Notes to the Company Financial Statements

1. Accounting policies

a. Basis of preparation

The financial statements on pages 95 to 101 comprise the separate financial statements of Pearson plc. As permitted by section 230(4) of the Companies Act 1985, only the Group's income statement has been presented.

The Company has no employees.

b. Group accounting policies

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

Investments

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

2. Investments in subsidiaries

All figures in £ millions	2007	2006
At beginning of year	7,103	6,883
Subscription for share capital in subsidiaries	425	1,019
External disposal	(1)	–
Disposal to subsidiary	(877)	(779)
Provision for impairment	–	(20)
At end of year	6,650	7,103

3. Financial instruments and risk management

The Company's financial instruments comprise amounts due to/from subsidiary undertakings, cash and cash equivalents, derivative financial instruments and current and non-current borrowings. Derivative financial instruments are held at fair value, with all other financial instruments held at amortised cost. The Company's approach to the management of financial risks is discussed on pages 22 to 24. The Company believes the value of its financial assets to be fully recoverable.

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

The carrying value of the Company's financial instruments is exposed to movements in interest rates and foreign currency exchange rates (primarily US dollars). The Company estimates that a 1% increase in interest rates would result in a £9m decrease in the carrying value of its financial instruments, with a 1% decrease in interest rates resulting in a £10m increase in their carrying value. The Company also estimates that a 10% strengthening in sterling would increase the carrying value of its financial instruments by £21m, while a 10% decrease in the value of sterling would decrease the carrying value by £25m. These increases and decreases in carrying value would be recorded through the income statement.

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

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

3. Financial instruments and risk management *continued*

All figures in £ millions	USD	GBP	EUR	2006 Total
Not later than one year	142	18	265	425
Later than one year and not later than five years	429	60	–	489
Later than five years	248	242	–	490
Total	819	320	265	1,404
Analysed as:				
Revolving credit facility and commercial paper	–	–	–	–
Bonds	561	511	423	1,495
Rate derivatives – inflows	(318)	(329)	(192)	(839)
Rate derivatives – outflows	576	138	34	748
Total	819	320	265	1,404

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 those prevailing at 31 December in the relevant year. Amounts drawn under revolving credit facilities 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. All derivative amounts are shown gross, although the company net settles these wherever possible.

4. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2007	2006
Cash at bank and in hand	1	48
Short-term bank deposits	60	105
	61	153

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

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

All figures in £ millions	2007	2006
Cash and cash equivalents	61	153
Bank overdrafts	(281)	(336)
	(220)	(183)

5. Financial liabilities – Borrowings

All figures in £ millions	2007	2006
Non-current		
10.5% Sterling Bonds 2008 (nominal amount £100m)	–	105
7% Global Dollar Bonds 2011 (nominal amount $500m)	264	266
7% Sterling Bonds 2014 (nominal amount £250m)	251	251
4.625% US Dollar notes 2018 (nominal amount $300m)	143	139
	658	761
Current		
Due within one year or on demand:		
Bank loans and overdrafts	644	363
6.25% Euro Bonds 2007 (nominal amount €591m)	–	421
10.5% Sterling Bonds 2008 (nominal amount £100m)	105	–
	749	784
Total borrowings	1,407	1,545

Included in the non-current borrowings above is £4m of accrued interest (2006: £10m).

Included in the current borrowings above is £7m of accrued interest (2006: £22m).

5. Financial liabilities – Borrowings *continued*

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

All figures in £ millions	2007	2006
Between one and two years	–	105
Between two and five years	264	266
Over five years	394	390
	658	761

As at 31 December 2007 the exposure of the borrowings of the Company to interest rate changes when the borrowings re-price is as follows:

All figures in £ millions	Total	One year	One to five years	More than five years
Carrying value of borrowings	1,407	749	264	394
Effect of rate derivatives	–	359	(7)	(352)
	1,407	1,108	257	42

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

All figures in £ millions	Effective interest rate	Carrying amount 2007	Market value 2007	Carrying amount 2006	Market value 2006
10.5% Sterling Bonds 2008	10.53%	–	–	105	106
7% Global Dollar Bonds 2011	7.16%	264	267	266	269
7% Sterling Bonds 2014	7.20%	251	261	251	265
4.625% US Dollar notes 2018	4.69%	143	135	139	135
		658	663	761	775

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

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

All figures in £ millions	2007	2006
US dollar	779	462
Sterling	620	654
Euro	8	429
	1,407	1,545

6. Derivative financial instruments

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

	2007			2006		
All figures in £ millions	Gross notional amounts	Assets	Liabilities	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	522	18	(8)	953	20	(17)
Interest rate derivatives – not in hedge relationship	796	7	(8)	1,026	9	(2)
Cross currency rate derivatives	150	26	–	410	57	–
Total	1,468	51	(16)	2,389	86	(19)
Analysed as expiring:						
In less than one year	320	28	–	976	50	–
Later than one year and not later than five years	796	13	(8)	1,005	26	(4)
Later than five years	352	10	(8)	408	10	(15)
Total	1,468	51	(16)	2,389	86	(19)

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

7. Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2006	804,020	201	2,477
Issue of shares – share option schemes	2,089	1	10
At 31 December 2006	806,109	202	2,487
Issue of shares – share option schemes	1,919	–	12
At 31 December 2007	808,028	202	2,499

The total authorised number of ordinary shares is 1,194m shares (2006: 1,190m shares) with a par value of 25p per share (2006: 25p per share). All issued shares are fully paid. All shares have the same rights.

8. Treasury shares

	Number of shares 000s	£m
At 1 January 2006	5,249	55
Purchase of treasury shares less contributions received	4,700	26
Release of treasury shares	(1,188)	(16)
At 31 December 2006	8,761	65
Purchase of treasury shares less contributions received	4,900	46
Release of treasury shares	(1,900)	(29)
At 31 December 2007	11,761	82

The Company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are held as treasury shares and have a par value of 25p per share. The nominal value of the Company's treasury shares amounts to £2.9m (2006: £2.2m). At 31 December 2007 the market value of the Company's treasury shares was £86.1m (2006: £67.6m).

9. Other reserves and retained earnings

All figures in £ millions	Special reserve	Retained earnings	Total
At 1 January 2006	447	1,026	1,473
Profit for the financial year	–	78	78
Dividends paid	–	(220)	(220)
Balance at 31 December 2006	447	884	1,331
Loss for the financial year	–	(43)	(43)
Dividends paid	–	(238)	(238)
At 31 December 2007	447	603	1,050

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

Included within retained earnings in 2007 is an amount of £131m (2006: £99m) relating to profit on intra-group disposals that is not distributable.

10. Contingencies

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

11. Audit fees

Statutory audit fees relating to the Company were £35,000 (2006: £35,000). Audit-related regulatory reporting fees relating to the Company were £nil (2006: £nil).

12. Related party transactions

Subsidiaries

The Company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the Company Balance Sheet.

These loans are generally unsecured and interest is calculated based on market rates. The Company has interest payable to subsidiaries during the year of £221m (2006: £149m) and interest receivable from subsidiaries during the year of £115m (2006: £61m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £33m (2006: £33m). Dividends received from subsidiaries in 2007 were £74m (2006: £28m).

Key management personnel

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

There were no other material related party transactions.