Notes to the company financial statements

1. Accounting policies

a. Basis of preparation

The financial statements on pages 143 to 151 comprise the separate financial statements of Pearson plc. As permitted by section 230(4) of the Companies Act 1985, only the Group's income statement has been presented.

The company has no employees.

b. Group accounting policies

The accounting policies applied in the preparation of these company financial statements are the same as those set out in note 1 to the Group financial statements with the addition of the following:

Investments

Investments in subsidiaries are stated at cost less provision for impairment.

2. Investments in subsidiaries

All figures in £ millions	2008	2007
At beginning of year	6,650	7,103
Subscription for share capital in subsidiaries	152	425
External disposal	–	(1)
Disposal to subsidiary	–	(877)
Currency revaluations	110	–
At end of year	6,912	6,650

3. Financial risk management

The company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments and current and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. The company's approach to the management of financial risks is consistent with the Group's treasury policy, as discussed in note 19 to the Group's financial statements. The company believes the value of its financial assets to be fully recoverable.

The company designates certain of its qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The carrying value of the company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The company estimates that a 1% increase in interest rates would result in a £57m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £63m increase in their carrying value. The company also estimates that a 10% strengthening in sterling would decrease the carrying value of its financial instruments by £44m, while a 10% decrease in the value of sterling would increase the carrying value by £55m. These increases and decreases in carrying value would be recorded through the income statement. Sensitivities are calculated using estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%.

Notes to the company financial statements continued

3. Financial risk management continued

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

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

All figures in £ millions	USD	GBP	EUR	2007 Total
Not later than one year	132	(30)	–	102
Later than one year and not later than five years	734	70	–	804
Later than five years	198	285	–	483
Total	1,064	325	–	1,389
Analysed as:				
Revolving credit facility and commercial paper	425	–	–	425
Bonds	546	483	–	1,029
Rate derivatives – inflows	(268)	(160)	–	(428)
Rate derivatives – outflows	361	2	–	363
Total	1,064	325	–	1,389

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the company net settles these amounts wherever possible.

Amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

4. Cash and cash equivalents

All figures in £ millions	2008	2007
Cash at bank and in hand	2	1
Short-term bank deposits	55	60
	57	61

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates. Cash and cash equivalents have fair values that approximate to their carrying amounts due to their short-term nature.

Cash and cash equivalents include the following for the purpose of the cash flow statement:

All figures in £ millions	2008	2007
Cash and cash equivalents	57	61
Bank overdrafts	(352)	(281)
	(295)	(220)

5. Financial liabilities – Borrowings

All figures in £ millions	2008	2007
Non-current		
Bank loans and overdrafts	132	–
7% Global Dollar Bonds 2011 (nominal amount $500m)	368	264
7% Sterling Bonds 2014 (nominal amount £250m)	254	251
4.625% US Dollar notes 2018 (nominal amount $300m)	237	143
	991	658
Current		
Due within one year or on demand:		
Bank loans and overdrafts	352	644
10.5% Sterling Bonds 2008 (nominal amount £100m)	–	105
	352	749
Total borrowings	1,343	1,407

Included in the non-current borrowings above is £5m of accrued interest (2007: £4m).

Included in the current borrowings above is £nil of accrued interest (2007: £7m).

Notes to the company financial statements continued

5. Financial liabilities – Borrowings continued

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

All figures in £ millions	2008	2007
Between one and two years	–	–
Between two and five years	500	264
Over five years	491	394
	991	658

As at 31 December 2008 the exposure to interest rate changes of the borrowings and amounts due to subsidiaries when the borrowings re-price is as follows:

All figures in £ millions	One year	One to five years	More than five years	Total
Re-pricing profile of borrowings	484	368	491	1,343
Amounts due to subsidiaries	1,006	243	591	1,840
Effect of rate derivatives	1,173	(254)	(919)	–
	2,663	357	163	3,183

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

		2008		2007	
All figures in £ millions	Effective interest rate	Carrying amount	Market value	Carrying amount	Market value
Bank loans and overdrafts	n/a	484	484	644	644
10.5% Sterling Bonds 2008	10.53%	–	–	105	102
7% Global Dollar Bonds 2011	7.16%	368	349	264	267
7% Sterling Bonds 2014	7.20%	254	258	251	261
4.625% US Dollar notes 2018	4.69%	237	169	143	135
		1,343	1,260	1,407	1,409

The market values are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the company's borrowings are denominated in the following currencies:

All figures in £ millions	2008	2007
US dollar	1,089	779
Sterling	254	620
Euro	–	8
	1,343	1,407

6. Derivative financial instruments

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

All figures in £ millions	2008 Gross notional amounts	2008 Assets	2008 Liabilities	2007 Gross notional amounts	2007 Assets	2007 Liabilities
Interest rate derivatives – in a fair value hedge relationship	398	44	–	522	18	(8)
Interest rate derivatives – not in a hedge relationship	1,867	140	(20)	796	7	(8)
Cross currency rate derivatives	–	–	–	150	26	–
Total	2,265	184	(20)	1,468	51	(16)
Analysed as expiring:						
In less than one year	487	3	(5)	320	28	–
Later than one year and not later than five years	859	47	(15)	796	13	(8)
Later than five years	919	134	–	352	10	(8)
Total	2,265	184	(20)	1,468	51	(16)

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

7. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2007	806,109	202	2,487
Issue of shares – share option schemes	1,919	–	12
At 31 December 2007	808,028	202	2,499
Issue of shares – share option schemes	1,248	–	6
At 31 December 2008	809,276	202	2,505

The total authorised number of ordinary shares is 1,198m shares (2007: 1,194m shares) with a par value of 25p per share (2007: 25p per share). All issued shares are fully paid. All shares have the same rights.

Notes to the company financial statements continued

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2007	8,761	65
Purchase of treasury shares	4,900	40
Contribution from subsidiaries	–	(23)
Release of treasury shares	(1,900)	(29)
Prior year contributions applied to release of shares	–	29
At 31 December 2007	11,761	82
Purchase of treasury shares	2,028	12
Contribution from subsidiaries	–	–
Release of treasury shares	(3,341)	(41)
Prior year contributions applied to release of shares	–	10
At 31 December 2008	10,448	63

The company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are treated as treasury shares for accounting purposes and have a par value of 25p per share. The nominal value of the company's treasury shares amounts to £2.6m (2007: £2.9m). At 31 December 2008 the market value of the company's treasury shares was £67.0m (2007: £86.1m).

9. Other reserves and retained earnings

All figures in £ millions	Special reserve	Retained earnings	Total
At 1 January 2007	447	884	1,331
Loss for the year	–	(43)	(43)
Dividends paid	–	(238)	(238)
Balance at 31 December 2007	447	603	1,050
Profit for the year	–	526	526
Currency translation differences on fair value hedges	–	(6)	(6)
Treasury shares released under employee share plans	–	(31)	(31)
Dividends paid	–	(257)	(257)
At 31 December 2008	447	835	1,282

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

Included within retained earnings in 2008 is an amount of £131m (2007: £131m) relating to profit on intra-group disposals that is not distributable.

10. Contingencies

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

11. Audit fees

Statutory audit fees relating to the company were £35,000 (2007: £35,000). Audit-related regulatory reporting fees relating to the company were £nil (2007: £nil).

12. Related party transactions

Subsidiaries

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

These loans are generally unsecured and interest is calculated based on market rates. The company has interest payable to subsidiaries during the year of £214m (2007: £221m) and interest receivable from subsidiaries during the year of £86m (2007: £115m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £33m (2007: £33m). Dividends received from subsidiaries in 2008 were £620m (2007: £74m).

Key management personnel

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

There were no other material related party transactions.