PEARSON PLC
Form 20-F
April 04, 2017

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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON April 3, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

(Mark One)

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

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2016

or

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

or

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

Commission file number 1-16055

PEARSON PLC

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

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London, England WC2R 0RL

(Address of principal executive offices)

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London, England WC2R 0RL

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

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

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

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

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

None

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

None

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

Ordinary Shares, 25p par value	822,126,713

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

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

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

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

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

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

Large accelerated filer	Accelerated filer	Non-accelerated filer

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

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

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

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

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INTRODUCTION

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

We have prepared the financial information contained in this Annual Report in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) which in respect of the accounting standards applicable to the Group do not differ from IFRS as adopted by the European Union (EU). Unless we indicate otherwise, any reference in this Annual Report to our consolidated financial statements is to the consolidated financial statements and the related notes, included elsewhere in this Annual Report.

We publish our consolidated financial statements in sterling. We have included, however, references to other currencies. In this Annual Report:

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

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

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

For convenience and except where we specify otherwise, we have translated some sterling figures into US dollars at the rate of £1.00 = $1.23, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2016. We do not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On February 28, 2017 the noon buying rate for sterling was £1.00 = $1.24.

The Group currently consists of its education business, plus a 47% interest in the consumer publishing business Penguin Random House. See Item 4. Information on the Company Overview of operating divisions . The Pearson plc Consolidated Financial Statements are included in this report on pages F-2 to F-76. The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-77 to F-143.

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FORWARD-LOOKING STATEMENTS

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

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

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

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PART I

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

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

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

The table below shows selected consolidated financial data under IFRS as issued by the IASB. The selected consolidated income statement data for the years ended December 31, 2016, 2015 and 2014 and the selected consolidated balance sheet data as at December 31, 2016 and 2015 have been derived from our audited consolidated financial statements included in Item 18. Financial Statements in this Annual Report.

On February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend.

On July 23, 2015, Pearson announced the sale of The Financial Times to Nikkei Inc. The transaction completed on November 30, 2015 and from that point Pearson no longer consolidated The Financial Times results or net assets. The results of The Financial Times have been included in discontinued operations for all years through to 2014 and for the 11 months to November 30, 2015.

On August 11, 2015, Pearson announced the sale of its 50% stake in The Economist Group. The transaction substantially completed on October 16, 2015 and from that point Pearson no longer had significant influence over The Economist Group. The share of profit after tax from the associate interest in the Economist Group has been included in discontinued operations for all years through to 2014 and for the period until October 16, 2015.

On November 29, 2013, Pearson announced the sale of the Mergermarket group which completed on February 4, 2014. The anticipated loss of control as at December 31, 2013 resulted in the Mergermarket business being classified as held for sale on the Pearson balance sheet at December 31, 2013. The results of the Mergermarket business have been included in discontinued operations for all the years through to 2014.

In October 2012, Pearson and Bertelsmann entered into an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction completed on July 1, 2013 and from that point, Pearson no longer controlled the Penguin Group of companies. Pearson accounts for its 47% associate interest in Penguin Random House on an equity basis.

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

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For convenience, we have translated the 2016 amounts into US dollars at the rate of £1.00 = $1.23, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2016.

	Year Ended December 31					
	2016 $	2016 £	2015 £	2014 £	2013 £	2012 £
	(In millions, except for per share amounts)					
Consolidated Income Statement data						
Sales operating	5,599	4,552	4,468	4,540	4,728	4,615
(Loss)/profit	(3,071)	(2,497)	(404)	348	431	469
(Loss)/profit after taxation from continuing operations	(2,872)	(2,335)	(352)	199	270	237
(Loss)/profit for the financial year	(2,872)	(2,335)	823	470	539	314
Consolidated Earnings data per share						
Basic (loss)/earnings per equity share(1)	(3.53)	(286.8)p	101.2p	58.1p	66.6p	38.7p
Diluted (loss)/earnings per equity share(2)	(3.53)	(286.8)p	101.2p	58.0p	66.5p	38.6p
Basic (loss)/earnings from continuing operations per equity share(1)	(3.53)	(286.8)p	(43.3)p	24.7p	33.3p	29.1p
Diluted (loss)/earnings from continuing operations per equity share(2)	(3.53)	(286.8)p	(43.3)p	24.6p	33.3p	29.0p
Dividends per ordinary share	0.64	52.0p	52.0p	51.0p	48.0p	45.0p
Consolidated Balance Sheet data at period end						
Total assets (non-current assets plus current assets)	12,381	10,066	11,635	11,397	10,931	11,348
Net assets	5,348	4,348	6,418	5,985	5,706	5,710
Long-term obligations(3)	(4,667)	(3,794)	(3,310)	(3,225)	(2,829)	(3,175)
Capital stock	252	205	205	205	205	204
Number of equity shares outstanding (millions of ordinary shares)	822	822	821	820	819	817

Notes:

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

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

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

Dividend information

We pay dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. Our board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. Our board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders approval at our annual general meeting. At our annual general meeting on May 5, 2017 our shareholders will be asked to approve a final dividend of 34.0p per ordinary share for the year ended December 31, 2016.

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The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in The City of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2016 fiscal year will be paid on May 12, 2017 (subject to shareholder approval).

Fiscal year	Interim	Final	Total	Interim	Final	Total
	(Pence per ordinary share)			(Cents per ordinary share)		
2016	18.0	34.0	52.0	23.6	41.8*	65.4*
2015	18.0	34.0	52.0	27.8	49.0	76.8
2014	17.0	34.0	51.0	27.6	51.5	79.1
2013	16.0	32.0	48.0	25.4	54.0	79.4
2012	15.0	30.0	45.0	24.3	46.7	71.0

* As the 2016 final dividend had not been paid by the filing date, the dividend has been translated into cents using the noon buying rate for sterling at December 31, 2016.

Future dividends will be dependent on our future earnings, financial condition and cash flow, as well as other factors affecting the Group. In January 2017, Pearson announced that the dividend will be rebased in 2017 to reflect portfolio changes, increased product investment, and our outlook for 2017.

Exchange rate information

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in The City of New York on each day during a monthly period and on the last day of each month during an annual period. On December 31, 2016 the noon buying rate for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes for sterling was £1.00 = $1.23. On February 28, 2017 the noon buying rate for sterling was £1.00 = $1.24.

Month	High	Low
February 2017	$ 1.26	$ 1.24
January 2017	$ 1.26	$ 1.21
December 2016	$ 1.27	$ 1.22
November 2016	$ 1.25	$ 1.22
October 2016	$ 1.28	$ 1.22
September 2016	$ 1.34	$ 1.30

Year Ended December 31	Average rate
2016	$ 1.34
2015	$ 1.53
2014	$ 1.65
2013	$ 1.57
2012	$ 1.59

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Risk Factors

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

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

Business transformation and change initiatives in support of our strategic goals to accelerate our digital transition and to simplify our business will continue throughout 2017. The pace and scope of change increases the risk that not all these changes will deliver within anticipated timeframes, or that the costs of these changes may increase. In addition, as a result of the increased pressure of transformational change, our business as usual activities may not perform in line with our plans or our level of customer service may not meet expectations. In parallel with the business transformation as we respond to the digital revolution and shift from a product to a services business, we will continue to look at opportunities to develop business models and further refine organization structures. Resistance to change could restrict the organization from making the necessary changes to the business model.

Risk related to data quality and integrity may lead to non-compliance with legal and other requirements which could damage our business.

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

Global economy and cyclical market factors may adversely impact our financial performance.

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

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

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

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

Students are seeking cheaper sources of content, e.g. online discounters, file sharing, use of pirated copies, and rentals, along with open source. This change in behavior puts downward pressure on textbook prices in our major markets, and this could adversely impact our results.

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

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

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

The results and growth of our US educational services and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. The inauguration of a new President of the US in January 2017 could result in changes in education policy and associated funding which may adversely impact Pearson businesses in the US. State, local and municipal education funding pressures remain, competition from low price and disruptive new business models continues and open source is promoted as a way to keep costs down for our customers. The current challenging environment could impact our ability to collect education-related debt.

State and local government leadership changes and resultant shifts in education policy can also affect the funding available for educational expenditure, which include the impact of educational reform. Similarly, changes in the government procurement process for textbooks, learning material and student tests, and vocational training programs can also affect our markets. Political pressure on testing, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year. For our UK examination and assessment businesses, changes in UK government policy have had, and could continue to have, a significant impact on our present business and 2017 particularly is a year of major qualification and accountability changes. Also, in June 2016 a UK referendum voted in favor of leaving the EU. The risk is one of uncertainty, as the full impacts of the UK s departure from the EU will not be known until the model that will replace the UK s membership becomes clearer.

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

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

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

If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit our ability to grow.

Our products and services largely comprise intellectual property delivered through a variety of print and digital media, online software applications and platforms. We rely on trademark, patent, copyright and other intellectual property laws to establish and protect our proprietary rights in these products and services.

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Our intellectual property rights (IPR) in countries such as the US and the UK, jurisdictions covering the largest proportion of our operations, are generally well established with the exception of patents, for which we only have a nascent portfolio based largely in the US. However, we also conduct business in other countries where our protection efforts have been limited or inconsistent and the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. Where we have registered or otherwise established our IPR, we cannot guarantee that such rights will provide competitive advantages due to:

- the challenges and costs of monitoring and enforcement in jurisdictions where competition may be intense;
- the limited and/or ineffective IPR protection and enforcement mechanisms available to us in many countries;
- the potential that our IPR may lapse, be invalidated, circumvented, challenged, or abandoned, or that we may otherwise lose the ability to assert our intellectual property rights against others.

Moreover, despite trademark, brand and copyright protection, third parties may copy, infringe or otherwise profit from our proprietary rights without our authorization. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance.

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

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

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

Our investment into inherently riskier emerging markets may deliver returns that are lower than anticipated.

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

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

Although we are committed to conducting business in a legal and ethical manner in compliance with local and international statutory requirements and standards applicable to our business, there is a risk that our management, employees or representatives may take actions that violate applicable laws and regulations

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prohibiting the making of improper payments for the purposes of obtaining or keeping business, including laws such as the US Foreign Corrupt Practices Act or the UK Bribery Act. Responding to investigations is costly and requires a significant amount of management s time and attention. In addition, investigations may adversely impact our reputation, or lead to litigation and financial impacts.

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

We continually acquire and dispose of businesses to achieve our strategic objectives and we will continue to consider both as means to pursue our strategic priorities, although we do not plan to make any significant acquisitions in the short term. In 2016, we completed our separation from the Financial Times.

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

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

Failure to comply with data privacy regulations could result in an incident or other issue potentially causing reputational damage to our brands and financial loss.

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

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

Cyber risk is continually evolving and comprises many complex external drivers: the ongoing digital revolution, increasing use of the cloud and increasingly sophisticated attack strategies. Across our businesses we hold large volumes of personally identifiable information including that of employees, customers, students and citizens. Despite our implementation of security measures, individuals may try to gain unauthorized access to our data in order to misappropriate such information for potentially fraudulent purposes. A significant breach can result in a devastating impact on Pearson s reputation, finance and student experience. Inability to prove due diligence can result in severe penalties and loss of business (existing and future).

Our reported earnings and cash flows may be adversely affected by changes in our pension costs and funding requirements.

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

It is our policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. Our earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in our defined benefit plans. Our greatest exposure relates to our UK defined benefit pension plan, which is valued every three years. Pension fund deficits may arise because of inadequate investment returns, increased member life expectancy, changes in actuarial assumptions and changes in pension regulations, including accounting rules and minimum funding requests. As of the end of 2016, the UK defined benefit plan continues to show a surplus on an IAS19 basis. Following discussions with the plan trustee in 2016, we have committed to targeting a self-sufficient level of funding, resulting in the plan becoming largely independent of Pearson by the end of 2019. However the plan s ability to achieve and maintain this standard remains subject to market conditions, meaning that additional funding could still be required from Pearson in the future.

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

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers, and educational and office facilities, as well as relationships with third party print sites. We have also outsourced some support functions, including information technology, warehousing and logistics to third party providers. The failure of third parties to whom we have outsourced business functions could adversely affect our reputation or financial condition. Failure to recover from a major disaster, (e.g. fire, flood, etc.) at a key facility or the disruption of supply from a key third party vendor or partner (e.g. due to bankruptcy) could restrict our ability to service our customers, and meet the terms of our contractual relationships with both government agencies and commercial customers. Penalty clauses and/or the failure to retain these contracts at the end of the contract term could adversely impact our future revenue growth. Similarly external threats, such as flu pandemic, terrorist attacks, strikes, weather etc., could all affect our business and employees, disrupting our daily business activities.

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

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

While we anticipate that our existing cash and cash equivalents, together with availability under our existing credit facility, commercial paper program, cash balances and cash from operations, will be sufficient to fund our operations for at least the next 12 months, we may need to raise additional capital to fund maturities totaling $850m in 2018 and future operations.

The Group maintains investment grade credit ratings with Moody s and Standard and Poor s which facilitate good access to capital markets. These credit ratings in February 2017 were Baa2 (Negative outlook) with Moody s and BBB (Negative outlook) with Standard and Poor s. The negative outlooks reflect weak trading performance in 2016, particularly in Q4, which if continuing may result in credit rating downgrades.

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Disruption in capital markets or potential concerns about Pearson credit such as indicated by the credit rating agencies may mean that this capital may not be available on favorable terms or may not be available at all.

We generate a substantial proportion of our revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuations could adversely affect our earnings and the strength of our balance sheet.

As with any international business, our earnings can be materially affected by exchange rate movements. Our main exposure is to movements in the US dollar to sterling exchange rate as approximately 60% of our total revenue is generated in US dollars. We also have exposure to a range of other international currencies including emerging market currencies. The operating loss for 2016, translated at 2015 average rates, would have been £454m or 18% lower.

A lack of sufficient capital resources could adversely impact our ability to operate.

If the global economy weakens further and/or the global financial markets collapse, we may not have access to or could lose our bank deposits, or suffer a significant increase in customer bad debts. Lack of sufficient capital resources could significantly limit our ability to take advantage of business and strategic opportunities. If replacement funds are not available, we may be required to delay, reduce the scope of, or eliminate material parts of our business strategy, including potential additional acquisitions or development of new products, services and technologies.

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

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

Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders, in line with our broader fiduciary duties. We are committed to complying with all statutory obligations, to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy.

If we fail to attract, retain and develop appropriately skilled employees, we may limit our ability to achieve our strategic and operational goals and our business may be harmed.

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

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

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

Failure to adequately protect the safety and security of people and assets could increase our costs and adversely impact our reputation.

We have implemented policies to safeguard the health, safety, well-being and protection of our employees, learners and stakeholders. However, there may be accidents or incidents that occur due to unforeseen risks, for example due to changing local and global threats, causing injury or harm to individuals and impacting our business operations.

Social, environmental and ethical risks may also adversely impact our business.

We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. These include ethical business behavior, compliance with UN Global Compact standards, environmental impact, people and data privacy.

Our business depends on a strong brand, and any failure to maintain, protect and enhance our brand would hurt our ability to retain or expand our business.

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

ITEM 4. *INFORMATION ON THE COMPANY*

Pearson plc

Pearson plc, (Pearson) is an international education company with its principal operations in the education and consumer publishing markets. We deliver content plus assessments, powered by services and technology, in order to drive personalized learning at scale. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names. We deliver our content in a variety of forms and through a variety of channels, including books and online services. We offer services as well as content, from test creation, administration and processing to teacher development and school software. Though we operate in more than 70 countries around the world, today our largest markets are the US (62% of sales) and Europe (14% of sales) on a continuing basis.

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

Overview

Pearson consists of its worldwide education business plus a 47% interest in Penguin Random House.

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

From 1 January 2014 the Group has been run as one global education company, organized around three geographical operating segments (North America, Core and Growth).

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Pearson owns a 47% interest in Penguin Random House, which was formed on July 1, 2013, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House. Pearson accounts for its interest in Penguin Random House on an equity basis.

Recent developments

On February 24, 2017, Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend.

On February 24, 2017, Pearson announced the intention to trigger the early repayment option on its $550m 6.25% Global Dollar bonds 2018. The bonds were fully redeemed on March 28, 2017.

On February 24, 2017, Pearson announced the intention to explore potential partnership for our English language learning business Wall Street English (WSE) and possible sale of our English test preparation business Global Education (GEDU) as we reduce our exposure to large scale direct delivery services and focus on more scalable online, virtual, and blended services.

Our strategy

Pearson s mission is to help people make progress in their lives through learning. Over the past decade, through a major program of organic investment and acquisitions, Pearson has become one of the leading education companies in the world, with unique geographic reach, product breadth and professional depth.

Pearson s goal is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, powered by services and technology.

Pearson s strategy is to combine world class-capabilities in content and assessment with technology and services, to enable more effective teaching and personalized learning at scale.

In 2017 the strategic growth drivers set out below will guide our work:

Develop digital & services: Our strategy is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, and services powered by technology. This will be focused on where we see the greatest potential for growth and scalability, and increasingly driven by our expertise in adaptive and personalized learning, enabling educators to be even more effective in reaching their students. Product and market strategy set our priorities for greatest growth and impact. Products are developed with insight from markets, to best meet local needs and opportunities.

Build market presence: One of our key strategic drivers is to build our market-leading presence in North America, the UK and other key markets. We also aim to build our leading presence in select developing markets to meet the growing global demand for education, while reducing the geographical complexity of Pearson in order to focus on fewer, bigger opportunities in education. Sales, branding and marketing functions build on our presence and reputation. Customer service and support creates valuable long-term relationships.

Deliver measurable outcomes: Our strategy is to improve access and outcomes in education. In other words, we want to help more learners learn more. Efficacy is becoming more deeply embedded into our strategy and is helping drive faster improvement in our content, assessment, services and technology. We are the only education company committed to efficacy with such rigor and at such scale and depth. Measuring and improving impact informs all strategic decisions, targeting areas with greatest potential need. Understanding customer and learner needs focuses investment on growth and impact opportunities.

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Our short term priorities are to simplify our portfolio, control costs and invest in the biggest opportunities in education. Our constant goals are: to deliver growth by building a sustainable business, being a trusted partner and reaching more learners, to create long-term value.

In 2017, we will be focused on holding or gaining share in all our major markets from seeking improvements in US higher education to building on the rapid growth we have achieved with virtual schools, online degrees, professional testing and the Pearson Test of English.

We have made Pearson a more focused business and lowered operating costs significantly over the past three years. We intend to continue to make Pearson simpler, more efficient and effective. We intend to further rationalize our platforms and tools, supply chain process and property portfolio; improve our efficacy and the speed with which we launch new product features; and ensure our digital and marketing capabilities are optimized and effective. These investments in stronger simpler platforms and in better learning outcomes should all contribute to better user experiences for the millions of teachers and students we serve.

Our recent announcement of our intention to exit our 47% stake of Penguin Random House reflects an intention that we will now focus entirely on our education strategy.

We are creating a more digital, services-led company that can maximize opportunities and mitigate threats by making education more accessible, affordable and effective for far more people. We are making Pearson a more efficient company, with digital services that support a new generation of personalized learning and which create subscription-style business models for us to renew and repeat sales.

Operating divisions

Pearson is one of the leading providers of educational courseware, assessment and digital teaching and learning technologies. We provide test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. We publish across the curriculum and provide a range of education services including teacher development, educational software and system-wide solutions.

We report Pearson s performance in three segments: North America, Growth, and Core.

North America Segment

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

Our North America school business offers early learning solutions that help educators and families teach fundamental math and literacy skills; elementary and secondary imprints publish leading school programs in reading, literature, math, science, and social studies; and digital instructional solutions for pre K-12, such as enVisionMATH and Miller-Levine Biology. Through our Connections Education business we provide school management services and operate virtual and blended schools.

Testing plays an integral role in determining educator and student success and we are the largest provider of educational assessment services in the US. We mark large-scale school examinations for the US federal government and more than 25 American states, scoring billions of machine-scorable test questions and evaluating more than 111 million essays, portfolios and open-ended test questions every year. Working with

educators and education advocates, our experts are helping to lead the development of Next-Generation Assessments that feature technology-enhanced items, performance-based assessments, and adaptive learning to foster problem-solvers and critical thinkers ready to compete in the global economy.

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

Our professional testing business, Pearson VUE (VUE), is a global leader in electronic testing for regulatory and certification boards, providing a full suite of services from test development to test delivery and data management. Pearson VUE offers exams through an extensive network of over 8,000 test centers across the globe, delivering the NCLEX exam for the National Council of State Boards of Nursing, the GMAT for the Graduate Management Admissions Council and numerous IT exams such as Cisco and CompTIA.

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

Our North America Higher Education business offers learning services for students, colleges and universities in the US. We provide learning tools and technologies. Our custom content and curriculum solutions offer educators the opportunity to tailor their programs based on the needs of students. We also offer workforce education products and flexible workforce development solutions to fill the growing skills gap and increased demand for quality certification prep training. College and career readiness is a K-20 issue, and it requires effective strategies employed in both K-12 and higher education. Our solutions are designed to help institutions retain students and prepare them for success in college and beyond.

Global digital user registrations of Mylab and related products are more than 13 million. The growing trend provides a wealth of data and analytics to improve the performance of individual students. Our advanced capabilities in data, analytics and adaptive learning, and our leading efficacy research, enable us to design a smart learning path for every student.

The demand for online learning is steadily rising and we see this area as one of the fastest growing parts of the market where we can see demand increasing significantly over the next few years, where we ve already got a good presence and where we think we could deploy our courseware, assessment, and technology capabilities at scale. Pearson Online Services runs fully online undergraduate and graduate learning programs, such as the programs at Arizona State University Online. Likewise, at school level, Connections Education, our virtual school business serves tens of thousands of students through both virtual and blended school programs.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division North America for a discussion of developments during 2016 with respect to this segment.

Core Segment

Our biggest Core markets are the UK, Australia, Italy, Germany, France and the Benelux countries. These are countries where we work closely with educators and policy makers to improve learning through creating curriculum, designing assessments and developing digital learning systems. Additionally we have many other markets, where we do not have scale ourselves, so we collaborate with others who share our values and commitment to efficacy to maximize reach and impact.

In the UK school market, we are the largest awarding organization offering academic and vocational qualifications that are globally recognized and benchmarked, with educational excellence rooted in names like Edexcel, BTEC and LCCI. Learners take our qualifications in many countries worldwide. We use our online

marking technology to mark over 94% of examination papers and our ResultsPlus service provides detailed analysis of every learner s examination results. We are also driving innovation through digital products such as Bug Club and ActiveLearn, and supporting skills for employability for progression in study, work and life.

Through Pearson College we are the only FTSE 100 company delivering degrees in the UK. Our students get the chance to learn from leading employers as well as experienced academics and subject experts, in the heart of a 21st Century business.

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

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division Core for a discussion of developments during 2016 with respect to this segment.

Growth Segment

Our aim is to take educational products and services and apply them at scale in countries such as Brazil, South Africa, China, India and other fast-growing economies. Around one third of our employees now work in these countries. We served over 600,000 students through our English language schools in China, Brazil and elsewhere, our partner schools in Brazil and India, and our higher education institutions in South Africa.

In Brazil we are leading primary and secondary education with our sistemas or learning systems which include COC, Dom Bosco and NAME. In South Africa we run 12 of our CTI and MGI campuses throughout the country. We have over 8,500 students enrolled in courses ranging from undergraduate degrees in IT and sociology, to business diplomas and Masters courses in psychology. Our campuses prioritize digital learning with the majority of our students accessing their courses through tablet devises, and focus on learning outcomes that prepare students for employment opportunities in their chosen careers.

Pearson s English assets make the Company the world s largest English language learning business. MyEnglish Lab and other English courseware registrations were over 860,000. The businesses in Pearson s English division include: Wall Street English (center-based learning for consumers); PTE Academic (computer-based test of English for study abroad and immigration); Pearson ELT (institutional English language courses including FOCUS, Poptropica English and Longman); and Grupo Multi (the leading adult English language training company in Brazil).

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

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

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division Growth for a discussion of developments during 2016 with respect to this segment.

Penguin Random House

On July 1, 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% respectively.

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

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

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

In 2016, our share of Penguin Random House profit after tax was £98m.

With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, on February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend. We will use proceeds from this action to maintain a strong balance sheet; invest in our business; and return excess capital to shareholders whilst retaining a solid investment grade credit rating.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division Penguin Random House for a discussion of developments during 2016 with respect to Penguin Random House.

Operating cycles

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

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

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

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

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

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

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

Competition

Pearson s businesses operate in highly competitive environments.

Pearson competes with other publishers and creators of educational materials and services. These companies include publishers such as Cengage Learning, McGraw-Hill and Houghton Mifflin Harcourt, and services companies, such as K-12 Inc, alongside smaller niche players that specialize in a particular academic discipline or focus on a learning technology. Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the school boards, educators and government officials making purchasing decisions.

Intellectual property

Our principal intellectual property assets consist of our:

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

We believe we have taken all reasonable legal steps to protect our key brands in our top markets and copyright in our content and have taken appropriate steps to develop a comprehensive patent program to ensure appropriate protection of emerging inventions that are critical to our new business strategies.

Raw materials

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

Government regulation

The manufacture of certain of our products in various markets is subject to governmental regulation relating to the discharge of materials into the environment. Our operations are also subject to the risks and uncertainties attendant to doing business in numerous countries. Some of the countries in which we conduct these operations maintain controls on the repatriation of earnings and capital and restrict the means available to us for hedging potential currency fluctuation risks. The operations that are affected by these controls, however, are not material to us. Accordingly, these controls have not significantly affected our international operations. Regulatory

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authorities may have enforcement powers that could have an impact on us. We believe, however, that in light of the nature of our business the risk of these sanctions does not represent a material threat to us.

Licenses, patents and contracts

We are not dependent upon any particular licenses, patents or new manufacturing processes that are material to our business or profitability. Likewise, we are not materially dependent upon any contracts with suppliers or customers, including contracts of an industrial, commercial or financial nature. Notwithstanding the foregoing, our Education business is dependent upon licensed rights since most textbooks and digital learning tools include content and/or software that is licensed to us by third parties (or assigned subject to royalty arrangements). In addition, some of our software products in various business lines, particularly those of our Clinical business, rely upon patents licensed from third parties.

Legal proceedings

We and our subsidiaries are from time to time the subject of legal proceedings incidental to the nature of our and their operations. These may include private litigation or arbitrations, governmental proceedings and investigations by regulatory bodies. We do not currently expect that the outcome of pending proceedings or investigations, either individually or in aggregate, will have a significant effect on our financial position or profitability nor have any such proceedings had such effect in the recent past. To our knowledge, there are no material proceedings in which any member of senior management or any of our affiliates is a party adverse to us or any of our subsidiaries or in respect of which any of those persons has a material interest adverse to us or any of our subsidiaries.

Organizational structure

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries and associates as at December 31, 2016, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

Name	Country of incorporation/residence	Percentage interest/voting power
Pearson Education Inc.	United States (Delaware)	100%
Pearson Education Ltd.	England and Wales	100%
NCS Pearson Inc.	United States (Minnesota)	100%
Penguin Random House LLC.	United States (Delaware)	47%
Penguin Random House Ltd.	England and Wales	47%

In February 2014 the Group acquired Grupo Multi, Brazil s leading adult English language training company. There were no significant acquisitions in 2015 or 2016.

During 2015 the Group disposed of its interest in the FT Group including its 50% share of The Economist. The Financial Times sale was completed on 30 November 2015 and the sale of our 50% share of The Economist Group was substantially completed on 16 October 2015 with the remaining stake sold in 2016. Also, in July 2015, the Group disposed of its interest in PowerSchool.

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

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

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Property, plant and equipment

Our headquarters are located at leasehold premises in London, England. We own or lease approximately 900 properties, including approximately 650 testing/teaching centers in over 55 countries worldwide, the majority of which are located in the United Kingdom, the United States and China.

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

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

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

We own the following principal properties at December 31, 2016:

General use of property	Location	Area in square feet
Office	Iowa City, Iowa, USA	312,760
Office	Southwark, London, UK	310,200
Warehouse/Office	Old Tappan, New Jersey, USA	212,041
Warehouse/Office	Cedar Rapids, Iowa, USA	205,000
Office	Hadley, Massachusetts, USA	137,070
Printing	Owatonna, Minnesota, USA	128,000
Office	Manchester, UK	139,680

We leased the following principal properties at December 31, 2016:

General use of property	Location	Area in square feet
Office	Hoboken, New Jersey, USA	216,273
Office	New York City, New York, USA	313,285
Office	Westminster, London, UK	282,923
Office	San Antonio, Texas, USA	117,063
Warehouse/Office	Austin, Texas, USA	226,076
Office	Boston, Massachusetts, USA	225,299
Office	Glenview, Illinois, USA	187,500
Office	Bloomington, Minnesota, USA	172,797
Warehouse/Office	Cape Town, South Africa	160,387
Warehouse/Office	Uttar Pradesh, India	145,041
Office	Harlow, UK	137,857
Office	Chandler, Arizona, USA	270,920
Warehouse	Sao Paulo, Brazil	132,331
Warehouse/Office	Cedar Rapids, Iowa, USA	119,682
Office	Centennial, Colorado, USA	117,554
Teaching Centre	Pretoria, South Africa	134,553
Warehouse	Naucalpan de Juarez, Mexico	113,638
Call Center/Office	Lawrence, Kansas, USA	105,000

Capital Expenditures

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

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ITEM 4A. ***UNRESOLVED STAFF COMMENTS***

The Company has not received, 180 days or more before the end of the 2016 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

ITEM 5. ***OPERATING AND FINANCIAL REVIEW AND PROSPECTS***

The following discussion and analysis is based on and should be read in conjunction with the consolidated financial statements, including the related notes, appearing elsewhere in this Annual Report. The financial statements have been prepared in accordance with IFRS as issued by the IASB.

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

General overview

Introduction

Pearson s primary segments for management and reporting are geographical as follows: North America, comprising the courseware, assessment and services businesses in US and Canada; Core, comprising the courseware, assessment and services businesses in more mature markets, including the UK, Australia and Italy; and Growth, comprising the courseware, assessment and services businesses in emerging markets, including Brazil, China, India and South Africa. In addition Pearson separately reports on an equity basis the results from its 47% interest in Penguin Random House (PRH).

On 16 October 2015, Pearson substantially completed the sale of its 50% interest in the Economist to EXOR and The Economist Group and on 30 November 2015 Pearson completed the sale of the Financial Times to Nikkei. The results of the Economist and the Financial Times are included in discontinued operations in 2014 and to the date of sale in 2015. Also, in July 2015, the Group disposed of its interest in PowerSchool to Vista Equity Partners for consideration of £222m realizing a pre-tax gain of £30m net of a £70m write down of related software assets. The PowerSchool business was not significant enough to meet the definition of a discontinued business and its results to the date of disposal are included in continuing operations.

On February 4, 2014, Pearson completed the sale of the Mergermarket Group to BC Partners. Mergermarket s results for 2014 to the date of sale have been included in discontinued operations.

Sales from continuing operations increased from £4,468m in 2015 to £4,552m in 2016, an increase of £84m or 2%. This year on year increase was the result of currency movements, primarily the strength of the US dollar relative to sterling during the year but also due to the strength of many of the other currencies that the Group is exposed to. In 2016 currency movements increased sales by £486m when compared to the equivalent figures at constant 2015 rates. When measured at 2015 constant exchange rates, our sales declined by 9%. Part of the decrease is due to the absence of sales from businesses sold during the year and we estimate that after excluding the impact of disposals, sales declined by 8% at constant exchange rates. This decrease is primarily explained by weakness in US higher education courseware, US K12 assessment and courseware and UK student assessment.

In 2016, Pearson reported an operating loss (from continuing operations) of £2,497m compared to a loss of £404m in 2015. The increase in the loss of £2,093m mainly reflects an increase in intangible charges. At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, we revised our strategic plans and our estimates for future cash flows and as a consequence made an impairment to North American goodwill of £2,548m. In 2015,

following economic and market deterioration in the Group s operations in emerging markets and ongoing cyclical and policy related pressures in the Group s mature market operations we impaired intangible assets in North America by £282m, in Core markets by £37m and in Growth markets by £530m. Operating profit before these impairments decreased by £394m in 2016 compared to 2015 mainly due to restructuring costs and the impact of lower revenues partly offset by favorable currency movements.

In January 2016, Pearson announced that it was embarking on a major restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. Total restructuring in 2016 amounted to £338m and includes costs associated with headcount reductions, property rationalization and closure or exit from certain systems, platforms, products and supplier and customer relationships. After excluding impairment and restructuring, currency movements increased operating profit by £78m when compared to the equivalent figures translated at constant 2015 exchange rates.

The loss before taxation in 2016 of £2,557m compares to a loss before taxation of £433m in 2015. The increase in the loss of £2,124m mainly reflects the £2,093m increase in the reported operating loss identified above and an increase in net finance costs of £31m, from £29m in 2015 to £60m in 2016. The Group s net interest payable increased from £46m in 2015 to £59m in 2016. The majority of the movement in net interest payable was due to a one-off release of accrued interest in 2015 following agreement of historical tax positions. The most significant element of the net interest payable figure is interest on bond debt with the impact of interest on tax provisions and interest receivable off setting each other. Interest on bond debt was in line with the prior year, with the savings from bond repayments offset by the impact of rising US dollar interest rates. Also included in net finance costs are net finance costs relating to employee benefit plans, foreign exchange and other gains and losses. In 2016 the total of these items was a loss of £1m compared to a gain of £17m in 2015. Income relating to employee benefit plans was £7m higher in 2016 than in 2015 mainly reflecting the better funding position in the UK pension plan at the beginning of 2016. Other gains and losses in 2016 and 2015 mainly relate to foreign exchange differences on un-hedged cash and cash equivalents, and other financial instruments.

Net cash generated from operations increased to £522m in 2016 from £518m in 2015. The increased cash flow reflects lower cash incentive payments and tight working capital partially offset by restructuring spend and higher pension deficit payments. Net interest paid at £51m in 2016 was the same as for 2015 and reflects the similar interest charge for the year after taking out the one-off release of accrued interest in 2015 following agreement of historical tax positions. Tax paid in 2016 was £45m compared to £232m in 2015. Tax paid in 2015 included the tax on disposals made during the year of approximately £103m whilst tax paid in 2016 included tax relief on pension payments made in connection with the disposal of the Financial Times in 2015. In addition the lower tax paid in 2016 also reflects lower profits following restructuring charges taken in the year.

Net capital expenditure on property, plant and equipment after proceeds from sales remained constant at £84m in both 2015 and 2016 and net capital expenditure on software intangibles reduced slightly from £160m in 2015 to £157m in 2016. The expenditure on both tangible and intangible capital is largely attributed to the continuing investment in enabling function technology designed to lower administrative costs. There were no significant acquisitions in either 2015 or 2016 and the net cash outflow in respect of businesses and investments acquired was £27m in 2015 and £21m in 2016. The net cash inflow in respect of businesses and investments disposed was £1,422m in 2015 compared to £42m in 2016. In 2015 the cash received largely related to the Financial Times, The Economist and PowerSchool disposals and in 2016 includes proceeds from the sale of the remaining stake in the Economist partially offset by costs paid in 2016 relating to the Financial Times sale in 2015. Dividends from joint ventures and associates decreased from £162m in 2015 to £131m in 2016 mainly due to the absence of dividends from the Economist and a smaller dividend from PRH. Dividends paid of £424m in 2016 compares to £423m in 2015 reflecting the same dividend per share in both years. Overall the Group s net borrowings increased from £654m at the end of 2015 to £1,092m at the end of 2016. The reduction in net debt was due to the factors noted above exacerbated by an increase in reported net debt due to the strengthening of the US dollar relative to sterling.

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Outlook

In North America, our largest market, our guidance for 2017 is based on assumptions of further declines in enrolment and other pressures in the US higher education courseware market. If the 2016 inventory correction (see Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by segment North America Courseware for further explanation of this item) at key channel partners partially unwinds, lower returns will result in net revenue growth in our US higher education courseware business of approximately 1%. If inventory levels continue to fall we expect the result to be a 7% net revenue decline. In both cases, we assume an underlying decline in demand of between 6% and 7% for US higher education courseware. Elsewhere in North America, we anticipate modest declines in school courseware revenues reflecting a slightly larger adoption market offset by our lower participation rate due to our earlier decision not to compete in the current California English Language Arts (ELA) adoption; and flat revenues in Open Territories (i.e. those US states in which schools purchase educational materials independently) reflecting a smaller impact from new products after a very successful 2016. We expect some continued pressure on testing revenues in North America due to the annualization of contract losses announced in 2015 and the roll-off of temporary contracts won in 2016, together with a further shift to digital tests which reduces revenue but benefits margins. We expect Connections Education to see double-digit growth in enrolment partially offset by some virtual school partners choosing to take some non-core services in-house. We expect online program management and professional certification to continue to grow well.

In our Core markets (which include the UK, Australia, Germany, France, the Benelux countries and Italy), we anticipate: flat revenues with continued growth in Pearson Test of English Academic and in Online Program Management due to program additions and new customer wins; growth in UK school and higher education courseware due to a strong slate of new products aligned with Pearson qualifications; offset by modest declines in UK student assessment, where revenue is expected to lag behind the greater stability that we are now seeing in vocational course registrations; together with business exits and weakness in smaller markets.

In our Growth markets (which include Brazil, China, India and South Africa and other fast growing economies), we expect a modest increase in revenues; with growth in China driven by new product offerings and center openings at Wall Street English; in South Africa due to improving enrolments in CTI, our private university; and in Brazil on evidence of greater economic stability. We expect courseware businesses across Growth to grow well on new product launches, offsetting some business exits as we focus on fewer, larger opportunities.

In Penguin Random House, we anticipate a broadly level publishing performance. We announced the intention to exit our 47% stake of the combined business reflecting an intention to focus entirely on our education strategy. Should Bertelsmann choose to buy Pearson s stake, or we elect to recapitalize the business and extract a dividend, we will use the proceeds to maintain a strong balance sheet, invest in our business and return excess capital to shareholders, while retaining a solid investment grade credit rating.

We completed the sale of a number of small subscale businesses which, combined, will have the effect of reducing 2017 adjusted operating profit by £10m. Group incentive compensation increased by £55m in 2016, lower than the budgeted £110m reflecting the weakness of performance versus budget. The incentive pool will be budgeted for in full in 2017 to ensure our workforce is properly incentivized.

To ensure efficient use of the cash balances we held at 31 December 2016, we announced that we will trigger the early repayment option on our $550m 6.25% Global dollar bonds 2018. These bonds were fully redeemed on March 28, 2017. We expect our interest charge to be £74m (2016: £59m) due to currency movements and increases in US dollar LIBOR.

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Sales information by segment

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

	Year Ended December 31		
	2016 £m	2015 £m	2014 £m
North America	2,981	2,940	2,906
Core	803	815	892
Growth	768	713	742
Total continuing operations	4,552	4,468	4,540
Discontinued operations		312	343
Total	4,552	4,780	4,883

Sales information by geographic market supplied

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

	Year Ended December 31		
	2016 £m	2015 £m	2014 £m
Continuing operations			
European countries	648	667	725
North America	2,947	2,907	2,871
Asia Pacific	632	590	565
Other countries	325	304	379
Total continuing operations	4,552	4,468	4,540
Discontinued operations			
European countries		198	236
North America		74	69
Asia Pacific		35	34
Other countries		5	4
Total discontinued operations		312	343
Total	4,552	4,780	4,883

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

Exchange rate fluctuations

We earn a significant proportion of our sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was £1:$1.33 in 2016, £1:$1.53 in 2015 and £1:$1.65 in 2014. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. In 2016, Pearson generated 65% of its continuing sales in the US (2015: 63%; 2014: 61%). In 2016 we estimate that a five cent change in the average exchange rate between the US dollar and sterling would have had an impact on our reported loss per share of approximately 10.0p and a five cent change in the closing exchange rate between the US dollar and sterling would have had an impact on shareholders funds of approximately £130m. See

Item 11. Quantitative and Qualitative Disclosures about Market Risk for more information. The year-end US dollar rate for 2016 was £1:$1.23 compared to £1:$1.47 for 2015 and £1:$1.56 for 2014. The total impact on shareholders funds of

foreign exchange translation was a gain of £913m in 2016 compared to a loss of £69m in 2015. These net movements are principally driven by movements in the US dollar as a significant portion of the Group s operations are in the US, however, in 2016 other currencies contributed to the foreign exchange gain as many of these other currencies also strengthened in comparison to sterling. In 2015 these other currencies were generally weaker relative to sterling and this weakness was more than enough to offset the gain from the stronger dollar.

Critical accounting policies

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

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

Results of operations

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

Consolidated results of operations

Sales

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

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

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

Growth sales increased by £55m or 8% from £713m in 2015 to £768 in 2016, almost all of the increase can be attributed to exchange and the strength of key emerging market currencies compared to sterling. We estimate that after excluding the impact of exchange rates and the incremental contribution from businesses disposed in 2015 and 2016 and the transfer of smaller businesses from the Core segment, sales declined by 1%. In China, growth in adult English language learning and English courseware was partly offset by declines in English test

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preparation. In Brazil, revenues declined due to enrolment declines in our English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to our previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015.

Cost of goods sold and operating expenses

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

	Year Ended December 31	
	2016	**2015**
	£m	**£m**
Cost of goods sold	2,093	1,981
Operating expenses		
Distribution costs	88	80
Selling, marketing and product development costs	908	895
Administrative and other expenses	1,240	1,195
Restructuring costs	329	35
Other net gains and losses	25	(13)
Other income	(85)	(98)
Total net operating expenses	2,505	2,094
Impairment of intangible assets	2,548	849
Total expenses	7,146	4,924

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

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

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

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

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

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

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

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

Share of results of joint ventures and associates

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

Operating loss / profit

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

Net finance costs

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

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

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

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Taxation

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

Discontinued operations

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

Profit/(loss) for the year

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

Earnings/(loss) per ordinary share

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

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

Exchange rate fluctuations

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

Sales and operating profit by segment

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

In our adjusted operating profit we have excluded other net gains and losses, acquisition costs, amortization and impairment of acquired intangibles and the cost of major restructuring. The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. We do not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical

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expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within our adjusted operating profit measure. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group. In 2016, the definition of adjusted operating profit has been amended to exclude the cost of major restructuring activity. In January 2016, Pearson announced that it was embarking on a restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. The costs of the program in 2016 are significant enough to exclude from our adjusted operating profit measure so as to better highlight the underlying performance.

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

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

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

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North America

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

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

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

North America courseware

In school courseware, revenue declined 10% with a smaller new Adoption Market and our lower participation rate partially offset by good growth and market share gains in Open Territories resulting from new product launches. Our new adoption participation rate fell from over 90% in 2015 to 64% in 2016 due to our decision not to compete for the California Grades K-8 English Language Arts (ELA) adoption with a core basal program. We won an estimated 30% share of adoptions competed for (31% in 2015) and 19% of total new adoption expenditure of $470m (29% of $730m in 2015) driven by strong performance in Indiana Math and Social Studies and South Carolina Science and Social Studies. In Open Territories, we grew strongly benefiting from our new MyPerspectives program in Grades 6 12 ELA, ReadyGen, Investigations 3.0, the extension of enVisionMATH to cover Grades 6 8 and growth in our digital reading intervention program, iLit.

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

During 2016, we performed strongly in Science and Business & Economics with key titles including: *Applying, Biochemistry: Concepts & Connections 1e*; Amerman, *Human Anatomy & Physiology 1e*; Marieb, *Human Anatomy & Physiology 10e*; Young, Freedman, *University Physics 14e* and Parkin, *Economics 12e*. Global digital registrations of MyLab and related products grew 2%. In North America, digital registrations grew

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

North America assessment

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

In professional certification, revenues grew 7% with VUE global test volume up 3% to almost 15 million, boosted by continued growth in IT, professional, US teacher certification programs and strong growth in GED (General Educational Development, the high school equivalency test that is part of a joint venture with the American Council on Education). We renewed our contracts with the Computing Technology Industry Association (CompTIA) for three years, the Florida Department of Business & Professional Regulation for five years, the American Register of Radiologic Technologists (ARRT) for seven years and a contract to administer insurance back office licensing services in North Carolina for five years.

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

North America services

Connections Education, our virtual school business, served nearly 73,000 full-time equivalent students through full-time virtual and blended school programs, up 6% on last year. Connections revenues grew 8%. Five new full-time online, statewide, partner schools opened for the 2016 17 school year in Arkansas, Washington, Colorado, Pennsylvania and New Mexico. The 2016 Connections Education Parent Satisfaction Survey showed strong results with 92% of families with students enrolled in full-time online partner schools stating that they would recommend the schools to others.

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

Core

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

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

Core courseware

Courseware revenues declined 7%. School revenues declined in smaller markets in Europe and Africa, in Australia as we exited a number of sub-scale market segments and in the UK primary due to a smaller adoption cycle, partially offset by growth in secondary in the UK due to new product launches aligned with our qualifications and the successful delivery of The Crunch food project in partnership with the Wellcome Trust. In higher education courseware, revenues declined in smaller markets, in Australia due to phasing and in the UK as we exited sub-scale market segments. In the UK, 2.1 million pupils are now using a Pearson digital service on ActiveLearn Primary, including Bug Club, up from 1.8 million a year ago. In a randomized control trial, where its impact was periodically assessed, Bug Club was shown to have made a highly statistically significant impact on pupils reading, vocabulary and spelling performance, with a greater positive impact in schools with a higher proportion of children receiving free school meals.

Core assessments

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

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

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

Core services

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

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

Growth

Growth sales increased by £55m, or 8%, to £768m in 2016 from £713m in 2015. Adjusted operating profit increased by £32m to a profit of £29m in 2016 from a loss of £3m in 2015. We estimate that after excluding the impact of exchange rates and the incremental contribution from businesses disposed in 2015 and 2016 and the transfer of smaller businesses from the Core segment, sales declined by 1%. In China, growth in adult English language learning and English courseware was partly offset by declines in English test preparation. In Brazil, revenues declined due to enrolment declines in our English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to our previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015.

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

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

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

Growth courseware

Courseware revenues grew 8%, due to strong growth in school textbook sales in South Africa and English language courseware in China, Argentina and Mexico partially offset by weakness in Brazil. We saw strong

growth in registrations for MyEnglishLab boosted by new editions of key titles such as Speakout and Top Notch. Middle East school courseware declined as a result of macroeconomic pressure and lower purchases from key international school clients.

Growth services

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

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

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

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

Penguin Random House

Pearson owns 47% of Penguin Random House the first truly global consumer book publishing company. Our share of Penguin Random House adjusted operating profits were £129m compared to £90m for 2015.

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

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

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

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

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

With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, on February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend. We will use proceeds from this action to maintain a strong balance sheet; invest in our business; and return excess capital to shareholders whilst retaining a solid investment grade credit rating.

The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-77 to F-143.

Results of operations

Year ended December 31, 2015 compared to year ended December 31, 2014

Consolidated results of operations

Sales

Our total sales from continuing operations decreased by £72m, or 2%, from £4,540m in 2014, to £4,468m in 2015. The 2015 sales benefitted from the impact of currency movements. The 2015 sales, translated at 2014 average exchange rates, would have been £137m less at £4,331m a 5% decrease at constant exchange rates. Part of the decrease is due to the absence of sales from businesses sold during the year and also in light of the evolution of our Connections Education business in North America a greater proportion of that revenue is now recognized on a net basis. We estimate that after excluding the impact of acquisitions and disposals and after taking account of the evolution of sales at Connections Education, sales declined by 2% at constant exchange rates.

North America sales increased by £34m or 1% from £2,906m to £2,940m, due to the strengthening of the US dollar against sterling. We estimate that after excluding the impact of exchange, the contribution from acquisitions and disposals and adjustments made in respect of Connections Education, North America sales declined by 1% in 2015 compared to 2014. Revenue growth in our professional and clinical assessments businesses was offset by contract losses in our State and National assessments businesses. In addition Higher Education and School courseware sales fell as a result of lower college enrolments and a smaller market opportunity in School despite market share gains in both Higher Education and School. North America continued to be the most significant source of our sales and as a proportion of sales contributed 66% in 2015 and 64% in 2014.

Core sales declined by £77m or 9% from £892m in 2014 to £815m in 2015. We estimate that after excluding acquisitions and disposals and the impact of exchange, Core sales declined by 5%. Growth in Pearson Online Services in Australia, Wall Street English in Italy, Clinical Assessment in Germany and the Pearson Test of English in Australia was more than offset by revenue declines in UK qualifications as the business nears the end of a period of policy change. In addition revenue declines at VUE, phasing and market weakness in Australian Higher Education courseware and the focusing of our UK school courseware on products that directly support Pearson Qualifications also contributed to the overall decline.

Growth sales declined by £29m or 4% from £742m in 2014 to £713m in 2015, much of the decline can be attributed to exchange and the strength of sterling against key emerging market currencies. We estimate that after

excluding the impact of exchange rates and the incremental contribution from acquisitions made in 2014 sales declined by 1%. In China, revenues grew modestly reflecting strong sales of premium services in our direct delivery English Language Learning businesses offset by list disposals. In Brazil, revenues were stable with good growth in private sistemas and language schools offset by declines in government funded sistemas and language schools. In South Africa, revenues declined significantly due to a smaller textbook adoption cycle and lower enrolments at CTI. In the Middle East, our business was impacted by the withdrawal from contracts in Saudi Arabia.

Cost of goods sold and operating expenses

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

	Year Ended December 31	
	2015	2014
	£m	£m
Cost of goods sold	1,981	2,021
Operating expenses		
Distribution costs	80	84
Selling, marketing and product development costs	895	931
Administrative and other expenses	1,195	1,168
Restructuring costs	35	64
Other net gains and losses	(13)	(2)
Other income	(98)	(120)
Total net operating expenses	2,094	2,125
Impairment of intangible assets	849	77
Total expenses	4,924	4,223

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and testing business and the cost of teaching and facilities in direct delivery businesses. Our cost of sales decreased by £40m, or 2%, from £2,021m in 2014, to £1,981m in 2015. The decrease corresponds primarily to the decrease in sales, with cost of sales at 44.3% of sales in 2015 compared to 44.5% in 2014.

Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs decreased due to the continuing shift to digital and services products.

Selling, marketing and product development costs. Our selling, marketing and product development costs decreased by £36m or 4% from £931m in 2014 to £895m in 2015. As a percentage of sales these costs were relatively consistent at 20.0% in 2015 and 20.5% in 2014, reflecting some continuing benefits of restructuring.

Administrative and other expenses. Our administrative and other expenses increased by £27m or 2% from £1,168m in 2014 to £1,195m in 2015. Increases in intangible amortization and investment in technology offset decreases in employee compensation.

Restructuring costs. Restructuring costs, which include costs for redundancy and property exits, returned to a more normal level in 2015 after a period of transformation in 2013 and 2014. Restructuring costs were £29m lower in 2015 at £35m compared with £64m in 2014.

Other net gains and losses. Included in other net gains and losses in 2015 is the profit on sale of PowerSchool of £30m net of £70m of write downs on related software assets and small losses on investments and

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costs relating to prior year disposals totaling £17m. Other gains and losses in 2014 are gains on the sale of joint venture interests in Safari Books Online and CourseSmart totaling £40m and a loss on the disposal of an investment in Nook Media of £38m.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions, together with the service fee income from Penguin Random House. Other operating income decreased to £98m in 2015 compared to £120m in 2014 mainly due to a reduction in Penguin Random House service fee income. This income decreased as Penguin Random House reduced its reliance on Pearson systems and processes and the fee of £41m in 2014 compares to a fee of £16m in 2015.

Impairment of intangible assets. Following significant economic and market deterioration in the Group s operations in emerging markets and ongoing cyclical and policy related pressures in the Group s mature market operations, management s expectations of future returns were revised down in the course of 2015, consistent with our outlook for 2018, resulting in the impairment of intangible assets in North America of £282m, in Core markets of £37m and in Growth markets of £530m. In 2014 impairments of £77m related to India.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased by £21m to £52m in 2015 from £31m in 2014. The increase is mainly due to Penguin Random House where there was an improved operating performance coupled with a reduced amortization charge.

Operating loss / profit

In 2015 there was an operating loss on a continuing basis of £404m compared to an operating profit on a continuing basis of £348m in 2014. The reduction in profit is entirely due to the impairment of intangible assets outlined above.

Net finance costs

Net finance costs reduced by £64m, from £93m in 2014 to £29m in 2015. Net interest payable in 2015 was £46m, compared to £64m in 2014. The majority of the movement in net interest payable is due to the release of accrued interest following agreement of historical tax positions. For our debt portfolio, our fixed rate policy reduces the impact of changes in market interest rates, however we were still able to benefit from low average US dollar interest rates during the year as the majority of the Group s debt is US dollar denominated. Year-on-year, average three month US dollar LIBOR rose by 0.1% to 0.3%. This slight increase in floating market interest rates, along with the impact of changes in our debt portfolio, foreign exchange translation and the effect of slightly lower levels of average net debt in the period led to little change in the year-on-year interest charge on debt. Interest receivable on cash balances held overseas was reduced from the prior year due mainly to the weakening of emerging market currencies against sterling. The Group s average net debt fell by £61m, largely as a result of disposals in the fourth quarter of 2015 offsetting the translation of our predominantly US dollar debt. These combined factors contributed to the overall decrease in the Group s average net interest payable from 3.6% to 2.7%.

Other net finance costs are finance income and costs on retirement benefits, finance costs on related to deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2015, the total of these items was a gain of £17m compared to a loss of £29m in 2014. Both the gain in 2015 and the loss in 2014 mainly relate to foreign exchange differences on unhedged cash and cash equivalents and other financial instruments. For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

Taxation

The total tax benefit in 2015 of £81m represents 18.7% of pre-tax losses and compares to a charge of £56m or 22.0% of pre-tax profits in 2014. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 20.25% in 2015 and 21.5% in 2014). The reduced rate in 2015 reflects the lack of tax relief on some of our goodwill impairments offset in part by adjustments arising from agreement of historical tax positions. Both these items were more significant in 2015 than they had been in 2014.

Discontinued operations

Profit from discontinued operations in 2015 was £1,175m compared to £271m in 2014 with the difference being due primarily to gains on disposals in the respective years.

On 16 October 2015, Pearson substantially completed the sale of its 50% interest in the Economist to EXOR and on 30 November 2015 Pearson completed the sale of the Financial Times to Nikkei. The pre-tax gains on these sales were £473m and £711m respectively. We expect both of these transactions to qualify for substantial shareholder exemption in the UK and therefore there was no tax on the Economist gain and tax on the Financial Times sale amounted to £49m. The gains on these transactions and the results for both 2014 and 2015 to the respective sale dates have been included in discontinued operations.

The sale of Mergermarket to BC partners was completed on 4 February 2014 and resulted in a gain of £244m before tax. The gain on sale and the results for 2014 to the date of sale have been included in discontinued operations. Also included in discontinued operations in 2014 is a gain of £29m relating to adjustments to liabilities arising on the formation of the Penguin Random House group. Although this transaction completed in 2013 there were subsequent adjustments relating to the potential transfer of pension liabilities and tax.

Profit for the year

The profit for the financial year in 2015 was £823m compared to a profit in 2014 of £470m. The 2015 profit includes the gains on the sale of the Financial Times and Economist partly offset by significant impairment charges in the year. The net of these items were more significant than disposal gains and impairment charges had been in 2014.

Earnings per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 101.2p in 2015 compared to 58.1p in 2014 based on a weighted average number of shares in issue of 813.3m in 2015 and 810.9m in 2014. The increase in earnings per share was due to the increase in profit for 2015 described above and was not significantly affected by the movement in the weighted average number of shares.

A diluted earnings per ordinary share was not calculated in 2015 as a result of the loss from continuing operations in 2015. The diluted earnings per share of 58.0p in 2014 was not significantly different from the basic earnings per share in that year as the effect of dilutive share options was again not significant.

Exchange rate fluctuations

Currency movement increased sales by £137m and had only a small impact on operating profit. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding our management of exchange rate risks.

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Sales and operating profit by segment

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

In our adjusted operating profit we have excluded other net gains and losses, acquisition costs and amortization and impairment of acquired intangibles. The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. We do not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within our adjusted operating profit measure. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group.

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

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

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£m	North America	Core	Growth	PRH	Continuing	Discontinued	Total
			Year Ended December 31, 2014				
Sales	2,906	892	742		4,540	343	4,883
	64%	*19%*	*16%*		*100%*		
Total operating profit	336	90	(93)	15	348	325	673
Add back:							
Other net gains and losses	(2)				(2)	(273)	(275)
Acquisition costs	2	1	3		6		6
Intangible charges	108	21	132	54	315	3	318
Adjusted operating profit: continuing operations	444	112	42	69	667		667
Adjusted operating profit: discontinued operations						55	55
Total adjusted operating profit	444	112	42	69	667	55	722
	61%	*15%*	*6%*	*10%*	*92%*	*8%*	*100%*

North America

North America sales increased by £34m or 1% from £2,906m to £2,940m and adjusted operating profit increased by £36m, or 8%, from £444m in 2014 to £480m in 2015. The increase in headline terms was a result of currency movements due to the strengthening of the US dollar against sterling. At constant exchange and after taking account of the contribution from acquisitions and disposals and adjustments made in respect of Connections Education, sales declined by 1% and adjusted profits increased by 1%, mainly reflecting sales declines in US Higher Education partially offset at a profit level by year-on-year cost savings.

In our statutory results in 2015 we recognized an impairment to our US goodwill of £282m following ongoing cyclical and policy related pressures in our main US markets and we also realized a gain on sale of PowerSchool of £30m net of the write down of related software assets. In addition to the gain on PowerSchool there were also small losses on the sale and write down of smaller investments of £11m. In 2014 we recognized a £38m loss on disposal of our 5% stake in Nook Media and a £40m gain on the disposal of our stakes in Safari Books Online and CourseSmart.

Overall adjusted operating margins in the North America business improved in 2015 to 16.3% compared to 15.3% in 2014 as a result of cost savings and the absence of restructuring costs following restructuring in 2014 and the benefit from list sales in 2015.

North America courseware

In school courseware, revenue declined year on year despite strong market share performance primarily due to a smaller overall adoption market as compared to 2014. Overall market share increased slightly driven by a strong performance in new adoption markets where we won 31% (2014: 25%) of new adoptions competed for, or 29% (2014: 25%) of the total new adoption market of $730m in 2015 (2014: $910m), led by a strong performance in Grades K-6 Social Studies in Texas and Indiana and in Grades K-6 Science in Oklahoma. We expanded iLit, our digital reading intervention program, covering a broader range of students including English Language Learners. Research studies show that students using iLit gain two or more years of reading growth in a year using this tablet based program. We launched ReadyGEN, a K-6 reading series and enVisionMATH2.0, the newest offering in the highly successful enVisionMATH K-6 math program.

Gross higher education courseware revenues fell 1.5% (compared to industry gross revenue declines of 2.7%) due to lower college enrolments offset by market share gains. Net revenues declined 5.7% (compared to

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industry net declines of 7.5%) reflecting the impact of higher returns. Our market share in courseware benefited from strong performance from key titles including: Hubbard *Economics 5e*, Hibbeler *Engineering Mechanics 14e* and Marieb *Human Anatomy & Physiology 10e*.

Global digital registrations of MyLab and related products grew 3% to nearly 13 million. In North America, digital registrations grew 3% to almost 11 million with good growth in Science, Business & Economics, Statistics, REVEL and skills applications like Pearson Writer, offset by softness in developmental Mathematics. Faculty generated case studies indicate that the use of MyLab programs, as part of a broader course redesign, can support improvements in student test scores and lower institutional cost. We launched a suite of features that include Adaptive Practice in our MyLabs to personalize subjects including mathematics and nursing practice, Predictive Analytics Early Alerts in Mastering to help science instructors support at-risk students, gamification features in Business and rich learning analytics dashboards in numerous products that offer deep insight into students progress, performance and engagement.

North America assessment

In State and National school Assessments, revenues for the full year declined due to contract losses. High-stakes online test volumes grew strongly, up 130% on 2014 to 26.4 million, as customers transitioned to computer based testing. Paper based high stakes test volumes grew 3% to 32.7 million. Pearson successfully delivered English Language Arts and Math PARCC assessments to over 4.8 million students across 11 states and the District of Columbia. ACT Aspire delivered Common Core aligned college and career readiness assessments to 1.3 million students up 67% from 2014 and was chosen for three new state-wide deployments in 2016. The states of Arkansas, Mississippi and Ohio will discontinue PARCC assessments in 2016. We were awarded contracts to deliver the Indiana Statewide Test of Educational Progress (ISTEP); renewed the Puerto Rican Tests of Academic Achievement (PPAA) and parts of the assessments contract awarded by the Texas Education Agency; and extended our contracts to administer the Mississippi Science Test and Mississippi Subject Area Testing Program. We ceased to administer the majority of the current Texas STAAR contract in September 2015. Pearson extended its partnership with the College Board for the SAT assessment with the award of a five-year contract for processing of the redesigned SAT and PSAT assessments. Pearson will continue to provide the essay-scoring component for the SAT until March 2016.

Clinical Assessment grew well benefiting from continued growth of the fifth edition of the *Wechsler Intelligence Scale for Children* (WISC-V), strong growth in *Behavior Assessment for Children 3e* (BASC) and rapid growth in Q-Interactive, Pearson s digital solution for Clinical assessment administration with geographic expansion and continued strong growth in active users to over 9,000 from 4,000 in 2014 with test administrations up over 400% to 1.3 million sub-tests.

In Professional, revenues grew strongly at VUE due to higher volumes of professional certification assessments. VUE global test volumes grew 11% year on year to 14.2 million, boosted by continued growth in IT, Professional and GED, with increased volumes from Microsoft Certified Professional (MCP) Program globally, National Council of State Boards of Nursing and US teacher certification programs. VUE renewed the Certiport Microsoft Office Specialists and Microsoft Technology Associate programs for an additional year and extended our partnership with Cisco Systems for three and half years.

North America services

Connections Education, our virtual school business served over 68,000 full time equivalent students through full-time virtual and blended school programs in 2015, up 11% from 2014 as a result of underlying growth and a new state-wide school in North Carolina. Connections manages 30 virtual public schools with three new full-time state-wide virtual public schools approved for the 2016-17 school year to serve students in Arkansas, Washington and New Mexico. In its annual Parent Satisfaction Survey 93% of parents of students enrolled in full-time online partner schools recommend Connections to other families.

In Pearson Online Services, our Higher Education Online Program Management (OPM) business, course enrolments grew strongly, up 25% to over 265,000, boosted by strong growth in Arizona State University Online where we renewed our partnership at the start of 2015. We extended our collaboration with Maryville University to launch a Bachelor and Master s in Cybersecurity and a Doctorate in Leadership. Ohio University is partnering with Pearson to launch a Master s in Financial Economics and Public Relations. University of Nevada Reno is partnering to increase access to the Master of Social Work degree program online. Pearson launched a new managed programs service model with Cincinnati State Technical and Community College, adapting traditional OPM services to the Community College market signing a landmark 10-year agreement to provide marketing, recruiting, admission, and retention services both to online and ground-based programs.

In enterprise solutions, Pearson signed significant large-scale, enterprise adoptions of cross-discipline digital content, where content is purchased via an upfront course fee and integrated with university IT systems, with Jones County College, National University, Algonquin College and the University of Missouri system. We signed an expanded strategic partnership agreement with Southern New Hampshire University s (SNHU) College of Online and Continuing Education (COCE). Pearson will support curriculum development, online tutoring, enterprise wide content and data integration, eBooks with a print-on-demand option and data and analytics services which will provide greater visibility into students achievement of learning outcomes. The Charles A. Dana Center at The University of Texas at Austin is collaborating with Pearson to provide web-based course resources to Community Colleges across Texas that dramatically shorten the time it takes for students to earn college credit in mathematics as part of the New Mathways Project. Three courses were launched in 2015: Foundations Mathematical Reasoning, Statistics Reasoning and Quantitative Reasoning, with more planned in 2016. Pearson was named as the premier US Green Building Council Education Partner and will offer curriculum and course services to universities, associations, training companies, corporations, and workforce education and apprenticeship programs. We are partnering with Broward College to launch new competency-based workforce certification pathways focused on IT and Healthcare. Pearson will support Broward s strategy by providing 12 industry certifications with existing workforce education courseware, as well as curriculum development services to build new courses towards certification and the Acclaim badging platform.

Core

Sales in our Core markets decreased by £77m, or 9%, from £892m in 2014 to £815m in 2015 while adjusted operating profit decreased by £7m, or 6%, from £112m in 2014 to £105m in 2015. At constant exchange there was a decline in sales of 5% and a decline in profits of 1%. Acquisitions and disposals were not significant in the Core segment in either 2015 or 2014. Growth in Pearson Online Services in Australia, Wall Street English in Italy, Clinical Assessment in Germany and the Pearson Test of English in Australia was more than offset by revenue declines in UK qualifications as the business nears the end of a period of policy change, revenue declines at VUE, phasing and market weakness in Australian Higher Education courseware and the focusing of our UK school courseware on products that directly support Pearson Qualifications. Adjusted operating profit declines were due to lower revenue offset by tight cost control.

In our statutory results in 2015 we recognized an impairment to our goodwill of £37m mainly related to our English language teaching businesses in Europe.

Core courseware

In courseware, UK school revenue fell with growth in primary school more than offset by declines in secondary as the vocational market contracted and our upper secondary revenues were impacted by lower market participation as we focus on products that directly support our qualifications. More than 5,400 UK Schools now subscribe to at least one Bug Club service, our primary school blended reading program, representing growth of nearly 16% in the year. There are over 1.8 million pupils, more than 9,000 schools and 152,000 teachers currently using a service on ActiveLearn Primary. Italy revenues declined slightly with market share gains in

primary offset by market weakness and a lower share in upper secondary. Australia revenues declined, with growth and increased market share in primary more than offset by a weaker secondary market.

In higher education courseware, UK revenues declined, primarily due to a weak market. In Australia, revenues declined significantly due to phasing and market weakness.

Core assessment

In the UK, qualifications have been impacted by government policy, where changes to accountability measures have led to a further 20% decline in BTEC registrations in 2015. GCSE and GCE entries for summer 2015 grew modestly compared with 2014 resulting from increases in GCSE registrations in Sport, ICT and Business and strength in iGCSE entries. We successfully delivered the National Curriculum Test for 2015, marking 4 million scripts from 1.7 million students and successfully transitioned the marking of the test to an online-only model.

Clinical assessment grew well with Germany benefiting from strong growth in Kaufman *Assessment Battery for Children* (K-ABC), partly offset by declines in Australia after a strong year in 2014 driven by the release of Wechsler *Primary and Preschool Scale of Intelligence IV*.

The Pearson Test of English Academic (PTEA) saw strong growth in test volumes and revenues after gaining approval from the Australian Department of Immigration and Border Protection to administer a broad range of language tests linked to visa applications. Wall Street English revenues fell slightly with strong growth in Italy offset by declines in Germany.

Core services

In online services, our Australian University Partnerships business grew strongly with combined course enrolments of nearly 4,000 up 380% from 2014. The growth of our partnership with Monash University was led by the Graduate Diploma in Psychology, which is now one of Monash s largest postgraduate courses. Our new partnership with Griffith University started very strongly seeing consistent demand for the MBA program and the launch of two further courses. Kings College London partnered with Pearson to launch online postgraduate degree programs in Psychology and Law. Total enrolled students at Pearson College doubled to 232.

Growth

Growth sales decreased by £29m, or 4%, to £713m in 2015 from £742m in 2014. Adjusted operating profit decreased by £45m to a loss of £3m in 2015 from a £42m profit in 2014. At constant exchange rate sales were flat compared to 2014. In China, revenues grew modestly reflecting strong sales of premium services in our direct delivery English Language Learning businesses offset by list disposals. In Brazil, revenues were stable with good growth in private sistemas and language schools offset by declines in government funded sistemas and language schools. In South Africa, revenues declined significantly due to a smaller textbook adoption cycle and lower enrolments at CTI, due to a reduction in the number of qualified students graduating from high school and tightening consumer credit affecting re-enrolment rates. In the Middle East, our business was impacted by the withdrawal from the Saudi Colleges of Excellence contracts.

Adjusted operating profit decreased due to the strengthening of Sterling against key Emerging Market currencies, revenue declines in South Africa, a contract termination charge arising from the transition of our three Saudi Arabian Colleges of Excellence to new providers, cost inflation and additional investment in China; partially offset by the benefits of restructuring and integration in Brazil.

In our statutory results, reflecting the significant economic and market deterioration in the Group s operations in emerging markets, we wrote down the balance sheet value of our goodwill and intangibles for businesses in Growth markets by £530m. This represented impairments of £269m for Brazil, £181m for China,

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£58m for South Africa and £22m for other Growth markets. In 2014 we impaired intangible assets in our Indian business by £77m largely reflecting the reduced value of online tutoring which was primarily focused on the US market.

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

Growth courseware

In South Africa, there was continued pressure on Government spending on textbooks due to budget pressures, which resulted in the value of the textbook market falling 60% from a peak of R2.9bn in 2013 to an estimated R1.15bn in 2015. We continued to perform well competitively and maintained a leading market share.

In India, Higher Education courseware revenues grew strongly.

We launched around 30 new MyEnglishLab products including *Top Notch 3e* and *Progress*. MyTOEFLLab and the second edition of MyIELTSLab successfully launched in China in WSE and Global Education. Global student registrations for MyEnglishLab and other ELT digital courseware grew 14% to 739,000. Pearson Test of English grew strongly in India.

Growth services

In Brazil, sistemas revenues grew well with strong growth in private sistemas partly offset by declines in NAME, our public sistema, following the cancellation of a large contract as a result of government spending cuts. Overall sistema enrolments fell 7% to nearly 449,000 with declines in NAME partly offset by growth in our three private sistemas, led by our largest sistema, COC. More than half of COC schools that participated in the High School National Exam (ENEM) ranked among the top 3 schools in their municipalities.

In India, enrolments at our managed schools grew 14% to nearly 27,000 students and we launched a pilot in more than 60 schools of MyPedia, an inside service sistema solution for schools comprising print and digital content, assessments and academic support services. Middle East school courseware and professional development revenues grew strongly on improved distribution.

In South Africa, after strong growth over a number of years, student enrolments at CTI universities fell by 16% to 11,300 driven by a 13% decline in qualified graduating high school students and tightening consumer credit affecting re-enrolment rates. In Mexico, our fully accredited online university partnership, UTEL, increased the number of students enrolled by 34% to nearly 12,600.

Cornell University partnered with Pearson to launch the Cornell-ILR Experienced Managers Program in India, with a blended learning approach combining online and in-person instruction.

In the Middle East, our three-year partnership with Taibah University in Saudi Arabia, to enable its transformation to a fully blended and personalized learning model, is progressing with over 4,000 students enrolled in our solution in 2015. Our partnership with the Preparatory Year Deanship at Um Al Qura University (PYP-UQU) to provide online learning and assessment technology has delivered 13,000 MyMathLab, MyITLab and MasteringPhysics licences. We withdrew from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015. This resulted in a termination charge.

In China, Wall Street English (WSE) achieved strong revenue growth, reflecting success in the premium segment and the growth in VIP branded offerings. Overall enrolments grew modestly to over 67,000 with new enrolments growing strongly. We launched the New Student Experience (NSE) in six pilot centers during

December 2015. The NSE delivers a major upgrade to the Wall Street English service with adaptive, personalized learning incorporating Pearson s Global Scale of English. Global Education achieved moderate revenue growth as the market shifted to more intensive premium courses with smaller class sizes and new products, which resulted in enrolments declining 6.5% to 85,110.

Grupo Multi in Brazil saw strong revenue growth at Wizard, our consumer facing franchised English language learning business, but this was offset by declines in government orders due to public spending cuts. We opened 40 new school-in-school units for Multi English franchises in K-12 sistemas partner schools.

Penguin Random House

Pearson owns 47% of Penguin Random House the first truly global consumer book publishing company. Our share of Penguin Random House adjusted operating profits were £90m compared to £69m for 2014.

Penguin Random House had a strong performance in 2015, boosted by publication of hundreds of Adult and Children s bestsellers across its territories, including the fiction mega-successes of *Grey* and *The Girl on the Train*, which each sold over 7 million copies.

The U.S. business published 584 *New York Times* print and e-book bestsellers in 2015 (2014: 760, based on a broader New York Times title count than 2015). The division benefited from the multi-million copy successes of *Grey* by E L James and the Adult debut novel *The Girl on the Train* by Paula Hawkins. Children s authors who extended their outstanding sales in 2015 include Dr. Seuss, John Green, R.J. Palacio, James Dashner, Rick Yancey, Drew Daywalt, and Oliver Jeffers. Additional notable Adult titles include *The Life-Changing Magic of Tidying Up* by Marie Kondo; *Rogue Lawyer* by John Grisham; *Lost Ocean* by Johanna Basford; *Between The World and Me* by Ta-Nehisi Coates; and the movie tie-in paperback *The Martian* by Andy Weir.

The UK business published 201 titles on the *Sunday Times* bestseller lists (2014: 206). The division enjoyed outstanding sales for *Grey* and *The Girl on the Train*, which each sold more than 2 million copies, and for Harper Lee s *Go Set A Watchman* and Jamie Oliver s *Everyday Super Food*. Great demand continued for Jeff Kinney s *Diary of a Wimpy Kid* and John Green s titles, and for DK Publishing s Star Wars publications. Penguin Random House s promising 2016 publishing lists include new titles from Lisa Brennan-Jobs, Bill Bryson, Lee Child, Harlan Coben, Phil Collins, Janet Evanovich, Ina Garten, John Grisham, Jazz Jennings, Jeff Kinney, Marie Kondo, John le Carré, Jojo Moyes, Jamie Oliver, James Patterson, Nathaniel Philbrick, Pope Francis, Nora Roberts, John Sandford, Danielle Steel and Star Wars.

Penguin Random House completed the sale of Author Solutions, its supported self-publishing services company, to an affiliate of Najafi Companies, an international private-investment firm, on 31 December 2015, and sold its Australian online bookseller Bookworld to online retailer Booktopia in August 2015.

The integration of Penguin and Random House continued to provide net benefits through organizational alignments and systems and warehouse combinations in 2015, as well as for 2016 and thereafter. The North America warehouse consolidation was completed in February 2015, and in December, the UK business announced it will be gradually closing its Rugby distribution center and relocating its inventory to two other locations. The integration in Spain and Latin America of Santillana with Grupo Editorial Penguin Random House remains on course.

With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, on February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend. We will use proceeds from this action to maintain a strong balance sheet; invest in our business; and return excess capital to shareholders whilst retaining a solid investment grade credit rating.

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The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-77 to F-143.

Liquidity and capital resources

Cash flows and financing

Net cash generated from operations increased by £4m (or 1%) to £522m in 2016 from £518m in 2015 reflecting lower cash incentive payments and tight working capital partially offset by restructuring spend and higher pension deficit payments. Net cash generated from operations decreased by £186m (or 26%) to £518m in 2015 from £704m in 2014 reflecting the impact of lower sales, higher returns in US Higher Education and increased debtor days, primarily in North America.

Net interest paid in 2016 was the same as 2015 at £51m and reflects the similar interest charge for the year after taking out the one-off release of accrued interest in 2015 following agreement of historical tax positions. Net interest paid in 2015 was lower than 2014 at £51m reflecting lower interest on bonds (following repayments), lower average net debt and higher interest income on cash balances held in emerging markets.

Capital expenditure on property, plant and equipment and software intangibles was £245m in 2016, £247m in 2015 and £182m in 2014. The expenditure in 2016 on both tangible and intangible capital is largely attributed to the continuing investment in enabling function technology designed to lower administrative costs. The increase in 2015 was entirely due to investment in software and technology platforms as the Group sought to harmonize and expand its technology capabilities.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £15m in 2016 against £20m in 2015 and £460m in 2014. There were no major acquisitions in 2016 or 2015. The major acquisition in 2014 was of Grupo Multi for £437m.

The sale of subsidiaries and associates produced a net cash outflow of £50m compared to an inflow of £1,409m in 2015 and an inflow of £366m in 2014. There were no significant disposals of subsidiaries and associates in 2016. The cash outflow in 2016 relates primarily to the disposal of the FT Group in 2015. The cash inflow in 2015 relates to the proceeds on the sale of the *Financial Times* of £858m, the proceeds on the sale of The Economist Group of £377m and proceeds on the sale of PowerSchool £222m. The cash inflow in 2014 primarily relates to the proceeds on sale of Mergermarket of £375m, less associated costs.

The cash outflow from financing of £697m in 2016 reflects a broadly flat dividend payment compared to 2015 and the repayment of a $350m US Dollar note. The cash outflow from financing of £364m in 2015 reflects a further 7% increase in the dividend, the repayment of a £300m Sterling bond, offset in part by the proceeds from the issue of a 500m Euro note. The cash outflow from financing of £534m in 2014 reflects a 7% increase in the dividend, the repayment of a $400m US dollar bond and a £250m sterling bond, offset in part by proceeds from the issue of a 500m Euro note.

Capital resources

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

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At December 31, 2016, our net debt was £1,092m compared to £654m at December 31, 2015 reflecting the strengthening of the US Dollar relative to Sterling and restructuring costs paid. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash, cash equivalents and liquid resources. Cash equivalents comprise short-term deposits with a maturity of up to 90 days, while liquid resources comprise short-term deposits with maturities of more than 90 days and other marketable instruments which are readily realizable and held on a short-term basis. Total Short-term, medium-term and long-term borrowing amounted to £2,468m at December 31, 2016, compared to £2,330m at December 31, 2015 reflecting the repayment of a $350m US Dollar note and exchange movements (primarily the strengthening of the US dollar against Sterling). At December 31, 2016, total cash and liquid resources were £1,459m, compared to £1,703m at December 31, 2015. This decrease reflects the payment of restructuring costs and investment in capital expenditure.

To ensure efficient use of the cash balances we held at 31 December 2016, we announced that we will trigger the early repayment option on our $550m 6.25% Global dollar bonds 2018. These bonds were fully redeemed on March 28, 2017.

Contractual obligations

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

	At December 31, 2016				
	Total £m	**Less than one year £m**	**One to two years £m**	**Two to five years £m**	**After five years £m**
Gross borrowings:					
Bank loans, overdrafts and commercial paper	39	39			
Bonds	2,420		723	453	1,244
Finance lease obligations	9	5	3	1	
Operating lease obligations	1,322	174	147	340	661
UK Pension funding obligations	250	250			
Total	4,040	468	873	794	1,905

At December 31, 2016 the Group had capital commitments for fixed assets, including finance leases already under contract, of £9m (2015: £8m). There are contingent liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities in respect of legal and royalty claims. None of these claims or guarantees is expected to result in a material gain or loss.

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

Off-Balance sheet arrangements

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

Borrowings

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

We have in place a committed revolving credit facility of $1.75bn, which matures in August 2021. At December 31, 2016, the full $1.75bn was available under this facility. This credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

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

We must maintain the ratio of our rolling 12 month average net debt to our EBITDA, which we explain below, at no more than 4:1.

EBITDA refers to earnings before interest, taxes, depreciation and amortization. We are currently in compliance with these covenants.

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

Treasury policy

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

Related parties

There were no significant or unusual related party transactions in 2016, 2015 or 2014. Refer to note 35 in Item 18. Financial Statements .

Accounting principles

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

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ITEM 6. ***DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES***

Directors and senior management

We are managed by a board of directors and a chief executive who reports to the board and manages through an executive committee. We refer to the board of directors, the chairman of the board of directors and the executive committee as our senior management .

The following table sets forth information concerning directors, as of February 28, 2017.

Name	Age	Position
Sidney Taurel	68	Chairman
John Fallon	54	Chief Executive
Elizabeth Corley, CBE	60	Non-executive Director
Vivienne Cox, CBE	57	Senior Independent Director
Josh Lewis	54	Non-executive Director
Linda Lorimer	64	Non-executive Director
Harish Manwani	63	Non-executive Director
Tim Score	56	Non-executive Director
Lincoln Wallen	56	Non-executive Director
Coram Williams	43	Chief Financial Officer

Sidney Taurel

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

Sidney has over 40 years of experience in business and finance, and is currently a board director and chairman of the Compensation Committee at IBM Corporation. Sidney is an advisory board member at pharmaceutical firms Takeda Pharmaceutical and Almirall. He was chief executive officer of global pharmaceutical firm Eli Lilly and Company from 1998 until 2008, chairman of the business from 1999 until 2008, and has been chairman emeritus since 2009. He was also a director at McGraw-Hill Financial, Inc., a role which he held from 1996 until April 2016. Sidney has received three US presidential appointments to: the Homeland Security Advisory Council, the President s Export Council and the Advisory Committee for Trade Policy and Negotiations, and is an officer of the French Legion of Honour.

John Fallon

Appointed October 3, 2012.

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

Elizabeth Corley, CBE

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

Elizabeth is non-executive vice chair of Allianz Global Investors, where she was chief executive officer, initially for Europe then globally, from 2005 to 2016. She was previously at Merrill Lynch Investment Managers

and Coopers & Lybrand. Elizabeth is a director of the FICC Markets Standards Board, a member of the ESMA stakeholder group and the advisory council of TheCityUK. She is a non-executive director of BAE Systems plc and the Financial Reporting Council. In addition, she is a member of FEAM s management committee, the CFA Institute Board of Governors, the Committee of 200 and a trustee of the British Museum. She is a fellow of the CFA UK Society and the Royal Society of Arts and is also a crime fiction author.

Vivienne Cox, CBE

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

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

Josh Lewis

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

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

Linda Lorimer

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

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

Harish Manwani

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

Harish has an extensive background in emerging markets and senior experience in a successful global organization. He was previously chief operating officer of consumer products company Unilever, having joined the company in 1976 as a marketing management trainee in India, and held senior management roles around the world, including North America, Latin America, Europe, Africa and Asia. He is non-executive chairman of

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Hindustan Unilever Limited in India, and serves on the boards of Whirlpool Corporation, Qualcomm Inc. and Nielsen Holdings. He is also on the board of the Indian School of Business and the Economic Development Board (EDB) of Singapore, and is global executive advisor at Blackstone Private Equity.

Tim Score

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

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

Lincoln Wallen

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

Lincoln is CEO of DWA Nova, a software-as-a-service company born out of DreamWorks Animation Studios in Los Angeles. He has worked at DreamWorks Animation for nine years in a variety of roles including chief technology officer and head of animation technology. He was formerly CTO at Electronic Arts Mobile where he was instrumental in shaping EA s approach to the mobile business. Lincoln s early career involved 20 years of professional IT and mathematics research, including a reader in Computer Science at Oxford. Lincoln graduated from Durham University in 1981 with a BSc in Mathematics and Physics, before completing his PhD in Artificial Intelligence at the University of Edinburgh. Lincoln is a non-executive director of the Smith Institute, an advisory board member of Hewlett Packard Enterprise and a member of the STEM Advisory Committee of the National Academy foundation.

Coram Williams

Appointed August 1, 2015.

Coram joined Pearson in 2003 and has held a number of senior positions including finance and operations director for Pearson s English Language Teaching business in Europe, Middle East & Africa, interim president of Pearson Education Italia and head of financial planning and analysis for Pearson. In 2008 Coram became CFO of The Penguin Group and was latterly appointed CFO of Penguin Random House in 2013. Coram trained at Arthur Andersen, and subsequently worked in both the auditing and consulting practices of the firm. He is a non-executive director of the Guardian Media Group.

The following table sets forth information concerning the executive committee, as at February 28, 2017

Name	**Position**
Sir Michael Barber	Chief Education Advisor
Tim Bozik	President, Global Product
Rod Bristow	President, Core Markets
Kevin Capitani	President, North America
Giovanni Giovannelli	President, Growth Markets
Albert Hitchcock	Chief Technology and Operations Officer
Kate James	Chief Corporate Affairs and Global Marketing Officer
Bjarne Tellmann	General Counsel and Chief Legal Officer
Bob Whelan	President, Pearson Assessments
Melinda Wolfe	Chief Human Resources Officer

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Sir Michael Barber

Sir Michael is Chief Education Advisor at Pearson and is a leading authority on education systems and reform. He leads Pearson s worldwide program of research into education policy and efficacy, advising on and supporting the development of products and services that deliver efficacy and build on research findings. He leads Pearson s strategy for developing innovative educational models for low-income families in the developing world. Sir Michael is a Distinguished Visiting Fellow at Harvard and holds an honorary doctorate from the University of Exeter. His publications include Oceans of Innovation and An Avalanche is Coming.

Tim Bozik

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

Rod Bristow

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

Kevin Capitani

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

Giovanni Giovannelli

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

Albert Hitchcock

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

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Kate James

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

Bjarne Tellmann

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

Bob Whelan

Bob is President, Pearson Assessment and has significant expertise in assessment and growing businesses. As President and Chief Executive Officer of Pearson VUE since January 2000, Bob led Pearson s growth as a global leader in computer-based assessments. He now leads Pearson s combined assessments businesses including K12 and clinical assessment as well as Pearson VUE. Bob received his BA from the University of Alabama in finance and economics.

Melinda Wolfe

In September 2013, Melinda Wolfe joined Pearson, becoming the company s first Chief Human Resources Officer charged with renewing Pearson s focus on its people at a time of major transformation of its education business. Over her career, she has led talent initiatives with a passionate focus on diversity at global companies including Bloomberg, American Express and Goldman Sachs. She began her career at Merrill Lynch, managing billions of dollars of project finance and public power transactions for public and private sector clients over a 14-year period. Melinda is a board member of Auburn Seminary, the Center for Talent Innovation, Planned Parenthood of New York City and ZanaAfrica.

Compensation of senior management

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

The principal duties of the committee are to:

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

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

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

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

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

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

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

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

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

Remuneration policy

The 2017 directors remuneration policy (2017 policy) described below will be put to shareholders for binding vote at the Annual General Meeting to be held on 5 May 2017. Subject to shareholder approval, the effective date of this policy will be 5 May 2017. However, it is proposed, subject to approval at the AGM, that changes to executive director incentives be made effective from the start of the 2017 performance periods. The intention of the committee is that the policy will remain in place for three years from the date of its approval.

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

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives. Base salary helps to recruit, reward and retain people and reflects competitive market level, role, skills, experience and individual contribution. Allowances and benefits help to recruit and retain people and reflect the local competitive market. Retirement benefits help to recruit and retain people and recognize their long-term commitment to the company. Annual incentives motivate the achievement of annual strategic goals and personal objectives, provide focus on key financial metrics and reward individual contribution to the success of the company. Long-term incentives help to recruit, reward and retain people, drive long-term earnings, share price growth and value creation, align interests of executives and shareholders, encourage long-term shareholding and commitment to the company and link management s long-term reward and wealth to corporate performance in a flexible way.

For benchmarking purposes, we review remuneration by reference to different comparator groups. We look at survey data from: select UK human capital-intensive businesses and UK and US media convergence companies with a focus on media, information services and technology (and cross-referenced with FTSE 100 companies with significant international exposure). These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Willis Towers Watson, use to make comparisons on remuneration takes this variation in size into account. We also look at publicly disclosed and proxy data for global media convergence comparators with a focus on media and technology. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

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

Base salary

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

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

For benchmarking purposes, we review remuneration by reference to different comparator groups. We look at survey data from: select UK human capital-intensive businesses; and UK and US media convergence companies with a focus on digital, information services and technology.

These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Willis Towers Watson, use to make comparisons on remuneration takes this variation in size into account.

We also look at publicly disclosed and proxy data for global media convergence comparators with a focus on media and technology and consider base salary levels within the broader FTSE 100. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

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

No malus or claw back provisions apply to base salary.

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

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

Allowances and benefits

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

Allowances and benefits received in 2016 are set out in the annual remuneration report.

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

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

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

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

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

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

Retirement benefits

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

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

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

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

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

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at 6 April 2006, was abolished by the Finance Act 2004. However, the Pearson Group Pension Plan has retained its own cap , which will increase annually in line with the UK Government s Index of Retail Prices (All Items). The cap was £150,600 as at 6 April 2016.

UK executive directors who are, or become, affected by the lifetime allowance or new hires who opt out of membership of the Plan may be provided with a cash supplement of normally up to 26% of salary as an alternative to further accrual of pension benefits.

No malus or claw back provisions apply to retirement benefits.

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

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

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

The pension entitlements of each director are as follows:

John Fallon	Member of the Pearson Group Pension Plan with an accrual rate of 1/30th of pensionable salary per annum, restricted to the plan earnings cap (£150,600 per annum in 2016/17). Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS. There are no enhanced early retirement benefits.
Coram Williams	Member of the Pearson Group Pension Plan with an accrual rate of 1/60th of pensionable salary per annum , restricted to the plan earnings cap (£150,600 per annum in 2016/17), with continuous service with a service gap. There are no enhanced early retirement benefits.

Annual incentives

Annual incentive does not form part of pensionable earnings.

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

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

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

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

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

Annual incentives will not exceed 200% of base salary.

For the chief executive officer, the individual maximum incentive opportunity that will apply for 2017 is 180% of base salary and 170% for the chief financial officer (which are the same opportunities as applied for 2016).

There is normally no pay-out for performance at threshold.

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

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

The funding of annual incentives will normally be related to the performance against financial and strategic imperatives performance targets. For 2017 and onwards, financial metrics will normally account for at least 75% of the total annual opportunity and be related to the performance against targets for Pearson s adjusted earnings per share and/or operating profit, sales, and operating cash flow. For 2017, the weightings will be: adjusted earnings per share 22.5%, operating profit 22.5%, sales 15% and operating cash flow 15%. The remaining total annual opportunity will be subject to performance metrics linked to strategic imperatives set by the committee as it considers appropriate in each year. These will be linked to:

a) Competitive performance: Holding or gaining share in major markets Higher Education direct/ecommerce sales to consumers

b) Transformation: Delivery of Enabling Program milestones to upgrade the customer experience, accelerate the digital transformation and the delivery of on-going cost, efficiency and process transformations

c) Culture, talent & brand: Improvement in brand favorability and year-on-year improvement in employee engagement survey scores

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

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

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

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

The performance period is one year.

Long-term incentives

Awards of restricted shares are made on an annual basis.

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

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

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

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

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

The long-term incentive plan also provides for the grant of stock options. Whilst it is not the committee s intention to grant stock options in 2017 or the foreseeable future, the committee believes that it should retain the flexibility of granting stock options in addition to, or instead of, restricted stock awards in the right circumstances. Any decision by the committee to grant stock options in the future would take account of best practice prevailing at the time. The committee would consult with shareholders before granting stock options to executive directors.

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

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

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

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

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

Restricted share awards to executive directors may normally be made up to a maximum face value of 400% of base salary. Awards in excess of 400% of base salary (and up to 25% over the normal maximum limit) may be made in exceptional circumstances, for example, for retention purposes or to reflect particular business situations. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favor among those consulted.

The committee retains flexibility to make exceptional awards of up to 25% above the normal limit in specific circumstances. The reasons for any such exceptional awards will be disclosed in the annual report for the year in which they are made. The value of awards at pay-out is subject to the extent to which performance and any other conditions are met and the share price at the time of vesting.

Whilst it is not the committee s intention to grant stock options in 2017 or the foreseeable future, the maximum value of stock option awards would be the equivalent expected value of, and in place of, the maximum restricted share awards set out above, based on an independent assessment of their net present value taking into account all the conditions.

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

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

The proportion of the award that vests at threshold level of performance under each performance condition is 25%.

For 2017 and onwards, awards will normally be subject to the achievement of targets for earnings per share, return on invested capital and relative total shareholder return. For 2017, and following shareholder consultation, the weighting of the performance metrics within the Pearson long-term incentive plan will be changed to 40% earnings per share, 30% return on invested capital and 30% relative total shareholder return (previously, one half, one third and one sixth, respectively).

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

Total shareholder return (TSR) is the return to shareholders from any growth in Pearson s share price and reinvested dividends over the performance period. For long-term incentive awards made in 2017 and onwards, TSR will be measured relative to the constituents of the FTSE 100 over a three-year period. Companies that drop out of the index are normally excluded i.e. only companies in the index for the entire period are counted. Share price is averaged over three months at the start and end of the performance period. Dividends are treated as reinvested on the ex-dividend date, in line with the Datastream methodology. The vesting of shares based on relative TSR is subject to the committee satisfying itself that the recorded TSR is a genuine reflection of the underlying financial performance of the business.

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

Adjusted earnings per share (EPS) is calculated by dividing the adjusted earnings attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding any ordinary shares purchased by the company and held in trust (see note [8] of the financial statements for a detailed description of adjusted earnings per share).

The performance period is three years.

Shareholding policy

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

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

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

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Service agreements

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

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

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

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

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

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

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

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

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

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

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

Executive directors non-executive directorships

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

Coram Williams is engaged as a NED of Guardian Media Group plc under a letter of appointment dated 14 December 2016. Although he formally joined the board on 26 January 2017 his remuneration is payable from 1 January 2017 recognizing time spent in preparation and induction. His remuneration is at the rate of £34,000 p.a., rising to £39,000 p.a. from 1 April 2017 when he will become chair of the audit committee. In accordance with our policy, Coram is permitted to retain these fees.

Chairman s and non-executive directors remuneration

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

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

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

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

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

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

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

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

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

The chairman s fees were reviewed in 2017 and have not been increased since his appointment. Fees for the non-executive directors were last increased with effect from 1 May 2014. Following a review of fees paid to non-executive directors, the board has determined that most fees will remain unchanged, other than a small increase to apply to membership and chairmanship of the reputation and responsibility committee. A fee has also been introduced for the newly formed nomination & governance committee. These changes will take effect from the AGM on 5 May 2017, subject to the approval of this policy.

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

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

Notes:

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

Remuneration of senior management

The remuneration received by the chairman and executive directors in respect of the financial year ending December 31, 2016 was as follows:

	Base Salary/ Fees £000	Allowances & Benefits(1) £000	Annual Incentives £000	Long-term Incentives £000	Retirement Benefits £000	Total £000
Chairman						
Sidney Taurel	500	16				516
Executive directors						
John Fallon	780	85	343	0	310	1,518
Coram Williams	515	53	193		47	808
Senior management as a group	**1,795**	**154**	**536**	**0**	**357**	**2,842**

Notes:

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

Share options for senior management

This table sets forth for each director the number of share options held as of December 31, 2016 as well as the exercise price, rounded to the nearest whole pence/cent, and the range of expiration dates of these options.

Director	Expiry Date

	Number of Options	Exercise Price	Earliest Exercise Date	
John Fallon	**1,109**	**811.2p**	**01/08/17**	**01/02/18**

Notes:

(1) No variations to the terms and conditions of share options were made during the year.
(2) The acquisition of shares under the worldwide save for shares plan is not subject to a performance condition.

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(3) All share options that become exercisable during the year are included in the single figure of total remuneration for that year. The value included in the single figure of total remuneration is the number of options multiplied by the difference between the discounted option price and the market value on the earliest exercise date. No share options became exercisable in 2016.

(4) The market price on 31 December 2016 was 818.5p per share and the range during the year was 657.5p to 975p.

Share ownership of senior management

The table below shows the number of ordinary shares and conditional shares held by directors and their connected persons as at December 31, 2016. Additional information with respect to share options held by, and bonus awards for, these persons is set out above in Remuneration of Senior Management and Share Options of Senior Management . The total number of ordinary shares held by senior management as of December 31, 2016 was 399,601.

As at 31 December 2016	Ordinary Shares(1)	Conditional Shares(2)
Sidney Taurel	50,000	
John Fallon	303,056	613,000
Coram Williams	10,010	351,000
Elizabeth Corley	3,956	
Vivienne Cox	3,980	
Josh Lewis	9,214	
Linda Lorimer	4,099	
Harish Manwani	5,393	
Tim Score	7,990	
Lincoln Wallen	1,903	

Notes:

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

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

(2) The register of directors interests (which is open to inspection during normal office hours) contains full details of directors shareholdings and options to subscribe for shares. The market price on 31 December 2016 was 818.5p per share and the range during the year was 657.5p to 975p.

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

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

All figures in £ millions	2016
Short-term employee benefits	6
Retirement benefits	1
Share-based payment costs	1
Total	**8**

Employee share ownership plans

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

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

In the United States, this plan operates as a stock purchase plan under Section 423 of the US Internal Revenue Code of 1986. This plan was introduced in 2000 following Pearson s listing on the New York Stock Exchange. Under it, participants save a portion of their monthly salary over six month periods, at the end of which they have the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period. The maximum employee contribution under the plan is $1,000 per month.

Board practices

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

However in accordance with the UK Corporate Governance Code, the board has resolved that all directors should offer themselves for re-election on an annual basis at the company s annual general meeting. Accordingly, all of the directors will offer themselves for re-election, at the forthcoming annual general meeting on May 5, 2017.

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

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

Audit committee

This committee provides the board with a vehicle to appraise our financial management and reporting and to assess the integrity of our accounting procedures and financial controls. Tim Score chairs this committee and its other members are Elizabeth Corley, Vivienne Cox, Linda Lorimer and Lincoln Wallen. Tim Score is also the designated audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission. Our internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee.

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Remuneration committee

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

Nomination & governance committee

This committee meets as required to consider the appointment of new directors, review management development and succession plans and review corporate governance matters. The committee is chaired by Vivienne Cox and its other members are Elizabeth Corley, Josh Lewis, Harish Manwani, Tim Score and Sidney Taurel.

Reputation & responsibility committee

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

Employees

The average number of persons employed by us in continuing operations during each of the three fiscal years ended 2016 were as follows:

32,719 in fiscal 2016,

37,265 in fiscal 2015, and

38,654 in fiscal 2014.

We, through our subsidiaries, have entered into collective bargaining agreements with employees in various locations. Our management has no reason to believe that we would not be able to renegotiate any such agreements on satisfactory terms. We encourage employees to contribute actively to the business in the context of their particular job roles and believe that the relations with our employees are generally good.

The table set forth below shows for 2016, 2015 and 2014 the average number of persons employed in each of our segments.

Average number employed	**2016**	**2015**	**2014**
North America	16,841	19,951	20,927
Core	5,664	5,936	6,139
Growth	9,868	11,114	11,406
Other	364	264	182
Continuing operations	**32,719**	**37,265**	**38,654**

The average number employed in discontinued operations was nil in 2016, 2,282 in 2015, and 2,295 in 2014.

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

As at February 28, 2017, the company had been notified under the Financial Conduct Authority s Disclosure and Transparency Rules of the following significant voting rights in its shares:

Name of shareholder	Number of ordinary shares held	% of outstanding ordinary shares represented by number of shares held
Schroders plc	91,897,898	11.17%
BlackRock, Inc.	57,336,108	6.97%
Silchester International Investors LLP	41,437,136	5.04%
Lindsell Train Limited	41,393,237	5.035%
Ameriprise Financial Inc and its group	41,236,375	5.02%

On February 28, 2017, record holders with registered addresses in the United States held 33,992,062 ADRs, which represented 4.1% of our outstanding ordinary shares. Some of these ADRs are held by nominees and so these numbers may not accurately represent the number of shares beneficially owned in the United States.

Loans and equity advanced to joint ventures and associates during the year and as at December 31, 2016 are shown in note 12 in Item 18. Financial Statements. Dividends receivable from joint ventures and associates are set out in note 12 in Item 18. Financial Statements . There were no other related party transactions in 2016.

ITEM 8. ***FINANCIAL INFORMATION***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-143 hereof.

Other than those events described in note 36 in Item 18. Financial Statements of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to our financial condition or results of operations since December 31, 2016. Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements of the educational book business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December.

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

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

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

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

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

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

on an annual basis for our five most recent fiscal years,

on a quarterly basis for our most recent quarter and two most recent fiscal years, and

on a monthly basis for the six most recent months.

Reference period	Ordinary shares High (In pence)	Low	Average daily trading volume (Ordinary shares)
Five most recent fiscal years			
2016	975	657.5	3,515,000
2015	1508	695	2,928,500
2014	1341	998	2,499,900
2013	1365	1119	2,065,900
2012	1294	1111	2,174,000
Most recent quarter and two most recent fiscal years			
2016 Fourth quarter	832.5	726	3,898,200
Third quarter	975	726	3,652,000
Second quarter	967	784.5	2,931,300
First quarter	913	657.5	3,575,100
2015 Fourth quarter	1224	695	3,376,500
Third quarter	1275	1074	2,849,300
Second quarter	1471	1205	2,673,500
First quarter	1508	1140	2,802,000
Most recent six months			
February 2017	674	634.5	4,941,500
January 2017	818.5	573	6,179,700
December 2016	827.5	780.5	2,740,800
November 2016	795.5	726	3,624,400
October 2016	832.5	743	5,287,200
September 2016	880	726	4,340,900

ITEM 10. ***ADDITIONAL INFORMATION***

Articles of association

We summarize below the material provisions of our articles of association, as amended, which have been filed as an exhibit to our annual report on Form 20-F for the year ended December 31, 2016. The summary below is qualified entirely by reference to the Articles of Association. We have multiple business objectives and purposes and are authorized to do such things as the board may consider fit to further our interests or incidental or conducive to the attainment of our objectives and purposes.

Directors powers

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

Interested directors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Borrowing powers

The board of Directors may exercise all powers to borrow money and to mortgage or charge our undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as

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collateral security for any of our or any third party s debts, liabilities or obligations. The board of directors must restrict the borrowings in order to secure that the aggregate amount of undischarged monies borrowed by us (and any of our subsidiaries), but excluding any intra-group debts, shall not at any time (without the previous sanction of the Company in the form of an ordinary resolution) exceed a sum equal to twice the aggregate of the adjusted capital and reserves.

Other provisions relating to directors

Under the articles of association, directors are paid out of our funds for their services as we may from time to time determine by ordinary resolution and, in the case of non-executive directors, up to an aggregate of £750,000 or such other amounts as resolved by the shareholders at a general meeting. Any Director who is not an Executive Director and who performs special services which in the opinion of the Board are outside the scope of the ordinary duties of a Director, may be paid such extra remuneration by way of additional fee, salary, commission or otherwise as the Board may determine in accordance with our remuneration policy. Under the articles of association, Directors currently are not required to hold any share qualification. However, our remuneration policy mandates a shareholding guideline for executive directors which they are expected to build towards over a specified period.

Annual general meetings

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

- approving final dividends;
- consideration of the accounts and balance sheet;
- ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;
- as holders of ordinary shares vote for the election of one-third of the members of the board of directors at every annual general meeting, the appointment or election of directors in the place of those retiring by rotation or otherwise. Notwithstanding the provisions of the Articles, the board has resolved that all directors should offer themselves for re-election annually, in accordance with the UK Corporate Governance Code;
- appointment or reappointment of, and determination of the remuneration of, the auditors; and
- the renewal, limitation, extension, variation or grant of any authority to the board in relation to the allotment of securities.

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

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

If a quorum for a meeting convened at the request of shareholders is not present within fifteen minutes of the appointed time, the meeting will be dissolved. In any other case, the general meeting will be adjourned to the same day in the next week, at the same time and place, or to a time and place that the chairman fixes. If at that rescheduled meeting a quorum is not present within fifteen minutes from the time appointed for holding the meeting, the shareholders present in person or by proxy will be a quorum. The chairman or, in his absence, the deputy chairman or any other

director nominated by the board, will preside as chairman at every general meeting.

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If no director is present at the general meeting or no director consents to act as chairman, the shareholders present shall elect one of their number to be chairman of the meeting.

Share Certificates

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

Share capital

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

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

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

Changes in capital

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

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

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

Voting rights

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

- the chairman of the meeting;
- at least three shareholders present in person or by proxy and entitled to vote;

any shareholder or shareholders present in person or by proxy representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting; or

any shareholder or shareholders present in person or by proxy holding shares conferring a right to vote at the meeting being shares on which the aggregate sum paid up is equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

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Dividends

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

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

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

Liquidation rights

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

Other provisions of the articles of association

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

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

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

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

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

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Limitations affecting holders of ordinary shares or ADSs

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

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

Material contracts

Pearson has not entered into any contracts outside the ordinary course of business during the two-year period immediately preceding the date of this Form 20-F. The Trust Deed entered into in 2015 with respect to 500.0 million aggregate principal amount of 1.375% guaranteed notes due 2025, issued by a subsidiary and guaranteed by Pearson, is filed as Exhibits 2.6 of this report.

Executive employment contracts

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

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

Exchange controls

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

Tax considerations

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

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

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

- dealers or traders in securities or currencies,
- financial institutions or other US holders that treat income in respect of the ordinary shares or ADSs as financial services income,
- insurance companies,
- tax-exempt entities,
- persons acquiring shares or ADSs in connection with employment,
- US holders that hold the ordinary shares or ADSs as a part of a straddle or conversion transaction or other arrangement involving more than one position,
- US holders that own, or are deemed for US tax purposes to own, 10% or more of the total combined voting power of all classes of our voting stock,
- US holders that have a principal place of business or tax home outside the United States, or
- US holders whose functional currency is not the US dollar.

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

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

Because US and UK tax consequences may differ from one holder to the next, the discussion set out below does not purport to describe all of the tax considerations that may be relevant to you and your particular situation. Accordingly, you are advised to consult your own tax advisor as to the US federal, state and local, UK and other, including foreign, tax consequences of investing in the ordinary shares or ADSs. Except where otherwise indicated, the statements of US and UK tax law set out below are based on the laws, interpretations and tax authority practice in force or applicable as of February 28, 2017, and are subject to any changes occurring after that date, possibly with retroactive effect.

UK income taxation of distributions

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

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

US income taxation of distributions

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

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

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

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

UK taxation of capital gains

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

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

US income taxation of capital gains

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

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

Estate and gift tax

The current Estate and Gift Tax Convention, or the Convention, between the US and the UK generally relieves from UK Inheritance Tax (the equivalent of US Estate and Gift Tax) the transfer of ordinary shares or of

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

Stamp duty

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

Following litigation, HM Revenue & Customs (HMRC) has accepted that it will no longer seek to apply the 1.5% SDRT charge when new shares are issued to a clearance service or depositary receipt system on the basis that the charge is not compatible with EU law. HMRC s view is that the 1.5% SDRT or stamp duty charge will continue to apply to transfers of shares into a clearance service or depositary receipt system, unless they are an integral part of an issue of share capital. This view is currently being challenged in further litigation. **Accordingly, specific professional advice should be sought before paying the 1.5% SDRT or stamp duty charge in any circumstances. The position may also be affected by the UK s proposed departure from the EU.**

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

Close company status

We believe that the close company provisions of the UK Corporation Tax Act 2010 do not apply to us.

Documents on display

Copies of our Memorandum and Articles of Association and filed as exhibits to this Annual Report and certain other documents referred to in this Annual Report are available for inspection at our registered office at 80 Strand, London WC2R 0RL (c/o the Company Secretary), or, in the US, at the registered office of Pearson Inc. at 330 Hudson Street, New York, New York, during usual business hours upon reasonable prior request.

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

Pearson s treasury function has primary responsibility for managing certain financial risks to which the Group is exposed. The group s treasury policies are approved by the board of Directors annually and the audit committee

receives regular reports on the Group s treasury activities, policies and procedures. Pearson s treasury function is not run as a profit center and does not enter into any transactions for speculative purposes. The treasury function is permitted to use derivatives for risk management purposes which may include interest rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts, of which interest rate swaps and forward foreign exchange swaps are the most commonly used.

Capital risk

The Group s objectives when managing capital are:

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

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

Interest and foreign exchange rate management

The Group s principal currency exposure is to the US dollar which represents more than 60% of the Group s sales. The Group s long-term bond debt is held in US dollars to provide a natural hedge of this exposure and is primarily held at floating rates which is achieved in two ways:

1. Issuing fixed rate US dollar bonds which are swapped to floating rates using interest rate swaps and;

2. Issuing fixed rate euro bonds which are swapped to US dollars and floating rates using cross-currency interest rate swaps.

Interest rate swaps are then used to fix an element of the interest charge for the next 12-24 months, in line with our interest rate hedging policy, which requires a proportion of the Group s gross debt to be fixed. At 31 December 2016, the group had contracts to fix $800m of debt for the next 12 months (2015: $850m).

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

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

Liquidity and re-financing risk management

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

At 31 December 2016, the Group had cash of £1.5 billion and an undrawn US dollar denominated revolving credit facility due 2021 of $1.75 billion (£1.4 billion). At 31 December 2015, the Group had cash of over £1.7 billion and an undrawn revolving credit facility due 2020 of $1.75 billion (£1.2 billion). The $1.75 billion facility contains interest cover and leverage covenants which the Group has complied with for the year ended 31 December 2016.

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Financial counterparty risk management

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

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

Fees paid by ADR holders

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

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

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

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

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

The Company received $50,000 as reimbursement from the depositary with respect to 2016 for standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing the proxy voting materials, and tabulation for the non-registered holders, any applicable performance indicators relating to the ADR facility, and legal fees).

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

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

PART II

ITEM 13. *DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES*

None.

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

None.

ITEM 15. *CONTROLS AND PROCEDURES*

Disclosure controls and procedures

An evaluation of the effectiveness our disclosure controls and procedures as of December 31, 2016 was carried out by management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures (as defined in Rules 13a- 15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as at December 31, 2016 at a reasonable assurance level. A controls system, no matter how well designed and operated, cannot provide absolute assurance to achieve its objectives.

Management s annual report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, and effected by the Company board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management has assessed the effectiveness of internal control over financial reporting as of December 31, 2016 based on the framework in *Internal Control Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management has concluded that the Company s internal control over financial reporting was effective as a December 31, 2016 based on criteria in *Internal Control Integrated Framework* (2013) issued by the COSO.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the effectiveness of the Company s internal control over financial reporting as of December 31, 2016, as stated in their report which appears on page F-2.

Change in internal control over financial reporting

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

ITEM 16A.*AUDIT COMMITTEE FINANCIAL EXPERT*

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

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

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

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

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

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

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

The following table sets forth remuneration paid to PwC for 2016 and 2015:

Auditors Remuneration	**2016 £m**	**2015 £m**
Audit fees	7	6
Tax fees		1
All other fees	2	3

Audit fees include £35,000 (2015: £35,000) of audit fees relating to the audit of the parent company.

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

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

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

Not applicable.

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

Period	**Total number of shares purchased**	**Average price paid per share**	**Total number of units purchased as part of publicly announced plans or programs**	**Maximum number of shares that may yet be purchased under the plans or programs**
February 1, 2013 February 28, 2013	1,000,000	£ 11.64	N/A	N/A
April 1, 2013 April 30, 2013	1,000,000	£ 11.53	N/A	N/A
June 1, 2013 June 30, 2013	1,972,725	£ 11.61	N/A	N/A
September 1, 2013 September 30, 2013	139,192	£ 12.57	N/A	N/A
April 1, 2014 April 30, 2014	906,892	£ 10.18	N/A	N/A

July 1, 2015	July 31, 2015	1,974,362	£	11.81	N/A	N/A
August 1, 2016	August 31, 2016	3,000,000	£	8.92	N/A	N/A

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Purchases of shares were made to satisfy obligations under Pearson employee share award programs. All purchases were made in open-market transactions. None of the foregoing share purchases was made as part of a publicly announced plan or program.

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

Not applicable.

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

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

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

Not applicable.

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PART III

ITEM 17. ***FINANCIAL STATEMENTS***

Not applicable.

ITEM 18. ***FINANCIAL STATEMENTS***

The financial statements filed as part of this Annual Report are included on pages F-1 through F-143 hereof.

ITEM 19. ***EXHIBITS***

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

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

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Pearson plc Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Pearson plc

In our opinion, the accompanying consolidated balance sheets and the related consolidated income statements, statements of comprehensive income, statements of changes in equity and cash flow statements present fairly in all material respects, the financial position of Pearson plc and its subsidiaries at December 31, 2016 and December 31, 2015 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with International Financial Reporting Standards as adopted by the European Union. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Annual Report on Internal Control Over Financial Reporting appearing under Item 15 of this Form 20-F. Our responsibility is to express opinions on these financial statements and on the Group s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and International Standards on Auditing. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control base on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

/s/PricewaterhouseCoopers LLP

London

United Kingdom

April 3, 2017

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Pearson plc Consolidated Financial Statements

Consolidated income statement

Year ended 31 December 2016

All figures in £ millions	Notes	**2016**	2015	2014
Sales	2	**4,552**	4,468	4,540
Cost of goods sold	4	**(2,093)**	(1,981)	(2,021)
Gross profit		**2,459**	2,487	2,519
Operating expenses	4	**(2,505)**	(2,094)	(2,125)
Impairment of intangible assets	11	**(2,548)**	(849)	(77)
Share of results of joint ventures and associates	12	**97**	52	31
Operating (loss)/profit	2	**(2,497)**	(404)	348
Finance costs	6	**(97)**	(100)	(140)
Finance income	6	**37**	71	47
(Loss)/profit before tax		**(2,557)**	(433)	255
Income tax	7	**222**	81	(56)
(Loss)/profit for the year from continuing operations		**(2,335)**	(352)	199
Profit for the year from discontinued operations	3		1,175	271
(Loss)/profit for the year		**(2,335)**	823	470
Attributable to:				
Equity holders of the company		**(2,337)**	823	471
Non-controlling interest		**2**		(1)
(Loss)/earnings per share from continuing and discontinued operations attributable to equity holders of the company during the year (expressed in pence per share)				
basic	8	**(286.8)p**	101.2p	58.1p
diluted	8	**(286.8)p**	101.2p	58.0p
(Loss)/earnings per share from continuing operations attributable to equity holders of the company during the year (expressed in pence per share)				
basic	8	**(286.8)p**	(43.3)p	24.7p
diluted	8	**(286.8)p**	(43.3)p	24.6p

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Pearson plc Consolidated Financial Statements

Consolidated statement of comprehensive income

Year ended 31 December 2016

All figures in £ millions	Notes	**2016**	2015	2014
(Loss)/profit for the year		**(2,335)**	823	470
Items that may be reclassified to the income statement				
Net exchange differences on translation of foreign operations Group		**910**	(85)	150
Net exchange differences on translation of foreign operations associates		**3**	16	25
Currency translation adjustment disposed Group			(10)	(2)
Attributable tax	7	**(5)**	5	(6)
Items that are not reclassified to the income statement				
Remeasurement of retirement benefit obligations Group	25	**(268)**	110	23
Remeasurement of retirement benefit obligations associates		**(8)**	8	(15)
Attributable tax	7	**58**	(24)	(1)
Other comprehensive income for the year		**690**	20	174
Total comprehensive (expense)/income for the year		**(1,645)**	843	644
Attributable to:				
Equity holders of the company		**(1,648)**	845	645
Non-controlling interest		**3**	(2)	(1)

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Pearson plc Consolidated Financial Statements

Consolidated balance sheet

As at 31 December 2016

All figures in £ millions	Notes	**2016**	2015
Assets			
Non-current assets			
Property, plant and equipment	10	**343**	320
Intangible assets	11	**3,442**	5,164
Investments in joint ventures and associates	12	**1,247**	1,103
Deferred income tax assets	13	**451**	276
Financial assets derivative financial instruments	16	**171**	78
Retirement benefit assets	25	**158**	337
Other financial assets	15	**65**	143
Trade and other receivables	22	**104**	115
		5,981	7,536
Current assets			
Intangible assets pre-publication	20	**1,024**	841
Inventories	21	**235**	211
Trade and other receivables	22	**1,357**	1,284
Financial assets derivative financial instruments	16		32
Financial assets marketable securities	14	**10**	28
Cash and cash equivalents (excluding overdrafts)	17	**1,459**	1,703
		4,085	4,099
Total assets		**10,066**	11,635
Liabilities			
Non-current liabilities			
Financial liabilities borrowings	18	**(2,424)**	(2,048)
Financial liabilities derivative financial instruments	16	**(264)**	(136)
Deferred income tax liabilities	13	**(466)**	(560)
Retirement benefit obligations	25	**(139)**	(139)
Provisions for other liabilities and charges	23	**(79)**	(71)
Other liabilities	24	**(422)**	(356)
		(3,794)	(3,310)
Current liabilities			
Trade and other liabilities	24	**(1,629)**	(1,390)
Financial liabilities borrowings	18	**(44)**	(282)
Financial liabilities derivative financial instruments	16		(29)
Current income tax liabilities		**(224)**	(164)
Provisions for other liabilities and charges	23	**(27)**	(42)
		(1,924)	(1,907)
Total liabilities		**(5,718)**	(5,217)

Net assets	**4,348**	6,418

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All figures in £ millions	Notes	2016	2015
Equity			
Share capital	27	**205**	205
Share premium	27	**2,597**	2,590
Treasury shares	28	**(79)**	(72)
Translation reserve		**905**	(7)
Retained earnings		**716**	3,698
Total equity attributable to equity holders of the company		**4,344**	6,414
Non-controlling interest		**4**	4
Total equity		**4,348**	6,418

These financial statements have been approved for issue by the board of directors on 14 March 2017 and signed on its behalf by

Coram Williams

Chief financial officer

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Pearson plc Consolidated Financial Statements

Consolidated statement of changes in equity

Year ended 31 December 2016

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

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

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	Equity attributable to equity holders of the company							
All figures in £ millions	Share capital	Share premium	Treasury shares	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
At 1 January 2014	205	2,568	(98)	(103)	3,128	5,700	6	5,706
Profit for the year					471	471	(1)	470
Other comprehensive income				173	1	174		174
Total comprehensive income				173	472	645	(1)	644
Equity-settled transactions					32	32		32
Tax on equity-settled transactions					(3)	(3)		(3)
Issue of ordinary shares under share option schemes		11				11		11
Purchase of treasury shares			(9)			(9)		(9)
Release of treasury shares			32		(32)			
Changes in non-controlling interest							2	2
Dividends					(397)	(397)	(1)	(398)
At 31 December 2014	205	2,579	(75)	70	3,200	5,979	6	5,985

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. Changes in non-controlling interest in 2016 relate to the buy-back of a non-controlling interest in our South African business. Changes in non-controlling interest in 2014 relate to the disposal of a non-controlling interest in a Chinese business.

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Pearson plc Consolidated Financial Statements

Consolidated cash flow statement

Year ended 31 December 2016

All figures in £ millions	Notes	**2016**	2015	2014
Cash flows from operating activities				
Net cash generated from operations	32	**522**	518	704
Interest paid		**(67)**	(75)	(86)
Tax paid		**(45)**	(232)	(163)
Net cash generated from operating activities		**410**	211	455
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	30	**(15)**	(9)	(448)
Acquisition of joint ventures and associates			(11)	(12)
Purchase of investments		**(6)**	(7)	(3)
Purchase of property, plant and equipment		**(88)**	(86)	(75)
Purchase of intangible assets		**(157)**	(161)	(107)
Disposal of subsidiaries, net of cash disposed	31	**(54)**	1,030	327
Proceeds from sale of associates		**4**	379	39
Proceeds from sale of investments		**92**	13	9
Proceeds from sale of property, plant and equipment	32	**4**	2	9
Proceeds from sale of intangible assets			1	2
Proceeds from sale of liquid resources		**42**	17	12
Loans repaid by related parties		**14**	7	(10)
Loans advanced				(2)
Investment in liquid resources		**(24)**	(29)	(22)
Interest received		**16**	24	13
Dividends received from joint ventures and associates		**131**	162	120
Net cash (used in)/received from investing activities		**(41)**	1,332	(148)
Cash flows from financing activities				
Proceeds from issue of ordinary shares	27	**7**	11	11
Purchase of treasury shares	28	**(27)**	(23)	(9)
Proceeds from borrowings		**4**	372	404
Repayment of borrowings		**(249)**	(300)	(538)
Finance lease principal payments		**(6)**	(1)	(4)
Transactions with non-controlling interest		**(2)**		
Dividends paid to non-controlling interest				(1)
Dividends paid to company s shareholders	9	**(424)**	(423)	(397)
Net cash used in financing activities		**(697)**	(364)	(534)
Effects of exchange rate changes on cash and cash equivalents		**81**	(19)	(2)
Net (decrease)/increase in cash and cash equivalents		**(247)**	1,160	(229)
Cash and cash equivalents at beginning of year		**1,671**	511	740
Cash and cash equivalents at end of year	17	**1,424**	1,671	511

The consolidated cash flow statement includes discontinued operations (see note 3).

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements

General information

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

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

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

These consolidated financial statements were approved for issue by the board of directors on 14 March 2017.

1. Accounting policies

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

a. Basis of preparation

These consolidated financial statements have been prepared on the going concern basis and in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. In respect of the accounting standards applicable to the Group there is no difference between EU-adopted and IASB-adopted IFRS.

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) to fair value through profit or loss.

1. Interpretations and amendments to published standards effective 2016 The following amendments and interpretations were adopted in 2016:

- Amendments to IAS 19 Employee Benefits Annual Improvements 2012-2014 cycle

- Amendments to IAS 16 Property Plant and Equipment and IAS 38 Intangible Assets Clarification of Acceptable Methods of Depreciation ans Amortisation

- Amendments to IAS 1 Presentation of Financial Statements Disclosure Initiative

In April 2016 the IFRS Interpretations Committee (IFRS IC) rejected a request to add to its agenda an item concerning cash pooling arrangements, specifically addressing when and whether particular cash pooling arrangements would meet the requirements for offsetting in accordance with IAS 32 Financial Instruments: Presentation . After consideration of the IFRS IC rejection notice, Pearson has settled many of the balances within its cash pooling arrangements during the first half of 2016 and has chosen to show any residual balances within these arrangements gross in the balance sheet at 31 December 2016. Pearson has considered the prior year comparatives in light of this guidance, and has concluded that those balances at 31 December 2015 that would not meet these requirements for net treatment are immaterial for restatement in the context of the overall presentation of the Group s balance sheet at this date.

The adoption of these new pronouncements from 1 January 2016 does not have a material impact on the consolidated financial statements.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

2. Standards, interpretations and amendments to published standards that are not yet effective The Group has not early adopted the following new pronouncements that are not yet effective:

IFRS 9 Financial Instruments , effective for annual reporting periods beginning on or after 1 January 2018. The new standard details the requirements for the classification, measurement and recognition of financial assets and liabilities, and makes changes to the current disclosure framework. Management is in the process of assessing the impact of IFRS 9 on the Group, in particular the new guidelines around hedging and the impairment of financial assets.

IFRS 15 Revenue from Contracts with Customers , effective for annual reporting periods beginning on or after 1 January 2018. The new standard specifies how and when an entity will recognise revenue and requires more detailed disclosures. Management continues to assess the impact of IFRS 15 on the Group. The implementation of IFRS 15 is complex due to the number of different revenue streams that the Group has and due to the fact that the Group s business model is continuing to evolve from print based products to digital based products and services. Based on work completed to date, management does not expect IFRS 15 to have a material impact on the amount of revenue to be recognised, however, there could be an impact on the timing of revenue recognition due to enhanced guidance around what constitutes a performance obligation. This may impact the split of revenue between periods within any given year and also between years.

Some of the key impacts of IFRS 15 on current revenue streams are as follows:

Courseware revenue from contracts related to the delivery of online content, to which customers have access for a period of time, is currently recognised evenly over that period of time. Under IFRS 15 the definition of a performance obligation may result in that same revenue being recognised at a point in time at the start of the contract although this would depend on the related hosting obligations.

Assessments revenue from certain assessments contracts is currently recognised over the period of time between a student signing up for the qualification and the point at which they complete and receive that qualification. Under IFRS 15 the definition of a performance obligation may result in that same revenue being recognised at points in time when certain activities are completed with the main focus being on the receipt of the final qualification.

Services revenue from certain direct delivery contracts is currently recognised over the period of service delivery. The current revenue recognition methodology may involve the use of assumptions around items such as average usage of online content, the average length of time to complete course modules and the average student drop-out rate. Under IFRS 15 there is enhanced guidance which may impact how these types of assumptions are calculated.

Management is currently favouring the modified retrospective transition method (sometimes called the cumulative catch-up transition method). Using this method would mean that the cumulative effect of initially applying IFRS 15 would be recognised as an adjustment to the opening balance sheet in the period of initial application. Comparative prior periods would not be adjusted. Additional disclosures would also be presented in the year of initial application to explain the impact of IFRS 15. If the modified retrospective transition method is used then management is also likely to elect to apply the practical expedient for completed contracts. Using this method would not prevent the Group from disclosing the impact on comparative years in narrative format.

IFRS 16 Leases , effective for annual reporting periods beginning on or after 1 January 2019. The new standard details the requirements for the classification, measurement and recognition of lease arrangements. Adoption of the new standard is likely to have an impact on the Group and management is currently assessing the impact.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

a. Basis of preparation continued

IAS 7 Statement of Cash Flows , effective for annual reporting periods beginning on or after 1 January 2017. The amendments to disclosure requirements aims to assist users of financial statements to evaluate changes in an entity s liabilities arising from financing activities. The Group is currently confirming the impacts of the new requirements which are not expected to be material.

In June 2015 the IASB issued an exposure draft ED/2015/5 Remeasurement on a Plan Amendment, Curtailment or Settlement/ Availability of a Refund from a Defined Benefit Plan (Proposed Amendments to IAS 19 and IFRIC 14). Management are currently evaluating these proposals and although the proposals have not yet been finalised, it should be noted that the current draft, if adopted, may restrict the Group s ability to recognise a pension asset in respect of pension surpluses in its UK defined benefit pension plan. In addition, the current draft may require certain elements of committed minimum funding contributions to be recognised as a liability on the balance sheet.

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

Consolidation: Business combinations classification of investments

Intangible assets: Goodwill

Intangible assets: Pre-publication assets

Taxation

Revenue recognition including provisions for returns

Employee benefits: Pensions

Consolidation: Business combinations determination of fair values (where relevant)

b. Consolidation

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

The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred in the operating expenses line of the income statement.

Identifiable assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The determination of fair values often requires significant judgements and the use of estimates, and, for material acquisitions, the fair value of the acquired intangible assets is determined by an independent valuer. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill.

See note 1e(1) for the accounting policy on goodwill. If this is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

b. Consolidation continued

On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest s proportionate share of the acquiree s net assets.

IFRS 3 Business Combinations has not been applied retrospectively to business combinations before the date of transition to IFRS.

Management exercises judgement in determining the classification of its investments in its businesses, in line with the following:

2. Subsidiaries Subsidiaries are entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

3. Transactions with non-controlling interests Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions, that is, as transactions with the owners in their capacity as owners. Any surplus or deficit arising from disposals to a non-controlling interest is recorded in equity. For purchases from a non-controlling interest, the difference between consideration paid and the relevant share acquired of the carrying value of the subsidiary is recorded in equity.

4. Joint ventures and associates Joint ventures are entities in which the Group holds an interest on a long-term basis and has rights to the net assets through contractually agreed sharing of control. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Ownership percentage is likely to be the key indicator of investment classification, however, other factors, such as board representation, may also affect the accounting classification. Judgement is required to assess all of the qualitative and quantitative factors which may indicate that the Group does, or does not, have significant influence over an investment. Penguin Random House is the Group s only material associate see note 12 for further details on the judgements involved in its accounting classification. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at the fair value of consideration transferred.

The Group s share of its joint ventures and associates post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves.

The Group s share of its joint ventures and associates results is recognised as a component of operating profit as these operations form part of the core publishing business of the Group and are an integral part of existing wholly-owned businesses. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group s share of losses in a joint venture or associate equals or exceeds its interest in the joint venture or associate, the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the joint venture or associate.

5. Contribution of a subsidiary to an associate or joint venture The gain or loss resulting from the contribution or sale of a subsidiary to an associate or a joint venture is recognised in full. Where such transactions do not involve cash consideration, significant judgements and estimates are used in determining the fair values of the consideration received.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

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.

3. Group companies The results and financial position of all Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

i) Assets and liabilities are translated at the closing rate at the date of the balance sheet

ii) Income and expenses are translated at average exchange rates

iii) All resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders equity. The Group treats specific inter-company loan balances, which are not intended to be repaid in the foreseeable future, as part of its net investment. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.33 (2015: $1.53) and the year end rate was $1.23 (2015: $1.47).

d. Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for intended use. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives as follows:

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

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

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

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets

1. Goodwill For the acquisition of subsidiaries made on or after 1 January 2010, goodwill represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired. For the acquisition of subsidiaries made from the date of transition to IFRS to 31 December 2009, goodwill represents the excess of the cost of an acquisition over the fair value of the Group s share of the net identifiable assets acquired. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisition of associates and joint ventures represents the excess of the cost of an acquisition over the fair value of the Group s share of the net identifiable assets acquired. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

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

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

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

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

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

5. Pre-publication assets Pre-publication assets represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating life cycle of the title, with a higher proportion of the amortisation taken in the earlier years.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

e. Intangible assets continued

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

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

f. Other financial assets

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

g. Inventories

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

h. Royalty advances

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realisable value of author contracts is overstated, this will have an adverse effect on operating profits as these excess amounts will be written off.

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors.

The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non-current assets.

i. Cash and cash equivalents

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

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

i. Cash and cash equivalents continued

Short-term deposits and marketable securities with maturities of greater than three months do not qualify as cash and cash equivalents and are reported as financial assets. Movements on these financial assets are classified as cash flows from financing activities in the cash flow statement where these amounts are used to offset the borrowings of the Group or as cash flows from investing activities where these amounts are held to generate an investment return.

j. Share capital

Ordinary shares are classified as equity.

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

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.

k. Borrowings

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

l. Derivative financial instruments

Derivatives are recognised at fair value and remeasured at each balance sheet date. The fair value of derivatives is determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

l. Derivative financial instruments continued

Changes in the fair value of derivatives are recognised immediately in finance income or costs. However, derivatives relating to borrowings and certain foreign exchange contracts are designated as part of a hedging transaction. The accounting treatment is summarised below:

Typical reason for designation	Reporting of gains and losses on effective portion of the hedge	Reporting of gains and losses on disposal
Net investment hedge		
The derivative creates a foreign currency liability which is used to hedge changes in the value of a subsidiary which transacts in that currency.	Recognised in other comprehensive income.	On disposal the accumulated value of gains and losses reported in other comprehensive income is transferred to the income statement.
Fair value hedges		
The derivative transforms the interest profile on debt from fixed rate to floating rate. Changes in the value of the debt as a result of changes in interest rates are offset by equal and opposite changes in the value of the derivative. The Group s debt is all swapped to floating rates and the contracts used are designated as fair value hedges.	Gains and losses on the derivative are reported in finance income or finance costs. However, an equal and opposite change is made to the carrying value of the debt (a fair value adjustment) with the benefit/cost reported in finance income or finance costs. The net result should be a zero charge on a perfectly effective hedge.	If the debt and derivative are disposed of, the value of the derivative and the debt (including the fair value adjustment) are reset to zero. Any resultant gain or loss is recognised in finance income or finance costs.
Non-hedge accounted contracts		
These are not designated as hedging instruments. Typically these are short-term contracts to convert debt back to fixed rates or foreign exchange contracts where a natural offset exists.	No hedge accounting applies.	

m. Taxation

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

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

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

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

m. Taxation continued

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

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

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on management s judgement of the application of tax legislation and best estimates of future settlement amounts. 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.

n. Employee benefits

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

When the calculation results in a potential asset, the recognition of that asset is limited to the asset ceiling that is the present value of any economic benefits available in the form of refunds from the plan or a reduction in future contributions. Management uses judgement to determine the level of refunds available from the plan in recognising an asset.

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

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. Net interest is calculated by applying the discount rate to the net defined benefit obligation and is presented as finance costs or finance income.

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

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

n. Employee benefits continued

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

3. Share-based payments The fair value of options or shares granted under the Group s share and option plans is recognised as an employee expense after taking into account the Group s best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised.

o. Provisions

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

The Group recognises a provision for deferred consideration. Where this is contingent on future performance or a future event, judgement is exercised in establishing the fair value.

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

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

p. Revenue recognition

The Group s revenue streams are courseware, assessments and services. Courseware includes curriculum materials provided in book form and/or via access to digital content. Assessments includes test development, processing and scoring services provided to governments, educational institutions, corporations and professional bodies. Services includes the operation of schools, colleges and universities, including sistemas in Brazil and English language teaching centres around the world as well as the provision of online learning services in partnership with universities and other academic institutions.

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

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

Revenue from the sale of off-the-shelf software is recognised on delivery or on installation of the software where that is a condition of the contract. In certain circumstances, where installation is complex, revenue is recognised

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

p. Revenue recognition continued

when the customer has completed their acceptance procedures. Where software is provided under a term licence, revenue is recognised on a straight-line basis over the period of the license.

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

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials or online access with textbooks and multiple deliverables within testing or service contracts, revenue is recognised for each element as if it were an individual contractual arrangement requiring the estimation of its relative fair value.

On certain contracts, where the Group acts as agent, only commissions and fees receivable for services rendered are recognised as revenue. Any third-party costs incurred on behalf of the principal that are rechargeable under the contractual arrangement are not included in revenue.

Income from recharges of freight and other activities which are incidental to the normal revenue generating activities is included in other income.

q. Leases

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

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

r. Dividends

Final dividends are recorded in the Group s financial statements in the period in which they are approved by the company s shareholders. Interim dividends are recorded when paid.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

1. Accounting policies continued

s. Discontinued operations

A discontinued operation is a component of the Group s business that represents a separate major line of business or geographical area of operations that has been disposed of or meets the criteria to be classified as held for sale.

Discontinued operations are presented in the income statement as a separate line and are shown net of tax.

t. Assets and liabilities held for sale

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

u. Trade receivables

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

2. Segment information

The primary segments for management and reporting are geographies as outlined below. In addition, the Group separately discloses the results from the Penguin Random House (PRH) associate.

The chief operating decision-maker is the Pearson Executive.

Continuing operations:

North America Courseware, Assessments and Services businesses in US and Canada.

Core Courseware, Assessments and Services businesses in more mature markets including UK, Australia and Italy.

Growth Courseware, Assessments and Services businesses in emerging markets including Brazil, China, India and South Africa. The results of the FT Group segment (to 30 November 2015) are shown as discontinued in 2015 and 2014.

The results for 2015 and 2014 have been restated to reflect minor changes in management responsibilities between the geographies which were effective from 1 January 2016.

For more detail on the services and products included in each business segment refer to item 4.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

					2016			
All figures in £ millions	**Notes**	**North America**	**Core**	**Growth**	**PRH**	**Corporate**	**Discontinued operations**	**Group**
Continuing operations								
Sales		**2,981**	**803**	**768**				**4,552**
Adjusted operating profit/(loss)		**420**	**57**	**29**	**129**			**635**
Intangible charges		**(2,684)**	**(16)**	**(33)**	**(36)**			**(2,769)**
Cost of major restructuring		**(172)**	**(62)**	**(95)**	**(9)**			**(338)**
Acquisition costs								
Other net gains and losses		**(12)**	**(12)**	**(1)**				**(25)**
Operating (loss)/profit		**(2,448)**	**(33)**	**(100)**	**84**			**(2,497)**
Finance costs	6							**(97)**
Finance income	6							**37**
Loss before tax								**(2,557)**
Income tax	7							**222**
Loss for the year from continuing operations								**(2,335)**
Segment assets		**4,859**	**1,461**	**859**		**1,640**		**8,819**
Joint ventures	12			**2**				**2**
Associates	12	**1**	**4**		**1,240**			**1,245**
Total assets		**4,860**	**1,465**	**861**	**1,240**	**1,640**		**10,066**
Other segment items								
Share of results of joint ventures and associates	12	**(1)**	**1**	**(1)**	**98**			**97**
Capital expenditure	10, 11	**153**	**42**	**51**				**246**
Pre-publication investment	20	**235**	**92**	**68**				**395**
Depreciation	10	**56**	**12**	**27**				**95**
Amortisation	11, 20	**394**	**109**	**116**				**619**
Impairment	11	**2,548**						**2,548**

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

		2015 Restated						
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
Continuing operations								
Sales		2,940	815	713				4,468
Adjusted operating profit/(loss)		480	105	(3)	90			672
Intangible charges		(386)	(79)	(583)	(41)			(1,089)
Cost of major restructuring								
Acquisition costs								
Other net gains and losses		19	(5)		(1)			13
Operating (loss)/profit		113	21	(586)	48			(404)
Finance costs	6							(100)
Finance income	6							71
Loss before tax								(433)
Income tax	7							81
Loss for the year from continuing operations								(352)
Segment assets		6,399	1,573	719		1,841		10,532
Joint ventures	12	1		3				4
Associates	12		6		1,093			1,099
Total assets		6,400	1,579	722	1,093	1,841		11,635
Other segment items								
Share of results of joint ventures and associates	12	(9)		(3)	64		16	68
Capital expenditure	10, 11	136	42	50			15	243
Pre-publication investment	20	218	63	66				347
Depreciation	10	42	9	18			6	75
Amortisation	11, 20	338	95	109			15	557
Impairment	11	282	37	530				849

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

				2014 Restated				
All figures in £ millions	Notes	North America	Core	Growth	PRH	Corporate	Discontinued operations	Group
Continuing operations								
Sales		2,906	892	742				4,540
Adjusted operating profit		444	112	42	69			667
Intangible charges		(108)	(21)	(132)	(54)			(315)
Cost of major restructuring								
Acquisition costs		(2)	(1)	(3)				(6)
Other net gains and losses		2						2
Operating profit/(loss)		336	90	(93)	15			348
Finance costs	6							(140)
Finance income	6							47
Profit before tax								255
Income tax	7							(56)
Profit for the year from continuing operations								199
Other segment items								
Share of results of joint ventures and associates	12		(1)	(3)	35		20	51
Depreciation	10	41	10	16			7	74
Amortisation	11, 20	306	99	121			16	542
Impairment	11			77				77

There were no material inter-segment sales in 2014, 2015 or 2016.

Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables our investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income and expenditure relating to acquisition and disposal transactions. In our adjusted operating profit we have excluded other net gains and losses, acquisition costs, amortization and impairment of acquired intangibles and the cost of major restructuring.

The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. We do not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within our adjusted operating profit measure. In 2016, intangible charges include the impairment of goodwill in the North American business of £2,548m (see note 11). In 2015, intangible charges included an impairment of goodwill and intangibles in our North American business of £282m, our Core business of £37m and our Growth business of £530m. In 2014 intangible charges include an impairment of goodwill and intangibles of £77m relating to our Growth business in India.

Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

understand the underlying trend in the performance of the Group. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are excluded from adjusted operating profit as they distort the performance of the Group. In 2016, the losses in the Core segment mainly relate to the closure of English language schools in Germany and in the North America segment to the sale of the Pearson English Business Solutions business. Other net gains and losses in 2015 in the North America segment is the profit on disposal of PowerSchool net of small losses on other investments. Included in other gains and losses in 2014 are gains on sale of joint venture interests in Safari Books online and CourseSmart and a loss on the sale of an investment in Nook Media.

In 2016, the definition of adjusted operating profit has been amended to exclude the costs of major restructuring activity. In January 2016, Pearson announced that it was embarking on a restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. The costs of this program in 2016 are significant enough to exclude from our adjusted operating profit measure so as to better highlight the underlying performance. Total restructuring in 2016 amounted to £338m and includes costs associated with headcount reductions, property rationalisation and closure or exit from certain systems, platforms, products and supplier and customer relationships. There was no major restructuring in either 2015 or 2014 and accordingly the change has no effect on the comparative adjusted operating profit.

Corporate costs are allocated to business segments including discontinued operations on an appropriate basis depending on the nature of the cost and therefore the total segment result is equal to the Group operating profit.

Segment assets, excluding corporate assets, consist of property, plant and equipment, intangible assets, inventories, receivables, deferred taxation and other financial assets and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and software (see notes 10 and 11).

Property, plant and equipment and intangible assets acquired through business combination were £10m (2015: £1m) (see note 30).

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Notes to the consolidated financial statements continued

2. Segment information continued

The following tables analyse the Group s revenue streams. Courseware includes curriculum materials provided in book form and/or via access to digital content. Assessments includes test development, processing and scoring services provided to governments, educational institutions, corporations and professional bodies. Services includes the operation of schools, colleges and universities, including sistemas in Brazil and English language teaching centres around the world as well as the provision of online learning services in partnership with universities and other academic institutions. School Systems includes PowerSchool and Family Education Network, both of which were disposed during 2015.

	2016			
All figures in £ millions	**North America**	**Core**	**Growth**	**Group**
Courseware				
School Courseware	**418**	**173**	**127**	**718**
Higher Education Courseware	**1,147**	**92**	**60**	**1,299**
English Courseware	**21**	**65**	**97**	**183**
	1,586	**330**	**284**	**2,200**
Assessments				
School and Higher Education Assessments	**378**	**268**	**21**	**667**
Clinical Assessments	**143**	**40**		**183**
Professional and English Certification	**333**	**112**	**49**	**494**
	854	**420**	**70**	**1,344**
Services				
School Services	**259**	**6**	**54**	**319**
Higher Education Services	**269**	**29**	**46**	**344**
English Services	**13**	**18**	**314**	**345**
School Systems				
	541	**53**	**414**	**1,008**
Total	**2,981**	**803**	**768**	**4,552**

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Notes to the consolidated financial statements continued

2. Segment information continued

	2015 restated			
All figures in £ millions	North America	Core	Growth	Group
Courseware				
School Courseware	406	178	112	696
Higher Education Courseware	1,207	94	57	1,358
English Courseware	22	65	84	171
	1,635	337	253	2,225
Assessments				
School and Higher Education Assessments	420	296	20	736
Clinical Assessments	126	32		158
Professional and English Certification	269	95	37	401
	815	423	57	1,295
Services				
School Services	209	1	47	257
Higher Education Services	223	26	70	319
English Services	18	28	286	332
School Systems	40			40
	490	55	403	948
Total	2,940	815	713	4,468

	2014 restated			
All figures in £ millions	North America	Core	Growth	Group
Courseware				
School Courseware	389	201	133	723
Higher Education Courseware	1,179	112	68	1,359
English Courseware	22	80	83	185
	1,590	393	284	2,267
Assessments				
School and Higher Education Assessments	416	309	17	742
Clinical Assessments	115	34		149
Professional and English Certification	228	100	16	344
	759	443	33	1,235
Services				
School Services	253		56	309

Higher Education Services	215	22	90	327
English Services	20	34	279	333
School Systems	69			69
	557	56	425	1,038
Total	2,906	892	742	4,540

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

2. Segment information continued

The Group operates in the following main geographic areas:

		Sales		Non-current assets	
All figures in £ millions	**2016**	2015	2014	**2016**	2015
Continuing operations					
UK	**393**	421	444	**946**	991
Other European countries	**255**	246	281	**134**	121
US	**2,829**	2,800	2,762	**3,351**	5,000
Canada	**118**	107	109	**268**	235
Asia Pacific	**632**	590	565	**205**	211
Other countries	**325**	304	379	**232**	144
Total continuing	**4,552**	4,468	4,540	**5,136**	6,702
Discontinued operations					
UK		134	170		
Other European countries		64	66		
US		72	68		
Canada		2	1		
Asia Pacific		35	34		
Other countries		5	4		
Total discontinued		312	343		
Total	**4,552**	4,780	4,883	**5,136**	6,702

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. The geographical split of non-current assets is based on the subsidiary s country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates and trade and other receivables.

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Notes to the consolidated financial statements continued

3. Discontinued operations

There are no discontinued operations in 2016. All discontinued operations in 2015 and 2014 relate to the FT Group (including the Group s 50% share in the Economist), Penguin and Mergermarket. An analysis of the results and cash flows of discontinued operations is as follows:

	2016	2015		2014			
All figures in £ millions	**Total**	FT Group	Total	Penguin	Mergermarket	FT Group	Total
Sales		312	312		9	334	343
Operating profit		48	48		2	50	52
Finance income/(costs)							
Profit before tax		48	48		2	50	52
Income tax		(8)	(8)		(1)	(7)	(8)
Profit after tax		40	40		1	43	44
Profit on disposal of Penguin				29			29
Attributable tax benefit							
Profit on disposal of The Economist		473	473				
Profit on disposal of Financial Times		711	711				
Attributable tax expense		(49)	(49)				
Mergermarket transaction costs							
Profit on disposal of Mergermarket					244		244
Attributable tax expense					(46)		(46)
Profit for the year from discontinued operations		1,175	1,175	29	199	43	271
Operating cash flows		31	31		2	24	26
Investing cash flows		3	3			(5)	(5)
Financing cash flows							
Total cash flows		34	34		2	19	21

Included in cost of disposal for Penguin for 2013 was a provision for amounts payable to Bertelsmann upon settlement of the transfer of Penguin s UK past service pension liabilities to the new PRH venture. During 2014, it was decided that this transfer would not go ahead as planned and the costs have been credited back in the £29m gain reported against the disposal in 2014.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

4. Operating expenses

All figures in £ millions	2016	2015	2014
By function:			
Cost of goods sold	**2,093**	1,981	2,021
Operating expenses			
Distribution costs	**88**	80	84
Selling, marketing and product development costs	**908**	895	931
Administrative and other expenses	**1,240**	1,195	1,168
Restructuring costs	**329**	35	64
Other net gains and losses	**25**	(13)	(2)
Other income	**(85)**	(98)	(120)
Total net operating expenses	**2,505**	2,094	2,125
Impairment of intangible assets	**2,548**	849	77
Total	**7,146**	4,924	4,223

Included in other income is service fee income from Penguin Random House of £4m (2015: £16m, 2014: £41m). Included in administrative and other expenses are research and efficacy costs of £23m (2015: £33m, 2014: £22m). In addition to the restructuring costs shown above there were restructuring costs in Penguin Random House of £9m (2015: £12m, 2014: £19m).

All figures in £ millions	Notes	2016	2015	2014
By nature:				
Royalties expensed		**264**	249	242
Other product costs		**616**	566	620
Employee benefit expense	5	**1,888**	1,742	1,832
Contract labour		**206**	182	183
Employee related expense		**122**	127	136
Promotional costs		**217**	163	149
Depreciation of property, plant and equipment	10	**95**	69	67
Amortisation of intangible assets pre-publication	20	**350**	281	292
Amortisation of intangible assets software	11	**84**	61	51
Amortisation of intangible assets other	11	**185**	199	184
Impairment of intangible assets	11	**2,548**	849	77
Property and facilities		**243**	219	204
Technology and communications		**188**	153	123
Professional and outsourced services		**378**	262	253
Other general and administrative costs		**140**	132	121
Costs capitalised to intangible assets		**(318)**	(219)	(195)
Acquisition costs				6
Other net gains and losses		**25**	(13)	(2)
Other income		**(85)**	(98)	(120)

Total	**7,146**	4,924	4,223

Other net gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets. In 2016, the losses in the Core segment mainly relate to the closure of English language schools in Germany and in the North America segment to the sale of the Pearson English Business Solutions

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

4. Operating expenses continued

business. Included in other net gains and losses within continuing operations in 2015 in the North America segment is the profit on disposal of PowerSchool net of small losses on other investments.

Included in other net gains and losses in continuing operations in 2014 are gains on the sale of joint venture interests in Safari Books Online and CourseSmart (£40m) and a loss on disposal of an investment in Nook Media (£38m).

During the year the Group obtained the following services from the Group s auditors:

All figures in £ millions	2016	2015	2014
The audit of parent company and consolidated financial statements	**5**	4	5
The audit of the company s subsidiaries	**2**	2	2
Total audit fees	**7**	6	7
Other assurance services	**1**	2	1
Other non-audit services	**1**	1	
Total other services	**2**	3	1
Tax compliance services		1	1
Total tax services		1	1
Total non-audit services	**2**	4	2
Total	**9**	10	9

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

All figures in £ millions	2016	2015	2014
Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act	**7**	6	7
Non-audit fees	**2**	4	2
Total	**9**	10	9

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

Included in non-audit fees are amounts related to carve out audits for disposals of £1m (2015: £1m, 2014: £nil).

5. Employee information

All figures in £ millions	Notes	**2016**	2015	2014
Employee benefit expense				
Wages and salaries (including termination benefits)		**1,661**	1,507	1,607
Social security costs		**124**	124	122
Share-based payment costs	26	**22**	26	32
Retirement benefits defined contribution plans	25	**67**	66	61
Retirement benefits defined benefit plans	25	**16**	19	21
Other post-retirement medical benefits	25	**(2)**		(11)
Total		**1,888**	1,742	1,832

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Notes to the consolidated financial statements continued

5. Employee information continued

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

Average number employed	2016	2015	2014
Employee numbers			
North America	**16,841**	19,951	20,927
Core	**5,664**	5,936	6,139
Growth	**9,868**	11,114	11,406
Other	**346**	264	182
Continuing operations	**32,719**	37,265	38,654

The employee benefit expense relating to discontinued operations was £nil (2015: £132m, 2014: £151m) and the average number employed was nil (2015: 2,282, 2014: 2,295).

6. Net finance costs

All figures in £ millions	Notes	2016	2015	2014
Interest payable		**(74)**	(61)	(81)
Net foreign exchange losses		**(21)**	(36)	(53)
Derivatives not in hedging relationships		**(2)**	(3)	(6)
Finance costs		**(97)**	(100)	(140)
Interest receivable		**15**	15	17
Net finance income in respect of retirement benefits	25	**11**	4	1
Net foreign exchange gains		**1**	43	17
Derivatives not in hedging relationships		**10**	9	12
Finance income		**37**	71	47
Net finance costs		**(60)**	(29)	(93)
Analysed as:				
Net interest payable reflected in adjusted earnings		**(59)**	(46)	(64)
Other net finance (costs)/income		**(1)**	17	(29)
Total net finance costs		**(60)**	(29)	(93)

Included in interest receivable is £1m (2015: £1m, 2014: £1m) of interest receivable from related parties. There was a net movement of £nil on fair value hedges in 2016 (2015: £nil, 2014: £nil), comprising a loss of £4m (2015: gain of £22m, 2014: loss of £27m) on the underlying bonds, off set by a gain of £4m (2015: loss of £22m, 2014: gain of £27m) on the related derivative financial instruments.

Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

7. Income tax

All figures in £ millions	Notes	**2016**	2015	2014
Current tax				
Charge in respect of current year		**(71)**	(155)	(96)
Adjustments in respect of prior years		**32**	42	30
Total current tax charge		**(39)**	(113)	(66)
Deferred tax				
In respect of temporary differences		**277**	185	8
Other adjustments in respect of prior years		**(16)**	9	2
Total deferred tax credit	13	**261**	194	10
Total tax credit		**222**	81	(56)

The adjustments in respect of prior years in 2016 primarily arise from revising the previous year s reporting to reflect the tax returns subsequently filed. This results in a change between deferred and current tax as well as an absolute benefit to the total tax charge. In addition there is a benefit from changes in estimates of uncertain tax positions. In 2015 and 2014 the adjustments mainly related to changes in estimates of uncertain tax positions following the agreement of historical tax positions.

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

All figures in £ millions	**2016**	2015	2014
(Loss)/profit before tax	**(2,557)**	(433)	255
Tax calculated at UK rate (2016: 20%, 2015: 20.25%)	**511**	88	(55)
Effect of overseas tax rates	**424**	52	(10)
Joint venture and associate income reported net of tax	**19**	10	7
Intangible impairment not subject to tax	**(722)**	(60)	(23)
Net (expense)/income not subject to tax	**(16)**	(6)	12
Gains and losses on sale of businesses not subject to tax	**15**	(32)	
Unutilised tax losses	**(25)**	(22)	(19)
Adjustments in respect of prior years	**16**	51	32
Total tax credit/(charge)	**222**	81	(56)
UK	**46**	(25)	
Overseas	**176**	106	(56)
Total tax credit/(charge)	**222**	81	(56)
Tax rate reflected in earnings	**8.7%**	18.7%	22.0%

Factors which may affect future tax charges include changes in tax legislation, transfer pricing regulations, the level and mix of profitability in different countries, and settlements with tax authorities.

In 2016 the Group impaired US goodwill (see note 11). The majority of this impairment charge is not deductible for tax purposes. In 2015, the impairment of goodwill and intangibles was deductible for tax purposes in the majority of territories.

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Notes to the consolidated financial statements continued

7. Income tax continued

The tax benefit/(charge) recognised in other comprehensive income is as follows:

All figures in £ millions	2016	2015	2014
Net exchange differences on translation of foreign operations	**(5)**	5	(6)
Remeasurement of retirement benefit obligations	**58**	(24)	(1)
	53	(19)	(7)

A tax charge of £nil (2015: tax charge £1m, 2014: tax charge £3m) relating to share-based payments has been recognised directly in equity.

8. Earnings per share

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares.

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares. In 2016, the Group has outstanding share options which are anti-dilutive but which could potentially dilute basic earnings per share in the future.

All figures in £ millions	Notes	2016	2015	2014
Loss for the year from continuing operations		**(2,335)**	(352)	199
Non-controlling interest		**(2)**		1
Earnings from continuing operations		**(2,337)**	(352)	200
Profit for the year from discontinued operations	3		1,175	271
Earnings		**(2,337)**	823	471
Weighted average number of shares (millions)		**814.8**	813.3	810.9
Effect of dilutive share options (millions)				1.0
Weighted average number of shares (millions) for diluted earnings		**814.8**	813.3	811.9
(Loss)/earnings per share from continuing and discontinued operations				
Basic		**(286.8)p**	101.2p	58.1p
Diluted		**(286.8)p**	101.2p	58.0p

(Loss)/earnings per share from continuing operations			
Basic	**(286.8)p**	(43.3)p	24.7p
Diluted	**(286.8)p**	(43.3)p	24.6p
Earnings per share from discontinued operations			
Basic		144.5p	33.4p
Diluted		144.5p	33.4p

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Notes to the consolidated financial statements continued

9. Dividends

All figures in £ millions	2016	2015	2014
Final paid in respect of prior year 34.0p (2015: 34.0p, 2014: 32.0p)	**277**	277	259
Interim paid in respect of current year 18.0p (2015: 18.0p, 2014: 17.0p)	**147**	146	138
	424	423	397

The directors are proposing a final dividend in respect of the financial year ended 31 December 2016 of 34.0p per share which will absorb an estimated £278m of shareholders funds. It will be paid on 12 May 2017 to shareholders who are on the register of members on 7 April 2017. 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 2015	388	601	29	1,018
Exchange differences	8	10	1	19
Additions	15	42	25	82
Disposals	(20)	(86)		(106)
Disposal through business disposal	(48)	(76)		(124)
Reclassifications	16	17	(33)	
At 31 December 2015	359	508	22	889
Exchange differences	**44**	**83**	**2**	**129**
Additions	**26**	**59**	**4**	**89**
Disposals	**(26)**	**(100)**		**(126)**
Disposal through business disposal	**(1)**	**(2)**		**(3)**
Reclassifications	**(4)**	**12**	**(8)**	
At 31 December 2016	**398**	**560**	**20**	**978**

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Notes to the consolidated financial statements continued

10. Property, plant and equipment continued

All figures in £ millions	Land and buildings	Plant and equipment	Assets in course of construction	Total
Depreciation				
At 1 January 2015	(231)	(453)		(684)
Exchange differences	(5)	(12)		(17)
Charge for the year	(22)	(53)		(75)
Disposals	18	82		100
Disposal through business disposal	48	59		107
At 31 December 2015	(192)	(377)		(569)
Exchange differences	**(26)**	**(62)**		**(88)**
Charge for the year	**(34)**	**(61)**		**(95)**
Disposals	**22**	**95**		**117**
Reclassifications	**1**	**(1)**		
At 31 December 2016	**(229)**	**(406)**		**(635)**
Carrying amounts				
At 1 January 2015	157	148	29	334
At 31 December 2015	167	131	22	320
At 31 December 2016	**169**	**154**	**20**	**343**

Depreciation expense of £21m (2015: £19m, 2014: £16m) has been included in the income statement in cost of goods sold and £74m (2015: £50m, 2014: £51m) in operating expenses. In 2016 £nil (2015: £6m, 2014: £7m) 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 £10m (2015: £8m).

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Notes to the consolidated financial statements continued

11. Intangible assets

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Cost							
At 1 January 2015	5,030	597	894	308	197	598	7,624
Exchange differences	105	17	25	(17)	(7)	(40)	83
Impairment	(826)						(826)
Additions internal development		125					125
Additions purchased		36					36
Disposals		(18)		(4)	(10)	(29)	(61)
Acquisition through business combination						1	1
Disposal through business disposal	(175)	(138)	(59)	(6)		(21)	(399)
At 31 December 2015	4,134	619	860	281	180	509	6,583
Exchange differences	**752**	**85**	**157**	**65**	**31**	**135**	**1,225**
Impairment	**(2,548)**						**(2,548)**
Additions internal development		**132**					**132**
Additions purchased		**25**					**25**
Disposals		**(49)**	**(37)**				**(86)**
Acquisition through business combination	**3**			**7**		**3**	**13**
Disposal through business disposal			**(6)**			**(47)**	**(53)**
Transfer to intangible assets pre-publication		**(14)**					**(14)**
At 31 December 2016	**2,341**	**798**	**974**	**353**	**211**	**600**	**5,277**

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

11. Intangible assets continued

All figures in £ millions	Goodwill	Software	Acquired customer lists, contracts and relationships	Acquired trademarks and brands	Acquired publishing rights	Other intangibles acquired	Total
Amortisation							
At 1 January 2015		(386)	(349)	(122)	(160)	(297)	(1,314)
Exchange differences		(14)	(8)	1	6	(6)	(21)
Impairment			(13)	(1)	(9)		(23)
Charge for the year		(74)	(99)	(40)	(10)	(53)	(276)
Disposals		18		4	10	29	61
Disposal through business disposal		99	39	3		13	154
At 31 December 2015		(357)	(430)	(155)	(163)	(314)	(1,419)
Exchange differences		**(60)**	**(83)**	**(32)**	**(27)**	**(75)**	**(277)**
Impairment							
Charge for the year		**(84)**	**(85)**	**(22)**	**(8)**	**(70)**	**(269)**
Disposals		**38**	**37**				**75**
Disposal through business disposal			**6**			**47**	**53**
Transfer to intangible assets pre-publication		**2**					**2**
At 31 December 2016		**(461)**	**(555)**	**(209)**	**(198)**	**(412)**	**(1,835)**
Carrying amounts							
At 1 January 2015	5,030	211	545	186	37	301	6,310
At 31 December 2015	4,134	262	430	126	17	195	5,164
At 31 December 2016	**2,341**	**337**	**419**	**144**	**13**	**188**	**3,442**

Goodwill

The goodwill carrying value of £2,341m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen (i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower. For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets which are amortised.

Other intangible assets

Other intangibles acquired include content, technology and software rights.

Intangible assets are valued separately for each acquisition and the primary method of valuation used is the discounted cash flow method. The majority of acquired intangibles are amortised using an amortisation profile based on the projected cash flows underlying the acquisition date valuation of the intangible asset, which

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Notes to the consolidated financial statements continued

11. Intangible assets continued

Other intangible assets continued

generally results in a larger proportion of amortisation being recognised in the early years of the asset s life. The Group keeps the expected pattern of consumption under review.

Amortisation of £17m (2015: £13m, 2014: £12m) is included in the income statement in cost of goods sold and £252m (2015: £247m, 2014: £222m) in operating expenses. In 2016, £nil (2015: £16m, 2014: £15m) of amortisation relates to discontinued operations.

The range of useful economic lives for each major class of intangible asset (excluding goodwill and software) is shown below:

Class of intangible asset	2016 Useful economic life
Acquired customer lists, contracts and relationships	**3 20 years**
Acquired trademarks and brands	**2 20 years**
Acquired publishing rights	**5 20 years**
Other intangibles acquired	**2 20 years**

The expected amortisation profile of acquired intangible assets is shown below:

All figures in £ millions	2016 One to five years	Six to ten years	More than ten years	Total
Class of intangible asset				
Acquired customer lists, contracts and relationships	**282**	**102**	**35**	**419**
Acquired trademarks and brands	**69**	**48**	**27**	**144**
Acquired publishing rights	**11**	**2**		**13**
Other intangibles acquired	**139**	**45**	**4**	**188**

Impairment tests for cash-generating units (CGUs) containing goodwill

Impairment tests have been carried out where appropriate as described below.

Following a reorganisation of the business effective 1 January 2014 goodwill was allocated to CGUs, or an aggregation of CGUs, where goodwill could not be reasonably allocated to individual business units. Impairment reviews were conducted on these CGUs. The carrying value of the goodwill in each of the CGUs, after the impact of impairments, is summarised below:

All figures in £ millions	2016	2015
North America	**1,295**	3,155
Core	**633**	635
Growth (includes Brazil, China, India and South Africa)		
Pearson VUE	**413**	344
Financial Times Group		

Total	**2,341**	4,134

The recoverable amount of each aggregated cash generating unit (CGU) is based on fair value less costs of disposal or value in use calculations as appropriate. Goodwill is tested at least annually for impairment. Other

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Notes to the consolidated financial statements continued

11. Intangible assets continued

Impairment tests for cash-generating units (CGUs) containing goodwill continued

than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially sensitive to exchange rate fluctuations.

At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the US higher education courseware business market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, strategic plans and estimates for future cash flows were revised and we determined during the goodwill impairment review that the fair value less costs of disposal of the North America cash generating unit (CGU) no longer supported the carrying value of this goodwill and as a consequence impaired goodwill by £2,548m. Fair value less cost of disposal was determined using post-tax discount rate of 9.2% for North America. Following the impairment, the recoverable amount of the North America CGU is £2,650m.

Key assumptions

For the purpose of estimating the fair value less costs of disposal of the CGUs, management has used an income approach based on present value techniques. The calculations use cash flow projections based on financial budgets approved by management covering a five-year period, management s best estimate about future developments and market assumptions. The fair value less costs of disposal measurement is categorised as Level 3 on the fair value hierarchy. The key assumptions used by management in the fair value less costs of disposal calculations were:

Discount rates The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average post-tax discount rates range from 7.9% to 15.5%. Discount rates are lower for those businesses which operate in more mature markets with low inflation and higher for those operating in emerging markets with higher inflation.

Perpetuity growth rates A perpetuity growth rate of 2% (2015: 2.0%) was used for cash flows subsequent to the approved budget period for CGUs operating in mature markets. This perpetuity growth rate is a conservative rate and is considered to be lower than the long-term historical growth rates of the underlying territories in which the CGU operates and the long-term growth rate prospects of the sectors in which the CGU operates. CGU growth rates between 4.4% and 7.0% were used for cash flows subsequent to the approved budget period for CGUs operating in emerging markets with high inflation. These growth rates are also below the long-term historical growth rates in these markets.

The key assumptions used by management in setting the financial budgets for the initial five-year period were as follows:

Forecast sales growth rates Forecast sales growth rates are based on past experience adjusted for the strategic direction and near-term investment priorities within each CGU. Key factors include USA and UK college enrolment rates, assessment growth rates, the success of new product launches, growth rates and economic conditions in emerging markets and the rate of growth in new services businesses. The five-year sales forecasts use average nominal growth rates between 2.0% and 8.6% for mature markets and between 7.0% and 19.8% for emerging markets with high inflation.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

11. Intangible assets continued

Key assumptions continued

Operating profits Operating profits are forecast based on historical experience of operating margins, adjusted for the impact of changes to product costs and cost saving initiatives, including the impact of the global restructuring programme benefits from 2016.

Cash conversion Cash conversion is the ratio of operating cash flow to operating profit. Management forecasts cash conversion rates based on historical experience, adjusted for the impact of product investment priorities and the shift to digital and service based business.

Sensitivities

The Group s impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates. The carrying value of goodwill in the Growth market CGU s was written down to £nil in 2015. In the North America CGU goodwill has been written down to fair value less costs of disposal and any further increase in discount rates or reduction in perpetuity growth rates would give rise to further impairment. A 0.1% increase in discount rates would cause the fair value less costs of disposal of the North America CGU to reduce by £35m and the Core GGU by £16m. A 0.1% reduction in perpetuity growth rates would cause the fair value less costs of disposal of the North America CGU to reduce by £30m and the Core CGU by £14m. The North America CGU which has been written down to fair value less costs of disposal and the Core CGU are highly sensitive to any reductions in short-term cash flows, whether driven by lower sales growth, lower operating profits or lower cash conversion. A 5% reduction in total annual operating profits, spread evenly across all CGUs, would give rise to an impairment of £209m in the North America CGU and £43m in the Core CGU.

2015 impairment tests

In 2015, following significant economic and market deterioration in the Group s operations in emerging markets and ongoing cyclical and policy related pressures in the Group s mature market operations, an impairment of £507m was booked in respect of the Group s Growth operations, representing impairments of £269m in the Brazil CGU, £181m in the China CGU, £48m in the South Africa CGU and £9m in the Other Growth CGU, thereby bringing the carrying value of goodwill in those CGUs down to £nil. Impairments of £10m and £13m were also booked in respect of other acquired intangibles in the South Africa and Other Growth CGUs respectively, bringing their carrying value down to £nil. Impairments of £282m and £37m were also booked in respect of the North America and Core CGUs respectively, bringing the carrying value of the goodwill in those CGUs down to fair value less costs of disposal.

12. Investments in joint ventures and associates

The amounts recognised in the balance sheet are as follows:

All figures in £ millions	**2016**	2015
Associates	**1,245**	1,099
Joint ventures	**2**	4
Total	**1,247**	1,103

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

The amounts recognised in the income statement are as follows:

All figures in £ millions	2016	2015
Associates	**98**	72
Joint ventures	**(1)**	(4)
Total	**97**	68

There are no discontinued operations in 2016. Included within the 2015 results are discontinued operations consisting of £17m profit from associates and £1m loss from joint ventures. For further information on discontinued operations and the profit on sale of associates and joint ventures, see notes 3 and 31.

Investment in associates

On 16 October 2015, the Group sold a 39% stake, out of its 50% stake, in The Economist (see note 31 for further information).

The Group has the following material associates:

	Principal place of business	Ownership interest	Nature of relationship	Measurement method
Penguin Random House Ltd	UK/Global	47%	See below	Equity
Penguin Random House LLC	US	47%	See below	Equity

On 1 July 2013 Penguin Random House (PRH) was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective trade publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% of the combined business respectively. Pearson owns its 47% interest in PRH via 47% interests in each of the two entities listed in the table above. Despite the separate legal structures of the two PRH entities, Pearson regards PRH as one combined global business. Consequently, Pearson discloses PRH as one single operating segment and presents disclosures related to its interests in PRH on a combined basis.

The shareholder agreement includes protective rights for Pearson as the minority shareholder, including rights to dividends. Management considers ownership percentage, board composition and the additional protective rights, and exercises judgement to determine that Pearson has significant influence over PRH and Bertelsmann has the power to direct the relevant activities and therefore control. PRH does not have a quoted market price.

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

The summarised financial information of the material associates is detailed below:

All figures in £ millions	2016 Penguin Random House	2015 Penguin Random House	2015 The Economist
Assets			
Current assets	**1,587**	1,354	
Non-current assets	**1,267**	1,244	
Liabilities			
Current liabilities	**(1,074)**	(1,034)	
Non-current liabilities	**(394)**	(358)	
Net assets	**1,386**	1,206	
Sales	**2,620**	2,453	276
Profit from continuing operations	**209**	136	
Profit from discontinued operations			34
Other comprehensive (expense)/income	**(14)**	51	
Total comprehensive income	**195**	187	34
Dividends received from associate	**131**	142	20

The information above reflects the amounts presented in the financial statements of the associates, adjusted for fair value and similar adjustments. Amounts presented in 2015 for The Economist cover the period up until the date of the partial disposal. The tax on Penguin Random House LLC is settled by the partners. For the purposes of clear and consistent presentation, the tax has been shown in the associate line items in the consolidated income statement and consolidated balance sheet, recording the Group s share of profit after tax consistently for the Penguin Random House associates.

A reconciliation of the summarised financial information to the carrying value of the material associates is shown below:

All figures in £ millions	2016 Penguin Random House	2015 Penguin Random House	2015 The Economist
Opening net assets	**1,206**	1,247	
Exchange differences	**179**	(1)	
Profit for the period	**209**	136	34
Other comprehensive (expense)/income	**(14)**	51	

Dividends, net of tax paid	**(194)**	(229)	(40)
Additions		2	
Reversal of distribution from associate in excess of carrying value			(3)
Disposal			9
Closing net assets	**1,386**	1,206	
Share of net assets	**651**	567	
Goodwill	**589**	526	
Carrying value of associate	**1,240**	1,093	

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Pearson plc Consolidated Financial Statements

Notes to the consolidated financial statements continued

12. Investments in joint ventures and associates continued

Investment in associates continued

Information on other individually immaterial associates is detailed below:

All figures in £ millions	2016	2015
Loss from continuing operations		(9)
Total comprehensive expense		(9)

Transactions with material associates

The Group has loans to Penguin Random House which are unsecured and interest is calculated based on market rates. The amount outstanding at 31 December 2016 was £33m (2015: £47m). The loans are provided under a working capital facility and fluctuate during the year. The loan outstanding at 31 December 2016 was repaid in its entirety in January 2017.

The Group also has a current asset receivable of £21m (2015: £27m) from Penguin Random House arising from the provision of services. Included in other income (note 4) is £4m (2015: £16m) of service fees.

Investment in joint ventures

Information on joint ventures, all of which are individually immaterial, is detailed below:

All figures in £ millions	2016	2015
Loss from continuing operations	**(1)**	(3)
Loss from discontinued operations		(1)
Total comprehensive expense	**(1)**	(4)

13. Deferred income tax

All figures in £ millions	2016	2015
Deferred income tax assets	**451**	276
Deferred income tax liabilities	**(466)**	(560)
Net deferred income tax	**(15)**	(284)

Substantially all of the deferred income tax assets are expected to be recovered after more than one year.

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. At 31 December 2016 the Group has unrecognised deferred income tax assets of £32m (2015: £32m) in respect of UK losses, £18m (2015: £11m) in respect of US losses and approximately £95m (2015: £70m) in respect of losses in other territories. The US losses relate to state taxes and therefore have expiry periods of between five and 20 years.

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

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13. Deferred income tax continued

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

All figures in £ millions	Notes	2016	2015
At beginning of year		**(284)**	(419)
Exchange differences		**(22)**	(26)
Income statement benefit	7	**261**	196
Disposal through business disposal	31	**(10)**	1
Tax benefit/(charge) to other comprehensive income or equity		**40**	(36)
At end of year		**(15)**	(284)

Included in the income statement above for 2016 is £nil (2015: £2m benefit) relating to discontinued operations.

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

All figures in £ millions	Trading losses	Returns provisions	Retirement benefit obligations	Deferred revenue	Other	Total
Deferred income tax assets						
At 1 January 2015	28	44	62	2	159	295
Exchange differences	5	3	4	1	8	21
Income statement charge	(14)	(4)	(3)	52	(67)	(36)
Tax charge to other comprehensive income or equity			(4)			(4)
At 31 December 2015	19	43	59	55	100	276
Exchange differences	**3**	**7**	**10**	**15**	**35**	**70**
Income statement (charge)/benefit		**(15)**	**(1)**	**50**	**75**	**109**
Disposal through business disposal				**(3)**	**(1)**	**(4)**
At 31 December 2016	**22**	**35**	**68**	**117**	**209**	**451**

Deferred tax assets on deferred revenue are net of liabilities in the US which arose on a change in tax treatment agreed in 2015 and which will unwind over 4 years. Other deferred income tax assets include temporary differences on goodwill, share-based payments, inventory and other provisions.

All figures in £ millions	Goodwill and intangibles	Retirement benefit obligations	Other	Total
Deferred income tax liabilities				

At 1 January 2015	(598)	(39)	(77)	(714)
Exchange differences	(41)		(6)	(47)
Income statement benefit	180	2	50	232
Disposal through business disposal	1			1
Tax charge to other comprehensive income or equity		(31)	(1)	(32)
At 31 December 2015	(458)	(68)	(34)	(560)
Exchange differences	**(85)**		**(7)**	**(92)**
Income statement benefit	**144**	**(3)**	**11**	**152**
Disposal through business disposal	**(7)**		**1**	**(6)**
Tax benefit to other comprehensive income or equity		**40**		**40**
At 31 December 2016	**(406)**	**(31)**	**(29)**	**(466)**

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13. Deferred income tax continued

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

14. Classification of financial instruments

The accounting classification of each class of the Group s financial assets and their carrying values, is as follows:

All figures in £ millions	Notes	**2016** Available for sale	**Fair value** Derivatives held for trading	**Fair value** Derivatives in hedging relationships	**Amortised cost** Loans and receivables	**Total carrying value**	2015 Available for sale	Fair value Derivatives held for trading	Fair value Derivatives in hedging relationships	Amortised cost Loans and receivables	Total Carrying value
Investments in unlisted securities	15	**65**				**65**	143				143
Cash and cash equivalents	17				**1,459**	**1,459**				1,703	1,703
Marketable securities		**10**				**10**	28				28
Derivative financial instruments	16		**3**	**168**		**171**		29	81		110
Trade receivables	22				**982**	**982**				963	963
Total financial assets		**75**	**3**	**168**	**2,441**	**2,687**	171	29	81	2,666	2,947

The carrying value of the Group s financial assets is equal to the market value.

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

	2016	2015