Notes to the consolidated financial statements

General information

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 6 March 2009.

1. Accounting policies

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

a. Basis of preparation

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

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

1. Interpretations and amendments to published standards effective in 2008

The Group adopted IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', effective for annual reporting periods beginning on or after 1 January 2008, in the prior accounting period. IFRIC 14 resulted in no change to the full recognition of the pension asset as disclosed in note 25.

The Group has adopted Reclassification Amendments to IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures,' issued in October 2008 but effective from 1 July 2008. The amendments allow additional reclassifications of certain classifications of financial instruments in rare circumstances, and management determined this was not relevant to the Group.

IFRIC 11 'Group and Treasury Share Transactions' is effective for annual reporting periods beginning on or after 1 March 2007. This addresses how to apply IFRS 2 'Share-based Payment' to arrangements involving an entity's own equity instruments, or equity instruments of another entity in the same group, in the stand alone accounts of the parent and group companies. Management have assessed that this interpretation has no impact on the Group's financial statements.

IFRIC 12 'Service Concession Arrangements' is effective for annual reporting periods beginning on or after 1 January 2008. This addresses the accounting by private sector entities that, by contract with a government, participate in developing, financing, operating and maintaining infrastructure assets relating to public services traditionally provided by governments. As none of the Group entities participate in these activities, IFRIC 12 is not relevant to the Group.

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

2. Standards, interpretations and amendments to published standards that are not yet effective – The Group has decided to early adopt IFRS 8 'Operating Segments' which is effective for annual reporting periods beginning on or after 1 January 2009. The new standard requires a management approach to reporting segmental information. After changes in the organisational structure within the Education business, six revised reporting segments were identified under IFRS 8 as detailed in note 2. The impact of the standard has been to revise the disclosure for the reported segments. Comparatives for 2007 have been restated.

The Group has not early adopted the following new pronouncements that are not yet effective:

Amendments to IFRS 2 'Share-based Payment' (effective for annual reporting periods beginning on or after 1 January 2009). The amendment clarifies that only service and performance conditions are vesting conditions, and that all cancellations whether Group or counterparty, should be accounted for the same way.

IAS 1 (Revised) 'Presentation of Financial Statements' (effective for annual reporting periods beginning on or after 1 January 2009). The amendments provide a number of presentational changes to the financial statements including prohibiting the presentation of items of income and expense in the statement of changes in equity and requiring them to be shown in a performance statement, the option to present the performance statement as a single statement of comprehensive income and the requirement to include a balance sheet as at the beginning of the earliest comparative period when an entity applies a retrospective change in accounting policy or makes a retrospective restatement.

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

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

'Improvements to Financial Reporting Standards 2008' (mostly effective for annual reporting periods beginning on or after 1 January 2009). This is the first standard published under the IASB's annual improvements process which is designed to deal with non-urgent minor amendments to standards. Thirty five amendments were issued, 24 resulting in changes in presentation, recognition or measurement, and 11 are expected to have no or minimal effect on accounting.

IFRIC 16 'Hedges of a Net Investment in Foreign Operations' (effective for annual reporting periods beginning on or after 1 October 2008). IFRIC 16 provides guidance on net investment hedging including which foreign currency risks within the Group qualify for hedging, and where the hedging instruments can be held within the Group.

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

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

Amendments to IAS 23 'Borrowing Costs' (effective for annual reporting periods beginning on or after 1 January 2009). The amendment requires capitalisation of borrowing costs that relate to qualifying assets (ones that take a substantial amount of time to get ready for use or sale, with the exception of assets measured at fair value or inventories manufactured in large quantities or on a repetitive basis). Management assessed the relevance of this amendment with respect to Group operations and concluded that it is not currently applicable to the Group as there are no material qualifying assets.

1. Accounting policies continued

a. Basis of preparation continued

Amendments to IAS 32 'Financial Instruments: Presentation' and IAS 1 'Presentation of Financial Statements' – Puttable Financial Instruments and Obligations arising on liquidation (effective for annual reporting periods beginning on or after 1 January 2009). The amendment requires puttable financial instruments, or instruments that impose on the entity an obligation to another party in respect of a share of net assets only on liquidation, to be classified as equity. Management assessed the relevance of this amendment with respect to the Group and concluded it is not relevant.

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

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

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

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

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

b. Consolidation

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

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

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

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

Notes to the consolidated financial statements continued

1. Accounting policies continued

b. Consolidation continued

3. Joint ventures and associates – Joint ventures are entities in which the Group holds an interest on a long-term basis and which are jointly controlled, with one or more other venturers, under a contractual arrangement. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at cost.

The Group's share of its joint ventures' and associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The Group's share of its joint ventures' and associates' results is recognised as a component of operating profit as these operations form part of the core publishing business of the Group and 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.

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.

Translation differences on other non-monetary items such as equities held at fair value are reported as part of the fair value gain or loss through the income statement. Fair value adjustments on non-monetary items such as equities classified as available for sale financial assets, are included in the fair value reserve in equity.

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 entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

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

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

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.85 (2007: $2.00) and the year end rate was $1.44 (2007: $1.99).

1. Accounting policies continued

d. Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives as follows:

Buildings (freehold):	20–50 years
Buildings (leasehold):	over the period of the lease
Plant and equipment:	3–10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

The carrying value of an asset is written down to its recoverable amount if the carrying value of the asset is greater than its estimated recoverable amount.

e. Intangible assets

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

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. An impairment loss is recognised to the extent that the carrying value of goodwill exceeds the recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. These calculations require the use of estimates and significant management judgement. A description of the key assumptions and sensitivities is included in note 11. Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

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

2. Acquired software – Software separately acquired for internal use is capitalised at cost. Software acquired in material business combinations is capitalised at its fair value as determined by an independent valuer. Acquired software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

3. Internally developed software – Internal and external costs incurred during the preliminary stage of developing computer software for internal use are expensed as incurred. Internal and external costs incurred to develop computer software for internal use during the application development stage are capitalised if the Group expects economic benefits from the development. Capitalisation in the application development stage begins once the Group can reliably measure the expenditure attributable to the software development and has demonstrated its intention to complete and use the software. Internally developed software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

4. Acquired intangible assets – Acquired intangible assets include customer lists and relationships, trademarks and brands, publishing rights, content and technology. These assets are capitalised on acquisition at cost and included in intangible assets. Intangible assets acquired in material business combinations are capitalised at their fair value as determined by an independent valuer. Intangible assets are amortised over their estimated useful lives of between two and 20 years, using a depreciation method that reflects the pattern of their consumption.

5. Pre-publication assets – Pre-publication costs represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating life cycle of the title, with a higher proportion of the amortisation taken in the earlier years. The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 33).

The assessment of the recoverability of pre-publication assets and the determination of the amortisation profile involve a significant degree of judgement based on historical trends and management estimation of future potential sales. An incorrect amortisation profile could result in excess amounts being carried forward as intangible assets that would otherwise have been written off to the income statement in an earlier period.

Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

Reviews are performed regularly to estimate recoverability of pre-publication assets. The carrying amount of pre-publication assets is set out in note 20.

f. Other financial assets

Other financial assets, designated as available for sale investments, are non-derivative financial assets measured at estimated fair value. Changes in the fair value are recorded in equity in the fair value reserve. On the subsequent disposal of the asset, the net fair value gains or losses are taken to the income statement.

g. Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale. Provisions are made for slow moving and obsolete stock.

h. Royalty advances

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realisable value of author contracts is overstated then 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. Newspaper development costs

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

j. Cash and cash equivalents

Cash and cash equivalents in the cash flow statement include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are included in borrowings in current liabilities in the balance sheet.

Short-term deposits and marketable securities with maturities of greater than three months do not qualify as cash and cash equivalents. Movements on these financial instruments are classified as cash flows from financing activities in the cash flow statement as these amounts are used to offset the borrowings of the Group.

k. Share capital

Ordinary shares are classified as equity.

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

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

l. Borrowings

Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. Accrued interest is included as part of borrowings. Where a debt instrument is in a fair value hedging relationship, an adjustment is made to its carrying value to reflect the hedged risk. Interest on borrowings is expensed as incurred.

1. Accounting policies continued

m. 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. The Group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of its bonds (fair value hedges) or hedges of net investments in foreign operations (net investment hedges).

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

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

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

n. Taxation

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

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

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

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

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

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

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, significant judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income together with any future tax planning strategies.

o. Employee benefits

1. Pension obligations – The retirement benefit asset and obligation recognised in the balance sheet represents the net of the present value of the defined benefit obligation and the fair value of plan assets at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high quality corporate bonds which have terms to maturity approximating the terms of the related liability.

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

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

Notes to the consolidated financial statements continued

1. Accounting policies continued

o. Employee benefits continued

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. The unwinding of the discount rate on the scheme liabilities and the expected return on scheme assets are presented as finance costs or finance income.

Obligations for contributions to defined contribution pension plans are recognised as an operating expense in the income statement as incurred.

2. Other post-retirement obligations – The expected costs of post-retirement healthcare and life assurance benefits are accrued over the period of employment, using a similar accounting methodology as for defined benefit pension obligations. The liabilities and costs relating to material other post-retirement obligations are assessed annually by independent qualified actuaries.

3. Share-based payments –The fair value of options or shares granted under the Group's share and option plans is recognised as an employee expense after taking into account the Group's best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised. The Group has applied IFRS 2 'Share-based Payment' retrospectively to all options granted but not fully vested at the date of transition to IFRS.

p. Provisions

Provisions are recognised if the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are discounted to present value where the effect is material.

The Group recognises a provision for deferred consideration when the payment of the deferred consideration is probable.

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

The provision is based on the present value of future payments for surplus leased properties under non-cancellable operating leases, net of estimated sub-leasing revenue.

q. Revenue recognition

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

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

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

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

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

1. Accounting policies continued

q. 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.

r. Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in financial liabilities – borrowings. The interest element of the finance cost is charged to the income statement over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the asset or the lease term.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases by the lessee. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

s. Dividends

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

t. Non-current assets and liabilities held for sale

Assets and liabilities are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is intended to recover their carrying amount principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale. Amounts relating to non-current assets and liabilities held for sale are classified as discontinued operations in the income statement where appropriate.

u. Trade receivables

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1q).

Notes to the consolidated financial statements continued

2. Segment information

Following the adoption of IFRS 8 ‘Operating Segments’ and changes in the organisational structure of the Education business, the Group has revised its reporting segments. The Group is now organised into six segments:

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

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

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

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

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

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

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

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

2. Segment information continued

All figures in £ millions	Notes	North American Education	International Education	Professional	FT Publishing	Interactive Data	Penguin	Corporate	Group
									2007
Continuing operations									
Sales (external)		1,667	735	226	344	344	846	–	4,162
Sales (inter-segment)		1	–	–	–	–	19	–	20
Adjusted operating profit		273	92	27	56	97	74	–	619
Amortisation of acquired intangibles		(20)	(10)	(1)	(6)	(7)	(1)	–	(45)
Operating profit		253	82	26	50	90	73	–	574
Finance costs	6								(150)
Finance income	6								44
Profit before tax									468
Income tax	7								(131)
Profit for the year from continuing operations									337
Segment assets		3,536	1,013	291	397	330	937	651	7,155
Joint ventures	12	–	5	–	4	–	2	–	11
Associates	12	1	3	–	5	–	–	–	9
Assets – continuing operations		3,537	1,021	291	406	330	939	651	7,175
Assets – discontinued operations		–	–	117	–	–	–	–	117
Total assets		3,537	1,021	408	406	330	939	651	7,292
Other segment items									
Share of results of joint ventures and associates	12	–	6	1	16	–	–	–	23
Capital expenditure	10, 11, 20	136	109	20	28	19	44	–	356
Depreciation	10	26	7	9	9	10	7	–	68
Amortisation	11, 20	159	45	11	9	8	30	–	262

In 2008, sales from the provision of goods were £3,411m (2007: £3,053m) and sales from the provision of services were £1,400m (2007: £1,109m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing, market pricing, corporate training and management service businesses are classified as being from the provision of services.

Notes to the consolidated financial statements continued

2. Segment information continued

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

Property, plant and equipment and intangible assets acquired through business combination were £253m (2007: £226m) (see note 30). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations. Discontinued operations relate to the Data Management business in 2008 and to the Data Management business, Government Solutions, Datamark and Les Echos in 2007 (see note 3).

The Group operates in the following main geographic areas:

	Sales		Non-current assets	
All figures in £ millions	2008	2007	2008	2007
Continuing operations				
UK	754	721	701	724
Other European countries	463	381	224	140
USA	2,861	2,448	4,624	3,146
Canada	167	143	209	183
Asia Pacific	415	351	179	114
Other countries	151	118	14	11
Total continuing	4,811	4,162	5,951	4,318
Discontinued operations				
UK	–	1	–	–
Other European countries	–	82	–	–
USA	8	78	–	117
Canada	–	–	–	–
Other countries	–	6	–	–
Total discontinued	8	167	–	117
Total	4,819	4,329	5,951	4,435

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. Non-current assets are based on the subsidiaries 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, other receivables and non-current assets classified as held for sale.

3. Discontinued operations

Discontinued operations relate to the Group's interest in Government Solutions (sold on 15 February 2007), Datamark (sold on 31 July 2007), Les Echos (sold on 24 December 2007) and the Data Management business (sold on 22 February 2008).

The results of the Data Management business (previously included in the Professional segment) have been included in discontinued operations for both 2007 and 2008. In anticipation of the loss on sale, an impairment to held for sale goodwill was charged to the income statement in 2007. The assets and liabilities of the Data Management business were reported as held for sale in the 31 December 2007 balance sheet.

The results of Government Solutions (previously included in the Professional segment) and Les Echos (previously included in the FT Publishing segment) were included in discontinued operations for 2007 and were consolidated up to the date of sale.

Datamark was sold immediately following its acquisition as part of the eCollege transaction and consequently none of the results for this business were consolidated.

An analysis of the results and cash flows of discontinued operations are as follows:

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

Notes to the consolidated financial statements continued

3. Discontinued operations continued

All figures in £ millions	Data Management	Les Echos	Datamark	Government Solutions	Total
					2007
Sales	56	82	–	29	167
Operating profit	12	1	–	2	15
Goodwill impairment	(97)	–	–	–	(97)
(Loss)/profit before tax	(85)	1	–	2	(82)
Attributable tax expense	(4)	–	–	(1)	(5)
(Loss)/profit after tax	(89)	1	–	1	(87)
Profit/(loss) on disposal of discontinued operations before tax	–	165	–	(19)	146
Attributable tax (expense)/benefit	–	–	7	(93)	(86)
(Loss)/profit for the year from discontinued operations	(89)	166	7	(111)	(27)
Operating cash flows	11	4	–	(8)	7
Investing cash flows	(1)	4	–	–	3
Financing cash flows	(10)	(7)	–	(4)	(21)
Total cash flows	–	1	–	(12)	(11)

4. Operating expenses

All figures in £ millions	2008	2007
By function:		
Cost of goods sold	2,174	1,910
Operating expenses		
Distribution costs	198	202
Administrative and other expenses	1,890	1,600
Other income	(102)	(101)
Total operating expenses	1,986	1,701
Total	4,160	3,611

4. Operating expenses continued

All figures in £ millions	Notes	2008	2007
By nature:			
Utilisation of inventory	21	832	732
Depreciation of property, plant and equipment	10	80	65
Amortisation of intangible assets – Pre-publication	20	244	192
Amortisation of intangible assets – Other	11	116	70
Employee benefit expense	5	1,553	1,288
Operating lease rentals		134	129
Other property costs		116	122
Royalties expensed		415	365
Advertising, promotion and marketing		244	195
Information technology costs		76	70
Other costs		452	484
Other income		(102)	(101)
Total		4,160	3,611

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

All figures in £ millions	2008	2007
Fees payable to the company's auditor for the audit of parent company and consolidated financial statements	3	3
The audit of the company's subsidiaries pursuant to legislation	2	1
Tax services	2	2
Other services	1	1
Total	8	7

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

All figures in £ millions	2008	2007
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	5	4
Non-audit fees	3	3
Total audit fees	8	7

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

Tax services include services related to tax planning and various other tax advisory matters.

Other services include due diligence on acquisitions and services related to the disposal of the Data Management business.

Notes to the consolidated financial statements continued

5. Employee information

All figures in £ millions	Notes	2008	2007
Employee benefit expense			
Wages and salaries (including termination benefits and restructuring costs)		1,317	1,087
Social security costs		119	100
Share-based payment costs	26	33	30
Pension costs – defined contribution plans	25	41	39
Pension costs – defined benefit plans	25	37	31
Other post-retirement benefits	25	6	1
		1,553	1,288

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

Average number employed	2008	2007
Employee numbers		
North American Education	15,412	14,327
International Education	5,718	5,291
Professional	2,641	2,540
FT Publishing	2,379	2,083
Interactive Data	2,413	2,300
Penguin	4,112	4,163
Other	909	918
Continuing operations	33,584	31,622
Discontinued operations	96	1,070
	33,680	32,692

6. Net finance costs

All figures in £ millions	Notes	2008	2007
Interest payable		(106)	(114)
Net foreign exchange losses		(11)	(25)
Other losses on financial instruments in a hedging relationship:			
– fair value hedges		(7)	(1)
– net investment hedges		–	(1)
Other losses on financial instruments not in a hedging relationship:			
– derivatives		(12)	(9)
Finance costs		(136)	(150)
Interest receivable		17	19
Finance income in respect of employee benefits	25	8	10
Net foreign exchange gains		–	8
Other gains on financial instruments in a hedging relationship:			
– fair value hedges		2	–
– net investment hedges		1	–
Other gains on financial instruments not in a hedging relationship:			
– amortisation of transitional adjustment on bonds		1	1
– derivatives		16	6
Finance income		45	44
Net finance costs		(91)	(106)
Analysed as:			
Net interest payable		(89)	(95)
Net foreign exchange losses reflected in adjusted earnings		(7)	–
Finance income in respect of employee benefits	25	8	10
Net finance costs reflected in adjusted earnings		(88)	(85)
Other net finance costs		(3)	(21)
Total net finance costs		(91)	(106)

The £5m (2007: £1m) net loss on fair value hedges comprises a £156m (2007: £20m) loss on the underlying bonds offset by a £151m (2007: £19m) gain on the related derivative financial instruments.

7. Income tax

All figures in £ millions	Notes	2008	2007
Current tax			
Charge in respect of current year		(89)	(71)
Other adjustments in respect of prior years		10	27
Total current tax charge		(79)	(44)
Deferred tax			
In respect of timing differences		(97)	(96)
Other adjustments in respect of prior years		4	9
Total deferred tax charge	13	(93)	(87)
Total tax charge		(172)	(131)

Notes to the consolidated financial statements continued

7. Income tax continued

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

All figures in £ millions	2008	2007
Profit before tax	585	468
Tax calculated at UK rate (2008: 28.5%, 2007: 30%)	(167)	(141)
Effect of overseas tax rates	(29)	(25)
Joint venture and associate income reported net of tax	7	7
Net expense not deductible for tax purposes	(1)	(9)
Utilisation of previously unrecognised tax losses	4	3
Unutilised tax losses	–	(2)
Prior year adjustments	14	36
Total tax charge	(172)	(131)
UK	(53)	(42)
Overseas	(119)	(89)
Total tax charge	(172)	(131)
Tax rate reflected in earnings	29.4%	28.0%

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

All figures in £ millions	2008	2007
Profit before tax	585	468
Add back: amortisation of acquired intangibles	86	45
Add back: other net finance costs	3	21
Adjusted profit before tax – continuing operations	674	534
Adjusted profit before tax – discontinued operations	–	15
Total adjusted profit before tax	674	549
Total tax charge	(172)	(131)
Add back: tax benefit on other net gains and losses	(7)	(9)
Add back: tax benefit on amortisation of acquired intangibles	(31)	(19)
Add back: tax benefit on other finance income	(1)	(6)
Tax amortisation benefit on goodwill and intangibles	33	25
Adjusted income tax charge – continuing operations	(178)	(140)
Adjusted income tax charge – discontinued operations	–	(5)
Total adjusted income tax charge	(178)	(145)
Tax rate reflected in adjusted earnings	26.4%	26.4%

The tax benefit on items charged to equity is as follows:

All figures in £ millions	2008	2007
Share-based payments	(7)	7
Pension contributions and actuarial gains and losses	10	28
Net investment hedges and other foreign exchange gains and losses	(1)	(6)
	2	29

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	2008	2007
Profit for the year from continuing operations		413	337
Minority interest		(31)	(26)
Earnings from continuing operations		382	311
Loss for the year from discontinued operations	3	(90)	(27)
Earnings		292	284
Weighted average number of shares (millions)		797.0	796.8
Effect of dilutive share options (millions)		0.5	1.3
Weighted average number of shares (millions) for diluted earnings		797.5	798.1
Earnings per share from continuing and discontinued operations			
Basic		36.6p	35.6p
Diluted		36.6p	35.6p
Earnings per share from continuing operations			
Basic		47.9p	39.0p
Diluted		47.9p	39.0p
Earnings per share from discontinued operations			
Basic		(11.3p)	(3.4p)

Adjusted

In order to show results from operating activities on a consistent basis, an adjusted earnings per share is presented. The company's definition of adjusted earnings per share may not be comparable to other similarly titled measures reported by other companies.

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

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

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

Notes to the consolidated financial statements continued

8. Earnings per share continued

Other net finance income/costs are foreign exchange and other gains and losses that represent short-term fluctuations in market value and foreign exchange movements on transactions and balances that are no longer in a hedge relationship. These gains and losses are subject to significant volatility and may not be realised in due course as it is normally the intention to hold these instruments to maturity. Other net finance costs of Group companies are included in finance costs or finance income as appropriate. Other net finance costs of joint ventures and associates are included within the share of results of joint ventures and associates within operating profit.

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

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

The following tables reconcile statutory earnings to adjusted earnings.

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

8. Earnings per share continued

All figures in £ millions	Statutory income statement	Re-analyse discontinued operations	Other net gains and losses	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Adjusted income statement
							2007
Operating profit	574	15	–	45	–	–	634
Net finance costs	(106)	–	–	–	21	–	(85)
Profit before tax	468	15	–	45	21	–	549
Income tax	(131)	(5)	(9)	(19)	(6)	25	(145)
Profit for the year from continuing operations	337	10	(9)	26	15	25	404
Profit for the year from discontinued operations	(27)	(10)	37	–	–	–	–
Profit for the year	310	–	28	26	15	25	404
Minority interest	(26)	–	–	(4)	–	(2)	(32)
Earnings	284	–	28	22	15	23	372
Weighted average number of shares (millions)							796.8
Adjusted earnings per share							46.7p

9. Dividends

All figures in £ millions	2008	2007
Final paid in respect of prior year 20.5p (2007: 18.8p)	163	150
Interim paid in respect of current year 11.8p (2007: 11.1p)	94	88
	257	238

The directors are proposing a final dividend in respect of the financial year ended 31 December 2008 of 22p per share which will absorb an estimated £176m of shareholders' funds. It will be paid on 8 May 2009 to shareholders who are on the register of members on 14 April 2009. These financial statements do not reflect this dividend.

Notes to the consolidated financial statements continued

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2007	313	631	11	955
Exchange differences	(2)	–	–	(2)
Additions	20	62	11	93
Disposals	(24)	(65)	–	(89)
Acquisition through business combination	–	27	–	27
Disposal through business disposal	(1)	(25)	–	(26)
Reclassifications	–	6	(6)	–
Transfer to non-current assets held for sale	(8)	(14)	–	(22)
At 31 December 2007	298	622	16	936
Exchange differences	54	138	6	198
Additions	6	67	6	79
Disposals	(7)	(38)	–	(45)
Acquisition through business combination	2	29	2	33
Reclassifications	2	21	(23)	–
At 31 December 2008	355	839	7	1,201

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2007	(128)	(479)	–	(607)
Exchange differences	–	1	–	1
Charge for the year	(14)	(54)	–	(68)
Disposals	11	63	–	74
Acquisition through business combination	–	(16)	–	(16)
Disposal through business disposal	–	20	–	20
Transfer to non-current assets held for sale	5	10	–	15
At 31 December 2007	(126)	(455)	–	(581)
Exchange differences	(30)	(102)	–	(132)
Charge for the year	(19)	(61)	–	(80)
Disposals	6	36	–	42
Acquisition through business combination	(1)	(26)	–	(27)
At 31 December 2008	(170)	(608)	–	(778)
Carrying amounts				
At 1 January 2007	185	152	11	348
At 31 December 2007	172	167	16	355
At 31 December 2008	185	231	7	423

10. Property, plant and equipment continued

Depreciation expense of £12m (2007: £13m) has been included in the income statement in cost of goods sold, £6m (2007: £5m) in distribution expenses and £61m (2007: £50m) in administrative and other expenses. There was no depreciation expense relating to discontinued operations in 2008 (2007: £3m).

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 £7m (2007: £6m).

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists & relationships	Acquired trademarks & brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2007	3,271	201	113	26	96	53	3,760
Exchange differences	(4)	(2)	–	1	3	–	(2)
Additions – internal development	–	20	–	–	–	–	20
Additions – purchased	–	13	–	–	–	–	13
Disposals	(34)	(19)	(2)	–	(3)	2	(56)
Acquisition through business combination	304	4	76	35	40	44	503
Transfer to non-current assets held for sale	(194)	–	–	–	–	–	(194)
At 31 December 2007	3,343	217	187	62	136	99	4,044
Exchange differences	1,082	71	77	24	31	62	1,347
Additions – internal development	–	29	–	–	–	–	29
Additions – purchased	–	16	–	–	–	–	16
Disposals	(8)	(27)	–	–	–	–	(35)
Acquisition through business combination	153	17	77	42	–	97	386
Disposal through business disposal	–	(1)	–	–	(2)	–	(3)
Transfer to Pre-publication	–	(12)	–	–	–	–	(12)
At 31 December 2008	4,570	310	341	128	165	258	5,772

Notes to the consolidated financial statements continued

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists & relationships	Acquired trademarks & brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2007	–	(135)	(15)	(1)	(15)	(13)	(179)
Exchange differences	–	1	–	–	–	1	2
Charge for the year	–	(25)	(13)	(3)	(17)	(12)	(70)
Disposals	–	19	–	–	–	–	19
Acquisition through business combination	–	(2)	–	–	–	–	(2)
Transfer to non-current assets held for sale	–	–	–	–	–	–	–
At 31 December 2007	–	(142)	(28)	(4)	(32)	(24)	(230)
Exchange differences	–	(50)	(15)	(3)	(13)	(12)	(93)
Charge for the year	–	(30)	(24)	(10)	(25)	(27)	(116)
Disposals	–	27	–	–	–	–	27
Acquisition through business combination	–	(13)	–	–	–	–	(13)
Disposal through business disposal	–	1	–	–	1	–	2
Transfer to Pre-publication	–	4	–	–	–	–	4
At 31 December 2008	–	(203)	(67)	(17)	(69)	(63)	(419)
Carrying amounts							
At 1 January 2007	3,271	66	98	25	81	40	3,581
At 31 December 2007	3,343	75	159	58	104	75	3,814
At 31 December 2008	4,570	107	274	111	96	195	5,353

Goodwill

The goodwill carrying value of £4,570m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. £3,309m of the carrying value relates to acquisitions completed between 1 January 1998 and 31 December 2002 and £1,261m relates to acquisitions completed after 1 January 2003 (the date of transition to IFRS).

For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower.

For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets, which are amortised, with only the remaining difference between the purchase price and the fair value of net assets acquired being allocated to goodwill.

Other intangible assets

Other intangibles acquired include content, technology and software rights. Amortisation of £5m (2007: £3m) is included in the income statement in cost of goods sold and £111m (2007: £67m) in administrative and other expenses.

11. Intangible assets continued

Impairment tests for cash-generating units containing goodwill

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

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

All figures in £ millions	Notes	2008	2007
US School Curriculum		937	677
US School Assessment and Information		722	414
US Higher Education		1,164	839
Canada		173	155
International Education Publishing		315	270
International Education Assessment and Testing		241	194
Professional Publishing		15	10
Professional Assessment and Testing		254	181
Pearson Education total		3,821	2,740
Financial Times		46	12
Mergermarket		130	126
Interactive Data		208	147
FT Group total		384	285
Penguin US		216	155
Penguin UK		95	111
Pearson Australia		54	52
Penguin total		365	318
Total goodwill – continuing operations		4,570	3,343
Goodwill held for sale	31	–	96
Total goodwill		4,570	3,439

During 2008, after the change in organisational structure the CGUs were reorganised and goodwill reallocated to the units affected. The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

Key assumptions

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

Discount rate – The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates used are in the range of 10.2% to 11.7% for the Pearson Education businesses (2007: 10.5% to 12.0%), 10.8% to 20.5% for the FT Group businesses (2007: 10.4% to 17.2%) and 8.8% to 10.4% for the Penguin businesses (2007: 8.9% to 11.7%).

Perpetuity growth rates – The cash flows subsequent to the approved budget period are based upon the long-term historic growth rates of the underlying territories in which the CGU operates and reflect the long-term growth prospects of the sectors in which the CGU operates. A perpetuity growth rate of 2.0% was used for all CGUs in 2008 (a range from 2.5% to 3.5% in 2007). The perpetuity growth rates are consistent with appropriate external sources for the relevant markets.

Notes to the consolidated financial statements continued

11. Intangible assets continued

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

Sensitivities

The Group's impairment review is sensitive to a change in the key assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group's sensitivity analysis, a reasonably possible change in the discount rate or perpetuity growth rate could cause an impairment in either the US School Curriculum or Penguin UK CGUs.

The fair value of US School Curriculum is 8% or approximately £77m above its carrying value, but an increase of 0.5 percentage points in the discount rate or a reduction of 0.6 percentage points in the perpetuity growth rate would cause the value in use to fall below the carrying value.

The fair value of Penguin UK is 24% or approximately £44m above its carrying value, but an increase of 1.4 percentage points in the discount rate or a reduction of 1.7 percentage points in the perpetuity growth rate would cause the value in use to fall below the carrying value.

12. Investments in joint ventures and associates

Joint ventures

All figures in £ millions	2008	2007
At beginning of year	11	12
Exchange differences	(4)	–
Share of profit after tax	6	4
Dividends	(5)	(8)
Additions and further investment	5	3
At end of year	13	11

Investments in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost.

The aggregate of the Group's share in its joint ventures, none of which are individually significant, are as follows:

All figures in £ millions	2008	2007
Assets		
Non-current assets	6	3
Current assets	21	23
Liabilities		
Current liabilities	(14)	(15)
Net assets	13	11
Income	36	61
Expenses	(30)	(57)
Profit after income tax	6	4

12. Investments in joint ventures and associates continued

Associates

All figures in £ millions	2008	2007
At beginning of year	9	8
Exchange differences	(5)	(1)
Share of profit after tax	19	19
Dividends	(16)	(24)
Additions	–	1
Distribution from associate in excess of carrying value	6	6
Actuarial losses on retirement benefit obligations	(3)	–
At end of year	10	9

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

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

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

2007 All figures in £ millions	Country of incorporation	% interest held	Assets	Liabilities	Revenues	Profit
The Economist Newspaper Ltd	England	50	63	(63)	131	15
Other			30	(21)	56	4
Total			93	(84)	187	19

The interest held in associates is equivalent to voting rights.

Notes to the consolidated financial statements continued

13. Deferred income tax

All figures in £ millions	2008	2007
Deferred income tax assets		
Deferred income tax assets to be recovered after more than 12 months	341	262
Deferred income tax assets to be recovered within 12 months	31	66
	372	328
Deferred income tax liabilities		
Deferred income tax liabilities to be settled after more than 12 months	(447)	(287)
Deferred income tax liabilities to be settled within 12 months	–	–
	(447)	(287)
Net deferred income tax	(75)	41

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

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The Group has unrecognised deferred income tax assets at 31 December 2008 in respect of UK losses of £28m (2007: £34m). None of these unrecognised deferred income tax assets have expiry dates associated with them.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

All figures in £ millions	Notes	2008	2007
At beginning of year		41	172
Exchange differences		(12)	(4)
Income statement charge	7	(93)	(87)
Acquisition through business combination	30	(4)	(45)
Disposal through business disposal	32	–	2
Tax (charge)/benefit to equity		(7)	3
At end of year		(75)	41

13. Deferred income tax continued

The movement in deferred income tax assets and liabilities during the year is as follows:

All figures in £ millions	Capital losses	Trading losses	Goodwill and intangibles	Returns provisions	Other	Total
Deferred income tax assets						
At 1 January 2007	76	129	25	66	121	417
Exchange differences	–	(5)	–	(1)	(2)	(8)
Acquisition through business combination	–	10	–	–	1	11
Income statement (charge)/benefit	(76)	(47)	(5)	14	19	(95)
Tax benefit to equity	–	–	–	–	3	3
At 31 December 2007	–	87	20	79	142	328
Exchange differences	–	19	6	28	40	93
Acquisition through business combination	–	2	–	–	–	2
Income statement charge	–	(35)	(6)	(1)	(3)	(45)
Tax charge to equity	–	–	–	–	(6)	(6)
At 31 December 2008	–	73	20	106	173	372

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

All figures in £ millions	Goodwill and intangibles	Other	Total
Deferred income tax liabilities			
At 1 January 2007	(149)	(96)	(245)
Exchange differences	3	1	4
Acquisition through business combination	(56)	–	(56)
Disposal through business disposal	–	2	2
Income statement (charge)/benefit	(12)	20	8
Tax benefit to equity	–	–	–
At 31 December 2007	(214)	(73)	(287)
Exchange differences	(73)	(32)	(105)
Acquisition through business combination	(5)	(1)	(6)
Income statement charge	(26)	(22)	(48)
Tax charge to equity	–	(1)	(1)
At 31 December 2008	(318)	(129)	(447)

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

Notes to the consolidated financial statements continued

14. Classification of financial instruments

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

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

14. Classification of financial instruments continued

All figures in £ millions	Notes	Fair value: Available for sale	Fair value: Derivatives deemed held for trading	Fair value: Derivatives in hedging relationships	Amortised cost: Loans and receivables	Amortised cost: Other liabilities	Total carrying value	Total market value
								2007
Investments in unlisted securities	15	52	–	–	–	–	52	52
Cash and cash equivalents	17	–	–	–	560	–	560	560
Marketable securities		40	–	–	–	–	40	40
Derivative financial instruments	16	–	16	35	–	–	51	51
Trade receivables	22	–	–	–	750	–	750	750
Total financial assets		92	16	35	1,310	–	1,453	1,453
Derivative financial instruments	16	–	(8)	(8)	–	–	(16)	(16)
Trade payables	24	–	–	–	–	(342)	(342)	(342)
Bank loans and overdrafts	18	–	–	–	–	(444)	(444)	(444)
Borrowings due within one year	18	–	–	–	–	(115)	(115)	(112)
Borrowings due after more than one year	18	–	–	–	–	(1,049)	(1,049)	(1,046)
Total financial liabilities		–	(8)	(8)	–	(1,950)	(1,966)	(1,960)

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

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

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

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

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

Notes to the consolidated financial statements continued

15. Other financial assets

All figures in £ millions	2008	2007
At beginning of year	52	17
Exchange differences	18	–
Acquisition of investments	1	–
Disposal of investments	(8)	–
Equity interest received on sale of Government Solutions	–	35
At end of year	63	52

Other financial assets comprise non-current unlisted securities.

16. Derivative financial instruments

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

			2008			2007
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,232	161	–	522	18	(8)
Interest rate derivatives – not in a hedge relationship	1,033	23	(20)	796	7	(8)
Cross currency rate derivatives – in a net investment hedge relationship	–	–	–	100	17	–
Cross currency rate derivatives – not in a hedge relationship	–	–	–	50	9	–
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.

At the end of 2008, 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 £161m and sterling £3m (2007: US dollar £(119)m and sterling £154m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2008 range from 4.45% to 7.0% (2007: 4.45% to 7.00%) and the floating rates are based on LIBOR in US dollar and sterling.

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

16. Derivative financial instruments continued

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement', the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

17. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2008	2007
Cash at bank and in hand	528	439
Short-term bank deposits	157	121
	685	560

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

At the end of 2008 the currency split of cash and cash equivalents was US dollars 36% (2007: 37%), sterling 22% (2007: 29%), euros 20% (2007: 16%) and other 22% (2007: 18%).

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	685	560
Bank overdrafts	(96)	(68)
	589	492

Notes to the consolidated financial statements continued

18. Financial liabilities – Borrowings

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

All figures in £ millions	2008	2007
Non-current		
Bank loans and overdrafts	132	–
4.7% US Dollar Bonds 2009 (nominal amount $350m)	–	176
7% Global Dollar Bonds 2011 (nominal amount $500m)	368	264
5.5% Global Dollar Bonds 2013 (nominal amount $350m)	258	–
5.7% US Dollar Bonds 2014 (nominal amount $400m)	322	211
7% Sterling Bonds 2014 (nominal amount £250m)	254	251
6.25% Global Dollar Bonds 2018 (nominal amount $550m)	445	–
4.625% US Dollar notes 2018 (nominal amount $300m)	237	143
Finance lease liabilities	3	4
	2,019	1,049
Current		
Due within one year or on demand:		
Bank loans and overdrafts	96	444
10.5% Sterling Bonds 2008 (nominal amount £100m)	–	105
4.7% US Dollar Bonds 2009 (nominal amount $350m)	244	–
Loan notes	–	8
Finance lease liabilities	4	2
	344	559
Total borrowings	2,363	1,608

Included in the non-current borrowings above is £12m of accrued interest (2007: £6m). Included in the current borrowings above is £1m of accrued interest (2007: £7m).

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

All figures in £ millions	2008	2007
Between one and two years	2	178
Between two and five years	759	266
Over five years	1,258	605
	2,019	1,049

18. Financial liabilities – Borrowings continued

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

All figures in £ millions	Effective interest rate	2008 Carrying value	2008 Market value	2007 Carrying value	2007 Market value
Bank loans and overdrafts	n/a	228	228	444	444
Loan notes	n/a	–	–	8	8
10.5% Sterling Bonds 2008	10.53%	–	–	105	102
4.7% US Dollar Bonds 2009	4.86%	244	243	176	176
7% Global Dollar Bonds 2011	7.16%	368	349	264	267
5.5% Global Dollar Bonds 2013	5.76%	258	227	–	–
5.7% US Dollar Bonds 2014	5.88%	322	262	211	203
7% Sterling Bonds 2014	7.20%	254	258	251	261
6.25% Global Dollar Bonds 2018	6.46%	445	352	–	–
4.625% US Dollar notes 2018	4.69%	237	169	143	135
Finance lease liabilities	n/a	7	7	6	6
		2,363	2,095	1,608	1,602

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

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

All figures in £ millions	2008	2007
US dollar	2,081	1,251
Sterling	277	357
Euro	5	–
	2,363	1,608

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

All figures in £ millions	2008	2007
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,085	1,007
	1,085	1,007

In addition to the above facilities, there are a number of short-term facilities that are utilised in the normal course of business.

All of the Group's borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

Notes to the consolidated financial statements continued

18. Financial liabilities – Borrowings continued

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

All figures in £ millions	2008	2007
Finance lease liabilities – minimum lease payments		
Not later than one year	4	2
Later than one year and not later than two years	2	2
Later than two years and not later than three years	1	1
Later than three years and not later than four years	–	1
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	7	6

The present value of finance lease liabilities is as follows:

All figures in £ millions	2008	2007
Not later than one year	4	2
Later than one year and not later than five years	3	4
Later than five years	–	–
	7	6

The carrying amounts of the Group's lease obligations approximate their fair value.

19. Financial risk management

The Group's approach to the management of financial risks together with sensitivity analyses is set out below.

Treasury policy

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. The Group borrows principally in US dollars and sterling, at both floating and fixed rates of interest, using derivative financial instruments ('derivatives'), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised below. All the treasury policies remained unchanged throughout 2008, with the exception of a change to the foreign exchange hedging policy made with effect from October 2008, which is explained later in this note. Some minor updates will also be made to treasury policies for 2009, largely to reflect current financial market conditions.

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

19. Financial risk management continued

Interest rate risk management

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2008 the hedging ratio, on the above basis, was approximately 49%. A simultaneous 1% change on 1 January in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £10m effect on profit before tax.

Use of interest rate derivatives

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

Liquidity and refinancing risk management

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2008 the average maturity of gross borrowings was 5.0 years of which bonds represented 90% of these borrowings (up from 4.6 years and up from 72% respectively at the beginning of the year).

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of the Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group's policy is to strive to maintain a rating of Baa1/BBB+ over the long term. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2008 the committed facilities amounted to £1,217m and their weighted average maturity was 3.4 years.

Notes to the consolidated financial statements continued

19. Financial risk management continued

Analysis of Group debt, including the impact of derivatives

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

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

All figures in £ millions	2008	2007
Cash and cash equivalents	685	560
Marketable securities	54	40
Derivative financial instruments	164	35
Bank loans, overdrafts and loan notes	(228)	(452)
Bonds	(2,128)	(1,150)
Finance lease liabilities	(7)	(6)
Net debt	(1,460)	(973)

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

All figures in £ millions	2008	2007
Fixed rate	781	567
Floating rate	679	406
Total	1,460	973

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

All figures in £ millions	2008	2007
US dollar	2,081	1,401
Sterling	277	207
Euro	5	–
Total	2,363	1,608

As at 31 December 2008 there were no outstanding cross-currency rate derivatives.

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

All figures in £ millions	Less than one year	One to five years	More than five years	Total
Re-pricing profile of borrowings	476	629	1,258	2,363
Effect of rate derivatives	1,173	(254)	(919)	–
Total	1,649	375	339	2,363

19. Financial risk management continued

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

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

				2007
All figures in £ millions	USD	GBP	EUR	Total
Not later than one year	153	(30)	–	123
Later than one year and not later than five years	966	70	–	1,036
Later than five years	420	285	–	705
Total	1,539	325	–	1,864
Analysed as:				
Revolving credit facilities and commercial paper	429	–	–	429
Bonds	1,017	483	–	1,500
Rate derivatives – inflows	(268)	(160)	–	(428)
Rate derivatives – outflows	361	2	–	363
Total	1,539	325	–	1,864

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.

Financial counterparty risk management

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

Notes to the consolidated financial statements continued

19. Financial risk management continued

Foreign currency risk management

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings with its forecast operating profit before depreciation and amortisation. This policy aims to dampen the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently are only the US dollar and sterling. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. In addition, our policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. Following the board's approval of a policy change in October 2008, currencies that account for less than 15% of Group operating profit before depreciation and amortisation may now be included in the above hedging process at the request of the chief financial officer. At the balance sheet date, no hedging transactions had been undertaken under that authority.

Included within year end net debt, the net borrowings/(cash) in the two principal currencies above (taking into account the effect of cross currency swaps) were: US dollar £1,777m and sterling £127m.

Use of currency debt and currency derivatives

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

19. Financial risk management continued

Financial instruments – sensitivity analysis

As at 31 December 2008 the sensitivity of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

All figures in £ millions	Carrying value	Impact of 1% increase in interest rates	Impact of 1% decrease in interest rates	Impact of 10% strengthening in sterling	Impact of 10% weakening in sterling
Investments in unlisted securities	63	–	–	(2)	3
Cash and cash equivalents	685	–	–	(41)	50
Marketable securities	54	–	–	(5)	6
Derivative financial instruments	164	(80)	88	(15)	18
Bonds	(2,128)	77	(84)	155	(189)
Other borrowings	(235)	–	–	19	(24)
Other net financial assets	580	–	–	(46)	57
Total financial instruments	(817)	(3)	4	65	(79)

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. The class 'Other net financial assets' comprises trade assets less trade liabilities.

The sensitivities of derivative instruments are calculated using established estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%. A large proportion of the movements shown above would impact equity rather than the income statement, depending on the location and functional currency of the entity in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

Notes to the consolidated financial statements continued

20. Intangible assets – Pre-publication

All figures in £ millions	2008	2007
Cost		
At beginning of year	1,264	1,152
Exchange differences	494	(7)
Additions	297	230
Disposals	(345)	(125)
Acquisition through business combination	78	19
Transfer from software	12	–
Transfer to non-current assets held for sale	–	(5)
At end of year	1,800	1,264
Amortisation		
At beginning of year	(814)	(750)
Exchange differences	(337)	1
Charge for the year	(244)	(192)
Disposals	345	125
Acquisition through business combination	(51)	(1)
Transfer from software	(4)	–
Transfer to non-current assets held for sale	–	3
At end of year	(1,105)	(814)
Carrying amounts		
At end of year	695	450

Included in the above are pre-publication assets amounting to £462m (2007: £292m) which will be realised in more than 12 months.

Amortisation is included in the income statement in cost of goods sold. There was no amortisation relating to discontinued operations in 2008 and 2007.

21. Inventories

All figures in £ millions	2008	2007
Raw materials	31	24
Work in progress	29	30
Finished goods	441	314
	501	368

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £832m (2007: £732m). In 2008 £56m (2007: £47m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

22. Trade and other receivables

All figures in £ millions	2008	2007
Current		
Trade receivables	1,030	750
Royalty advances	111	84
Prepayments and accrued income	62	48
Other receivables	135	59
Receivables from related parties	4	5
	1,342	946
Non-current		
Royalty advances	102	68
Prepayments and accrued income	3	4
Other receivables	47	57
	152	129

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns. The movements on the provision for bad and doubtful debts are as follows:

All figures in £ millions	2008	2007
At beginning of year	(52)	(46)
Exchange differences	(18)	(1)
Income statement movements	(27)	(19)
Utilised	27	15
Acquisition through business combination	(2)	(3)
Disposal through business disposal	–	2
At end of year	(72)	(52)

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

Notes to the consolidated financial statements continued

22. Trade and other receivables continued

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

All figures in £ millions	2008	2007
Within due date	1,110	819
Up to three months past due date	248	171
Three to six months past due date	60	51
Six to nine months past due date	21	12
Nine to 12 months past due date	15	19
More than 12 months past due date	20	19
Total trade receivables	1,474	1,091
Less: provision for bad and doubtful debts	(72)	(52)
Less: provision for sales returns	(372)	(281)
Transfer to non-current assets held for sale	–	(8)
Net trade receivables	1,030	750

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

23. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Leases	Other	Total
At 1 January 2008	37	9	21	67
Exchange differences	5	2	9	16
Charged to income statement	2	–	7	9
Released to income statement	–	(1)	(5)	(6)
Acquisition through business combination – current year	3	–	16	19
Acquisition through business combination – prior year adjustments	(4)	–	7	3
Utilised	–	(2)	(17)	(19)
At 31 December 2008	43	8	38	89

23. Provisions for other liabilities and charges continued

All figures in £ millions	2008	2007
Analysis of provisions		
Non-current	33	44
Current	56	23
	89	67

Deferred consideration primarily relates to the acquisition of Mergermarket in 2006. These amounts are payable in 2009.

Lease commitments relate primarily to onerous lease contracts, acquired through business combinations, which have various expiry dates up to 2017. The provision is based on current occupancy estimates.

24. Trade and other liabilities

All figures in £ millions	2008	2007
Trade payables	450	342
Social security and other taxes	35	23
Accruals	501	402
Deferred income	444	290
Interest payable	10	–
Dividends payable to minority interest	5	12
Other liabilities	205	171
	1,650	1,240
Less: non-current portion		
Accruals	42	30
Deferred income	87	58
Interest payable	1	–
Other liabilities	91	102
	221	190
Current portion	1,429	1,050

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

The deferred income balances comprise:

– multi-year obligations to deliver workbooks to adoption customers in school businesses;

– advance payments in assessment and testing businesses;

– subscription income in school, newspaper and market pricing businesses;

– advertising income relating to future publishing days in newspaper businesses; and

– obligations to deliver digital content in future periods.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations

Background

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

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

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

Pearson also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

Assumptions

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

			2008			2007
%	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	2.80	2.80	2.80	3.30	2.93	3.00
Rate used to discount plan liabilities	6.40	6.25	6.25	5.80	6.01	6.05
Expected return on assets	6.33	7.60	–	6.50	7.27	–
Expected rate of increase in salaries	4.30	4.50	–	5.00	4.36	–
Expected rate of increase for pensions in payment and deferred pensions	2.30 to 4.20	–	–	2.50 to 4.30	–	–
Initial rate of increase in healthcare rate	–	–	9.00	–	–	9.50
Ultimate rate of increase in healthcare rate	–	–	5.00	–	–	5.00

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

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

The UK mortality assumptions have been derived by adjusting standard mortality tables (PMFA 92 tables projected forward with medium cohort improvement factors). The Group changed its mortality assumptions in the UK in 2007 to reflect an assumed increased life expectancy of pensioners by adding a 1% floor to the medium cohort projections.

For the US plans, the assumptions used were based on standard US mortality tables. In 2007 GAM94 was used, and in 2008 this was updated to RP2000 to reflect the mortality assumption now more prevalent in the US.

25. Retirement benefit and other post-retirement obligations continued

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK and US Group plans is as follows:

	UK		US	
	2008	2007	2008	2007
Male	21.5	21.3	17.6	17.9
Female	21.8	21.6	20.2	21.3

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

	UK		US	
	2008	2007	2008	2007
Male	23.3	23.1	17.6	17.9
Female	23.8	23.6	20.2	21.3

Financial statement information

The amounts recognised in the income statement are as follows:

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

						2007
All figures in £ millions	UK Group plan	Defined benefit other	Sub-total	Defined contribution	PRMB	Total
Current service cost	29	2	31	39	1	71
Total operating expense	29	2	31	39	1	71
Expected return on plan assets	(96)	(7)	(103)	–	–	(103)
Interest on plan liabilities	84	7	91	–	2	93
Net finance (income)/expense	(12)	–	(12)	–	2	(10)
Net income statement charge	17	2	19	39	3	61
Actual (loss)/return on plan assets	128	4	132	–	–	132

The total operating charge is included in administrative and other expenses. The UK Group plan current service cost includes £14m (2007: £10m) relating to defined contribution sections.

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	2008 UK Group plan	2008 Other funded plans	2008 Other unfunded plans	2008 Total	2007 UK Group plan	2007 Other funded plans	2007 Other unfunded plans	2007 Total
Fair value of plan assets	1,478	100	–	1,578	1,744	109	–	1,853
Present value of defined benefit obligation	(1,429)	(149)	(16)	(1,594)	(1,682)	(117)	(12)	(1,811)
Net pension (liability)/asset	49	(49)	(16)	(16)	62	(8)	(12)	42
Other post-retirement medical benefit obligation				(68)				(47)
Other pension accruals				(34)				(28)
Net retirement benefit obligations				(118)				(33)
Analysed as:								
Retirement benefit assets				49				62
Retirement benefit obligations				(167)				(95)

The following (losses)/gains have been recognised in the statement of recognised income and expense:

All figures in £ millions	2008	2007
Amounts recognised for defined benefit plans	(74)	79
Amounts recognised for post-retirement medical benefit plans	3	1
Total recognised in year	(71)	80
Cumulative amounts recognised	53	124

The fair value of plan assets comprises the following:

%	2008 UK Group plan	2008 Other funded plans	2008 Total	2007 UK Group plan	2007 Other funded plans	2007 Total
Equities	28.0	3.1	31.1	34.3	3.4	37.7
Bonds	40.8	2.2	43.0	34.9	2.0	36.9
Properties	7.4	0.1	7.5	7.7	–	7.7
Other	17.5	0.9	18.4	17.2	0.5	17.7

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

25. Retirement benefit and other post-retirement obligations continued

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

All figures in £ millions	2008 UK Group plan	2008 Other plans	2008 Total	2007 UK Group plan	2007 Other plans	2007 Total
Fair value of plan assets						
Opening fair value of plan assets	1,744	109	1,853	1,528	105	1,633
Exchange differences	–	23	23	–	1	1
Expected return on plan assets	104	7	111	96	7	103
Actuarial gains and (losses)	(234)	(34)	(268)	32	(3)	29
Contributions by employer	54	3	57	152	5	157
Contributions by employee	9	–	9	8	–	8
Benefits paid	(72)	(8)	(80)	(72)	(6)	(78)
Other movements	(127)	–	(127)	–	–	–
Closing fair value of plan assets	1,478	100	1,578	1,744	109	1,853
Present value of defined benefit obligation						
Opening defined benefit obligation	(1,682)	(129)	(1,811)	(1,683)	(127)	(1,810)
Exchange differences	–	(38)	(38)	–	1	1
Current service cost	(33)	(3)	(36)	(29)	(2)	(31)
Past service cost	–	(1)	(1)	–	–	–
Interest cost	(93)	(7)	(100)	(84)	(7)	(91)
Actuarial gains and (losses)	189	5	194	50	–	50
Contributions by employee	(9)	–	(9)	(8)	–	(8)
Benefits paid	72	8	80	72	6	78
Other movements	127	–	127	–	–	–
Closing defined benefit obligation	(1,429)	(165)	(1,594)	(1,682)	(129)	(1,811)

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

Notes to the consolidated financial statements continued

25. Retirement benefit and other post-retirement obligations continued

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

All figures in £ millions	2008	2007
Opening defined benefit obligation	(47)	(48)
Exchange differences	(19)	–
Current service cost	(1)	(1)
Past service cost	(5)	–
Interest cost	(3)	(2)
Actuarial gains and (losses)	3	1
Benefits paid	4	3
Closing defined benefit obligation	(68)	(47)

The history of the defined benefit plans is as follows:

All figures in £ millions	2008	2007	2006	2005	2004
Fair value of plan assets	1,578	1,853	1,633	1,500	1,280
Present value of defined benefit obligation	(1,594)	(1,811)	(1,810)	(1,803)	(1,615)
Net pension asset/(liability)	(16)	42	(177)	(303)	(335)
Experience adjustments on plan assets	(268)	29	74	140	67
Experience adjustments on plan liabilities	194	50	28	(119)	(127)

Funding

The UK Group plan is self-administered with the plan's assets being held independently of the Group. The trustees of the plan are required to act in the best interest of the plan's beneficiaries. The most recently completed triennial actuarial valuation for funding purposes was completed as at 1 January 2006 and revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by 31 December 2014. In 2008 the Group contributed £21m (2007: £121m including a special contribution of £100m) and has agreed to contribute £21.9m per annum thereafter in excess of an estimated £30m of regular contributions.

The Group expects to contribute $92m in 2009 and $86m in 2010 to its US pension plans.

25. Retirement benefit and other post-retirement obligations continued

Sensitivities

The net retirement benefit obligations are calculated using a number of assumptions, the most significant being the discount rate used to calculate the defined benefit obligation. The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows:

	2008	
All figures in £ millions	1% increase	1% decrease
Effect on:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(180.1)	209.6
(Decrease)/increase of aggregate of service cost and interest cost – UK Group plan	(2.2)	1.1
(Decrease)/increase in defined benefit obligation – US plan	(12.2)	14.5

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

	2008	
All figures in £ millions	1% increase	1% decrease
Effect on:		
Increase/(decrease) in post-retirement medical benefit obligation	3.3	(2.9)
Increase/(decrease) of aggregate of service cost and interest cost	0.2	(0.1)

Notes to the consolidated financial statements continued

26. Share-based payments

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

All figures in £ millions	2008	2007
Pearson plans	25	23
Interactive Data plans	8	7
Total share-based payment costs	33	30

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

Worldwide Save for Shares Plan – Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

Employee Stock Purchase Plan – In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six month periods. At the end of the period, the employee has the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

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

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

The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in July 2007, March 2008 and July 2008, vest dependent on relative shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2007 and 2008 vest depending on continuing service over a three-year period.

Annual Bonus Share Matching Plan – This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis of up to one share for every one held.

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

26. Share-based payments continued

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

	2008		2007	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	16,781	13.15	18,861	13.36
Granted during the year	1,437	5.35	773	6.90
Exercised during the year	(683)	4.85	(1,326)	5.80
Forfeited during the year	(3,082)	11.56	(1,434)	19.63
Expired during the year	(74)	6.06	(93)	7.68
Outstanding at end of year	14,379	13.14	16,781	13.15
Options exercisable at end of year	11,527	14.97	13,999	14.63

Options were exercised regularly throughout the year. The weighted average share price during the year was £6.44 (2007: £8.02). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

The options outstanding at the end of the year have weighted average remaining contractual lives and exercise prices as follows:

	2008		2007	
Range of exercise prices £	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 5	453	1.23	930	1.56
5 – 10	5,113	2.84	4,909	3.22
10 – 15	5,481	1.97	7,257	2.62
15 – 20	908	0.84	980	1.85
20 – 25	350	1.19	400	2.19
>25	2,074	1.19	2,305	2.19
	14,379	2.05	16,781	2.62

In 2008 and 2007 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

Notes to the consolidated financial statements continued

26. Share-based payments continued

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

	2008 Weighted average	2007 Weighted average
Fair value	£1.67	£2.53
Weighted average share price	£6.96	£8.91
Weighted average exercise price	£5.35	£6.90
Expected volatility	21.41%	19.72%
Expected life	4.1 years	4.0 years
Risk free rate	4.28%	5.34%
Expected dividend yield	4.54%	3.29%
Forfeiture rate	3.6%	3.5%

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

The following shares were granted under restricted share arrangements:

	2008		2007	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Annual Bonus Share Matching Plan	253	6.73	143	7.67
Long-Term Incentive Plan	4,152	5.78	3,377	7.12

Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Until 31 December 2007, they were discounted by the dividend yield (2007: 3.26%) to take into account any dividends foregone. From 2008, shares granted include the entitlement to dividends during the vesting period and therefore the share price is not discounted. The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. Participants of the Long-Term Incentive Plan are entitled to dividends during the vesting period. The number of shares to vest has been adjusted, based on historical experience, to account for any potential forfeitures.

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions were considered by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

Subsidiary share option plans

Interactive Data, a 62% subsidiary of the Group, operates the following share-based payment plans:

2001 Employee Stock Purchase Plan

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

26. Share-based payments continued

2000 Long-Term Incentive Plan

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

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

Interactive Data employees purchased 183,318 shares (2007: 186,343) under the 2001 Employee Stock Purchase Plan at an average share price of $22.95(£15.96) (2007: $17.77; £8.93). The weighted average fair value at the date of grant was $6.59 (£4.58) (2007: $4.76; £2.39).

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

	2008			2007		
	Number of share options 000s	Weighted average exercise price $	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price $	Weighted average exercise price £
Outstanding at beginning of year	9,827	18.21	9.15	10,506	16.33	8.34
Granted during the year	1,449	24.95	17.35	1,560	27.17	13.65
Exercised during the year	(895)	15.37	10.69	(1,935)	14.88	7.48
Forfeited during the year	(99)	22.05	15.34	(293)	20.38	10.24
Expired during the year	(18)	12.17	8.46	(11)	18.12	9.10
Outstanding at end of year	10,264	19.38	13.48	9,827	18.21	9.15
Options exercisable at end of year	6,865	16.89	11.75	6,199	15.27	7.67

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

	2008		2007	
Range of exercise prices $	Number of share options 000s	Weighted average contractual life Years	Number of share options 000s	Weighted average contractual life Years
0 – 4.4	–	–	–	–
4.4 – 7.5	47	1.3	72	2.1
7.5 – 12	1,502	2.4	1,745	3.4
12 – 20	2,987	4.6	3,464	5.6
› 20	5,728	8.0	4,546	8.5
	10,264	6.2	9,827	6.6

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26. Share-based payments continued

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

	Long-Term Incentive Plan		Employee Stock Purchase Plan	
	2008	2007	2008	2007
	Weighted average	Weighted average	Weighted average	Weighted average
Fair value	$5.58	$6.60	$6.59	$4.76
Weighted average share price	$24.95	$27.17	$22.95	$17.77
Weighted average exercise price	$24.95	$27.17	$22.95	$17.77
Expected volatility	24.20%	23.40%	33.70%	20.50%
Expected life	5.7 years	5.0 years	0.5 years	0.5 years
Risk free rate	1.5% to 3.5%	4.2% to 4.9%	2.0% to 2.4%	4.3% to 5.1%
Expected dividend yield	2.2%	1.9%	2.1%	2.0%
Forfeiture rate	0.0%	0.0%	0.0%	0.0%

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

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

	2008			2007		
	Number of shares 000s	Weighted average fair value $	Weighted average fair value £	Number of shares 000s	Weighted average fair value $	Weighted average fair value £
2000 Long-Term Incentive Plan	194	25.43	17.69	185	27.07	13.60

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

27. Share capital and share premium

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

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

27. Share capital and share premium continued

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings (see notes 27, 28 and 29).

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

28. Treasury shares

	Pearson plc		Interactive Data		Total
	Number of shares 000s	£m	Number of shares 000s	£m	£m
At 1 January 2007	8,761	130	6,052	59	189
Purchase of treasury shares	4,900	40	1,177	16	56
Release of treasury shares	(1,900)	(29)	–	–	(29)
At 31 December 2007	11,761	141	7,229	75	216
Purchase of treasury shares	2,028	12	1,976	35	47
Release of treasury shares	(3,341)	(41)	–	–	(41)
At 31 December 2008	10,448	112	9,205	110	222

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.3% (2007: 1.5%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

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

The nominal value of Pearson plc treasury shares amounts to £2.6m (2007: £2.9m). The nominal value of Interactive Data treasury shares amounts to £0.06m (2007: £0.04m).

At 31 December 2008 the market value of Pearson plc treasury shares was £67.0m (2007: £86.1m) and the market value of Interactive Data treasury shares was £157.9m (2007: £119.9m).

Notes to the consolidated financial statements continued

29. Other reserves and retained earnings

All figures in £ millions	Notes	Translation reserve	Fair value reserve	Total other reserves	Retained earnings
At 1 January 2007		(592)	–	(592)	1,568
Net exchange differences on translation of foreign operations		25	–	25	–
Cumulative translation adjustment disposed – subsidiaries	32	53	–	53	–
Profit for the year attributable to equity holders of the company		–	–	–	284
Dividends paid to equity holders of the company	9	–	–	–	(238)
Equity settled transactions	26	–	–	–	30
Actuarial gains on retirement benefit obligations – Group	25	–	–	–	80
Treasury shares released under employee share plans	28	–	–	–	(29)
Taxation on items charged to equity	7	–	–	–	29
At 31 December 2007		(514)	–	(514)	1,724
Net exchange differences on translation of foreign operations		1,050	–	1,050	–
Cumulative translation adjustment disposed – subsidiaries	32	49	–	49	–
Cumulative translation adjustment disposed – joint venture		1	–	1	–
Profit for the year attributable to equity holders of the company		–	–	–	292
Dividends paid to equity holders of the company	9	–	–	–	(257)
Equity settled transactions	26	–	–	–	33
Actuarial losses on retirement benefit obligations – Group	25	–	–	–	(71)
Actuarial losses on retirement benefit obligations – associate		–	–	–	(3)
Treasury shares released under employee share plans	28	–	–	–	(41)
Taxation on items charged to equity	7	–	–	–	2
At 31 December 2008		586	–	586	1,679

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. Included in the translation reserve in 2007 was a £49m loss relating to net assets classified as held for sale.

30. Business combinations

On 2 January 2008 the Group acquired 100% of Money-Media, a US based company offering online news and commentary for the money management industry. On 30 January 2008 the Group completed its acquisition of 100% of Harcourt Assessment after receiving clearance from the US Department of Justice.

30. Business combinations continued

The provisional assets and liabilities arising from acquisitions are as follows:

All figures in £ millions	Notes	2008 Harcourt Assessment Fair value	2008 Money-Media Fair value	2008 Other Fair value	2008 Total Fair value	2007 Total Fair value
Property, plant and equipment	10	6	–	–	6	11
Intangible assets	11	174	10	36	220	197
Intangible assets – Pre-publication	20	27	–	–	27	18
Inventories		7	–	–	7	15
Trade and other receivables		48	2	4	54	28
Cash and cash equivalents		5	–	11	16	–
Trade and other liabilities		(40)	(4)	(8)	(52)	(38)
Financial liabilities – Borrowings		–	–	–	–	(1)
Current income tax liabilities		–	–	(3)	(3)	4
Net deferred income tax liabilities	13	–	–	(4)	(4)	(45)
Provisions for other liabilities and charges	23	(19)	–	(7)	(26)	(2)
Minority interest		–	–	(2)	(2)	–
Assets held for sale		3	–	–	3	–
Net assets acquired at fair value		211	8	27	246	187
Goodwill	11	113	25	15	153	304
Total		324	33	42	399	491
Satisfied by:						
Cash		(321)	(33)	(40)	(394)	(468)
Deferred consideration		–	–	–	–	(12)
Net prior year adjustments		(3)	–	(2)	(5)	(11)
Total consideration		(324)	(33)	(42)	(399)	(491)

All figures in £ millions	Harcourt Assessment	Money-Media	Other	2008 Total	2007 Total
Carrying value of net assets/(liabilities) acquired	81	(2)	(1)	78	41
Fair value adjustments	130	10	28	168	146
Fair value	211	8	27	246	187

The goodwill arising on the acquisition of Harcourt Assessment and Money-Media results from substantial cost and revenue synergies and from benefits that cannot be separately recognised, such as the assembled workforce. The fair value adjustments relating to these acquisitions were finalised during 2008.

Notes to the consolidated financial statements continued

30. Business combinations continued

Harcourt Assessment

All figures in £ millions	Carrying value	Fair value adjs	Fair value
Property, plant and equipment	7	(1)	6
Intangible assets	10	164	174
Intangible assets – Pre-publication	35	(8)	27
Inventories	8	(1)	7
Trade and other receivables	50	(2)	48
Cash and cash equivalents	5	–	5
Trade and other liabilities	(39)	(1)	(40)
Provisions for other liabilities and charges	(3)	(16)	(19)
Assets held for sale	8	(5)	3
Net assets acquired at fair value	81	130	211
Goodwill			113
Total			324

Money-Media

All figures in £ millions	Carrying value	Fair value adjs	Fair value
Intangible assets	–	10	10
Trade and other receivables	2	–	2
Trade and other liabilities	(4)	–	(4)
Net assets acquired at fair value	(2)	10	8
Goodwill			25
Total			33

Net cash outflow on acquisition:

All figures in £ millions	2008	2007
Cash – Current year acquisitions	(394)	(468)
Cash – Acquisitions yet to complete	(12)	–
Deferred payments for prior year acquisitions and other items	(5)	(4)
Cash and cash equivalents acquired	16	–
Cash outflow on acquisition	(395)	(472)

Harcourt Assessment contributed £150m of sales and £25m to the Group’s profit before tax between the date of acquisition and the balance sheet date. Money-Media contributed £9m of sales and £4m to the Group’s profit before tax between the date of acquisition and the balance sheet date. Other businesses acquired contributed £2m to the Group’s sales and £1m to the Group’s profit before tax between the date of acquisition and the balance sheet date.

If the acquisitions had been completed on 1 January 2008, the Group estimates that sales for the period would have been £4,826m and profit before tax would have been £587m.

31. Non-current assets classified as held for sale

In 2007, assets classified as held for sale related to Data Management. The Group recognised an impairment on the goodwill allocated to the Data Management business in anticipation of the loss on disposal (see note 3). There are no assets or liabilities classified as held for sale at the 2008 balance sheet date.

31. Non-current assets classified as held for sale continued

All figures in £ millions	Notes	2008	2007
Property, plant and equipment	10	–	7
Intangible assets – Goodwill		–	96
Intangible assets – Pre-publication	20	–	2
Inventories		–	4
Trade and other receivables		–	8
Non-current assets classified as held for sale		–	117
Other liabilities		–	(9)
Liabilities directly associated with non-current assets classified as held for sale		–	(9)
Net assets classified as held for sale		–	108

32. Disposals

			2008	2007
All figures in £ millions	Data Management	Other	Total	Total
Disposal of subsidiaries				
Property, plant and equipment	(7)	–	(7)	(16)
Intangible assets	(1)	–	(1)	(6)
Intangible assets – Pre-publication	(2)	–	(2)	–
Inventories	(4)	(3)	(7)	(1)
Trade and other receivables	(8)	–	(8)	(95)
Cash and cash equivalents	–	–	–	(14)
Net deferred income tax liabilities	–	–	–	2
Trade and other liabilities	9	–	9	73
Retirement benefit obligations	–	–	–	3
Provisions for other liabilities and charges	–	–	–	1
Minority interest	–	(5)	(5)	(8)
Attributable goodwill	(98)	(8)	(106)	(250)
Cumulative translation adjustment	(49)	–	(49)	(53)
Net assets disposed	(160)	(16)	(176)	(364)
Cash received	111	15	126	495
Deferred receipts	–	2	2	–
Other proceeds received	–	–	–	35
Costs	(4)	(1)	(5)	(20)
(Loss)/profit on sale	(53)	–	(53)	146

	2008	2007
Cash flow from disposals		
Cash – Current year disposals	126	495
Costs paid	(15)	(12)
Cash and cash equivalents disposed	–	(14)
Net cash inflow	111	469

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

Notes to the consolidated financial statements continued

33. Cash generated from operations

All figures in £ millions	Notes	2008	2007
Net profit		323	310
Adjustments for:			
Income tax		209	222
Depreciation	10	80	68
Amortisation of purchased intangible assets	11	86	45
Amortisation of other intangible assets	11	30	25
Loss on sale of property, plant and equipment		1	1
Net finance costs	6	91	106
Share of results of joint ventures and associates	12	(25)	(23)
Loss/(profit) on sale of discontinued operations	3	53	(146)
Goodwill impairment of discontinued operation	3	–	97
Net foreign exchange adjustment from transactions		105	11
Share-based payment costs	26	33	30
Pre-publication		(58)	(38)
Inventories		(12)	(1)
Trade and other receivables		(81)	(5)
Trade and other liabilities		82	80
Retirement benefit obligations		(14)	(126)
Provisions for other liabilities and charges		(9)	3
Net cash generated from operations		894	659
Dividends from joint ventures and associates		23	32
Purchase of property, plant and equipment		(75)	(86)
Purchase of intangible assets		(45)	(33)
Finance lease principal payments		(3)	(2)
Proceeds from sale of property, plant and equipment		2	14
Add back: Special pension contribution		–	100
Operating cash flow		796	684
Operating tax paid		(89)	(61)
Net operating finance costs paid		(76)	(90)
Operating free cash flow		631	533
Non-operating tax paid		–	(26)
Special pension contribution		–	(100)
Total free cash flow		631	407
Dividends paid (including to minorities)		(285)	(248)
Net movement of funds from operations		346	159
Acquisitions and disposals		(285)	(15)
Purchase of treasury shares		(47)	(72)
New equity		6	12
Other movements on financial instruments		8	(7)
Net movement of funds		28	77
Exchange movements on net debt		(515)	9
Total movement in net debt		(487)	86

33. Cash generated from operations continued

Net cash generated from operations is translated at an exchange rate approximating to the rate at the date of cash flow. In 2008 the difference between this rate and the average rate used to translate profit gives rise to a large currency adjustment in the reconciliation between net profit and net cash generated from operations. This adjustment reflects the timing difference between recognition of profit and the related cash receipts or payments.

Included in net cash generated from operations is an amount of £nil (2007: £7m) relating to discontinued operations.

Operating cash flow, operating free cash flow and total free cash flow are non-GAAP measures and have been disclosed as they are part of Pearson's corporate and operating measures. Following the completion of the latest actuarial valuation of the UK Group pension plan as at January 2006, the Group agreed that during 2007 it would make additional payments to the plan amounting to £100m. The Group excluded this £100m from its definition of operating cash flow and operating free cash flow as it distorted the underlying operating performance for that year.

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

All figures in £ millions	2008	2007
Net book amount	3	15
Loss on sale of property, plant and equipment	(1)	(1)
Proceeds from sale of property, plant and equipment	2	14

The principal other non-cash transactions are movements in finance lease obligations of £2m (2007: £4m).

34. Contingencies

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

35. Commitments

Capital commitments

Capital expenditure contracted for at the balance sheet date but not yet incurred is as follows:

All figures in £ millions	2008	2007
Property, plant and equipment	–	3

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. The lease expenditure charged to the income statement during the year is disclosed in note 4.

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

All figures in £ millions	2008	2007
Not later than one year	149	123
Later than one year and not later than two years	138	116
Later than two years and not later than three years	129	102
Later than three years and not later than four years	118	93
Later than four years and not later than five years	108	85
Later than five years	970	834
	1,612	1,353

Notes to the consolidated financial statements continued

36. Related party transactions

Joint ventures and associates – Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. Amounts falling due from joint ventures and associates are set out in note 22.

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

There were no other material related party transactions.

No guarantees have been provided to related parties.

37. Events after the balance sheet date

During 2008 Pearson's International Education business announced its intention to increase its stakes in Longman Nigeria from 29% to 51% for £9m and Maskew Miller Longman (MML), its South African publishing business, from 50% to 85%.

Under the terms of the MML agreement, Pearson intends to create a new Southern Africa business and in return for the increased stake in MML our current joint venture partner will receive £46m in cash and a 15% interest in Pearson's Heinemann and Edexcel businesses in that region.

In addition Pearson's International Education business also announced the acquisition of Fronter, a European online learning company based in Oslo, for £16m.

The Longman Nigeria acquisition completed in early January 2009 and the Fronter acquisition in February 2009. The MML transaction is expected to complete in the second quarter of 2009 following regulatory approval.