Notes to the Consolidated Financial Statements

General information
Pearson plc (the Company) and its subsidiaries (together the Group) are involved in the provision of information for the educational sector, consumer publishing and business information.

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 13 March 2008.

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 2007 – The Group has adopted IFRS 7 'Financial Instruments: Disclosures' from 1 January 2007. The impact of the standard has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments (see notes 14, 16, 19 and 21). The Group has also adopted Amendments to IAS 1 'Presentation of Financial Statements – Capital Disclosures' which resulted in the presentation of its objectives, policies and processes for managing capital as set out in note 26.

In addition, IFRIC 10 'Interim Financial Reporting and Impairment' is mandatory for the Group's accounting periods beginning on or after 1 January 2007. Management assessed the relevance of this interpretation with respect to the Group's operations and concluded that it is not relevant to the Group.

(2) Standards, interpretations and amendments to published standards that are not yet effective – The Group has decided to adopt IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' before its effective date (1 January 2008). IFRIC 14 resulted in no change to the full recognition of the pension asset as disclosed in note 24.

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

– IFRS 8 'Operating Segments' (effective for annual reporting periods beginning on or after 1 January 2009). IFRS 8 requires an entity to adopt the 'management approach' to reporting on the financial performance of its operating segments, revise explanations of the basis on which the segment information is prepared and provide reconciliations to the amounts recognised in the income statement and balance sheet;

– Amendment to IAS 23 'Borrowing Costs' (effective for annual reporting periods beginning on or after 1 January 2009). The amendment to IAS 23 requires capitalisation of borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale, with the exception of assets measured at fair value or inventories manufactured or produced in large quantities on a repetitive basis;

– IFRIC 11 'Group and Treasury Share Transactions' (effective for annual reporting periods beginning on or after 1 March 2007). IFRIC 11 addresses how to apply IFRS 2 Share-based Payment to share-based payment arrangements involving an entity's own equity instruments or equity instruments of another entity in the same 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:

– 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 none of the Group entities operate a customer loyalty programme, IFRIC 13 is not relevant to the Group's operations;

– IFRIC 12 'Service Concession Arrangements' (effective for annual reporting periods beginning on or after 1 January 2008). IFRIC 12 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.

(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.	

1. Accounting policies *continued*

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.

(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 $2.00 (2006: $1.84) and the year end rate was $1.99 (2006: $1.96).

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):	50 years (or over the period of the lease if shorter)
Plant and equipment:	3–20 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.

1. Accounting policies *continued*

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. The recoverable amounts of cash-generating units have been determined based on value in use calculations. These calculations require the use of estimates (see 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 five 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 five years.

(4) Acquired intangible assets – Acquired intangible assets comprise publishing rights, customer lists and relationships, technology, trade names and trademarks. 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 32).

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. Reviews are performed regularly to estimate recoverability of pre-publication assets. The carrying amount of pre-publication assets is set out in note 17.

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 through 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.

1. Accounting policies *continued*

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.

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/obligation recognised in the balance sheet represents the present value of the defined benefit obligation, less 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.

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.

1. Accounting policies *continued*

(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 in the period in which 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.

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 held for sale and discontinued operations

Non-current assets are classified as assets 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 held for sale are classified as discontinued operations in the income statement where appropriate.

u. Trade receivables

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

2. Segment information

Due to the differing risks and rewards associated with each business segment and the different customer focus of each segment, the Group's primary segment reporting format is by business. The Group is organised into the following five business segments:

School – publisher of textbooks and web-based learning tools, provider of testing and software services for primary and secondary schools;

Higher Education – publisher of textbooks and related course materials for colleges and universities;

Penguin – publisher with brand imprints such as Penguin, Putnam, Berkley, Viking, Dorling Kindersley;

FT Publishing – publisher of the *Financial Times,* other business newspapers, magazines and specialist information;

Interactive Data – provider of financial and business information to financial institutions and retail investors.

The remaining business group, Professional, brings together a number of education publishing, testing and services businesses that publish texts, reference and interactive products for industry professionals and does not meet the criteria for classification as a 'segment' under IFRS. For more detail on the services and products included in each business segment refer to the Business Review.

Primary reporting format – business segments

All figures in £ millions	Notes	School	Higher Education	Professional	FT Publishing	Interactive Data	Penguin	Corporate	Group
									2007
Continuing operations									
Sales (external)		1,537	793	298	344	344	846	–	4,162
Sales (inter-segment)		1	–	–	–	–	19	–	20
Operating profit before joint ventures and associates		169	159	26	34	90	73	–	551
Share of results of joint ventures and associates		6	–	1	16	–	–	–	23
Operating profit		175	159	27	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
Reconciliation to adjusted operating profit									
Operating profit		175	159	27	50	90	73	–	574
Amortisation of acquired intangibles		28	2	1	6	7	1	–	45
Adjusted operating profit – continuing operations		203	161	28	56	97	74	–	619
Segment assets		2,780	1,742	318	397	330	937	651	7,155
Joint ventures	12	5	–	–	4	–	2	–	11
Associates	12	3	1	–	5	–	–	–	9
Assets – continuing operations		2,788	1,743	318	406	330	939	651	7,175
Assets – discontinued operations		–	–	117	–	–	–	–	117
Total assets		2,788	1,743	435	406	330	939	651	7,292
Total liabilities		(798)	(266)	(130)	(251)	(129)	(220)	(1,624)	(3,418)
Other segment items									
Capital expenditure	10, 11, 17	147	98	20	28	19	44	–	356
Depreciation	10	22	11	9	9	10	7	–	68
Amortisation	11, 17	124	80	11	9	8	30	–	262

2. Segment information *continued*

All figures in £ millions	Notes	School	Higher Education	Professional	FT Publishing	Interactive Data	Penguin	Corporate	Group
									2006
Continuing operations									
Sales (external)		1,455	795	280	280	332	848	–	3,990
Sales (inter-segment)		1	–	–	–	–	18	–	19
Operating profit before joint ventures and associates		161	161	23	13	82	58	–	498
Share of results of joint ventures and associates		6	–	1	17	–	–	–	24
Operating profit		167	161	24	30	82	58	–	522
Finance costs	6								(133)
Finance income	6								59
Profit before tax									448
Income tax	7								(4)
Profit for the year from continuing operations									444
Reconciliation to adjusted operating profit									
Operating profit		167	161	24	30	82	58	–	522
Adjustment to goodwill on recognition of pre-acquisition deferred tax		–	–	–	–	–	7	–	7
Amortisation of acquired intangibles		17	–	1	2	7	1	–	28
Other net gains and losses of associates		–	–	–	(4)	–	–	–	(4)
Other net finance costs of associates		–	–	–	(1)	–	–	–	(1)
Adjusted operating profit – continuing operations		184	161	25	27	89	66	–	552
Segment assets		2,684	1,347	580	317	314	954	703	6,899
Joint ventures	12	5	–	–	4	–	3	–	12
Associates	12	4	–	–	4	–	–	–	8
Assets – continuing operations		2,693	1,347	580	325	314	957	703	6,919
Assets – discontinued operations		–	–	294	–	–	–	–	294
Total assets		2,693	1,347	874	325	314	957	703	7,213
Total liabilities		(662)	(268)	(177)	(300)	(131)	(269)	(1,762)	(3,569)
Other segment items									
Capital expenditure	10, 11, 17	124	88	30	19	20	38	–	319
Depreciation	10	21	8	19	9	13	7	–	77
Amortisation	11, 17	117	78	21	4	7	34	–	261

In 2007, sales from the provision of goods were £3,086m (2006: £3,031m) and sales from the provision of services were £1,076m (2006: £959m). 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.

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. Segment liabilities comprise operating liabilities and retirement benefit obligations and exclude borrowings and derivative liabilities. Corporate assets and liabilities comprise cash and cash equivalents, marketable securities, borrowings 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 17).

Property, plant and equipment and intangible assets acquired through business combination were £226m (2006: £173m) (see note 29). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations. Discontinued operations relate to Government Solutions, Datamark, Les Echos and the Data Management business (see note 3).

2. Segment information *continued*

Secondary reporting format – geographic segments

The Group's business segments are managed on a worldwide basis and operate in the following main geographic areas:

All figures in £ millions	Sales 2007	Sales 2006	Total assets 2007	Total assets 2006	Capital expenditure 2007	Capital expenditure 2006
Continuing operations						
European countries	1,102	1,003	1,827	1,608	90	70
North America	2,591	2,585	4,867	4,908	248	231
Asia Pacific	351	295	365	327	14	12
Other countries	118	107	96	56	2	2
Total	4,162	3,990	7,155	6,899	354	315
Discontinued operations						
European countries	83	103	–	9	1	1
North America	78	314	117	281	1	2
Other countries	6	16	–	4	–	1
Total	167	433	117	294	2	4
Joint ventures and associates	–	–	20	20	–	–
Total	4,329	4,423	7,292	7,213	356	319

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.

3. Discontinued operations

Discontinued operations relate to the following disposals made in the year (see note 31):

- Government Solutions (sold 15 February 2007)
- Datamark (acquired with eCollege and subsequently sold on 31 July 2007)
- Les Echos (sold 24 December 2007)

The results of Government Solutions (previously included in the Professional segment) and Les Echos (previously included in the FT Publishing segment) have been included in discontinued operations for both 2006 and 2007 and have been 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 have been consolidated.

On 22 February 2008 the Group completed the sale of its Data Management business (previously included in the Professional segment) and this business has been included in discontinued operations for the full year in both 2006 and 2007. In anticipation of the loss on sale, an impairment to held for sale goodwill has been charged to the income statement in 2007.

The assets and liabilities of the Data Management business have been reported as held for sale in the 31 December 2007 balance sheet. At 31 December 2006 held for sale assets and liabilities relate to Government Solutions (see note 30).

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

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

3. Discontinued operations *continued*

All figures in £ millions	Government Solutions	Data Management	Les Echos	Total 2006
Sales	286	61	86	433
Operating profit	22	13	5	40
Profit before tax	22	13	5	40
Attributable tax expense	(8)	(5)	(2)	(15)
Profit after tax	14	8	3	25
Profit/(loss) on disposal of discontinued operations before tax	–	–	–	–
Attributable tax expense	–	–	–	–
Profit for the year from discontinued operations	14	8	3	25
Operating cash flows	20	9	4	33
Investing cash flows	(8)	(2)	–	(10)
Financing cash flows	(1)	(7)	(7)	(15)
Total cash flows	11	–	(3)	8

4. Operating expenses

All figures in £ millions	2007	2006
By function:		
Cost of goods sold	1,910	1,841
Operating expenses		
Distribution costs	264	288
Administrative and other expenses	1,538	1,462
Other income	(101)	(99)
Total operating expenses	1,701	1,651
Total	3,611	3,492

All figures in £ millions	Notes	2007	2006
By nature:			
Utilisation of inventory	18	732	702
Depreciation of property, plant and equipment	10	65	68
Amortisation of intangible assets – Pre-publication	17	192	210
Amortisation of intangible assets – Other	11	70	48
Employee benefit expense	5	1,288	1,225
Operating lease rentals		129	122
Other property costs		122	121
Royalties expensed		365	360
Advertising, promotion and marketing		195	190
Information technology costs		70	71
Other costs		484	474
Other income		(101)	(99)
Total		3,611	3,492

4. Operating expenses *continued*

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

All figures in £ millions	2007	2006
Fees payable to the Company's auditor for the audit of parent company and consolidated accounts	1	1
The audit of the Company's subsidiaries pursuant to legislation	2	4
Other services pursuant to legislation	1	4
Tax services	2	1
Other services	1	1
Total	7	11

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

All figures in £ millions	2007	2006
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	4	9
Non-audit fees	3	2
Total audit fees	7	11

Other services pursuant to legislation represent fees payable for services in relation to other statutory filings or engagements that are required to be carried out by the appointed auditor. In particular, this includes fees for attestation under section 404 of the Sarbanes-Oxley Act.

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

Other services include services related to the disposal of the Data Management business, due diligence on acquisitions and advisory services in relation to information technology and section 404.

5. Employee information

All figures in £ millions	Notes	2007	2006
Employee benefit expense			
Wages and salaries (including termination benefits and restructuring costs)		1,087	1,035
Social security costs		100	101
Share-based payment costs	25	30	25
Pension costs – defined contribution plans	24	39	36
Pension costs – defined benefit plans	24	31	29
Other post-retirement benefits	24	1	(1)
		1,288	1,225

The details of the emoluments of the directors of Pearson plc are shown on pages 35 to 49.

Average number employed	2007	2006
Employee numbers		
School	12,906	11,064
Higher Education	5,098	4,368
Professional	3,458	3,204
Penguin	4,163	3,943
FT Publishing	2,083	1,766
Interactive Data	2,300	2,200
Other	1,614	1,669
Continuing operations	31,622	28,214
Discontinued operations	1,070	6,127
	32,692	34,341

6. Net finance costs

All figures in £ millions	Notes	2007	2006
Interest payable		(114)	(117)
Net foreign exchange losses		(25)	(2)
Other losses on financial instruments in a hedging relationship:			
– fair value hedges		(1)	–
– net investment hedges		(1)	(2)
Other losses on financial instruments not in a hedging relationship:			
– derivatives		(9)	(12)
Finance costs		(150)	(133)
Interest receivable		19	23
Finance income in respect of employee benefits	24	10	4
Net foreign exchange gains		8	21
Other gains on financial instruments in a hedging relationship:			
– fair value hedges		–	–
– net investment hedges		–	–
Other gains on financial instruments not in a hedging relationship:			
– amortisation of transitional adjustment on bonds		1	8
– derivatives		6	3
Finance income		44	59
Net finance costs		(106)	(74)
Analysed as:			
Net interest payable		(95)	(94)
Finance income in respect of employee benefits	24	10	4
Net finance costs reflected in adjusted earnings		(85)	(90)
Other net finance (costs)/income		(21)	16
Total net finance costs		(106)	(74)

The £1m net loss on fair value hedges comprises a £20m loss on the underlying bonds offset by a £19m gain on the related derivative financial instruments.

7. Income tax

All figures in £ millions	Notes	2007	2006
Current tax			
Charge in respect of current year		(71)	(81)
Recognition of previously unrecognised trading losses		–	23
Other adjustments in respect of prior years		27	35
Total current tax charge		(44)	(23)
Deferred tax			
In respect of timing differences		(96)	(73)
Recognition of previously unrecognised capital losses		–	76
Recognition of previously unrecognised trading losses		–	37
Other adjustments in respect of prior years		9	(21)
Total deferred tax (charge)/benefit	13	(87)	19
Total tax charge		(131)	(4)

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	2007	2006
Profit before tax	468	448
Tax calculated at UK rate	(141)	(135)
Effect of overseas tax rates	(25)	(17)
Joint venture and associate income reported net of tax	7	7
Income not subject to tax	3	5
Expenses not deductible for tax purposes	(12)	(18)
Utilisation of previously unrecognised tax losses	3	7
Recognition of previously unrecognised tax losses	–	136
Unutilised tax losses	(2)	(3)
Prior year adjustments	36	14
Total tax charge	(131)	(4)
UK	(42)	(15)
Overseas	(89)	11
Total tax charge	(131)	(4)
Add back: tax benefit on other net gains and losses	(9)	(4)
Add back: tax benefit on amortisation of acquired intangibles	(19)	(10)
Add back: tax (benefit)/charge on other finance income	(6)	5
Tax amortisation benefit on goodwill and intangibles	25	25
Recognition of tax losses	–	(127)
Adjusted income tax charge – continuing operations	(140)	(115)
Adjusted income tax charge – discontinued operations	(5)	(15)
Total adjusted income tax charge	(145)	(130)
Tax rate reflected in adjusted earnings	26.4%	25.9%

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

All figures in £ millions	2007	2006
Share-based payments	7	2
Pension contributions and actuarial gains and losses	28	9
Net investment hedges and other foreign exchange gains and losses	(6)	1
	29	12

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.

8. Earnings per share *continued*

All figures in £ millions	Notes	2007	2006
Profit for the year from continuing operations		337	444
Minority interest		(26)	(23)
Earnings from continuing operations		311	421
(Loss)/profit for the year from discontinued operations	3	(27)	25
Earnings		284	446
Weighted average number of shares (millions)		796.8	798.4
Effect of dilutive share options (millions)		1.3	1.5
Weighted average number of shares (millions) for diluted earnings		798.1	799.9
Earnings per share from continuing and discontinued operations			
Basic		35.6p	55.9p
Diluted		35.6p	55.8p
Earnings per share from continuing operations			
Basic		39.0p	52.7p
Diluted		39.0p	52.6p
Earnings per share from discontinued operations			
Basic		(3.4p)	3.2p

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:

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.

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.

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. From 2007 the Group has also added 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. The 2006 comparative has been restated accordingly. In 2006, the Company excluded tax benefits from the recognition of its tax losses which due to their size and non-recurring nature were not considered to be fully reflective of the underlying tax rate of the Group.

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

8. Earnings per share *continued*

The following tables reconcile statutory earnings to adjusted earnings.

All figures in £ millions	Statutory income statement	Re-analyse discontinued operations	Other net gains and losses	Amortisation of acquired intangibles	Other net finance costs/income	Tax amortisation benefit	Recognition of tax losses	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
Minorities	(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

All figures in £ millions	Statutory income statement	Re-analyse discontinued operations	Other net gains and losses	Amortisation of acquired intangibles	Other net finance costs/income	Tax amortisation benefit	Recognition of tax losses	Adjusted income statement
								2006
Operating profit	522	40	(4)	35	(1)	–	–	592
Net finance costs	(74)	–	–	–	(16)	–	–	(90)
Profit before tax	448	40	(4)	35	(17)	–	–	502
Income tax	(4)	(15)	(4)	(10)	5	25	(127)	(130)
Profit for the year from continuing operations	444	25	(8)	25	(12)	25	(127)	372
Profit for the year from discontinued operations	25	(25)	–	–	–	–	–	–
Profit for the year	469	–	(8)	25	(12)	25	(127)	372
Minorities	(23)	–	–	(3)	–	(2)	–	(28)
Earnings	446	–	(8)	22	(12)	23	(127)	344
Weighted average number of shares (millions)								798.4
Adjusted earnings per share								43.1p

9. Dividends

All figures in £ millions	2007	2006
Final paid in respect of prior year 18.8p (2006: 17p)	150	136
Interim paid in respect of current year 11.1p (2006: 10.5p)	88	84
	238	220

The directors are proposing a final dividend in respect of the financial year ended 31 December 2007 of 20.5p per share which will absorb an estimated £164m of shareholders' funds. It will be paid on 9 May 2008 to shareholders who are on the register of members on 11 April 2008. These financial statements do not reflect this dividend.

10. Property, plant and equipment

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Cost				
At 1 January 2006	328	683	7	1,018
Exchange differences	(20)	(54)	–	(74)
Transfers	–	(11)	(1)	(12)
Additions	12	52	13	77
Disposals	(9)	(32)	–	(41)
Acquisition through business combination	9	12	–	21
Reclassifications	–	8	(8)	–
Transfer to non-current assets held for sale	(7)	(27)	–	(34)
At 31 December 2006	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

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2006	(130)	(504)	–	(634)
Exchange differences	10	41	–	51
Transfers	–	5	–	5
Charge for the year	(17)	(60)	–	(77)
Disposals	4	27	–	31
Acquisition through business combination	–	(8)	–	(8)
Transfer to non-current assets held for sale	5	20	–	25
At 31 December 2006	(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)
Carrying amounts				
At 1 January 2006	198	179	7	384
At 31 December 2006	185	152	11	348
At 31 December 2007	172	167	16	355

Depreciation expense of £13m (2006: £18m) has been included in the income statement in cost of goods sold, £5m (2006: £6m) in distribution expenses and £50m (2006: £53m) in administrative and other expenses. In 2007 £3m (2006: £9m) relates to discontinued operations.

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 £6m (2006: £4m).

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired publishing rights	Other intangibles acquired	Total intangibles acquired	Total
Cost						
At 1 January 2006	3,654	197	68	83	151	4,002
Exchange differences	(396)	(17)	(8)	(8)	(16)	(429)
Transfers	–	6	–	–	–	6
Additions	–	29	–	–	–	29
Disposals	(5)	(2)	–	–	–	(7)
Acquisition through business combination	246	4	36	117	153	403
Adjustment on recognition of pre-acquisition deferred tax	(7)	–	–	–	–	(7)
Transfer to non-current assets held for sale	(221)	(16)	–	–	–	(237)
At 31 December 2006	3,271	201	96	192	288	3,760
Exchange differences	(4)	(2)	3	1	4	(2)
Additions	–	33	–	–	–	33
Disposals	(34)	(19)	(3)	–	(3)	(56)
Acquisition through business combination	304	4	40	155	195	503
Transfer to non-current assets held for sale	(194)	–	–	–	–	(194)
At 31 December 2007	3,343	217	136	348	484	4,044

All figures in £ millions	Goodwill	Software	Acquired publishing rights	Other intangibles acquired	Total intangibles acquired	Total
Amortisation						
At 1 January 2006	–	(129)	(5)	(14)	(19)	(148)
Exchange differences	–	13	1	2	3	16
Transfers	–	(5)	–	–	–	(5)
Charge for the year	–	(23)	(11)	(17)	(28)	(51)
Disposals	–	1	–	–	–	1
Acquisition through business combination	–	(1)	–	–	–	(1)
Transfer to non-current assets held for sale	–	9	–	–	–	9
At 31 December 2006	–	(135)	(15)	(29)	(44)	(179)
Exchange differences	–	1	–	1	1	2
Charge for the year	–	(25)	(17)	(28)	(45)	(70)
Disposals	–	19	–	–	–	19
Acquisition through business combination	–	(2)	–	–	–	(2)
Transfer to non-current assets held for sale	–	–	–	–	–	–
At 31 December 2007	–	(142)	(32)	(56)	(88)	(230)
Carrying amounts						
At 1 January 2006	3,654	68	63	69	132	3,854
At 31 December 2006	3,271	66	81	163	244	3,581
At 31 December 2007	3,343	75	104	292	396	3,814

Other intangibles acquired include customer lists and relationships, software rights, technology, trade names and trademarks. Amortisation of £3m (2006: £4m) is included in the income statement in cost of goods sold and £67m (2006: £47m) in administrative and other expenses. In 2007 £nil (2006: £3m) of software amortisation relates to discontinued operations.

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 the Group's cash-generating units identified according to the business segment. Goodwill has been allocated as follows:

All figures in £ millions	Notes	2007	2006
Higher Education		1,031	780
School Curriculum (2006: School Book)		867	683
School Assessment and Information (2006: School Assessment and Testing)		540	342
School Technology		–	356
Other Assessment and Testing		247	490
Technology and Business Publishing (2006: Other Book)		55	56
Pearson Education total		2,740	2,707
Penguin US		155	156
Penguin UK		111	114
Pearson Australia		52	44
Penguin total		318	314
Financial Times		12	4
Mergermarket		126	97
Interactive Data		147	149
FT Group total		285	250
Total goodwill – continuing operations		3,343	3,271
Goodwill held for sale	30	96	221
Total goodwill		3,439	3,492

Goodwill has been allocated for impairment purposes to 11 cash-generating units (CGUs). During 2007, three CGUs, School Book, School Assessment and Testing and Other Book were renamed following the reorganisation of the School segment. The reorganisation resulted in the School Technology CGU being allocated between School Assessment and Information (formerly School Assessment and Testing) and School Curriculum (formerly School Book). 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.

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 cash-generating unit. The average pre-tax discount rates used are in the range of 10.5% to 12.0% for the Pearson Education businesses, 8.9% to 11.7% for the Penguin businesses and 10.4% to 17.2% for the FT Group businesses.

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. The perpetuity growth rates used vary between 2.5% and 3.5%. The perpetuity growth rates are consistent with appropriate external sources for the relevant markets.

Cash flow growth rates – The cash flow growth rates are derived from forecast sales growth taking into consideration past experience of operating margins achieved in the cash-generating unit. 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 and the perpetuity rates. Based on the Group's sensitivity analysis, a reasonable possible change in a single factor will not cause impairment in any of the Group's CGUs.

However, a significant adverse change in our key assumptions could result in an impairment in our School Curriculum and/or Penguin UK CGUs as their fair value currently exceeds their carrying value only by between 10% and 20%.

12. Investments in joint ventures and associates

Joint ventures

All figures in £ millions	2007	2006
At beginning of year	12	12
Exchange differences	–	(3)
Share of profit after tax	4	3
Dividends	(8)	(4)
Additions and further investment	3	4
At end of year	11	12

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	2007	2006
Assets		
Non-current assets	3	3
Current assets	23	24
Liabilities		
Current liabilities	(15)	(15)
Net assets	11	12
Income	61	52
Expenses	(57)	(49)
Profit after income tax	4	3

Associates

All figures in £ millions	2007	2006
At beginning of year	8	24
Exchange differences	(1)	(1)
Share of profit after tax	19	21
Dividends	(24)	(41)
Additions	1	–
Distribution from associate in excess of carrying value	6	5
At end of year	9	8

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, were as follows:

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

2006 All figures in £ millions	Country of incorporation	% Interest held	Assets	Liabilities	Revenues	Profit
The Economist Newspaper Ltd	England	50	64	(64)	122	18
Other			28	(20)	48	3
Total			92	(84)	170	21

The interest held in associates is equivalent to voting rights.

13. Deferred income tax

All figures in £ millions	2007	2006
Deferred income tax assets		
Deferred income tax assets to be recovered after more than 12 months	262	288
Deferred income tax assets to be recovered within 12 months	66	129
	328	417
Deferred income tax liabilities		
Deferred income tax liabilities to be settled after more than 12 months	(287)	(245)
Deferred income tax liabilities to be settled within 12 months	–	–
	(287)	(245)
Net deferred income tax	41	172

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 2007 in respect of UK losses of £34m (2006: £35m). 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	2007	2006
At beginning of year		172	181
Exchange differences		(4)	(16)
Income statement (charge)/benefit	7	(87)	19
Acquisition through business combination	29	(45)	(26)
Disposal through business disposal	31	2	–
Tax benefit to equity		3	14
At end of year		41	172

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 asset						
At 1 January 2006	–	134	35	83	133	385
Exchange differences	–	(17)	(4)	(10)	(11)	(42)
Income statement benefit/(charge)	76	12	(6)	(7)	(12)	63
Tax benefit to equity	–	–	–	–	11	11
At 31 December 2006	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

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

13. Deferred income tax *continued*

All figures in £ millions	Goodwill and intangibles	Other	Total
Deferred income tax liabilities			
At 1 January 2006	(117)	(87)	(204)
Exchange differences	15	11	26
Acquisition through business combination	(20)	(6)	(26)
Income statement charge	(27)	(17)	(44)
Tax benefit to equity	–	3	3
At 31 December 2006	(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)

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

14. Financial instruments and risk management

The Group's approach to the management of financial risks together with sensitivity analysis is set out on pages 22 to 24. The accounting classification of each class of the Group's financial assets and financial liabilities, together with their fair values, is as follows:

		2007						
		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	52	–	–	–	–	52	52
Marketable securities		40	–	–	–	–	40	40
Derivative financial instruments	16	–	16	35	–	–	51	51
Trade receivables	19	–	–	–	750	–	750	750
Cash and cash equivalents	20	–	–	–	560	–	560	560
Total financial assets		92	16	35	1,310	–	1,453	1,453
Derivative financial instruments	16	–	(8)	(8)	–	–	(16)	(16)
Trade payables	23	–	–	–	–	(342)	(342)	(342)
Bank loans and overdrafts	21	–	–	–	–	(444)	(444)	(444)
Borrowings due within one year	21	–	–	–	–	(115)	(115)	(112)
Borrowings due after more than one year	21	–	–	–	–	(1,049)	(1,049)	(1,046)
Total financial liabilities		–	(8)	(8)	–	(1,950)	(1,966)	(1,960)

14. Financial instruments and risk management *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	2006 Total carrying value	2006 Total market value
Investments in unlisted securities	15	17	–	–	–	–	17	17
Marketable securities		25	–	–	–	–	25	25
Derivative financial instruments	16	–	25	61	–	–	86	86
Trade receivables	19	–	–	–	768	–	768	768
Cash and cash equivalents	20	–	–	–	592	–	592	592
Total financial assets		42	25	61	1,360	–	1,488	1,488
Derivative financial instruments	16	–	(2)	(17)	–	–	(19)	(19)
Trade payables	23	–	–	–	–	(343)	(343)	(343)
Bank loans and overdrafts	21	–	–	–	–	(173)	(173)	(173)
Borrowings due within one year	21	–	–	–	–	(422)	(422)	(400)
Borrowings due after more than one year	21	–	–	–	–	(1,148)	(1,148)	(1,157)
Total financial liabilities		–	(2)	(17)	–	(2,086)	(2,105)	(2,092)

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 (see page 22).

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 profit & loss account upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies on page 57.

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

All figures in £ millions	2007 USD	2007 GBP	2007 EUR	2007 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

14. Financial instruments and risk management *continued*

All figures in £ millions	USD	GBP	EUR	2006 Total
Not later than one year	166	18	265	449
Later than one year and not later than five years	758	60	–	818
Later than five years	478	242	–	720
Total	1,402	320	265	1,987
Analysed as:				
Revolving credit facilities and commercial paper	99	–	–	99
Bonds	1,045	511	423	1,979
Rate derivatives – inflows	(318)	(329)	(192)	(839)
Rate derivatives – outflows	576	138	34	748
Total	1,402	320	265	1,987

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.

15. Other financial assets

All figures in £ millions	Notes	2007	2006
At beginning of year		17	18
Exchange differences		–	(1)
Equity interest received on sale of Government Solutions	31	35	–
At end of year		52	17

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 on pages 22 to 24. The Group's outstanding derivative financial instruments are as follows:

All figures in £ millions	2007 Gross notional amounts	2007 Assets	2007 Liabilities	2006 Gross notional amounts	2006 Assets	2006 Liabilities
Interest rate derivatives – in a fair value hedge relationship	522	18	(8)	953	20	(17)
Interest rate derivatives – not in a hedge relationship	796	7	(8)	1,026	9	(2)
Cross currency rate derivatives – in a net investment hedge relationship	100	17	–	230	40	–
Cross currency rate derivatives – not in a hedge relationship	50	9	–	180	17	–
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.

At the end of 2007, 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 £(119)m, and sterling £154m (2006: US dollar £(247)m, euro £157m and sterling £157m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2007 range from 4.45% to 7.00% (2006: 3.02% to 7.00%) and the floating rates are based on LIBOR in US dollar and sterling.

16. Derivative financial instruments *continued*

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.

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings 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.

At the end of 2006, the Group held an amount of £29m as collateral under a mark-to-market agreement. This reflected the amount, at market rates prevailing at the end of October 2006, owed to the Group by a counterparty for a set of three related rate derivatives. The amount was settled at the beginning of February 2007, along with repayment of the €591m bond.

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. Intangible assets – Pre-publication

All figures in £ millions	2007	2006
Cost		
At beginning of year	1,152	1,357
Exchange differences	(7)	(148)
Transfers	–	6
Additions	230	213
Disposals	(125)	(280)
Acquisition through business combination	19	4
Transfer to non-current assets held for sale	(5)	–
At end of year	1,264	1,152
Amortisation		
At beginning of year	(750)	(931)
Exchange differences	1	111
Charge for the year	(192)	(210)
Disposals	125	280
Acquisition through business combination	(1)	–
Transfer to non-current assets held for sale	3	–
At end of year	(814)	(750)
Carrying amounts		
At end of year	450	402

Included in the above are pre-publication assets amounting to £292m (2006: £243m) 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 2007 and 2006.

18. Inventories

All figures in £ millions	2007	2006
Raw materials	24	26
Work in progress	30	28
Finished goods	314	300
	368	354

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 £732m (2006: £702m). In 2007 £47m (2006: £46m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

19. Trade and other receivables

All figures in £ millions	2007	2006
Current		
Trade receivables	750	768
Royalty advances	84	91
Prepayments and accrued income	48	34
Other receivables	59	58
Receivables from related parties	5	2
	946	953
Non-current		
Royalty advances	68	80
Prepayments and accrued income	4	4
Other receivables	57	40
	129	124

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	2007	2006
At beginning of year	(46)	(45)
Exchange differences	(1)	3
Income statement movements	(19)	(23)
Utilised	15	21
Acquisition through business combination	(3)	(2)
Disposal through business disposal	2	–
At end of year	(52)	(46)

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

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

All figures in £ millions	2007	2006
Within due date	811	810
Up to three months past due date	161	177
Three to six months past due date	43	62
Six to nine months past due date	7	6
Nine to 12 months past due date	13	8
More that 12 months past due date	4	1
Total trade receivables	1,039	1,064
Less: provision for sales returns	(281)	(243)
Transfer to non-current assets held for sale	(8)	(53)
Net trade receivables	750	768

The Group's provision for bad and doubtful debts is specific to individual debts identified during the bad debt review process. Consequently the ageing analysis above is presented after deducting the associated specific bad debt provision. 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.

20. Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2007	2006
Cash at bank and in hand	439	421
Short-term bank deposits	121	171
	560	592

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

At the end of 2007 the currency split of cash and cash equivalents is US dollars 37% (2006: 31%), sterling 29% (2006: 35%), euros 16% (2006: 21%) and other 18% (2006: 13%).

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	560	592
Bank overdrafts	(68)	(61)
	492	531

21. Financial liabilities – Borrowings

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

All figures in £ millions	2007	2006
Non-current		
10.5% Sterling Bonds 2008 (nominal amount £100m)	–	105
4.7% US Dollar Bonds 2009 (nominal amount $350m)	176	178
7% Global Dollar Bonds 2011 (nominal amount $500m)	264	266
7% Sterling Bonds 2014 (nominal amount £250m)	251	251
5.7% US Dollar Bonds 2014 (nominal amount $400m)	211	206
4.625% US Dollar notes 2018 (nominal amount $300m)	143	139
Finance lease liabilities	4	3
	1,049	1,148
Current		
Due within one year or on demand:		
Bank loans and overdrafts	444	173
6.125% Euro Bonds 2007 (nominal amount €591m)	–	421
10.5% Sterling Bonds 2008 (nominal amount £100m)	105	–
Loan notes	8	–
Finance lease liabilities	2	1
	559	595
Total borrowings	1,608	1,743

Included in the non-current borrowings above is £6m of accrued interest (2006: £12m). Included in the current borrowings above is £7m of accrued interest (2006: £22m).

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

All figures in £ millions	2007	2006
Between one and two years	178	107
Between two and five years	266	445
Over five years	605	596
	1,049	1,148

As at 31 December 2007 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
Carrying value of borrowings	559	444	605	1,608
Effect of rate derivatives	359	(7)	(352)	–
	918	437	253	1,608

21. Financial liabilities – Borrowings *continued*

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
4.7% US Dollar Bonds 2009	4.86%	176	176	178	176
7% Global Dollar Bonds 2011	7.16%	264	267	266	269
7% Sterling Bonds 2014	7.20%	251	261	251	265
5.7% US Dollar Bonds 2014	5.88%	211	203	206	203
4.625% US Dollar notes 2018	4.69%	143	135	139	135
Finance lease liabilities	n/a	4	4	3	3
		1,049	1,046	1,148	1,157

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	2007	2006
US dollar	1,251	966
Sterling	357	356
Euro	–	421
	1,608	1,743

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

All figures in £ millions	2007	2006
Floating rate		
– expiring within one year	–	–
– expiring beyond one year	1,007	894
	1,007	894

During the year, the Group extended the maturity date of its main revolving credit facility by one year, and also entered into a short-term bridge financing facility.

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.

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

All figures in £ millions	2007	2006
Finance lease liabilities – minimum lease payments		
Not later than one year	2	1
Later than one year and not later than two years	2	3
Later than two years and not later than three years	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	6	4

The present value of finance lease liabilities is as follows:

All figures in £ millions	2007	2006
Not later than one year	2	1
Later than one year and not later than five years	4	3
Later than five years	–	–
	6	4

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

22. Provisions for other liabilities and charges

All figures in £ millions	Deferred consideration	Leases	Other	Total
At 1 January 2007	25	12	15	52
Exchange differences	(1)	–	(1)	(2)
Charged to consolidated income statement				
– Additional provisions: interest	2	–	–	2
– Additional provisions: prior year adjustments	3	–	–	3
– Additional provisions: other	–	–	12	12
– Unused amounts reversed	–	(1)	(1)	(2)
Acquisition through business combination	12	–	2	14
Disposal through business disposal	–	–	(1)	(1)
Utilised	(4)	(2)	(5)	(11)
At 31 December 2007	37	9	21	67

All figures in £ millions	2007	2006
Analysis of provisions		
Non-current	44	29
Current	23	23
	67	52

Deferred consideration, including interest and prior year adjustments, primarily relates to the acquisition of Mergermarket in 2006. These amounts are payable in March 2009. Additional amounts incurred relate to the Group's smaller acquisitions during the year (see note 29).

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.

23. Trade and other liabilities

All figures in £ millions	2007	2006
Trade payables	342	343
Social security and other taxes	23	18
Accruals	402	345
Deferred income	290	276
Dividends payable to minority	12	–
Other liabilities	171	178
	1,240	1,160
Less: non-current portion		
Accruals	30	24
Deferred income	58	47
Other liabilities	102	91
	190	162
Current portion	1,050	998

The carrying value of the Group's trade and other liabilities approximates its fair value.

The deferred income balances comprise:

– multi-year obligations to deliver workbooks to adoption customers in school businesses;
– advance payments in contracting 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.

24. 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.

			2007			2006
%	UK Group plan	Other plans	PRMB	UK Group plan	Other plans	PRMB
Inflation	3.30	2.93	3.00	3.00	2.91	3.00
Rate used to discount plan liabilities	5.80	6.01	6.05	5.20	5.70	5.85
Expected return on assets	6.50	7.27	–	6.40	7.18	–
Expected rate of increase in salaries	5.00	4.36	–	4.70	4.37	–
Expected rate of increase for pensions in payment and deferred pensions	2.50 to 4.30	–	–	2.10 to 4.60	–	–
Initial rate of increase in healthcare rate	–	–	9.50	–	–	10.00
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. 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 (GAM94).

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
	2007	2006	2007	2006
Male	21.3	20.9	17.9	17.9
Female	21.6	21.3	21.3	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
	2007	2006	2007	2006
Male	23.1	22.2	17.9	17.9
Female	23.6	22.5	21.3	21.3

24. Retirement benefit and other post-retirement obligations *continued*

Financial statement information

The amounts recognised in the income statement are as follows:

All figures in £ millions	UK Group plan	Defined benefit other	Sub total	Defined contribution	PRMB	Total
						2007
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 return on plan assets	128	4	132	–	–	132

All figures in £ millions	UK Group plan	Defined benefit other	Sub total	Defined contribution	PRMB	Total
						2006
Current service cost	27	2	29	36	1	66
Past service cost	–	–	–	–	(2)	(2)
Total operating expense/(income)	27	2	29	36	(1)	64
Expected return on plan assets	(85)	(7)	(92)	–	–	(92)
Interest on plan liabilities	78	7	85	–	3	88
Net finance (income)/expense	(7)	–	(7)	–	3	(4)
Net income statement charge	20	2	22	36	2	60
Actual return on plan assets	153	13	166	–	–	166

The total operating charge is included in administrative and other expenses.

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	UK Group plan	Other funded plans	Other unfunded plans	Total	UK Group plan	Other funded plans	Other unfunded plans	Total
				2007				2006
Fair value of plan assets	1,744	109	–	1,853	1,528	105	–	1,633
Present value of defined benefit obligation	(1,682)	(117)	(12)	(1,811)	(1,683)	(115)	(12)	(1,810)
Net pension asset/(liability)	62	(8)	(12)	42	(155)	(10)	(12)	(177)
Other post-retirement medical benefit obligation				(47)				(48)
Other pension accruals				(28)				(25)
Net retirement benefit obligations				(33)				(250)
Analysed as:								
Retirement benefit asset				62				–
Retirement benefit obligations				(95)				(250)

The following gains have been recognised in the statement of recognised income and expense:

All figures in £ millions	2007	2006
Amounts recognised for defined benefit plans	79	102
Amounts recognised for post-retirement medical benefit plans	1	5
Total recognised in year	80	107
Cumulative amounts recognised	124	44

24. Retirement benefit and other post-retirement obligations *continued*

The fair value of plan assets comprises the following:

%	2007 UK Group plan	2007 Other funded plans	2007 Total	2006 UK Group plan	2006 Other funded plans	2006 Total
Equities	34.3	3.4	37.7	46.6	3.9	50.5
Bonds	34.9	2.0	36.9	23.8	2.1	25.9
Properties	7.7	–	7.7	9.2	–	9.2
Other	17.2	0.5	17.7	14.0	0.4	14.4

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

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

All figures in £ millions	2007 UK Group plan	2007 Other plans	2007 Total	2006 UK Group plan	2006 Other plans	2006 Total
Fair value of plan assets						
Opening fair value of plan assets	1,528	105	1,633	1,390	110	1,500
Exchange differences	–	1	1	–	(12)	(12)
Expected return on plan assets	96	7	103	85	7	92
Actuarial gains and losses	32	(3)	29	68	6	74
Contributions by employer	152	5	157	43	2	45
Contributions by employee	8	–	8	7	–	7
Benefits paid	(72)	(6)	(78)	(65)	(8)	(73)
Closing fair value of plan assets	1,744	109	1,853	1,528	105	1,633
Present value of defined benefit obligation						
Opening defined benefit obligation	(1,683)	(127)	(1,810)	(1,661)	(142)	(1,803)
Exchange differences	–	1	1	–	15	15
Current service cost	(29)	(2)	(31)	(27)	(2)	(29)
Interest cost	(84)	(7)	(91)	(78)	(7)	(85)
Actuarial gains and losses	50	–	50	25	3	28
Contributions by employee	(8)	–	(8)	(7)	–	(7)
Benefits paid	72	6	78	65	8	73
Acquisition through business combination	–	–	–	–	(2)	(2)
Closing defined benefit obligation	(1,682)	(129)	(1,811)	(1,683)	(127)	(1,810)

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

All figures in £ millions	2007	2006
Opening defined benefit obligation	(48)	(60)
Exchange differences	–	8
Current service cost	(1)	(1)
Past service cost	–	2
Interest cost	(2)	(3)
Actuarial gains and losses	1	5
Benefits paid	3	4
Reclassifications	–	(3)
Closing defined benefit obligation	(47)	(48)

24. Retirement benefit and other post-retirement obligations *continued*

The history of the defined benefit plans is as follows:

All figures in £ millions	2007	2006	2005	2004	2003
Fair value of plan assets	1,853	1,633	1,500	1,280	1,164
Present value of defined benefit obligation	(1,811)	(1,810)	(1,803)	(1,615)	(1,454)
Net pension asset/(liability)	42	(177)	(303)	(335)	(290)
Experience adjustments on plan assets	29	74	140	67	88
Experience adjustments on plan liabilities	50	28	(119)	(127)	(113)

Funding

The UK Group plan is self-administered with the plans' 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 2007 the Group contributed £121m (including a special contribution of £100m) and has agreed to contribute £21m in 2008 and £21.9m per annum thereafter in excess of an estimated £30m of regular contributions.

The Group expects to contribute $70m in 2008 and $73m in 2009 to its US pension plans.

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:

	2007	
All figures in £ millions	1% increase	1% decrease
Effect on:		
(Decrease)/increase in defined benefit obligation – UK Group plan	(222)	275
(Decrease)/increase of aggregate of service cost and interest cost – UK Group plan	(4.6)	5.8
(Decrease)/increase in defined benefit obligation – US plan	(6.7)	7.3

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

	2007	
All figures in £ millions	1% increase	1% decrease
Effect on:		
(Decrease)/increase in post-retirement medical benefit obligation	(3.7)	4.1
Increase/(decrease) of aggregate of service cost and interest cost	0.1	(0.1)

25. 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	2007	2006
Pearson plans	23	18
Interactive Data plans	7	7
Total share-based payment costs	30	25

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 third, fifth or seventh anniversary after grant 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.

25. Share-based payments *continued*

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 and/or 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 October 2006 and July 2007 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 2006 and 2007 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.

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

	2007		2006	
	Number of share options 000s	Weighted average exercise price £	Number of share options 000s	Weighted average exercise price £
Outstanding at beginning of year	18,861	13.36	21,677	13.15
Granted during the year	773	6.90	837	6.30
Exercised during the year	(1,326)	5.80	(1,396)	5.36
Forfeited during the year	(1,434)	19.63	(1,828)	15.39
Expired during the year	(93)	7.68	(429)	6.72
Outstanding at end of year	16,781	13.15	18,861	13.36
Options exercisable at end of year	13,999	14.63	15,595	14.14

Options were exercised regularly throughout the year. The weighted average share price during the year was £8.02 (2006: £7.45). 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:

	2007		2006	
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	930	1.56	1,649	1.94
5 – 10	4,909	3.22	5,254	3.85
10 – 15	7,257	2.62	7,638	3.63
15 – 20	980	1.85	1,050	2.88
20 – 25	400	2.19	424	3.19
>25	2,305	2.19	2,846	3.22
	16,781	2.62	18,861	3.42

In 2007 and 2006 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.

25. Share-based payments *continued*

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

	2007 Weighted average	2006 Weighted average
Fair value	£2.53	£1.92
Weighted average share price	£8.91	£7.66
Weighted average exercise price	£6.90	£6.30
Expected volatility	19.72%	23.12%
Expected life	4.0 years	4.0 years
Risk free rate	5.34%	4.42%
Expected dividend yield	3.29%	3.52%
Forfeiture rate	3.5%	5.0%

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:

	2007		2006	
	Number of shares 000s	Weighted average fair value £	Number of shares 000s	Weighted average fair value £
Annual Bonus Share Matching Plan	143	7.67	90	6.27
Long-Term Incentive Plan	3,377	7.12	3,585	6.96

Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant discounted by the dividend yield (2007: 3.26%; 2006: 3.66%) to take into account any dividends foregone. 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.

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 186,343 shares (2006: 206,324) under the 2001 Employee Stock Purchase Plan at an average share price of $17.77 (£8.93) (2006: $15.58; £7.96). The weighted average fair value at the date of grant was $4.76 (£2.39) (2006: $3.98; £2.03).

25. Share-based payments *continued*

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

	2007			2006		
	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	10,506	16.33	8.34	10,068	15.16	8.37
Granted during the year	1,560	27.17	13.65	1,835	20.58	10.52
Exercised during the year	(1,935)	14.88	7.48	(1,252)	12.88	6.58
Forfeited during the year	(293)	20.38	10.24	(139)	19.02	9.72
Expired during the year	(11)	18.12	9.10	(6)	11.46	5.86
Outstanding at end of year	9,827	18.21	9.15	10,506	16.33	8.34
Options exercisable at end of year	6,199	15.27	7.67	6,547	14.11	7.21

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

	2007		2006	
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	–	–	30	3.1
4.4 – 7.5	72	2.1	157	2.3
7.5 – 12	1,745	3.4	2,164	4.4
12 – 20	3,464	5.6	4,640	6.4
> 20	4,546	8.5	3,515	9.0
	9,827	6.6	10,506	6.8

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 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	
	2007	2006	2007	2006
	Weighted average	Weighted average	Weighted average	Weighted average
Fair value	$6.60	$6.57	$4.76	$3.98
Weighted average share price	$27.17	$20.58	$17.77	$15.58
Weighted average exercise price	$27.17	$20.58	$17.77	$15.58
Expected volatility	23.40%	25.90%	20.50%	18.32%
Expected life	5.0 years	4.7 years	0.5 years	0.5 years
Risk free rate	4.2% to 4.9%	4.6% to 5.1%	4.3% to 5.1%	3.7% to 5.2%
Expected dividend yield	1.9%	0.0%	2.0%	0.0%
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:

	2007			2006		
	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	185	27.07	13.60	196	20.82	10.64

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

Notes to the Consolidated Financial Statements *continued*

26. 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 ordinary shares – share option schemes	2,089	1	10
At 31 December 2006	806,109	202	2,487
Issue of ordinary 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.

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.

The capital structure of the Group consists of debt (see note 21), cash and cash equivalents (see note 20) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings (see notes 26, 27 and 28).

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 on pages 22 to 24.

27. Treasury shares

	Pearson plc		Interactive Data		Total
	Number of shares 000s	£m	Number of shares 000s	£m	£m
At 1 January 2006	5,249	110	4,552	43	153
Purchase of treasury shares	4,700	36	1,500	16	52
Release of treasury shares	(1,188)	(16)	–	–	(16)
At 31 December 2006	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

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 25). These shares, representing 1.5% (2006: 1.1%) of called-up share capital, are held as treasury shares 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 £2.9m (2006: £2.2m). The nominal value of Interactive Data treasury shares amounts to £0.04m (2006: £0.03m).

At 31 December 2007 the market value of Pearson plc treasury shares was £86.1m (2006: £67.6m) and the market value of Interactive Data treasury shares was £119.9m (2006: £74.3m).

28. Other reserves and retained earnings

All figures in £ millions	Notes	Translation reserve	Fair value reserve	Total other reserves	Retained earnings
At 1 January 2006		(175)	–	(175)	1,214
Net exchange differences on translation of foreign operations		(417)	–	(417)	–
Profit for the year attributable to equity holders of the Company		–	–	–	446
Dividends paid to equity holders of the Company	9	–	–	–	(220)
Equity settled transactions	25	–	–	–	25
Actuarial gains on retirement benefit obligations	24	–	–	–	107
Treasury shares released under employee share plans	27	–	–	–	(16)
Taxation on items charged to equity	7	–	–	–	12
At 31 December 2006		(592)	–	(592)	1,568
Net exchange differences on translation of foreign operations		25	–	25	–
Cumulative translation adjustment disposed	31	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	25	–	–	–	30
Actuarial gains on retirement benefit obligations	24	–	–	–	80
Treasury shares released under employee share plans	27	–	–	–	(29)
Taxation on items charged to equity	7	–	–	–	29
At 31 December 2007		(514)	–	(514)	1,724

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 is a £49m loss (2006: £53m loss) relating to net assets classified as held for sale.

29. Business combinations

On 4 May 2007, the Group announced that it had agreed to acquire Harcourt Assessment, a leading test provider, and Harcourt Education International, publisher of textbooks and online materials. The Harcourt Education International acquisition has closed in several stages, following regulatory reviews of the relevant authorities where required. The acquisition of Harcourt Assessment completed on 30 January 2008 and is therefore excluded from the numbers below (see note 36).

On 31 July 2007, the Group acquired eCollege, a leader in the US online distance learning market. In addition, several other businesses were acquired in the current year, mainly within the FT Group. None of these other acquisitions were individually material to the Group. The largest single acquisition in 2006 was Mergermarket.

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

					2007	2006
All figures in £ millions	Notes	Harcourt Fair value	eCollege Fair value	Other Fair value	Total Fair value	Total Fair value
Property, plant and equipment	10	6	5	–	11	13
Intangible assets	11	81	100	16	197	156
Intangible assets – Pre-publication	17	16	2	–	18	4
Inventories		15	–	–	15	14
Trade and other receivables		12	13	3	28	24
Cash and cash equivalents		–	–	–	–	28
Trade and other liabilities		(23)	(12)	(3)	(38)	(52)
Financial liabilities – Borrowings		–	(1)		(1)	(3)
Current income tax		2	2	–	4	–
Net deferred income tax liabilities	13	(21)	(24)	–	(45)	(26)
Retirement benefit obligations	24	–	–	–	–	(2)
Provisions for other liabilities and charges	22	(1)	–	(1)	(2)	(3)
Equity minority interest		–	–	–	–	(9)
Net assets acquired at fair value		87	85	15	187	144
Goodwill	11	68	181	55	304	246
Total		155	266	70	491	390
Satisfied by:						
Cash		(155)	(266)	(47)	(468)	(382)
Deferred consideration		–	–	(12)	(12)	(17)
Net prior year adjustments		–	–	(11)	(11)	9
Total consideration		(155)	(266)	(70)	(491)	(390)
Carrying value of net assets acquired		25	15	1	41	48
Fair value adjustments		62	70	14	146	96
Fair value to the Group		87	85	15	187	144

The goodwill arising on the acquisition of Harcourt and eCollege 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 the acquisition of Harcourt and eCollege are provisional and will be finalised during 2008. They include the valuation of intangible assets and the related deferred tax effect. Prior year adjustments relate to the finalisation of fair value adjustments and increases in deferred consideration relating to Mergermarket.

29. Business combinations *continued*

Harcourt

All figures in £ millions	Carrying value	Fair value adjs	Provisional fair value
Property, plant and equipment	6	–	6
Intangible assets	–	81	81
Intangible assets – Pre-publication	14	2	16
Inventories	15	–	15
Trade and other receivables	12	–	12
Trade and other liabilities	(23)	–	(23)
Current income tax	2	–	2
Net deferred income tax liabilities	–	(21)	(21)
Provisions for other liabilities and charges	(1)	–	(1)
Net assets acquired at fair value	25	62	87
Goodwill			68
Total			155

eCollege

All figures in £ millions	Carrying value	Fair value adjs	Provisional fair value
Property, plant and equipment	5	–	5
Intangible assets	2	98	100
Intangible assets – Pre-publication	2	–	2
Trade and other receivables	13	–	13
Trade and other liabilities	(10)	(2)	(12)
Financial liabilities – Borrowings	(1)	–	(1)
Current income tax	2	–	2
Net deferred income tax assets/(liabilities)	2	(26)	(24)
Net assets acquired at fair value	15	70	85
Goodwill			181
Total			266

Net cash outflow on acquisition:

All figures in £ millions	2007	2006
Cash – Current year acquisitions	(468)	(382)
Deferred payments for prior year acquisitions and other items	(4)	(9)
Cash and cash equivalents acquired	–	28
Cash outflow on acquisition	(472)	(363)

Harcourt contributed £71m of sales and £7m to the Group's profit before tax between the date of acquisition and the balance sheet date. eCollege contributed £15m 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 £4m to the Group's sales and £2m 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 2007, the Group estimates that sales for the period would have been £4,307m and profit before tax would have been £479m.

30. Non-current assets classified as held for sale

The Group disposed of its Data Management business on 22 February 2008 and this business is classified as held for sale in 2007. The Data Management business was formerly part of the Group's Other Assessment and Testing cash-generating unit (CGU) and was carved out of this CGU in preparation for disposal. As a result, the Group has recognised an impairment on the goodwill allocated to the Data Management business in anticipation of the loss on disposal (see note 3). In 2006, assets classified as held for sale related to Government Solutions. The major classes of assets and liabilities comprising the operations classified as held for sale at the balance sheet date are as follows:

All figures in £ millions	Notes	2007	2006
Property, plant and equipment	10	7	9
Intangible assets – Goodwill		96	221
Intangible assets – Other	11	–	7
Intangible assets – Pre-publication		2	–
Inventories		4	1
Trade and other receivables		8	56
Non-current assets classified as held for sale		117	294
Other liabilities		(9)	(26)
Liabilities directly associated with non-current assets classified as held for sale		(9)	(26)
Net assets classified as held for sale		108	268

31. Disposals

					2007	2006
All figures in £ millions	Government Solutions	Les Echos	Datamark	Other	Total	Total
Disposal of subsidiaries						
Property, plant and equipment	(10)	(3)	(3)	–	(16)	–
Intangible assets	(6)	–	–	–	(6)	–
Inventories	–	–	(1)	–	(1)	–
Trade and other receivables	(63)	(26)	(5)	(1)	(95)	–
Cash and cash equivalents	–	(14)	–	–	(14)	–
Deferred income tax liabilities	–	2	–	–	2	–
Trade and other liabilities	23	42	6	2	73	(1)
Retirement benefit obligations	–	3	–	–	3	–
Provisions for other liabilities and charges	–	1	–	–	1	–
Equity minority interests	–	–	–	(8)	(8)	(4)
Attributable goodwill	(221)	(4)	(17)	(8)	(250)	(5)
Cumulative translation adjustment	(53)	–	–	–	(53)	–
Net (assets)/liabilities disposed	(330)	1	(20)	(15)	(364)	(10)
Cash received	286	174	20	15	495	10
Other proceeds received	35	–	–	–	35	–
Costs	(10)	(10)	–	–	(20)	–
(Loss)/profit on sale	(19)	165	–	–	146	–

	2007	2006
Cash flow from disposals		
Cash – Current year disposals	495	10
Costs paid	(12)	–
Cash and cash equivalents disposed	(14)	–
Net cash inflow	469	10

Details of the businesses disposed are shown in note 3.

The proceeds received for the sale of Government Solutions include £286m in cash, £20m in Loan Stock and a 10% interest in the acquiring company valued at £15m.

Other includes share options exercised in Interactive Data.

32. Cash generated from operations

All figures in £ millions	Notes	2007	2006
Net profit		310	469
Adjustments for:			
Income tax		222	19
Depreciation	10	68	77
Amortisation of purchased intangible assets	11	45	28
Adjustment on recognition of pre-acquisition deferred tax	11	–	7
Amortisation of other intangible assets	11	25	23
Investment in pre-publication assets	17	(230)	(213)
Amortisation of pre-publication assets	17	192	210
Loss on sale of property, plant and equipment		1	2
Net finance costs	6	106	74
Share of results of joint ventures and associates	12	(23)	(24)
Profit on sale of discontinued operations	3	(146)	–
Goodwill impairment of discontinued operation	3	97	–
Net foreign exchange gains/(losses) from transactions		11	(37)
Share-based payment costs	25	30	25
Inventories		(1)	(16)
Trade and other receivables		(5)	(60)
Trade and other liabilities		80	54
Retirement benefit obligations		(126)	(17)
Provisions		3	–
Net cash generated from operations		659	621
Dividends from joint ventures and associates	12	32	45
Purchase of property, plant and equipment		(86)	(68)
Purchase of intangible assets		(33)	(29)
Finance lease principal payments		(2)	(3)
Proceeds from sale of property, plant and equipment		14	8
Add back: Special pension contribution		100	–
Add back: Cash spent against integration and fair value provisions		–	1
Operating cash flow		684	575
Operating tax paid		(61)	(59)
Net operating finance costs paid		(90)	(82)
Operating free cash flow		533	434
Non-operating tax paid		(26)	–
Special pension contribution		(100)	–
Cash spent against integration and fair value provisions		–	(1)
Total free cash flow		407	433
Dividends paid (including to minorities)		(248)	(235)
Net movement of funds from operations		159	198

Included in net cash generated from operations is an amount of £7m (2006: £33m) relating to discontinued operations.

Operating cash flow, operating free cash flow and total free cash flow have been disclosed as they are part of Pearson's corporate and operating measures. 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 has excluded this £100m from its definition of operating cash flow and operating free cash flow as it distorts the underlying operating performance for the year.

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

All figures in £ millions	2007	2006
Net book amount	15	10
Loss on sale of property, plant and equipment	(1)	(2)
Proceeds from sale of property, plant and equipment	14	8

The principal other non-cash transactions are movements in finance lease obligations of £4m (2006: £4m).

33. 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.

34. Commitments

Capital commitments

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

All figures in £ millions	2007	2006
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	2007	2006
Not later than one year	123	123
Later than one year and not later than two years	116	113
Later than two years and not later than three years	102	103
Later than three years and not later than four years	93	90
Later than four years and not later than five years	85	83
Later than five years	834	857
	1,353	1,369

35. 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 19.

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.

36. Events after the balance sheet date

On 2 January 2008, the Group completed its acquisition of Money-Media, a US-based company offering online news and commentary for the money management industry, for $64m.

On 30 January 2008, the Group completed its $647m acquisition of Harcourt Assessment from Reed Elsevier, after receiving clearance from the US Department of Justice.

Also on 30 January 2008, the Group announced that it had agreed to sell its 50% interest in Financial Times Deutschland (FTD) to its joint venture partner, Gruner + Jahr. The Group's share of FTD assets at 31 December 2007 was €8m and a small profit on sale is expected.

On 22 February 2008, the Group completed the sale of its Data Management business to M & F Worldwide Corp. for $225m. The Group expects to report a loss on this transaction in 2008 after taking into account the cumulative translation adjustment and tax.