 31 December 2017.

Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

	2017			2016			2015		
All figures in %	**UK Group plan**	**Other plans**	**PRMB**	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	**3.2**	**1.6**	**1.5**	3.3	1.6	1.5	3.1	2.5	2.5
Rate used to discount plan liabilities	**2.5**	**3.0**	**3.0**	2.5	3.8	3.9	3.7	4.0	4.0
Expected rate of increase in salaries	**3.7**	**3.0**	**3.0**	3.8	3.0	3.0	3.6	3.0	3.0
Expected rate of increase for pensions in payment and deferred pensions	**2.1 to 5.1**			2.2 to 5.1			1.9 to 5.1		
Initial rate of increase in healthcare rate			**6.5**			6.8			7.0
Ultimate rate of increase in healthcare rate			**5.0**			5.0			5.0

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25. Retirement benefit and other post-retirement obligations continued

Assumptions continued

The UK discount rate is based on corporate bond yields adjusted to reflect the duration of liabilities. In 2017, the Group revised the portfolio of corporate bonds used to exclude bonds with an implicit government guarantee. Under the previous methodology, the 2017 UK discount rate would have been lower by around 0.1%.

The US discount rate is set by reference to a US bond portfolio matching model.

The inflation rate for the UK Group plan of 3.2% reflects the RPI rate. In line with changes to legislation in 2010, certain benefits have been calculated with reference to CPI as the inflationary measure and in these instances a rate of 2.2% has been used.

The expected rate of increase in salaries has been set at 3.7% for 2017 with a short-term assumption of 2.0% for three years.

For the UK plan, the mortality base table assumptions have been updated and are derived from the SAPS S2 for males and females, adjusted to reflect the observed experience of the plan, with CMI model improvement factors. A 1.5% long-term rate improvement on the CMI model is applied for both males and females.

For the US plans, the mortality table (RP 2017) and 2017 improvement scale (MP 2017) with generational projection for male and female annuitants has been adopted.

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK Group plan and US plans is as follows:

	UK		US	
All figures in years	**2017**	2016	**2017**	2016
Male	**23.6**	23.5	&nb	